

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

**FORM 10-K**

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

For the fiscal year ended January 31, 2005

OR

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

For the Transition from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-22823

**QAD Inc.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**77-0105228**

(I.R.S. Employer Identification No.)

**6450 Via Real  
Carpinteria, California 93013**

(Address of principal executive offices and zip code)

Registrant's telephone number, including area code **(805) 684-6614**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, \$.001 par value**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or an amendment to this Form 10-K. ☐

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). ☒ YES ☐ NO

As of July 30, 2004, the last business day of the Registrant's most recently completed second fiscal quarter, there were 34,172,714 shares of the Registrant's common stock outstanding, and the aggregate market value of such shares held by non-affiliates of the Registrant (based on the closing sale price of such shares on the NASDAQ National Market on July 31, 2004) was approximately \$132,819,908. Shares of the Registrant's common stock held by each executive officer and director and by each entity that owns 5% or more of the Registrant's outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 31, 2005, there were 33,883,437 shares of the Registrant's common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Items 10 through 14 of Part III incorporate information by reference from the Definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held on June 21, 2005.

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**QAD INC.**  
**FISCAL YEAR 2005 FORM 10-K ANNUAL REPORT**  
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## FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K 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 Item 7 entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in particular the subsection of Item 7 entitled "Factors That May Affect Future Results and Market Price of Stock." 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, including the Quarterly Reports on Form 10-Q to be filed by QAD in fiscal 2006.

## PART I

### ITEM 1. BUSINESS

#### ABOUT QAD

QAD, a Delaware corporation, was founded in 1979 and is a provider of enterprise resource planning (ERP) software applications for global manufacturing companies. QAD enterprise applications provide robust functionality for managing operations and resources for manufacturing within and beyond the enterprise, enabling global manufacturers to collaborate with customers, suppliers and partners to make and deliver the right product, at the right cost, at the right time.

QAD enterprise applications are focused and optimized for select manufacturing industry segments: automotive, consumer products, electronics, food and beverage, industrial and medical. QAD's core enterprise application suite MFG/PRO and related QAD applications address the needs of today's multinational manufacturers, enabling them to think and operate globally while preserving their ability to meet local requirements by providing business-critical functions and processes at two levels: 1) the Enterprise, providing traditional ERP functionality for intra-enterprise functions; and 2) the Extended Enterprise, providing communication capabilities for supplier-management and customer-management functions.

QAD has built a solid customer base of global Fortune 1000 and mid-market manufacturers who are prospects for future sales of QAD's enterprise applications. With 25 years of focus on the manufacturing industry, and approximately 5,300 licensed sites of our software around the world, QAD is well-qualified to meet the business and technology requirements of global manufacturing companies worldwide. We develop our products with input from leading multinational manufacturers within the vertical industries we serve. This vertical industry focus is a key differentiator for QAD, enabling our customers to implement QAD applications rapidly, realize a high return on investment and achieve a lower total cost of ownership when compared with the product offerings of competitors targeting the industries we serve.

Global service and support are important components of our solutions. We are one of a few select organizations with the capabilities and industry expertise required to implement our solutions almost anywhere in the world, in multiple languages and currencies, and support business processes tailored to local financial and operational practices. Our geographic management structure enables our global practices to meet local requirements and our services to be delivered effectively within each region. We support our customers' global operations through

our network of regional support centers as well as certain alliances and online support, accessible 24 hours a day, seven days a week, virtually anywhere in the world.

## **CUSTOMERS**

As of January 31, 2005, our software was licensed at approximately 5,300 sites in more than 90 countries. No single customer accounted for more than 10 percent of total revenue during any of our last three fiscal years. The following are among the companies and/or subsidiaries of those companies that have each generated more than \$1.0 million in software license, maintenance and services billings over the last three fiscal years:

### *Automotive*

ArvinMeritor, Caterpillar, Delco Remy International, Delphi Automotive Systems, DURA Automotive Systems, Eaton, Federal-Mogul, Ford Motor Company, Freudenberg & Company, GKN, Johnson Controls, Lear, Safety Components, Textron, Webasto

### *Consumer Products*

Applica, Avent, Avery Dennison, Avon Products, Black & Decker, Cussons, David Yurman, Imperial Tobacco Group, Neschen, Sherwin-Williams, Top Flite, U.S. Cotton, Villeroy & Boch

### *Electronics*

Allied Telsyn, Anritsu, Epson, FEI, General Electric, HP Indigo, Invensys, Lem Holding, Lucent Technologies, Moog, Philips Electronics, Thompson Multimedia

### *Food and Beverage*

Bakkersland, Coca-Cola, Friesland, Kraft Foods, Lion Nathan, Mars, National Brands, National Foods, PepsiCo, Rich Products, Sara Lee, Wander

### *Industrial*

Actaris, AKZO Nobel, Albany International, Alcoa, Amcor, Culligan, Distinctive Appliances, Enodis, Ingersoll-Rand, Metso, Rockwell Automation, Saint-Gobain, Schlumberger, Thales

### *Medical*

American Type Culture, Arrow International, C.R. Bard, Cephalon, Flexsys, Genzyme, GlaxoSmithKline, Johnson & Johnson, Mayne Group, Medex, Medtronic, Metrologic Instruments, Teleflex, UCB Pharma

## **INDUSTRY BACKGROUND AND COMPETITION**

Manufacturing businesses continue to be subject to increasing global competition, resulting in pressure to lower production costs, improve product performance and quality, increase responsiveness to customers and shorten product development, manufacturing and delivery cycles. Globalization and the outsourcing of manufacturing to countries throughout the world has greatly increased the scope and complexity of multinational manufacturing organizations, while the Internet has had a profound effect on the way these companies conduct business. We believe that

manufacturers who focus on collaborating across their supply chain, including their distribution channels, suppliers and customers in their business, will reap significant benefits.

To accomplish this, we believe manufacturers within our target markets typically choose from five types of enterprise solutions:

**Global Manufacturing industry-focused ERP solutions:** These solutions are designed and built on a single platform with a singular focus on the unique needs of manufacturing enterprises and provide a robust suite of capabilities that enable the integration and management of critical data within a manufacturing enterprise. These solutions support internal and external business processes such as sales order management, procurement, inventory management, product lifecycle management, supply chain management, manufacturing planning and control, service and support, project management, distribution and finance. We believe QAD is the only significant provider of global manufacturing industry-focused ERP solutions that are designed to handle these internal and select external business processes that are highly beneficial for manufacturing operations in the industries we serve. We believe our focus on meeting the needs of manufacturers within these industries has resulted in software applications that are more fully integrated than point solutions (defined below) and result in faster implementations, a lower total cost of ownership and a higher return on investment than mega-suite solutions (also defined below).

**Mega-suite ERP solutions:** (a term originally coined by Gartner Research in its October 2002 report entitled "ERP II Will Support Performance/Relationship Management"). These solutions are designed with the goal of trying to satisfy the needs of multiple industries, including manufacturing, but also unrelated industries such as banking, insurance, retail, state and local government, telecommunications, entertainment and education, among others. These solutions attempt to satisfy the diverse needs of many different industries within a single database and software application and provide a wide set of functionality. QAD believes that a lack of focus on the manufacturing sector has caused manufacturers who purchase these mega-suite applications to experience longer implementation times, a higher total cost of ownership and a lower return on investment than for QAD solutions. We believe this is because the mega-suites' extremely broad industry scope and higher solution complexity limits their effectiveness in addressing the specific needs of manufacturing enterprises, individual plants or divisions for our targeted vertical markets. Examples of mega-suite ERP vendors currently competing in the market include SAP, Oracle and Microsoft.

**Roll-up solutions:** These solutions are neither designed nor built as single solutions, but rather are the result of continued consolidation in the ERP market. QAD uses the term "roll-up" to describe legacy ERP vendors who employ an acquisition strategy. Gartner Research began referring to these vendors as "Collectors" in their December 2003 report, "Management Update: The ERP Market and Vendors in 2004." In recent years, we have seen many companies focus on growing their revenue by acquiring legacy or point solutions. Often the acquired solutions have similar features and overlapping functionality with the roll-up vendors' existing solutions already available on different platforms. QAD believes that the resulting solution set created when diverse applications from multiple companies are brought together is usually not easily or well unified and generally consists of multiple applications that rely on dissimilar technologies. We also believe that these roll-up solutions present considerable risk to customers because long term support for similar solutions on multiple platforms is unlikely and could result in a costly transition to a new system in the future, and because these solutions lack the cohesion and integrated functionality expected by global manufacturers. Examples of roll-up vendors currently competing in the market include

Infor (which purchased former roll-up vendor Mapics in January 2005, and was formerly known as Agilysis), SSA, Epicor and GEAC.

**Regional solutions:** These solutions are designed to provide functionality that is highly targeted to meet the needs of a specific region or country. Vendors of these solutions typically lack the global reach and financial viability that global manufacturers expect of their ERP vendors. Examples of regional solution vendors currently competing in the market include IFS and Intenia, where we see competition most often in Europe and Australia, respectively; User Friendly Software in China and Datasul in South America.

**Point solutions:** These solutions are designed to provide a fairly narrow set of functionality. Examples include solutions that provide functionality such as only procurement capabilities, only customer relationship management capabilities or only supply chain management capabilities. We believe these solutions tend to be highly specialized within a limited functionality scope compared to the four types of ERP suite solutions defined above and they often lack integration with processes to which they are directly related.

QAD's manufacturing industry-focused ERP solutions are designed for the specific needs of manufacturing enterprises in the industries we serve to handle their internal and select external business processes. We believe this focus has helped us deliver software applications and services that are more fully integrated than point solutions or roll-ups and yield faster implementations, a lower total cost of ownership and a higher return on investment than mega-suite solutions. We also believe that regional vendors lack the global capabilities or financial viability that global manufacturers expect of their ERP vendors.

The enterprise software applications market is highly competitive and rapidly changing. It is affected by new product introductions and other market activities, including consolidations among industry participants and the entry of new participants.

As the market for enterprise software continues to develop, companies with significantly greater resources could attempt to increase their presence in these markets by acquiring technology and related resources or forming strategic alliances with our competitors or with our current or potential partners. The dynamic nature of the emerging market space leads us to believe that numerous smaller, but well-capitalized, vendors, may emerge as strong competitors.

Increased competition and consolidation in these markets is likely to result in price reductions, reduced operating margins and changes in market share, any one of which could adversely affect us. Many of our competitors are significantly larger and have broader footprints across our industry. These present or future competitors may have significantly greater financial, technical, marketing and other resources, greater name recognition and a larger installed base of customers than we do. As a result, they may be able to devote greater resources to the development, promotion and sale of their products. Although we believe we offer, and will continue to offer, products that are competitive, we can make no assurance that we will be able to compete successfully with existing or new competitors or that competition will not adversely affect us.

## THE QAD STRATEGY

Our primary Company objective is to be the leading global provider of manufacturing industry-focused ERP and supply chain solutions. We will continue to target multinational, large and midrange manufacturing and distribution companies within the following industry

segments: automotive, consumer products, electronics, food and beverage, industrial and medical. Our strategies for achieving our primary objective include the following:

- *Leverage Our Customer Base.* As of January 31, 2005, QAD software was licensed at approximately 5,300 sites in more than 90 countries. With a substantial customer base and a maintenance renewal rate in excess of 90%, we expect to continue to benefit from selling additional products and services to existing customers. We plan to leverage our favorable reputation and track record to capitalize on this opportunity to build additional business for our product offerings.
- *Expand Our Customer Base.* We leverage our existing relationships to expand our customer base by targeting the many related divisions that reside within the same corporate structure as our existing customers. We believe these divisions may have either outgrown their legacy ERP solutions or need to extend the capabilities of those legacy ERP solutions with our supply chain capabilities. We have found that we can be successful generating revenue in new, related divisions by using existing divisions of our customers as "internal" references.
- *Leverage our market position and expertise in key vertical industries.* We believe we have strong market positions in the vertical industries we serve. We have developed even further expertise and strength in specific market niches within these vertical industries that we can continue to leverage into leadership positions. For example, in our target automotive vertical market, QAD has customer relationships with some of the largest automotive Tier 1 suppliers who supply components to the automotive Original Equipment Manufacturers (OEM). In our target medical market, we have many customer relationships and gained significant expertise in the medical-device market. Our focus on meeting the needs of these and the other vertical industries we target has driven us to design specific functionality for these markets.
- *Leverage our market position and reputation in markets emerging as global manufacturing centers.* We believe that our vertical industry focus enables our customers to implement QAD solutions more rapidly, realize a high and rapid return on investment and achieve a lower total cost of ownership compared to the product offerings of competitors targeting the industries we serve. These characteristics make QAD an attractive solution for manufacturers in markets that are emerging as global manufacturing centers, such as China and Eastern Europe, and multinational manufacturers who need to manage outsourced manufacturing relationships in these markets. As an example of an emerging market advantage, an April 2004 survey entitled "China Auto Industry Suppliers Survey," conducted by the Economist Corporate Network, reports that QAD was "easily the leading provider of ERP systems" to automotive suppliers in China, with 56 percent of Chinese automotive suppliers using ERP relying on QAD. We believe our understanding of emerging markets, such as that in China, provides us a competitive advantage in other emerging manufacturing markets, such as Eastern Europe, Southeast Asia and South America.
- *Leverage Global Network of Alliances.* Strategic alliances with partners expand our sales reach, improve our marketing impact, provide technological advantages and strengthen our strategic position in the industries that we serve. We leverage the expertise of distribution, software, services and technology alliances to meet the diverse needs of our customers. We augment our direct sales organization with a global network of more than 40 distributors and sales agents, as well as numerous service organizations that offer consulting and implementation services to expand our reach.

**QAD SOLUTIONS**

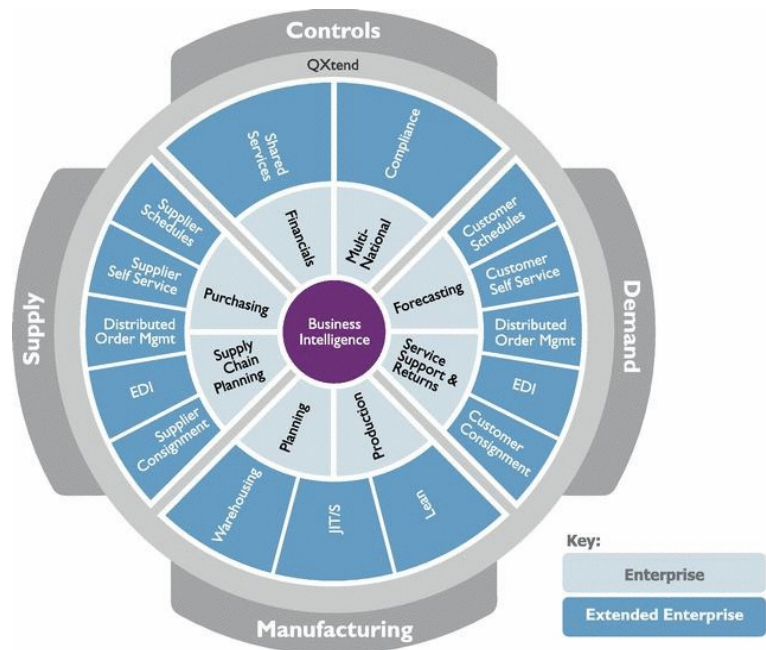
QAD provides both enterprise applications and professional services to address the requirements of global manufacturers within the automotive, consumer products, electronics, food and beverage, industrial and medical industries.

QAD's core enterprise application suite MFG/PRO and related QAD applications provide functionality at two levels required by global manufacturers—the Enterprise level and the Extended Enterprise level. We define the functions that streamline processes within the four walls of a manufacturing plant as the "Enterprise" solutions. We define the functions that streamline processes with their outside customers, suppliers and partners as the "Extended Enterprise" solutions.

Additionally, we have an integration framework, known as QXtend. It enables seamless interaction among QAD applications and other enterprise applications such as financials, human resources, customer relationship management (CRM) and legacy applications.

Within the ERP Enterprise and Extended Enterprise contexts, we believe our solutions include functionality that help manufacturers respond to market pressures causing them to invest in technology and business improvement projects.

**QAD SOLUTIONS**



The diagram above provides a visual framework of current market pressures and the types of Enterprise and Extended Enterprise functionality QAD's core enterprise application suite MFG/PRO and related applications offer to address them.

On the outside of the diagram are the current external market pressures that global manufacturers face; in the center is the pressure manufacturers face to improve business performance through deeper business intelligence. Key functionality within QAD's Enterprise and Extended Enterprise solutions that address these pressures are depicted in the adjacent wedge-shaped pieces inside the diagram. QAD's integration layer, QXtend, surrounds the QAD solutions to create a unified system.



Current market pressures include:

**Manufacturing:** These include the introduction of new manufacturing techniques to increase quality, reduce cost and increase throughput. To help customers respond, QAD solutions include:

*Enterprise Solutions*

- *Planning.* QAD MFG/PRO includes manufacturing planning functions to help customers make decisions faster and deploy resources more effectively by converting external and internal demands for products into detailed manufacturing, procurement and resource utilization plans. Capabilities range from enterprise-level strategic planning functions through plant level master production scheduling and material requirements planning.
- *Production.* QAD MFG/PRO includes manufacturing control functions to support any combination of manufacturing methods, including discrete, repetitive, lean and just-in-time (JIT). It helps manufacturers control activities on the production floor, from identifying missing parts to labor reporting, and provides a closed-loop environment with transaction, variance and lot/serial traceability reporting, lean manufacturing and quality management.

*Extended Enterprise Solutions*

- *Lean Manufacturing.* QAD's Lean Manufacturing solution helps manufacturers manage fluctuating customer demand and minimize inventory carrying costs by synchronizing manufacturing processes with the extended supply chain and responding to changes in demand and supply. QAD Lean Manufacturing sends electronic signals within a manufacturing plant or to suppliers via electronic data interchange or through the Internet, making accurate inventory replenishment information immediately visible and thereby reducing information lead-time and eliminating waste in the flow of material from suppliers to customers.
- *Just-In-Time Sequencing (JIT/S).* QAD's JIT/S solution, which is currently in the early adopter phases, allows manufacturers to produce and deliver components and subsystems in the exact sequence and timeframe that products are being manufactured on the assembly line. QAD JIT/S enables manufacturers to deliver unique product configurations on an item-by-item basis, while keeping inventory on hand to a minimum.
- *Warehousing.* QAD's Advanced Inventory Management (AIM) solution offers a range of inventory management capabilities that enable manufacturers to control the receipt, put away, storage, picking and shipping of inventory using warehouses. QAD AIM solution provides increased inventory visibility and precision with better warehouse space utilization and includes advanced inventory replenishment capabilities, put-away and picking logic and radio-frequency scheduling of warehouse staff.

**Supply:** These include the need to increase collaboration with suppliers and improve the management of inventory. To help customers respond, QAD solutions include:

*Enterprise Solutions*

- *Purchasing.* QAD MFG/PRO includes purchasing functions for integrated purchasing, supplier schedules and quality management. It provides a link between plans, operations and trading partners, and supports requisitions, purchase orders, receiving, vouchering (supplier invoice processing) and supplier performance tracking. For manufacturers who need more extensive functionality, QAD offers PRO/PLUS, a

module that builds on MFG/PRO's basic purchasing capabilities with additional tools to streamline the purchase requisition process, monitor supplier performance and other productivity enhancements.

- *Supply Chain Planning.* QAD MFG/PRO includes supply chain planning functions consisting of distribution requirements planning (DRP), enterprise operations management (EOM) and linked site costing. Distribution requirements planning (DRP) is a planning function designed to balance supply and demand in a time-phased manner for items transferred between sites. Enterprise operations planning (EOP) is a strategic as well as tactical production planning tool designed to help manufacturers balance supply and demand across sites. Linked-site costing functions let manufacturers specify default cost source sites for items held at multiple sites in one database.

#### *Extended Enterprise Solutions*

- *Supplier Schedules.* QAD MFG/PRO includes supplier schedule functions that supplement QAD purchasing functions to support high-volume, repetitive deliveries. Functionality enables manufacturers to produce schedules for specific dates, and even hours of delivery, in the near term, and provides insight into long-term plans that can be used to plan orders for raw materials, production and deliveries.
- *Supplier Self Service.* QAD's Supply Visualization hosted solution on MFGx.net promotes collaboration within the supply chain by providing authorized suppliers real-time visibility into critical inventory and order data over the Internet. It allows suppliers to closely monitor how items are being consumed, and to determine the timing and volume needed to replenish stock.
- *Distributed Order Management (DOM).* QAD MFG/PRO includes sales and distribution functions that monitor inventory balances, and manage purchasing and sales order entry activities. They enable seamless management, analysis, planning and control of activities related to the procurement of raw materials, or parts, and distribution of finished goods.
- *Electronic Data Interchange (EDI).* QAD's EDI ECommerce solution allows customers to have real-time collaboration with suppliers electronically. It provides a streamlined method of managing electronic communications between trading partners, QAD solutions and other enterprise solutions, and enables users to manipulate, analyze, edit, and reprocess EDI documents quickly and efficiently.
- *Supplier Consignment Inventory.* QAD's Supplier Consignment Inventory solution extends the purchase order process by providing new types of transactions to receive material and identify it as consigned. With Supplier Consignment Inventory, the financial transaction on consignment inventory can be delayed until it is consumed, but the material is still visible for planning. When consumption is reported back to the supplier, the supplier can transfer liability for the material in its system and issue an invoice if self-billing is not being used.

**Demand:** These include the need to increase collaboration with customers and improve responsiveness and customer service. QAD solutions include:

#### *Enterprise Solutions*

- *Forecasting.* QAD MFG/PRO includes forecasting functions that apply statistical methods and extrapolation techniques to evaluate underlying patterns in sales history

data to help predict future demand. These forecasts are used to develop the master production schedule and drive material requirements planning (MRP).

- *Service, Support & Returns.* QAD's Service/Support Management (SSM) solution allows manufacturers to manage all aspects of after-sales support and service operations. It provides capabilities for call centers, repair depots, field service organizations and companies servicing the equipment they sell.

#### *Extended Enterprise Solutions*

- *Customer Schedules.* QAD MFG/PRO includes customer schedules functions that enable manufacturers to process customer orders using a set of scheduled shipment dates and quantities, rather than discrete sales orders. These schedules are used to create cumulative, schedule-driven sales orders with multiple line items. The customer schedules functions also support "retro billing", a price changing practice common among automotive suppliers and many commodity-driven markets where the cost of raw materials, not the process cost, causes prices to fluctuate.
- *Customer Self Service.* QAD's Customer Self Service (CSS) is a web-based order entry and visibility solution that enables global manufacturers to offer easy to use self-service to their customers and distributors via the Internet, 24 hours a day, seven days a week. It facilitates streamlined self-service order management, using a hierarchical product catalog and browser-based order entry processes.
- *Distributed Order Management (DOM).* QAD MFG/PRO includes sales and distribution functions that monitor inventory balances and manage purchasing and sales order entry activities. They enable seamless management, analysis, planning and control of activities related to the procurement of raw materials, or parts and distribution of finished goods.
- *Electronic Data Interchange (EDI).* QAD's EDI ECommerce solution allows customers to have real-time collaboration with trading partners electronically. It provides a streamlined method of managing electronic communications between trading partners, QAD solutions and other enterprise solutions, and enables users to manipulate, analyze, edit, and reprocess EDI documents quickly and efficiently.
- *Customer Consignment Inventory.* QAD's Customer Consignment Inventory solution extends the sales order process by providing new transactions to ship material and identify it as in-transit or consigned. It enables the user to plan, order, ship, track and report, customer-consigned material, while deferring invoicing and accounts receivable (AR) transactions. QAD Customer Consignment Inventory directly supports vendor managed inventory (VMI) concepts by giving manufacturers control over their own inventory, within limits, at the customer's site.

**Controls:** Formerly referred to as regulatory or legal requirements, these address the constant pressure on manufacturers to increase fiscal controls and comply with government and industry regulations. To help customers respond, QAD solutions include:

#### *Enterprise Solutions*

- *Financials.* QAD MFG/PRO includes financial functions that provide multiple entity (company) and multiple currency support suitable for the financial management of small and large enterprises. These modules are seamlessly integrated with the sales and distribution, planning, and manufacturing functions of MFG/PRO to report the financial implications of the company's activities.

- *Multinational.* QAD solutions are designed for global business and maximum flexibility and are available in 27 languages. Our technology's architecture preserves operational flexibility so that the customer can select the production models, plant locations, and financial reporting that best suit its business. Additionally, QAD solutions have multi-currency support throughout the entire application, and accounting transactions can be recorded in multiple currencies and reported on either in its transaction currency or translated at the then prevailing exchange rate to the operation's currency.

#### *Extended Enterprise Solutions:*

- *Shared Services.* QAD's Shared Services Domain solution allows multi-entity consolidations and eliminations to be performed across multiple general ledgers. Sophisticated chart of account mapping capabilities allow for different chart of accounts to be consolidated and full traceability to originating transactions can be maintained, critical for audit ability.
- *Compliance.* QAD MFG/PRO and related solutions provide best-practice manufacturing and business processes for automated activities, with a multitude of embedded basic internal process security and controls throughout the application modules that work to provide transaction integrity throughout supply chain processes. These security and control features, if set-up, implemented, and utilized to their fullest degree, provide an excellent foundation for systematic internal control demonstration.

**Business Intelligence:** These include the need to access and analyze operational data within the manufacturing enterprise in order to help improve business performance.

To help customers respond, QAD provides the QAD Business Intelligence (BI) module to help companies leverage and analyze data from their QAD system to help make better informed business decisions. QAD BI comprises two primary components: a data transformer and a set of pre-defined business models. The data transformer performs extraction, transformation and loading functions on the raw data collected by MFG/PRO, ensures its consistency, and then aggregates this content in a separate, dedicated business intelligence data warehouse. Pre-defined business models for inventory monitoring, sales analysis and manufacturing performance, among others, incorporate 150 key performance indicators (KPIs) and provide a framework for mapping the collated data to a meaningful format.

*Global services and support.* In addition to providing core functionality required by global manufacturers in our enterprise software, QAD Global Services offers consulting, support and education for QAD solutions. They offer strategic consulting, business solution design and implementation, application management services and technical services to our customers.

Our customer support organization operates attended and automated support systems around the world, including a global call tracking and escalation system. Our solution-centered support provides customers with online access to customer service solutions 24 hours a day, seven days a week, giving customers the ability to download the latest updates to our software.

We also offer comprehensive education and training services to our customers and service providers that we continue to enhance with both online and classroom training.

#### **VALUE OF QAD SOLUTIONS**

We believe that QAD is well-positioned to continue to meet the requirements of global manufacturing customers in the industries we serve by providing solutions that deliver:

*Focused Expertise and Functionality for Specific Industries.* Our industry expertise and strategy of developing industry-specific solutions has enabled us to achieve strong positions in the

automotive, consumer products, electronics, food and beverage, industrial and medical industries. In order to stay at the forefront of the industries we serve, QAD partners with our customers through active industry development groups to define enhancements and additional industry-specific functionality for the next generation of QAD solutions.

***Rapid Implementations and Time-to-Benefit.*** The industry-specific features and functionality of QAD solutions mean customers in the industries we serve can have feature-rich solutions for significantly less customization cost, and can implement those solutions in significantly less time than other manufacturing ERP solutions, so customers are able to achieve rapid time-to-benefit. QAD's low total cost of ownership, rapid implementations and favorable time-to-benefit compared to its competitors were verified in an April 2003 study titled "Deriving Value From 21st Century ERP Applications" published by industry analyst firm META Group. To date, another industry study of this kind has not been completed.

***Global Capabilities.*** Our reputation for best-in-class manufacturing applications is supported by a proven track record of successful multinational deployments. Our solutions are available in as many as 27 languages and incorporate functionality that address both global and local requirements and practices in many of our major markets. Additionally, our Global Services organization makes us one of a few select organizations with the capability to implement our solutions across the globe and support those solutions in multiple languages and countries.

***Supply Chain Efficiencies.*** QAD's Extended Enterprise solutions help global manufacturers manage resources beyond the enterprise, enabling them to speed communications, streamline business processes and achieve more efficient interactions between partners, suppliers and customers.

***Open Integration Architecture.*** Our open systems architecture incorporates Open Applications Group Integration Specification standards and advanced Internet technologies in order to deliver open, flexible and scalable end-to-end enterprise and supply chain solutions.

## **QAD PRODUCT ALLIANCES**

We have a number of ongoing business alliances that extend the functionality of our software through the addition of integrated best-in-class applications. We have also entered into select agreements with third-party software developers who provide functionality that has been embedded into or integrated with QAD software and alliance arrangements to deliver more complete solutions for the vertical markets we target. Additionally, we support a number of different hardware platforms. Our alliances include Progress Software Corporation, Cognos, Adexa, ILOG, Sterling Commerce, Vertex and Oracle. These and other business affiliations are closely aligned to our organization and participate in the selling process.

## **TECHNOLOGY**

QAD MFG/PRO has been developed with a commercially available toolset marketed by Progress Software Corporation (Progress) that works with relational databases provided by Progress and Oracle Corporation. Our software operates under UNIX, Linux and Windows NT operating systems.

In fiscal 2005, QAD introduced its Shared Services Domain solution. This architectural enhancement was developed in response to customer demand to address situations where multiple divisions within a single enterprise need to maintain different currencies, charts of accounts, manufacturing configurations and other business options on a single system. With Shared Services Domain, QAD has given customers the ability to create multiple, virtual QAD MFG/PRO data structures, we call instances, all within a single database. Each instance has its own unique identity and behaves like an independent MFG/PRO database. Customers gain flexibility to run QAD

MFG/PRO according to their business processes—using one centralized database to run multiple day-to-day business operations where productivity and central control make sense, or in a decentralized mode where functions need to perform as autonomous operations.

In fiscal 2005, we also saw increased customer interest in a new computing model called Web Services. This emerging model enables customers to leverage multiple, best-of-breed applications in their enterprise reducing the need for costly or time consuming integration to be written in order for applications to interact and share information with one another. This enables customers to easily integrate applications, such as financial or shop floor applications, to QAD software.

To enable customers to take advantage of Web Services, in fiscal year 2005 QAD adopted a Service Oriented Architecture (SOA) within its QXtend integration framework. QAD Enterprise and Extended Enterprise solutions enable resources and information within applications to be more easily made available to participants in the network via SOA. This capability is enabled by Progress Software's latest products, Sonic and OpenEdge.

## **RESEARCH AND DEVELOPMENT**

Our principal research and development staff is focused on developing new functionality for the industries we serve and on providing continuing updates and improvements to QAD applications to better serve the needs of our customers.

We have embarked on an opportunistic strategy of acquiring certain niche products to extend and enhance our solutions. These acquisitions involve third-party products, or software developed by customers, that are already used in conjunction with our software, but only in a limited geography. We believe that our ability to enhance and globalize these products and distribute, service and support them internationally offers us a unique opportunity.

We are committed to the continuing development of our products through in-house and third-party development. As of January 31, 2005, approximately 250 research and development personnel, comprised of 200 internal personnel and 50 outside consultants, were involved in the development of QAD solutions.

We continue to utilize high quality, cost-effective development resources wherever possible. In December 2004, QAD augmented its existing Shanghai, China operations with the establishment of a new research and development (R&D) center that will focus on developing core product functionality for QAD solutions and functionality designed specifically for the Chinese market. The establishment of the Shanghai R&D center adds to QAD's existing R&D centers in the United States, Australia, Spain, Ireland and India.

Our research and development expenses totaled \$33.2 million, \$36.2 million and \$33.4 million in fiscal 2005, 2004 and 2003, respectively.

## **SALES AND MARKETING**

QAD sells and supports its products and services through direct and indirect sales channels and service organizations located throughout the world.

Our direct sales organization is composed of approximately 85 commissioned sales people. We continually align our sales organization and our business strategies with market conditions in order to ensure that we sustain our effectiveness in the sales process. Within each territory, a focus on the industries we serve is maintained through marketing, local product development and sales training.

Our indirect sales channel consists of over 40 distributors and sales agents worldwide. We do not grant exclusive rights to any of our distributors or sales agents. Our distributors and sales agents primarily sell independently to companies within their geographic territory, but may also

work in conjunction with our direct sales organization. In addition, we leverage our relationships with implementation service providers, hardware vendors and other third parties to identify sales opportunities on a global basis.

Our marketing strategy includes developing demand for our products by consistently communicating with QAD vertical prospects and key audiences to increase awareness. QAD undertakes a variety of marketing activities such as analyst relations, press relations, investor relations, sales and marketing events, advertising, the development of sales tools, and the continued improvement of our Web site. The global marketing organization plans and coordinates focused campaigns as set forth in our strategic plan. The team utilizes marketing automation tools to support our field sales organization and our direct and indirect marketing efforts.

## EMPLOYEES

As of January 31, 2005, we had approximately 1,200 full-time employees of which approximately 500 were in support and services, 200 were in research and development, 280 were in sales and marketing and 220 were in administration. Generally, our employees are not represented by collective bargaining agreements. However, certain employees of our Netherlands and French subsidiaries are represented by statutory works councils as required under the local laws. Employees of our Brazilian subsidiary are represented by a collective bargaining agreement with the Data Processing Union. We believe that, in general, our employee relations are good.

## EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below is certain information concerning our executive officers. All ages are as of March 31, 2005.

| NAME                   | AGE | POSITION(S)   |
|------------------------|-----|---|
| Pamela M. Lopker       | 50  | Chairman of the Board and President                               |
| Karl F. Lopker         | 53  | Chief Executive Officer   |
| Daniel Lender          | 38  | Executive Vice President and Chief Financial Officer              |
| Vincent P. Niedzielski | 51  | Executive Vice President, Research and Development                |
| Murray W. Ray          | 57  | Executive Vice President, Global Services and Human Resources     |
| Roland B. Desilets     | 43  | Executive Vice President, General Counsel and Secretary           |
| Michael Lodato         | 40  | Executive Vice President, Chief Marketing Officer                 |
| Valerie J. Miller      | 41  | Vice President, Corporate Controller and Chief Accounting Officer |

*Pamela M. Lopker* founded QAD in 1979 and has been Chairman of the Board and President since the Company's incorporation in 1981. Prior to founding QAD, Ms. Lopker served as Senior Systems Analyst for Comtek Research from 1977 to 1979. She is certified in Production and Inventory Management by the American Production and Inventory Control Society. Ms. Lopker earned a Bachelor of Arts degree in Mathematics from the University of California, Santa Barbara. She is married to Karl F. Lopker, Chief Executive Officer of QAD.

*Karl F. Lopker* has served as Chief Executive Officer and a Director of the Company since joining QAD in 1981. Previously, he founded Deckers Outdoor Corporation in 1973 and was President until 1981. Mr. Lopker is certified in Production and Inventory Management by the American Production and Inventory Control Society. Mr. Lopker earned a Bachelor of Science degree in Electrical Engineering from the University of California, Santa Barbara. Mr. Lopker is married to Pamela M. Lopker, Chairman of the Board and President of QAD.

*Daniel Lender* has served as Executive Vice President and Chief Financial Officer since July 2003. Previously, he had served as the Company's Vice President of Global Sales Operations and Vice President of Latin America. Mr. Lender joined QAD in 1998 as Treasurer following a nine-year tenure with the former Republic National Bank of New York, last serving as Vice President and Treasurer of the Bank's Delaware subsidiary. He earned a Master of Business Administration degree from the Wharton School of the University of Pennsylvania and a Bachelor of Science degree in Applied Economics and Business Management from Cornell University.

*Vincent P. Niedzielski* has served as Executive Vice President, Research and Development, since joining QAD in April 1996. Prior to joining QAD, Mr. Niedzielski served as Vice President, Production and Development at Candle Corporation for 12 years. Mr. Niedzielski received a Bachelor of Science degree in Mathematics and Computer Science from the University of Scranton.

*Murray W. Ray* has served as Executive Vice President, Global Services and Human Resources since February 2001. He joined QAD in August 1996 and was appointed Vice President of Global Services in October 1998. Prior to joining QAD, Mr. Ray was a Director of Professional Services at AT&T. Previously, he served 11 years at the former Digital Equipment Corp. as an Industrial Marketing Manager and then as a Director of Professional Services. Mr. Ray received a Bachelor of Science degree in Mathematics and Statistics from the University of Western Australia.

*Roland B. Desilets* has served as Executive Vice President, General Counsel and Secretary since April 2001, when he rejoined QAD after spending one year as Vice President and General Counsel of Atlas Commerce, Inc. Mr. Desilets initially joined QAD in 1993 serving as Regional General Counsel until 1998 when he was named Corporate General Counsel. Previously he was Intellectual Property Counsel for Unisys Corporation. Mr. Desilets holds a Juris Doctor degree from Widener University School of Law, a Master of Science degree in Computer Science from Villanova University and a Bachelor of Science degree in Physics from Ursinus College.

*Michael Lodato* has served as Executive Vice President, Chief Marketing Officer at QAD since September 2003. He joined the Company in March 2002 as Chief Marketing Officer. Previously, Mr. Lodato was Vice President of Marketing and Market Development at DigitalThink, Inc. Prior to that, he served Siebel Systems, Inc. as Senior Director of Strategic Accounts and held leadership positions at Sybase, Inc. and KPMG Consulting, Inc. (now known as BearingPoint). Mr. Lodato earned a Bachelor of Arts degree in Management Science from the University of California, San Diego.

*Valerie J. Miller* has served as Vice President, Corporate Controller and Chief Accounting Officer since June 2001. She joined QAD as Assistant Corporate Controller in May 1999 after serving eight years in various financial positions at Allergan, Inc. Ms. Miller began her career at



the public accounting firm of Ernst & Young. She is a Certified Public Accountant and received a Bachelor of Arts degree in Business Economics with an Accounting emphasis from the University of California, Santa Barbara.

## **SEGMENT REPORTING**

Segment financial information for fiscal 2005, 2004 and 2003 is presented in note 11 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

## **AVAILABLE INFORMATION**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Commission Act of 1934, as amended, are available free of charge on our website at [www.qad.com](http://www.qad.com), as soon as reasonably practicable after such reports have been electronically filed or otherwise furnished to the Securities and Exchange Commission.

## **ITEM 2. PROPERTIES**

During fiscal 2005, QAD completed the construction of its new company headquarters in Summerland, California where we own 28 acres of property. The construction project added an additional 83,000 square feet of office space to the previously existing 45,000 square feet, which allowed the consolidation of QAD's corporate operations. The Company's headquarters were previously located in Carpinteria, California. We moved out of our leased space in Carpinteria, California in two phases. In December 2004, we vacated certain space and immediately entered into a sublease arrangement. As a result, we took a \$0.7 million charge in the fourth quarter of fiscal 2005. Then, on March 18, 2005, we moved our data center from the Carpinteria location to our new corporate headquarters. The move resulted in an impairment charge of approximately \$0.9 million in the first quarter of fiscal 2006. We continue to use our Carpinteria address as our mailing address until we register our corporate headquarters' address as our mailing address.

QAD has over 30 additional offices located across four geographic regions with lease commitments ranging from 2005 until 2019. These include major offices located in the United States, the Netherlands, Australia, the United Kingdom, Mexico, Poland, Thailand, China, Spain, France and Japan.

Although we may seek new or expanded facilities in the future, we expect that our current domestic and international facilities will be sufficient to meet our needs for at least the next 12 months.

## **ITEM 3. LEGAL PROCEEDINGS**

We are not party to any material legal proceedings. We are 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 our consolidated financial position or results of operations.

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

None.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

QAD common stock has been traded on the NASDAQ National Market (NASDAQ) since our initial public offering in August 1997 (under the symbol QADI). The following table sets forth the low and high prices for QAD's common stock as reported by NASDAQ in each quarter of the last two fiscal years.

|                | Low Price | High Price |
|----------------|-----------|------------|
| Fiscal 2005:   |           |            |
| Fourth quarter | \$ 7.12   | \$ 9.33    |
| Third quarter  | 5.82      | 10.29      |
| Second quarter | 8.95      | 11.20      |
| First quarter  | 10.54     | 17.14      |
| Fiscal 2004:   |           |            |
| Fourth quarter | \$ 10.69  | \$ 15.74   |
| Third quarter  | 7.17      | 13.00      |
| Second quarter | 4.95      | 9.75       |
| First quarter  | 3.14      | 5.36       |

#### *Holders*

As of March 31, 2005, there were approximately 350 shareholders of record of our common stock, although there is a much larger number of beneficial owners.

#### *Dividends*

During the fiscal 2005 second quarter, we declared a one-time special dividend of \$0.10 per share of common stock. In addition, we announced the initiation of quarterly cash dividends. We declared three quarterly dividends in fiscal 2005 of \$0.025 per share of common stock. Continuing quarterly cash dividends are subject to the continued profitability and liquidity requirements of QAD.

During the fiscal 2005 second quarter, we established a dividend reinvestment plan. The plan commenced with the payment of the first quarterly cash dividend.

#### *Recent Sales of Unregistered Securities*

None.

#### *Issuer Purchases of Equity Securities*

During the fiscal 2005 second quarter, the Board of Directors approved an open market stock repurchase program authorized for one year to buy up to one million shares of QAD common stock. Purchases under QAD's repurchase program may be made from time to time, without prior notice. During fiscal 2005, we repurchased approximately 742,000 shares at an average repurchase price of \$7.52 per share, including fees.

The following table summarizes common stock repurchases made during fiscal 2005, by quarter:

| Period            | Total Number<br>of Shares<br>Purchased <sup>(1)</sup> | Average<br>Price Paid<br>per Share <sup>(2)</sup> | Total Number<br>of Shares<br>Purchased as Part<br>of Publicly Announced<br>Program <sup>(3)</sup> | Remaining Authorized<br>Number of Shares to be<br>Purchased Under the<br>Program |
|-------------------|---|---|---|--|
| 2/1/04 - 4/30/04  | —   | \$ —  | —   | —  |
| 5/1/04 - 7/31/04  | 144,865   | \$ 10.20  | 144,865   | 855,135  |
| 8/1/04 - 10/31/04 | 597,443   | \$ 6.87   | 597,443   | 257,692  |
| 11/1/04 - 1/31/05 | —   | \$ —  | —   | 257,692  |

(1) All share repurchases were made in open-market transactions.

(2) Average price per share is calculated on a settlement basis plus commission.

(3) In June 2004 the Board of Directors authorized an open market repurchase program for one year to buy up to one million shares of QAD common stock.

## ITEM 6. SELECTED FINANCIAL DATA

|   | Years Ended January 31, <sup>(1)</sup> |           |                         |            |                     |
|---|--|-----------|-------------------------|------------|---------------------|
|   | 2005 <sup>(8)</sup>                    | 2004      | 2003 <sup>(3),(4)</sup> | 2002       | 2001 <sup>(2)</sup> |
| (in thousands, except per share data)                       |  |           |                         |            |                     |
| <b>STATEMENTS OF OPERATIONS DATA:</b>                       |  |           |                         |            |                     |
| Revenues:   |  |           |                         |            |                     |
| License fees  | \$ 60,545                              | \$ 69,029 | \$ 56,023               | \$ 62,820  | \$ 69,202           |
| Maintenance and other                                       | 113,729                                | 114,686   | 106,294                 | 103,624    | 98,314              |
| Services  | 56,932                                 | 46,937    | 32,931                  | 39,341     | 48,683              |
| Total revenue   | 231,206                                | 230,652   | 195,248                 | 205,785    | 216,199             |
| Operating income (loss)                                     | 23,386                                 | 17,995    | (3,295)                 | (832)      | (19,011)            |
| Income (loss) before cumulative effect of accounting change | 24,483                                 | 16,317    | (6,598)                 | (5,313)    | (25,406)            |
| Cumulative effect of accounting change <sup>(5)</sup>       | —                                      | —         | 1,051                   | —          | —                   |
| Net income (loss)   | \$ 24,483                              | \$ 16,317 | \$ (7,649)              | \$ (5,313) | \$ (25,406)         |
| Basic net income (loss) per share:                          |  |           |                         |            |                     |
| Before cumulative effect of accounting change               | 0.72                                   | 0.49      | (0.19)                  | (0.16)     | (0.76)              |
| Cumulative effect of accounting change                      | —                                      | —         | 0.03                    | —          | —                   |
| Basic net income (loss) per share                           | \$ 0.72                                | \$ 0.49   | \$ (0.22)               | \$ (0.16)  | \$ (0.76)           |
| Diluted net income (loss) per share:                        |  |           |                         |            |                     |
| Before cumulative effect of accounting change               | 0.70                                   | 0.47      | (0.19)                  | (0.16)     | (0.76)              |
| Cumulative effect of accounting change                      | —                                      | —         | 0.03                    | —          | —                   |
| Diluted net income (loss) per share                         | \$ 0.70                                | \$ 0.47   | \$ (0.22)               | \$ (0.16)  | \$ (0.76)           |
| Cash dividends per share                                    | \$ 0.18                                | —         | —                       | —          | —                   |
| <b>BALANCE SHEET DATA:</b>                                  |  |           |                         |            |                     |
| Cash and equivalents  | 55,289                                 | 46,784    | 43,688                  | 36,782     | 24,500              |
| Total assets  | 207,093                                | 189,828   | 162,306                 | 158,009    | 181,462             |
| Current portion of long-term debt <sup>(6)</sup>            | 1,725                                  | 11,987    | 2,000                   | 2,157      | 1,448               |
| Long-term debt <sup>(7)</sup>                               | 23,911                                 | 7,720     | 9,125                   | 15,345     | 19,460              |

- (1) Historical results of operations are not necessarily indicative of future results. Refer to "Factors That May Affect Our Future Results or The Market Price of Our Stock" under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for discussion of factors that may impact future results.
- (2) Fiscal 2001 includes restructuring charges of \$5.1 million impacting operating income (loss). The purpose of the initiative was to strengthen operating and financial performance by sharpening the focus on our multinational customers.
- (3) Fiscal 2003 includes restructuring charges of \$5.3 million impacting operating income (loss). This cost reduction program was aimed at reducing annualized operating expense by better aligning expense with then current business levels.
- (4) In the fiscal 2003 fourth quarter, we acquired TRW ISCS which resulted in increased services revenue, as well as certain increased costs and expenses impacting operating income (loss) during that quarter and for the fiscal 2004 and 2005 full year. This acquisition is described in greater detail in note 2 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.
- (5) In connection with the adoption of SFAS 142 on February 1, 2002, and in accordance with its transition provisions, a \$1.1 million impairment loss related to the Asia Pacific region goodwill was recorded as a cumulative effect of a change in accounting principle.
- (6) Fiscal 2004 includes \$10.5 million related to a construction loan to finance the construction of our new company headquarters. We converted the construction loan to a permanent loan upon completion of the construction project in fiscal 2005.
- (7) Fiscal 2005 includes \$18.0 million of financing related to our new company headquarters in Summerland, California, of which \$17.7 million is included in long term debt as of January 31, 2005 and secured solely by property.
- (8) Fiscal 2005 includes a \$6.5 million tax benefit from the reversal of valuation allowances.

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## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K 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 this Item 7 entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in particular the subsection of this Item 7 entitled "Factors That May Affect Future Results and Market Price of Stock." 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, including the Quarterly Reports on Form 10-Q to be filed by QAD in fiscal 2006.

### INTRODUCTION

The following discussion should be read in conjunction with our financial statements and notes thereto included in Item 15 of this Annual Report on Form 10-K.

### OVERVIEW

#### *The Business*

QAD, a Delaware corporation, was founded in 1979 and is a provider of enterprise resource planning (ERP) software applications for global manufacturing companies. QAD enterprise applications provide robust functionality for managing operations and resources for manufacturing within and beyond the enterprise, enabling global manufacturers to collaborate with customers, suppliers and partners to make and deliver the right product, at the right cost, at the right time.

QAD enterprise applications are focused and optimized for select manufacturing industry segments: automotive, consumer products, electronics, food and beverage, industrial and medical. QAD's core enterprise application suite MFG/PRO and related QAD applications address the needs of today's multinational manufacturers, enabling them to think and operate globally while preserving their ability to meet local requirements by providing business-critical functions and processes at two levels: 1) the Enterprise, providing traditional ERP functionality for intra-enterprise functions; and 2) the Extended Enterprise, providing communication capabilities for supplier-management and customer-management functions.

QAD has built a solid customer base of global Fortune 1000 and mid-market manufacturers who are prospects for future sales of QAD's enterprise applications. With 25 years of focus on the manufacturing industry, and approximately 5,300 licensed sites of our software around the world, QAD is well-qualified to meet the business and technology requirements of global manufacturing companies worldwide. We develop our products with input from leading multinational manufacturers within the vertical industries we serve. This vertical industry focus is a key differentiator for QAD, enabling our customers to implement QAD applications rapidly, realize a high return on investment and achieve a lower total cost of ownership when compared with the product offerings of competitors targeting the industries we serve.

Global service and support are important components of our solutions. We are one of a few select organizations with the capabilities and industry expertise required to implement our solutions almost anywhere in the world, in multiple languages and currencies, and support business processes tailored to local financial and operational practices. Our geographic management structure enables our global practices to meet local requirements and our services to be delivered effectively within each region. We support our customers' global operations through our network of regional support centers as well as certain alliances and online support, accessible 24 hours a day, seven days a week, virtually anywhere in the world.

#### *Industry Factors*

The enterprise software applications industry is highly competitive, rapidly changing and affected by new product introductions and other market activities, including consolidations among industry participants and the entry of new participants.

In viewing the competition, QAD separates its competition into four groups: *mega-suite solutions*, *roll-up solutions*, *regional solutions* and *point solution solutions*.

**Mega-suite ERP solutions:** (a term originally coined by Gartner Research in its October 2002 report entitled "ERP II Will Support Performance/Relationship Management"). These solutions are designed with the goal of trying to satisfy the needs of multiple industries, including manufacturing, but also unrelated industries such as banking, insurance, retail, state and local government, telecommunications, entertainment and education, among others. These solutions attempt to satisfy the diverse needs of many different industries within a single database and software application and provide a wide set of functionality. QAD believes that a lack of focus on the manufacturing sector has caused manufacturers who purchase these mega-suite applications to experience longer implementation times, a higher total cost of ownership and a lower return on investment than with QAD solutions. We believe this is because the mega-suites' extremely broad industry scope and higher solution complexity limits their effectiveness in addressing the specific needs of manufacturing enterprises, individual plants or divisions for our targeted vertical markets. Examples of mega-suite ERP vendors currently competing in the market include SAP, Oracle and Microsoft.

**Roll-up solutions:** These solutions are neither designed nor built as single solutions, but rather are the result of continued consolidation in the ERP market. QAD uses the term "roll-up" to describe legacy ERP vendors who employ an acquisition strategy. Gartner Research began referring to these vendors as "Collectors" in their December 2003 report, "Management Update: The ERP Market and Vendors in 2004." In recent years, we have seen many companies focus on growing their revenue by acquiring legacy or point solutions. Often the acquired solutions have similar features and overlapping functionality with the roll-up vendors' existing solutions already available on different platforms. QAD believes the resulting solution set created when diverse applications from multiple companies are brought together is usually not easily or well unified and generally consists of multiple applications that rely on dissimilar technologies. We also believe that these roll-up solutions present considerable risk to customers because long term support for similar solutions on multiple platforms is unlikely and could result in a costly-transition to a new system in the future, and because these solutions lack the cohesion and integrated functionality expected by global manufacturers. Examples of roll-up vendors currently competing in the market include Infor (which purchased former roll-up vendor Mapics in January 2005, and was formerly known as Agilysis), SSA, Epicor and GEAC.

Regional solutions: These solutions are designed to provide functionality that is highly targeted to meet the needs of a specific region or country. Vendors of these solutions typically lack the global reach and financial viability that global manufacturers expect of their ERP vendors. Examples of regional solution vendors currently competing in the market include IFS and Intentia, where we see competition most often in Europe and Australia, respectively, User Friendly Software in China and Datasul in South America.

Point solutions: These solutions are designed to provide a fairly narrow set of functionality. Examples include solutions that provide functionality such as only procurement capabilities, only customer relationship management capabilities or only supply chain management capabilities. We believe these solutions tend to be highly specialized within a limited functionality scope compared to manufacturing industry-focused ERP solutions such as QAD, or the other three types of ERP suite solutions defined above and they often lack integration with processes to which they are directly related.

QAD's manufacturing industry-focused ERP solutions are designed for the specific needs of manufacturing enterprises in the industries we serve to handle their internal and select external business processes. We believe this focus has helped us deliver software applications and services that are more fully integrated than point solutions or roll-ups, and yield faster implementations, a lower total cost of ownership and a higher return on investment than mega-suite solutions. We also believe that regional vendors lack the global capabilities or financial viability that global manufacturers expect of their ERP vendors.

As the market for enterprise software continues to develop, companies with significantly greater resources could attempt to increase their presence in these markets by acquiring or forming strategic alliances with our competitors or with our current or potential partners. The dynamic nature of the emerging market space leads us to believe that numerous smaller, but well-capitalized vendors may emerge as strong competitors. Increased competition in these markets is likely to result in price reductions, reduced operating margins and changes in market share, any one of which could adversely affect us. Many of our present or future competitors may have significantly greater financial, technical, marketing and other resources, greater name recognition and a larger installed base of customers than we do. As a result, they may be able to devote greater resources to the development, promotion and sale of their products. Although we believe we offer, and will continue to offer, products that are competitive, we can make no assurance that we will be able to compete successfully with existing or new competitors or that competition will not adversely affect us.

#### *Economic Factors*

Global economic factors can impact the growth rates of manufacturing companies within our target markets. As our customers experience fluctuations in the demand for the products they manufacture, they may react by adjusting their operations and level of investing. At times, these reactions may include increasing, decreasing or delaying capital software purchases, which can directly impact the level and timing of our revenue. We routinely monitor indices that measure reported and forecasted global and regional manufacturing production levels. We consider these indices, among other factors, in forecasting the demand for our own products and services. Recently reported global manufacturing production indices reflect expansion in production and orders in the majority of geographies where we do business, believed to be driven in part by an upturn in economic confidence. This optimism continues to be tempered by the potential for economic volatility due to uncertainties related to the global political environment. With these factors in mind, we remain cautiously optimistic regarding the economic factors that could impact our growth opportunities.



### *Compliance Factors*

Compliance factors, such as the requirements associated with the Sarbanes-Oxley Act of 2002, have had an impact on us and on our customers. The cost and effort of our own compliance with Sarbanes-Oxley has been significant, at approximately \$1.6 million of additional outside consulting and audit fees for fiscal 2005. Many of our customers have also been impacted by such compliance efforts, which we believe has contributed to delays in capital software buying decisions during fiscal 2005. We continue to monitor market reaction as first year compliance efforts come to completion, anticipating a potential release of pent up demand. We are cautiously optimistic that previously delayed capital software buying decisions may fuel growth in fiscal 2006 and beyond. We are aware that our current and potential customers could choose another software vendor's solution, if they perceive there is greater benefit from a compliance perspective.

### *Executive Focus On Operations*

In addition to the industry and economic factors described above, management continually monitors QAD's performance within our business segments. Our business segments consist of a corporate operating segment and four geographic regions: North America; Europe, the Middle East and Africa (EMEA); Asia Pacific and Latin America. For more information regarding our business segments, see note 11 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

Regional performance measures such as revenues, operating margins and days' sales outstanding are reviewed routinely. In addition, we closely monitor our level of personnel and related expenses, which represents the largest portion of our expense structure. We also monitor revenue dollars per employee and the productivity levels of our support and services personnel. We consider this data in our decision-making process related to additions or reductions in spending.

### **CRITICAL ACCOUNTING POLICIES**

We consider certain accounting policies related to revenue recognition, accounts receivable allowances, impairment of long-lived assets, capitalized software development costs, valuation of deferred tax assets and accounting for stock-based compensation to be critical policies due to the significance of these items to our operating results and 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 our software, customer support and services including technical, implementation and training. 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. We use the residual method to recognize revenue. When a license agreement includes one or more elements to be delivered at a future date, if vendor-specific, objective evidence of the fair value of all undelivered elements exists then the revenue for the undelivered element is 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 for which we review 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 methods 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.
- *Goodwill and Intangible Assets.* Goodwill and other intangible assets at January 31, 2005, was \$11.6 million and \$0.3 million, respectively, accounting for 6% 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. Effective February 1, 2002,

we adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142) which 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 4 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

- *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 exceed 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.* 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. At January 31, 2005, we had \$7.8 million of deferred tax assets, net of valuation allowances, consisting of \$41.4 million of gross deferred tax assets offset by valuation allowances of \$33.6 million. 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. At April 30, 2004 and January 31, 2005, we performed an assessment of the recoverability of our net deferred tax assets. We determined that some 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 \$1.2 million at April 30, 2004 and \$5.3 million at January 31, 2005, resulting from the reduction of previously recorded valuation allowances against net deferred tax assets. 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.
- *Stock-based Compensation Expense.* We account for our stock option grants in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving

Stock Compensation." As such, compensation expense is generally recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price or in connection with the modification to outstanding awards and/or changes in grantee status.

Compensation expense related to stock options granted to non-employees is accounted for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123) and EITF 96-18, "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods, or Services", which requires entities to recognize an expense based on the fair value of the related awards. Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure—an Amendment of FASB Statement No. 123" amended SFAS 123 to provide alternative methods of transition for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation. We are not currently required to transition to a fair value method of accounting for stock-based employee compensation. Instead, we have elected to provide the required disclosures as if we had transitioned. For pro forma net income (loss) and related income (loss) per share had we applied the fair value recognition provisions of SFAS 123, as amended, to stock-based employee compensation, see note 1 to Notes to Consolidated Financial Statements within this Annual Report on Form 10-K.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 123R, "Share-Based Payment" (SFAS 123R). SFAS 123R will require us to account for our stock options using a fair-value-based method as described in such statement and recognize the resulting compensation expense in our financial statements. We are currently evaluating the requirements of SFAS 123R. We have not determined the method of adoption and have not determined whether the adoption will result in amounts recognized in the income statement that are similar to the current pro forma disclosures under SFAS 123. The actual annual expense is dependent on a number of factors, including the number of stock options granted, our common stock price and related expected volatility and other inputs utilized in estimating the fair value of the stock options at the time of grant. Accordingly, the adoption in fiscal 2007 of SFAS 123R will likely have a substantial material effect on our results of operations and results of operations may not be comparative on a historical basis.

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 Consolidated Statements of Operations:

|  | Years Ended January 31, |      |      |
|--|-------------------------|------|------|
|  | 2005                    | 2004 | 2003 |
| Revenue:   |                         |      |      |
| License fees   | 26%                     | 30%  | 29%  |
| Maintenance and other  | 49                      | 50   | 54   |
| Services   | 25                      | 20   | 17   |
| Total revenue  | 100                     | 100  | 100  |
| Costs and expenses:  |                         |      |      |
| Cost of license fees   | 4                       | 5    | 4    |
| Cost of maintenance, service and other                                       | 36                      | 35   | 34   |
| Sales and marketing  | 25                      | 26   | 32   |
| Research and development   | 14                      | 16   | 17   |
| General and administrative   | 11                      | 10   | 11   |
| Amortization of intangibles from acquisitions                                | —                       | —    | 1    |
| Impairment loss  | —                       | —    | —    |
| Restructuring  | —                       | —    | 3    |
| Total costs and expenses   | 90                      | 92   | 102  |
| Operating income (loss)  | 10                      | 8    | (2)  |
| Other (income) expense   | —                       | —    | 1    |
| Income (loss) before income taxes and cumulative effect of accounting change | 10                      | 8    | (3)  |
| Income tax (benefit) expense   | (1)                     | 1    | 1    |
| Income (loss) before cumulative effect of accounting change                  | 11                      | 7    | (4)  |
| Cumulative effect of accounting change                                       | —                       | —    | —    |
| Net income (loss)  | 11%                     | 7%   | (4)% |

### Comparison of fiscal 2005 revenue to fiscal 2004

Total revenue for fiscal 2005 was \$231.2 million, an increase of \$0.5 million, from \$230.7 million in fiscal 2004. Revenues remained relatively flat year over year, reflecting increases in services revenues offset by decreases in license fees, maintenance and other revenue. Our customers are widely dispersed, such that no single customer accounted for more than 10% of our total revenue in any of the last three fiscal years. Holding foreign currency exchange rates constant to fiscal 2004, fiscal 2005 revenue would have been approximately \$225.9 million, representing a decrease of \$4.8 million or 2%. All revenue categories were positively impacted by currency fluctuations in the current year.

License revenue was \$60.5 million for fiscal 2005, down \$8.5 million, or 12%, from \$69.0 million in fiscal 2004. Holding foreign currency exchange rates constant to fiscal 2004, fiscal 2005 license revenue would have been approximately \$59.9 million, representing a \$9.1 million, or 13%, decrease from last year. All of our business segments experienced decreases in license revenue over the prior year. We have continued to sell our software at prices comparable to the previous two fiscal years. 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 fiscal 2005, 39 customers placed license orders totaling more than \$300,000, compared to

49 customers in fiscal 2004. We believe that the lower number of sizable orders this year can be attributed, in part, to our customers focusing on Sarbanes-Oxley compliance rather than systems implementations.

Maintenance and other revenue was \$113.7 million for fiscal 2005, representing a decrease of \$1.0 million, or 1%, from the \$114.7 million for fiscal 2004. Holding exchange rates constant to those prevailing in fiscal 2004, fiscal 2005 maintenance and other revenue would have been approximately \$111.5 million, representing a \$3.2 million, or 3%, decrease from last year. Maintenance revenue decreased \$1.8 million year over year due in part to improvements in our maintenance renewal backlog in fiscal 2005 which has resulted in fewer significant cases of delayed renewal commitments than in the prior year, which has an unfavorable impact when comparing to last year. In addition, other revenue decreased \$1.3 million, primarily due to lower hardware sales in the Asia Pacific region year over year. One of the ways management measures our success in securing contract renewals is by measuring 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 has remained consistent, in excess of 90% for both fiscal 2005 and 2004.

Services revenue was \$56.9 million for fiscal 2005, representing an increase of \$10.0 million, or 21%, when compared to last year at \$46.9 million. Holding exchange rates constant to those prevailing during fiscal 2004, fiscal 2005 services revenue would have been approximately \$54.4 million, reflecting a \$7.5 million, or 16%, increase over last year. The effect of the change in exchange rates mainly related to fluctuations in the euro. Increases in North America were partly offset by decreases in EMEA region. Our services backlog as of the current year-end is slightly lower than fiscal 2004, primarily due to the timing of major contract awards.

#### *Comparison of fiscal 2004 revenue to fiscal 2003*

Total revenue for fiscal 2004 was \$230.7 million, an increase of \$35.4 million, or 18%, from fiscal 2003, reflecting increases in all revenue categories and regions. Holding foreign currency exchange rates constant to fiscal 2003, fiscal 2004 revenue would have been approximately \$221.6 million, representing an increase of \$26.4 million, or 13%, over fiscal 2003.

License revenue was \$69.0 million for fiscal 2004, up \$13.0 million, or 23%, from \$56.0 million for fiscal 2003. Holding foreign currency exchange rates constant to fiscal 2003, fiscal 2004 license revenue would have been approximately \$67.6 million, representing an \$11.6 million, or 21%, increase over fiscal 2003. All of our business segments experienced increases over the prior year. The increase over fiscal 2003 reflected a higher volume of user licenses sold, due in part to the favorable impact of a return to somewhat higher IT spending levels within our customer base during fiscal 2004. We believe that this shift was partly attributable to a more positive outlook regarding the economy and the global political environment. In addition, we experienced increases in revenue within the Asia Pacific region during fiscal 2004, partly due to greater success in our sales execution process in Asia. In relation to the number of customers that had placed sizable license orders in the period, during fiscal 2004, 49 customers placed license orders totaling more than \$300,000, compared to 39 customers in fiscal 2003.

Maintenance and other revenue was \$114.7 million for fiscal 2004, representing an increase of \$8.4 million, or 8%, over the \$106.3 million for fiscal 2003. Holding exchange rates constant to those prevailing in fiscal 2003, fiscal 2004 maintenance and other revenue would have been approximately \$111.3 million, representing a \$5.0 million, or 5%, increase over last year. The increase in maintenance revenue was made up of increases in each of our regions. The

year-over-year increase was primarily due to additional maintenance on new license sales, partially offset by cancellations within our existing customer base.

Services revenue was \$46.9 million for fiscal 2004, representing an increase of \$14.0 million, or 43%, when compared to fiscal 2003 at \$32.9 million. Holding foreign currency exchange rates constant to fiscal 2003, fiscal 2004 services revenue would have been approximately \$42.7 million, reflecting a \$9.7 million, or 30%, increase over the prior year. The effect of the change in exchange rates mainly related to fluctuations in the euro. In addition, services revenue increased over fiscal 2003 due to the inclusion of a full year of services revenue in fiscal 2004 in the EMEA region from the TRW ISCS acquisition that was completed in November 2002. Also contributing to the increase was an increase in the number of larger license sales, primarily in North America, which typically lead to significant services engagements. Our services backlog as of the fiscal 2004 year-end had increased over the prior year-end mainly due to the assimilation of the TRW ISCS operations. In North America, we experienced an increase in the number and size of services contracts awarded to our services organization, rather than our partners or other service providers in fiscal 2004.

*Comparison of costs and expenses—fiscal 2005, 2004 and 2003*

**Total Cost of Revenue.** Total cost of revenue (combined cost of license fees and cost of maintenance, service and other revenue) was \$91.5 million for both fiscal 2005 and 2004 and was \$75.0 million for fiscal 2003 and as a percentage of total revenue was 40%, for both fiscal 2005 and 2004 and was 38% for fiscal 2003. Holding exchange rates constant to the most recent preceding fiscal year, total cost of revenue would have been approximately \$88.5 million and \$85.9 million for fiscal 2005 and 2004, respectively, reflecting the impact of the weakening U.S. dollar in comparison to other currencies. At constant exchange rates, the total cost of revenue percentage for both fiscal 2005 and fiscal 2004 would have decreased 1% to 39%.

Fiscal 2005 and 2004 included employee separation costs of \$1.6 million and \$2.0 million, respectively (mainly in EMEA). Fiscal 2003 included non-recurring expense reductions related to two separate royalty contract accruals totaling \$1.2 million, resulting in a one-point decrease in the total cost of revenue percentage to 38%. Excluding the impact of the royalty expense reduction, the total cost of revenue percentage would have been 39% in fiscal 2003.

**Sales and Marketing.** Sales and marketing expense was \$56.6 million, \$60.2 million and \$61.7 million for fiscal 2005, 2004 and 2003, respectively. The decrease of \$3.6 million from fiscal 2004 to fiscal 2005 was primarily related to lower personnel expenses of \$3.8 million, lower travel expenses of \$1.2 million and lower marketing expenses of \$0.8 million, all related to our cost containment efforts in fiscal 2005, partially offset by increased sales agent fees of \$0.8 million and the unfavorable currency impact of \$1.8 million, mainly due to the strengthening of the euro.

The decrease of \$1.5 million from fiscal 2003 to 2004 was mainly related to lower salaries and related allocations, partly due to the favorable impact of the fiscal 2003 cost containment efforts on the fiscal 2004 results, significantly offset by the unfavorable impact of the weakening of the U.S. dollar, mainly in relation to the euro and the Australian dollar, higher bonus expense on improved performance metrics and the inclusion of \$0.9 million of additional employee separation costs in fiscal 2004.

**Research and Development.** Research and development expense, which is managed on a global basis, was \$33.2 million, \$36.2 million and \$33.4 million in fiscal 2005, 2004 and 2003, respectively. The decrease of \$3.0 million from fiscal 2004 to 2005 was primarily attributable to lower personnel expenses of \$2.6 million, primarily due to our cost containment efforts in North America and a lower level of contractor expense in the current year.

The increase from fiscal 2003 to 2004 was primarily due to increased personnel, consulting and related expenses aligned with our investment in the development of our products in fiscal 2004. In addition, we were unfavorably impacted by the weakening of the U.S. dollar relative to certain other currencies, mainly the euro and Australian dollar, in fiscal 2004.

*General and Administrative.* General and administrative expense was \$26.1 million, \$24.2 million and \$21.8 million for fiscal 2005, 2004 and 2003, respectively. The \$1.8 million increase from fiscal 2004 to 2005 was mainly related to a \$1.3 million increase in professional fees, primarily related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002, and \$0.7 million unfavorable currency fluctuation related to the weakening of the U.S. dollar.

The \$2.4 million increase from fiscal 2003 to 2004 was primarily due to incrementally higher expense in EMEA, including personnel and associated costs related to the TRW ISCS acquisition completed in November 2002, higher bonuses on improved performance metrics and the impact of the weakening of the U.S. dollar.

*Amortization of Intangibles from Acquisitions.* Amortization of intangibles from acquisitions totaled \$0.5 million, \$0.9 million and \$1.2 million in fiscal 2005, 2004 and 2003, respectively. The year over year declines were primarily related to certain intangible assets that had become fully amortized.

*Impairment Loss.* SFAS 142 requires us to analyze goodwill for impairment at least on an annual basis or when a triggering event requires an additional analysis. We have chosen November 30th of our fiscal year as our annual test period. During the fourth quarter of fiscal 2005, 2004 and 2003, in connection with our annual test, all reporting units containing goodwill were valued and tested for impairment. The results of this test yielded no indication of impairment for the reporting units that had goodwill on their balance sheets as of the test date, which included EMEA, Latin America and Asia Pacific.

During fiscal 2004 and 2003, we made earnout payments to the selling entity of an acquired business in our Asia Pacific reporting unit of \$0.3 million and \$0.2 million, respectively, based on financial performance under the purchase agreement. The payments effectively served to increase the purchase price of the acquisition, thus adding to our goodwill balance. Based on the earnout payments, under SFAS 142, the Asia Pacific reporting unit was valued and tested for impairment. In fiscal 2004, no impairment was indicated. In accordance with the provisions of SFAS 142, the fiscal 2003 additional \$0.2 million of goodwill in Asia Pacific was fully impaired and the related impairment loss is included in our Consolidated Statement of Operations for fiscal 2003.

*Restructuring.* In prior years, we implemented restructuring programs designed to strengthen operations and financial performance. Charges and adjustments related to restructurings are included in "Restructuring" in our Consolidated Statements of Operations. During fiscal 2004 and 2003, we recorded \$(0.3) million and \$5.3 million, respectively, related to restructuring. Below is a discussion of those restructuring programs and related activity through January 31, 2005.

During fiscal 2003, we implemented cost reduction programs aimed at reducing annualized operating expenses to better align them with then current business levels. The related actions resulted in a combined \$4.4 million charge that included a reduction of approximately 130 employees across all regions and functions (\$4.1 million), facility consolidations (\$0.1 million) and associated asset write-downs (\$0.2 million). In addition, during fiscal 2003, we recorded an adjustment of \$0.9 million as an increase to total costs and expenses, related to a fiscal 2002 restructuring accrual due to our inability to sublease certain office space as originally planned. During fiscal 2004, we recorded an adjustment of \$0.3 million as a decrease to total costs and expenses related to the fiscal 2002 restructuring accrual to reflect a change in utilization related to



a previously vacated leased office space. As of January 31, 2005 the restructuring accruals, as adjusted, were fully utilized.

*Total Other (Income) Expense.* Total other (income) expense was \$1.0 million, \$(1.4) million and \$2.0 million in fiscal 2005, 2004 and 2003, respectively. The \$2.4 million unfavorable change from fiscal 2004 to 2005 mainly relates to a \$1.5 million gain on sale of property in fiscal 2004. In addition, interest expense increased \$0.9 million due to additional interest incurred in relation to the \$18.0 million long-term financing, as described in the Contractual Obligations section below.

The favorable change from fiscal 2003 to 2004 was primarily related to the inclusion of the \$1.5 million gain on the sale of property in fiscal 2004, and a favorable change in foreign currency transaction and remeasurement (gains) and losses when compared to fiscal 2003.

*Income Tax Expense.* We recorded an income tax benefit of \$2.1 million in fiscal 2005 and income tax expense of \$3.1 million and \$1.3 million in fiscal years 2004 and 2003, respectively. These amounts include taxes in profitable jurisdictions. We have not provided tax benefits for certain jurisdictions in loss positions due to management's determination regarding the uncertainty of the realization of these tax benefits. These amounts also include benefits related to the reversal of tax valuation allowances of \$6.5 million in fiscal 2005. For further information regarding income taxes, please see note 8 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

*Cumulative Effect of Accounting Change.* During fiscal 2003, we adopted SFAS 142 related to impairment tests for goodwill, resulting in the reporting of a cumulative effect of a change in accounting principle of \$1.1 million. For a further discussion related to this change, see note 4 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

## **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.

Our principal sources of liquidity are cash flows generated from operations and our cash and equivalents and marketable securities balances. Cash and equivalents and marketable securities combined were \$68.3 million and \$59.8 million at January 31, 2005 and 2004, respectively. Our working capital increased to \$27.6 million as of January 31, 2005 from \$6.0 million as of January 31, 2004. The increase in working capital of \$21.6 million from last year-end includes a \$15.0 million decrease in current liabilities and a \$6.6 million increase in current assets. The \$15.0 million decrease in current liabilities primarily related to a \$10.3 million decrease in our current portion of long-term debt. During fiscal 2005, we repaid all of our borrowings under our construction loan as described below and entered into a new long-term loan agreement secured by our property located in Summerland, California.

The \$6.6 million increase in current assets related primarily to an \$8.5 million increase in cash and equivalents as detailed in our Consolidated Statement of Cash Flows for the year ended January 31, 2005, partially offset by lower accounts receivable, mainly related to higher collections in the current year. Accounts receivable days' sales outstanding, using the count back method, increased slightly to 60 days at January 31, 2005, from 58 days at January 31, 2004.

### **Net Cash**

Net cash, defined as cash and equivalents and marketable securities less short and long term debt, increased slightly to \$42.7 million as of January 31, 2005 from \$40.1 million at January 31,

2004. Cash increases from operating cash flow were offset by additional debt, incurred to finance the construction of our corporate headquarters.

## **Cash Flows**

The following is a summary of cash flows for fiscal 2005, 2004 and 2003:

### *Operating Activities*

Cash provided by operating activities was \$23.0 million, \$19.8 million and \$13.4 million in fiscal 2005, 2004 and 2003, respectively. The increase from fiscal 2004 to 2005 related primarily to an increase in net income year over year offset by a decrease in depreciation and amortization and a non-cash tax benefit from the reversal of deferred tax valuation allowances of \$6.5 million. In addition, accounts receivable reflected a net decrease in fiscal 2005 due to collections in excess of billings, versus a net increase in accounts receivable in fiscal 2004. Increases to cash flow in fiscal 2005 were offset by decreases in other liabilities which primarily relates to higher income tax payments and payroll-related payments in fiscal 2005.

Operating activities in fiscal 2005 include \$0.7 million of exit costs related to an office lease we vacated in December 2004. At the time we vacated the lease we secured a sub-lease for an amount less than our current lease payments. Therefore, we incurred a non-cash impairment charge in fiscal 2005.

The increase from fiscal 2003 to 2004 related primarily to the shift in our financial results of operations from a net loss to net income. This was partially offset by the impact of an increase in accounts receivable in fiscal 2004 due to billings in excess of collections, versus a decrease in accounts receivable in fiscal 2003 related to collections in excess of billings.

### *Investing Activities*

Cash used in investing activities for fiscal 2005, 2004 and 2003 was \$13.0 million, \$21.2 million and \$3.3 million, respectively, mainly related to the purchase of property and equipment.

Purchases of property and equipment for fiscal 2005, 2004 and 2003 were \$10.6 million, \$17.8 million and \$9.3 million, respectively. Property and equipment purchases primarily relate to capital investments of \$6.6 million, \$13.8 million and \$4.3 million, respectively, for the construction of our new company headquarters on property owned by QAD in Summerland, California. Upon securing our construction loan in fiscal 2003, approximately \$6.8 million was transferred into a restricted cash account at Santa Barbara Bank and Trust (SBB&T). Of the restricted cash amount, approximately \$2.5 million was used to pay costs related to the project before loan proceeds were borrowed from SBB&T. At January 31, 2003, the remaining restricted cash balance was \$1.0 million and was fully utilized to fund the construction project during fiscal 2004. In fiscal 2004, these purchases were partially offset by the proceeds from the sale of a parcel of property located in Carpinteria, California. We moved into our new company headquarters in May 2004, and shortly thereafter we paid our construction loan in full and entered into a long-term financing arrangement with Mid-State bank, which is secured by the property.

We invest funds in short term marketable securities on which we earn interest income. This balance can fluctuate based on our short-term investing decisions. In fiscal 2003 and 2004, we sold \$7.5 million and \$0.5 million, respectively, in marketable securities. In fiscal 2004, we made purchases at a cost of \$7.0 million.

In April 2004, we acquired certain assets and liabilities of Oxford Consulting Group, Inc. located in the United States. We paid \$0.8 million in cash upon consummation which is included in "Acquisitions of businesses, net of cash acquired" in our January 31, 2005 Consolidated Statement of Cash Flows.

In November 2002, we acquired the TRW Integrated Supply Chain Solutions (TRW ISCS) business covering 10 European countries and North America from BDM International, Inc. (a wholly-owned subsidiary of TRW Inc.) and TRW Inc. Prior to the acquisition, TRW ISCS, a QAD alliance partner pursuant to an agreement with QAD, operated businesses that primarily focused on systems installation, integration and services in connection with the MFG/PRO software owned and licensed by QAD and other QAD-related goods and services. Under the terms of the Stock and Asset Purchase Agreement, QAD paid \$1.0 million in cash and incurred transaction costs, including direct acquisition costs, involuntary termination costs and facility related costs, of approximately \$5.7 million. QAD funded the purchase price paid to BDM International, Inc. and TRW Inc. with cash generated from operating activities. Among the assets acquired by QAD from TRW ISCS was approximately \$1.8 million in cash and equivalents. Because the cash acquired exceeded the cash expended for the acquisition, the net cash impact of \$0.8 million for the acquisition is reflected as cash provided from investing activities in our fiscal 2003 Consolidated Statement of Cash Flows.

In March 2003, we sold a 34-acre undeveloped parcel of property in Carpinteria, California for \$3.3 million, net of associated fees. The book value of this property was \$1.8 million resulting in a \$1.5 million gain on disposal of the property.

#### *Financing Activities*

Cash (used in) provided by financing activities was \$(2.1) million, \$2.9 million and \$(5.5) million for fiscal 2005, 2004 and 2003, respectively.

The fiscal 2005 activity includes loan proceeds of \$17.8 million from a loan agreement we entered into with Mid-State Bank in July of 2004. We used \$14.3 million of the proceeds to pay the then existing construction loan with SBB&T. We implemented a dividend program during the year and as a result, paid \$5.1 million in dividends to our common stockholders. Proceeds from the issuance of common stock was \$2.8 million, primarily related to the exercise of stock options. In addition, our board of directors approved a stock repurchase program to repurchase up to 1.0 million shares of common stock. Approximately 742,000 shares of common stock were repurchased for \$5.6 million during fiscal 2005.

The fiscal 2004 activity includes approximately \$15.2 million in expenditures related to a "Modified Dutch Auction" tender offer, in which we purchased approximately 2.9 million shares of our common stock at a price of \$5.00 per share. Proceeds from the issuance of common stock were \$9.6 million and \$0.9 million for fiscal 2004 and 2003, respectively, primarily related to the exercise of stock options. Also included in the fiscal 2004 proceeds from the issuance of stock was the December 2003 exercise of a warrant by Recovery Equity Investors II, L.P. to purchase 225,000 shares of QAD common stock at an exercise price of \$7.50 per share for which QAD received \$1.7 million in cash. In addition, fiscal 2004 includes \$10.5 million in proceeds from the construction loan related to the building of our new headquarters in Summerland, California.

Upon securing our construction loan in fiscal 2003, \$6.8 million was transferred to a restricted cash account at SBB&T, of which approximately \$4.3 million was used within that fiscal year, to pay off the existing first deed mortgage secured by the property.

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

## CONTRACTUAL OBLIGATIONS

The following summarizes our significant contractual obligations at January 31, 2005 and the effect these contractual obligations are expected to have on our liquidity and cash flows in future periods.

| (in millions)                   | Year Ended January 31, |         |        |        |        |            | Total   |
|---------------------------------|------------------------|---------|--------|--------|--------|------------|---------|
|                                 | 2006                   | 2007    | 2008   | 2009   | 2010   | Thereafter |         |
| Credit facility                 | \$ 1.5                 | \$ 6.1  | \$ —   | \$ —   | \$ —   | \$ —       | \$ 7.6  |
| Notes payable                   | 0.2                    | 0.2     | 0.2    | 0.3    | 0.3    | 16.7       | 17.9    |
| Notes payable interest payments | 1.2                    | 1.2     | 1.2    | 1.1    | 1.1    | 4.8        | 10.6    |
| Lease obligations               | 5.8                    | 4.3     | 2.0    | 1.6    | 1.4    | 4.2        | 19.3    |
| Technology purchases            | 4.0                    | 0.2     | —      | —      | —      | —          | 4.2     |
| Total                           | \$ 12.7                | \$ 12.0 | \$ 3.4 | \$ 3.0 | \$ 2.8 | \$ 25.7    | \$ 59.6 |

### Credit Facility

Effective April 7, 2005, we entered into a new unsecured loan agreement with Comerica Bank. The agreement provides a three-year commitment for a \$20 million line of credit (CB Facility). On April 7, 2005, we terminated our existing \$30 million secured credit facility with Wells Fargo Foothill, Inc. Amounts then outstanding under the Wells Fargo Foothill Facility were repaid with funds borrowed from the 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 EBITDA. We will pay an annual commitment fee of between 0.25% and 0.50% calculated on the average unused portion of the \$20 million CB Facility. The rate is determined by our ratio of funded debt to our 12-month trailing EBITDA.

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.

The balance sheet classification as of January 31, 2005 consists of \$1.5 million in "Current portion of long-term debt" and \$6.1 million in "Long-term debt" as we have the ability and intent to repay \$1.5 million of the amount borrowed from the CB Facility within the next twelve months. For a detailed discussion regarding our Wells Fargo Foothill Facility outstanding as of January 31, 2005, see note 7 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report of Form 10-K. As of January 31, 2005, we were in compliance with the Wells Fargo Foothill Facility covenants, as amended.

### *Notes Payable*

On July 28, 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 on July 28, 2014. Over the term of the loan, we will make 119 monthly payments of \$115,000 and one final payment of \$15.4 million. Total proceeds were \$17.8 million, which was net of transaction fees of \$0.2 million. A portion of these proceeds were used to repay our then existing construction loan with Santa Barbara Bank and Trust. The balance of the note payable at January 31, 2005 was \$17.9 million.

### *Lease Obligations*

We lease certain office facilities, office equipment and automobiles under operating lease agreements. Future minimum rental payments under non-cancelable operating lease commitments with terms of more than one year are included in the above table of contractual obligations. For further discussion of our leased office facilities, see Item 2 entitled "Properties" included elsewhere in this Annual Report on form 10-K.

### *Technology Purchases*

Subsequent to our fiscal 2005 year-end, QAD acquired intellectual property comprised of certain software that is complementary to MFG/PRO and that will enhance the financial and architectural capabilities of MFG/PRO. The acquisition price was approximately \$3.7 million, payable in four installments. The first payment of approximately \$1.3 million was made in February 2005. The final payment is due in May 2006.

During the fiscal 2004 third quarter, QAD acquired intellectual property comprised of certain software that is complementary to MFG/PRO and is part of our Customer Self-Service solution. The acquisition price included a total of \$0.8 million in guaranteed payments, payable annually over three years, beginning with \$0.3 million paid upon acquisition. The agreement sets forth additional potential future contingent payments by QAD of up to \$0.3 million per year for three years commencing upon acquisition, based on future sales of the acquired software when used with certain versions of MFG/PRO.

During the fiscal 2004 fourth quarter, QAD acquired intellectual property comprised of certain software that is complementary to MFG/PRO and is part of our Business Intelligence solution. The acquisition price included a total of \$0.9 million in guaranteed payments, payable annually over three years beginning with \$0.3 million that was due in February 2004. The agreement also sets forth potential future contingent payments by QAD for three years commencing upon acquisition, based on future sales of the acquired software.

## FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF STOCK

### HISTORICAL FLUCTUATIONS IN QUARTERLY RESULTS AND POTENTIAL FUTURE SIGNIFICANT FLUCTUATIONS

Our quarterly revenue, expenses and operating results have varied significantly in the past. We anticipate that such fluctuations will continue in the future as a result of a number of factors, many of which are outside our control. The factors affecting these fluctuations include demand for our products and services, the size, timing and structure of significant licenses purchased by customers, market acceptance of new or enhanced versions of our software products and products that operate with our products, the publication of opinions about us, our products and technology by industry analysts, the entry of new competitors and technological advances by competitors, delays in localizing our products for new markets, delays in sales as a result of lengthy sales cycles, changes in operating expenses, foreign currency exchange rate fluctuations, changes in accounting principles, changes in pricing policies by us or our competitors, customer order deferrals in anticipation of product enhancements or new product offerings by us or our competitors, the timing of the release of new or enhanced versions of our software products and products that operate with our products, changes in the method of product distribution and licensing (including the mix of direct and indirect channels), product life cycles, changes in the mix of products and services licensed or sold by us, customer cancellation of major planned software development programs or maintenance contracts and general, regional or market economic factors and the global political environment.

We have historically recognized a substantial portion of our revenue from sales booked and shipped in the last month of a quarter. As a result, the magnitude of quarterly fluctuations in license fees may not become evident until late in, or at the end of, a particular quarter. If sales forecasted from a specific customer for a particular quarter are not realized in that quarter, we are unlikely to be able to generate revenue from alternate sources in time to compensate for the shortfall. As a result, a lost or delayed sale could have an adverse effect on our quarterly operating results. To the extent that significant sales occur earlier than expected, operating results for subsequent quarters may be adversely affected. We have also historically operated with little backlog for licenses because our products are generally shipped as orders are received. As a result, revenue from license fees in any quarter is substantially dependent on orders booked and shipped in that quarter. Sales derived through indirect channels are more difficult to predict and may have lower profit margins than direct sales.

*A significant portion of our revenue in any quarter may be derived from a limited number of large, non-recurring license sales.* We expect to continue to experience from time to time large, individual license sales, which may cause significant variations in quarterly license fees. We also believe that the purchase of our products is relatively discretionary and generally involves a significant commitment of a customer's capital resources. Therefore, a downturn in any potential customer's business could result in order cancellations that could have a significant adverse impact on our revenue and quarterly results. Moreover, actual or perceived declines in general economic conditions, worsening of the global political environment or a delay in the improvement of the current economic situation may result in significant reductions in corporate spending for information technology, which could result in delays, cancellations or reductions of orders for our products.

*The services business may fluctuate. Services staffing increases our overhead and the services business reduces our gross margins.* Services revenue remains a substantial part of our business. Services revenue increased in fiscal 2004 and 2005, due primarily to the TRW ISCS acquisition, the Oxford acquisition and an increase in license sales in fiscal 2004. While the expenses associated with services operations are relatively predictable, the revenues are dependent upon the

timing and size of customer orders to provide the services. To the extent that we are not successful in securing orders from customers to provide services on a regular basis, our results may be negatively affected.

*Fixed expense level is based on expected revenues.* Our expense level is relatively fixed and is based, in significant part, on expectations of future revenue. Because our expense level is relatively fixed, if revenue levels are below expectations, expense could be disproportionately high as a percentage of total revenue. If this were to occur, operating results would be immediately and adversely affected and losses could occur.

*Because of the significant fluctuations in our revenue, period-to-period comparisons may not be meaningful.* Based upon the factors described above, we believe that our quarterly revenue, expenses and operating results are likely to vary significantly in the future, that period-to-period comparisons of our results of operations are not necessarily meaningful and that, as a result, these comparisons should not be relied upon as indications of future performance. Moreover, there can be no assurance that our revenue will grow in future periods or that we will be profitable on a quarterly or annual basis. We have in the past, and may in the future, experience quarterly losses.

## **RISKS ASSOCIATED WITH SALES CYCLE**

*Our products involve a long sales cycle and the timing of sales is difficult to predict.* Because the licensing of our primary products generally involves a significant commitment of capital by our customers (which typically range from approximately \$50,000 to several million dollars), the sales cycle associated with a customer's purchase of our products is generally lengthy (with a typical duration of 4 to 15 months), varies from customer to customer and is subject to a number of significant risks over which we have little or no control. These risks include customers' budgetary constraints, timing of budget cycles, concerns about the introduction of new products by us or our competitors and actual or perceived declines in general economic conditions that can result in delays or cancellations of information systems investments. Due in part to the strategic nature of our products, potential customers are typically cautious in making product acquisition decisions. The decision to license our products generally requires us to provide a significant level of education to prospective customers regarding the uses and benefits of our products, and we must frequently commit substantial presales resources in the sales cycle.

While we believe we have established a robust global support and services organization over the past several years, we continue to rely on third-parties for a portion of our implementation and systems support services, which in the past caused sales cycles to be lengthened and may have resulted in the loss of sales. Further, the uncertainty of the outcome of our sales efforts and the length of our sales cycles could still result in substantial fluctuations in operating results. If sales forecasted from a specific customer for a particular quarter are not realized in that quarter, then we are unlikely to be able to generate revenue from alternative sources in time to compensate for the shortfall. As a result, and due to the relatively large size of some orders, a lost or delayed sale could have an adverse effect on our quarterly and/or annual operating results.

## **DEPENDENCE ON THIRD-PARTY PRODUCTS**

*We are dependent on third-party products, particularly Progress software.* MFG/PRO software is written in a programming language that is proprietary to Progress Software Corporation (Progress). We have entered into a license agreement with Progress that provides us and each of our subsidiaries, among other things, with the perpetual, worldwide, royalty-free right to use the Progress programming language to develop and market our software products. Effective July 2002, we entered a three-year extension of the agreement with Progress under which Progress provides support to us at no charge.

Our success is dependent upon Progress continuing to develop, support and enhance its programming language, its toolset and database, as well as the continued market acceptance of Progress as a standard database program and continuing our relationship with them. We have in the past, and may in the future, experience product release delays because of delays in the release of Progress products or product enhancements. Any of these delays could have an adverse effect on our business, operating results and financial condition. MFG/PRO software employs Progress programming interfaces that allow MFG/PRO software to operate with Oracle Corporation database software. However, MFG/PRO software does not run within programming environments other than Progress and our customers must acquire rights to Progress software in order to use MFG/PRO software. We are in the process of extending our current Value Added Reseller relationship with Progress.

We also are reliant on the Java programming language (Java) in developing and supporting our products. For instance, the user interface for MFG/PRO software products employs Java. The failure to successfully incorporate Java in new products, to convert MFG/PRO software to Java-interfaced Progress software components, to extend the MFG/PRO Java user interfaces, or of Java or Enterprise Java Beans technology to maintain market acceptance, could have an adverse effect on us.

We also maintain development and product alliances with other third-parties. These alliances include software developed to be sold in conjunction with QAD software products, technology developed to be included in or encapsulated within QAD software products and numerous third-party software programs that generally are not sold with QAD software but interoperate directly with QAD software through application program interfaces. We occasionally enter into joint development agreements with our third-party software development alliances that govern ownership of the technology collectively developed. In addition, we have embarked on an opportunistic strategy of acquiring certain niche products to extend and enhance our product offering. These acquisitions involve third party products, or software developed by a customer, that were already in use with our software but only on a limited basis geographically. These include products such as our customer self-service solution, our inventory management product, known as AIM, our QAD Sequencing (or Just in Time) software, our Business Intelligence solution and an enhancement to our finance solution. While we believe these products will yield significant value to QAD in the future, at this point they are at various stages of being integrated into our product offering.

Each of our partner agreements and third-party development, product acquisition or reseller agreements contain strict confidentiality and non-disclosure provisions for the service provider, end-user and third-party developer. Our third-party development agreements contain restrictions on the use of QAD technology outside of the development process. Any failure to establish or maintain successful relationships with these third-party software providers or third-party installation, implementation and development partners or failure of these third-party software providers to develop and support their software could have an adverse effect on us. Any failure by them to provide appropriate indemnification in the event of an alleged infringement by a third-party related to their products could have an adverse effect on us.

#### **RAPID TECHNOLOGICAL CHANGE**

*The market for our software products is characterized by rapid technological advances, evolving industry standards in computer hardware and software technology, changes in customer requirements and frequent new product introductions and enhancements as well as industry consolidation.* Customer requirements for products can change rapidly as a result of innovations or changes within the computer hardware and software industries, the introduction of new products and technologies (including new hardware platforms and programming languages) and the emergence,



evolution or widespread adoption of, or changes to, industry standards including those related to consolidation in the industry. For example, increasing commercial use of the Internet is giving rise to new customer requirements and new industry standards. Our future success will depend upon our ability to continue to enhance our current product line and to develop and introduce new products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements, keep pace with industry and compliance standards and achieve market acceptance. In particular, we believe our future success will depend on our ability to convert our products to component objects, as well as our ability to develop products that will operate and interoperate across the Internet and assist customers to operate within the Extended Enterprise. We cannot ensure that we will be successful in developing and marketing, on a timely and cost-effective basis, product enhancements or new products that respond to technological advances by others. Our products may also not achieve market acceptance. Our failure to successfully develop and market product enhancements or new products could have an adverse effect on us.

*New software releases and enhancements may adversely affect our software sales.* While we generally take steps to avoid interruptions of sales due to the pending availability of new products, customers may delay their purchasing decisions in anticipation of the general availability of new or enhanced QAD software or other software, which could have an adverse effect on us. The actual or anticipated introduction of new products, technologies and industry standards can also render existing products obsolete or unmarketable or result in delays in the purchase of those products. As a result, the life cycles of our products are difficult to estimate. We must respond to developments rapidly and incur substantial product development expenses. Any failure by us to anticipate or respond adequately to developments in technology or customer requirements, or any significant delays in the introduction of new products, could result in a loss of revenue. Moreover, significant delays in the general availability of new releases, significant problems in the installation or implementation of new releases, or customer dissatisfaction with new releases could adversely affect us.

## **PROPRIETARY RIGHTS AND LICENSING**

*Our success is dependent upon our proprietary technology and other intellectual property.* We rely primarily on a combination of the protections provided by applicable copyright, trademark and trade secret laws, as well as on confidentiality procedures and licensing arrangements, to establish and protect our rights in our software and related materials and information. We enter into license agreements with each of our customers. Each of these license agreements provides for the non-exclusive license of QAD software. These licenses generally are perpetual and contain strict confidentiality and non-disclosure provisions, a limited warranty covering our software and indemnification for the customer from infringement actions related to our software.

The pricing policy for each license is based on a standard price list and may vary based on a number of parameters including the number of end-users, number of sites, number of modules, number of languages, the country in which the license is granted and level of ongoing support, training and services to be provided by QAD.

In fiscal 2005, we started implementing a new Business Process Cycle (BPC) pricing and licensing model for some of our solutions. Currently, our applications are priced and licensed primarily on a per user basis. With BPC pricing, QAD products will be licensed based upon a combination of the number of users and the extent to which a QAD customer leverages QAD's software to automate and optimize key business processes. There are no assurances that such a licensing model will be accepted in the market place or will yield revenue comparable to the current licensing method.

To facilitate our customers' ability to customize our software, we generally license our software to end-users in both object code (machine-readable) and source code (human-readable) formats. While this practice facilitates customization, making software available in source code also makes it easier for third-parties to copy or modify our software for impermissible purposes. Distributors or other persons may independently develop a modified version of our software. Our license agreements generally allow the use of our software solely by the customer for internal purposes without the right to sublicense or transfer the software to third-parties. Although we currently have no patents, we have two pending patent applications.

We believe that the measures we take to protect our proprietary technology and other intellectual property afford only limited protection. Despite our efforts, it may be possible for third-parties to copy portions of our products, to reverse engineer them or to obtain and use information that we regard as proprietary. In addition, the laws of certain countries do not protect our proprietary rights to the same extent as the laws of the United States. Accordingly, there can be no assurance that we will be able to protect our proprietary software against unauthorized copying or use, which could adversely affect our competitive position. Furthermore, there can be no assurance that our competitors will not independently develop technology similar to ours.

*We may be faced with or need to bring infringement claims to protect our rights.* We have been in the past, and may be in the future, subject to claims of intellectual property infringement and may increasingly be subject to these types of claims as the number of products and competitors in our targeted vertical markets grows and the functionality of products in other industry segments overlaps. Although we do not believe that any of our products infringe upon the proprietary rights of third-parties, there can be no assurance that third-parties will not claim infringement by us with respect to current or future products.

We may also initiate or be subject to claims or litigation with or against third-parties for infringement of our proprietary rights or to establish the validity of our proprietary rights, which could result in significant expense to us, cause product shipment delays, require us to enter royalty or licensing agreements and divert the efforts of our technical and management personnel from productive tasks, whether or not such litigation were determined in our favor.

We also periodically acquire intellectual property from third-parties. In some instances, this intellectual property is prepared on a work-for-hire or similar basis, and in other instances, we license the intellectual property. We have been in the past, and expect to be in the future, party to disputes about ownership, license scope and royalty or fee terms with respect to intellectual property.

*Our intellectual property rights may be significantly affected by third-party relationships and actions.* We have in the past, and may in the future, resell certain software which we license from third-parties. In addition, we have in the past, and may in the future, jointly develop software in which we will have co-ownership or cross-licensing rights. There can be no assurance that these third-party software arrangements and licenses will continue to be available to us on terms that provide us with the third-party software we require, provide adequate functionality in our products on terms that adequately protect our proprietary rights, or are commercially favorable to us. The loss of or inability to maintain or obtain any of these software licenses, including a loss as a result of a third-party infringement claim, could result in delays or reductions in product shipments until equivalent software, if any, could be identified, licensed or developed and integrated.

*We may be exposed to product liability claims.* While our license agreements with our customers typically contain provisions designed to limit our exposure to potential material product liability claims including appropriate warranty, indemnification waiver and limitation of liability

provisions, it is possible that such provisions may not be effective under the laws of some jurisdictions. Although we have not experienced any product liability claims to date, we may be subject to claims in the future. We have an errors and omissions insurance policy. However, this insurance may not continue to be available to us on commercially reasonable terms, or at all. A successful product liability or errors or omissions claim brought against us could have an adverse effect on us. Moreover, defending a suit, regardless of its merits, could entail substantial expense and require the time and attention of key management personnel, either of which could have an adverse effect on us.

## **EXTENDED ENTERPRISE SOLUTIONS**

*The market for Extended Enterprise solutions is uncertain.* A significant element of our strategy is the acceptance of our Extended Enterprise solution, a series of new solutions targeted at enabling manufacturers to communicate with customers and suppliers. We have devoted substantial resources to developing our Extended Enterprise solutions, such as CSS, EDI, and supply visualization hosted on MFGx.net, and are working with third-parties to develop software components that may be included as part of or incorporated within such Extended Enterprise solutions. However, we cannot ensure our other planned releases for such Extended Enterprise solutions, whether developed by us or third-parties, will achieve the performance standards required for commercialization. In addition, our Extended Enterprise solutions may not achieve market acceptance or be profitable. If our Extended Enterprise solutions do not achieve such performance standards or do not achieve market acceptance, we would be adversely affected.

*The underlying technology being used to develop some of our applications has been updated and is dependent on specific technologies.* Our Extended Enterprise solutions are being designed and built using updated Progress Software technology, as well as the object-oriented technology of Sun Microsystems—Java 2 Enterprise Edition (J2EE). Our Extended Enterprise solutions depend on the commercial success of platforms that support Progress Software and Enterprise Java Beans in Application Server environments. In addition, we have embarked on an opportunistic strategy of acquiring certain niche products to extend and enhance our product offering, including those for the Extended Enterprise solutions. The success of the Extended Enterprise solutions will depend on our ability to successfully enhance and globalize these acquired products and distribute, service and support them internationally.

Object-oriented applications, such as our Extended Enterprise solutions, are characterized by technology development styles and programming languages that differ from those used in traditional software applications. We believe that the flexibility inherent in object-based functionality will play a key role in the competitive manufacturing, distribution, financial, planning and service/support management information technology strategies of customers in our targeted industry segments. We cannot ensure that we will be successful in developing our other planned Extended Enterprise solutions on a timely basis or that our Extended Enterprise solutions will achieve market acceptance.

## **MARKET CONCENTRATION**

*Our target markets are concentrated and, as a result, we are dependent upon achieving success in those markets.* We have made a strategic decision to concentrate our product development and sales and marketing in certain primary vertical industry segments—automotive, consumer products, electronics, food and beverage, industrial and medical. An important element of our strategy is to achieve technological and market leadership recognition for our software products in these segments. The failure of our products to achieve or maintain substantial market acceptance in one or more of these segments could have an adverse effect on us. If any of these targeted industry segments experience a material slowdown in expansion or in prospects for future growth,

that downturn would adversely affect the demand for our products. A discussion of concentration of our credit risk is contained in note 1 within the Notes to Consolidated Financial Statements included in Item 15 of this Annual Report on Form 10-K.

#### **DEPENDENCE UPON KEY PERSONNEL**

*We are dependent upon key personnel.* Our future operating results depend in significant part upon the continued service of a relatively small number of key technical and senior management personnel, including Founder, Chairman of the Board and President, Pamela M. Lopker, and Chief Executive Officer, Karl F. Lopker, neither of whom is bound by an employment agreement. Pamela and Karl Lopker are married to each other and, as of March 31, 2005, jointly and beneficially owned approximately 53% of QAD's outstanding common stock.

Our future success also depends on our continuing ability to attract and retain other highly qualified technical and managerial personnel. Competition for these personnel can be intense, and we have at times experienced difficulty in recruiting and retaining qualified personnel. We may be unable to retain our key technical and managerial employees and we may not be successful in attracting, assimilating and retaining other highly qualified technical and managerial personnel in the future. The loss of any member of our key technical and senior management personnel or the inability to attract and retain additional qualified personnel could have an adverse effect on us. We do not currently have key-person insurance covering any of our employees.

#### **DEPENDENCE UPON DEVELOPMENT AND MAINTENANCE OF SALES AND MARKETING CHANNELS**

*We are dependent upon the development and maintenance of sales and marketing channels.* We sell and support our products through direct and indirect sales organizations throughout the world. In the past, we have made significant expenditures in the expansion of our sales and marketing force, primarily outside the United States. More recently, we have tailored our sales and marketing expenditures to align more closely with our targeted vertical and geographic markets. Our future success will depend in part upon the productivity of our sales and marketing force and our ability to continue to attract, integrate, train, motivate and retain new sales and marketing personnel.

Competition for sales and marketing personnel in the software industry can be intense. We cannot ensure that we will be successful in hiring these personnel in accordance with our plans. Neither can there be assurance that our recent and planned expenses in sales and marketing will ultimately prove to be successful or that the incremental revenue generated will exceed the significant incremental costs associated with these efforts. In addition, our sales and marketing organization may not be able to compete successfully against the significantly more extensive and better funded sales and marketing operations of many of our current and potential competitors. If we are unable to develop and manage our sales and marketing force effectively, we could be adversely affected.

Our indirect sales channel consists of over 40 distributors and sales agents worldwide (sales channels). We do not grant exclusive distribution rights to our sales channels. Our sales channels primarily sell independently to companies within their geographic territory but may also work in conjunction with our direct sales organization. We will need to maintain and expand our relationships with our existing sales channels to expand the distribution of our products. Our current or future sales channels may not provide the level and quality of expertise and service required to successfully license our software products. We also may not be able to maintain effective, long-term relationships with them. In addition, our selected sales channels may not continue to meet our sales needs. Further, they may market software products in competition with

us in the future or otherwise reduce or discontinue their relationships with or support of us and our products. Any failure to successfully maintain our existing indirect sales channel relationships or to establish new relationships in the future could have an adverse effect on us. Also, if any of our distributors or sales agents exclusively adopts a product other than QAD software products, or if any distributor or sales agent reduces its sales efforts relating to our software products or increases support for competitive products, we could be adversely affected.

## **RELIANCE ON RELATIONSHIPS WITH THIRD-PARTIES**

*We are reliant on relationships with third-parties.* We have certain relationships with a number of consulting and systems integration organizations that we believe are important to our worldwide sales, marketing, service and support activities and the implementation of our products. We are aware that these third-party providers do not provide system integration services exclusively for our products and in many instances these firms have similar, and often more established, relationships with our principal competitors. We expect to continue to utilize third-party system integrators.

QAD global services is a significant part of our business that offers technical, implementation and learning services to our customers. We have designed our service organization so that we can subcontract our services to third-party providers for specific technical needs and also subcontract services from our providers to meet our capacity requirements. We believe this method allows for additional flexibility in ensuring our customers' needs for services are met. These relationships also assist us in keeping pace with the technological and marketing developments of major software vendors, and, in certain instances, provide us with technical assistance for our product development efforts.

*We typically enter into separate agreements with each of our distribution and service providers.* These agreements make available to our providers the non-exclusive right to promote and market QAD software products and to provide training, installation, implementation and other services for QAD software products within a defined territory for a specified period of time (generally two years). Our installation and implementation providers generally do not receive fees for the sale of our software products unless they participate actively in a sale as a sales agent. However, they generally are permitted to set their own rates for their installation and implementation services, and we typically do not receive a royalty or percentage fee from these providers on services performed. We also enter into similar agreements with our distribution providers that grant these providers the non-exclusive right, within a specified territory, to market, license, deliver and support our software products. In exchange for these distribution services, we grant a discount to the provider for the license of our software products.

These third-parties may not provide the level and quality of service required to meet the needs of our customers and we may not be able to maintain an effective, long-term relationship with these third-parties. Any failure to maintain our existing relationships or to establish new relationships in the future, or the failure of these third-parties to meet the needs of our customers, could have an adverse effect on us. In addition, if these third-parties exclusively adopt a product or technology other than QAD software product or technology, or if these third-parties reduce their support of QAD software products and technology or increase such support for competitive products or technology, we could be adversely affected.

We also rely on third-parties for the development or interoperation of key components of our software. These research and product alliances develop software to be sold in conjunction with our software products, technology to be included in or incorporated within QAD software products and numerous third-party software programs that generally are not sold with QAD software products, but interoperate directly with QAD software through application program

interfaces. We generally enter into reseller or joint development agreements with our third-party software development partners that govern ownership of the technology collectively developed. Each of our partner agreements and third-party development agreements contains strict confidentiality and non-disclosure provisions for the service provider, end-user and third-party developer. Our third-party development agreements contain restrictions on the use of our technology outside of the development process. Any failure to establish or maintain successful relationships with these third-party software providers or these third-party implementation and development alliances or the failure of these third-party software providers to develop and support their software could have an adverse effect on us.

## **INTEGRATION OF ACQUIRED BUSINESS AND INTELLECTUAL PROPERTY**

We have continued an opportunistic strategy of acquiring certain niche products to extend and enhance our product offering. These acquisitions involve third-party products, or software developed by a customer, that were already in use with our software but only on a limited basis geographically. These include products such as a module within our Customer Self Service module (known as CSS), our inventory management product (known as AIM), our EDI solutions, our financial solution enhancement, our QAD Sequencing (or Just in Time) software and our Business Intelligence solution. While we believe these products will yield significant value to QAD in the future, at this point they are at various stages of being integrated into our product offering. There is no assurance that we will be successful in integrating these acquisitions, or any future acquisitions, into our business and any failure to do so may adversely affect our results.

## **RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS**

*Our operations are international in scope, which exposes us to additional risk, including currency-related risk.* For the last three fiscal years, we derived approximately 60% of our total revenue from sales outside the United States. Of our more than 5,300 licensed sites in more than 90 countries, as of January 31, 2005, approximately 80% are outside the United States. Our foreign exchange risk is discussed in Item 7A of this Annual Report on Form 10-K.

*Continued terrorism threats and war in the Middle East have had a negative impact on the global economy.* The adverse consequences of war and the effects of terrorism have had a negative affect on the global economy. Prolonged conflict could negatively impact our ability to raise additional funds if needed and our revenues will be adversely affected if consumers and businesses choose to cut back spending due to conflicts or such threats.

*Labor laws vary by country exposing us to potential costs not typically borne in the United States.* The nature of our international business, and that of our customers, is such that we have to regularly review the composition of our workforce on a country by country basis and determine if we have the appropriate workforce in place. We have in the past, and may in the future, be subject to costs associated with restructuring our workforce in a given country. The costs of such restructurings, should they be necessary, may be significant and could adversely affect our results.

## **RISKS DUE TO BUSINESS INTERRUPTIONS**

*Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure and other events beyond our control.* A substantial portion of our facilities, including our corporate headquarters and other critical business operations, are located near major earthquake faults. Although the facilities in which we host our computer systems are designed to be fault tolerant and disaster recovery procedures are in place, the systems are susceptible to damage from fire, floods, earthquakes, power loss, telecommunications failures, and similar events. In addition, terrorist acts or acts of war may cause damage or disruption to us and our employees, facilities,

suppliers, distributors and customers, which could have a material adverse effect on our operations and financial results. If a business interruption occurs, our business could be seriously harmed.

## **EFFECT OF SUBSTANTIAL SALES OF STOCK**

*Substantial sales of our stock could negatively affect its price.* As of January 31, 2005, QAD had 33.8 million shares of common stock outstanding and 4.5 million outstanding stock options under stock option plans. As a result, a substantial number of shares of common stock will be eligible for sale in the public market at various times in the future. Sales of substantial amounts of such shares could adversely affect the market price of our stock.

## **MARKET CONSOLIDATION**

*The ERP software market has experienced significant consolidation.* This consolidation has included numerous mergers and acquisitions including hostile takeovers such as the Oracle/Peoplesoft transaction. As a result, many prospective buyers are experiencing some reluctance in purchasing applications that could have a short lifespan due to an acquisition resulting in the application's life being abruptly cut short. In addition, increased competition and consolidation in these markets is likely to result in price reductions, reduced operating margins and changes in market share, any one of which could adversely affect us. QAD's controlled company status makes it highly unlikely that a hostile takeover of the company would occur.

## **THE MARKET FOR OUR STOCK IS VOLATILE**

*The market prices for securities of technology companies, such as QAD, have been quite volatile.* Quarter to quarter variations in our operating results, changes in our guidance on revenues and earnings estimates, announcements of technological innovations or new products by us, or by our competitors, the loss or gain of significant customers or changes in stock market analysts estimates, announcements of major contract awards, changes in accounting standards or regulatory requirements as promulgated by the FASB, PCAOB, SEC, NASDAQ or other regulatory entities, and other events or factors may have a significant impact on the market price of our stock. In addition, the securities of many technology companies have experienced extreme price and volume fluctuations, which have often been unrelated to the companies' operating performance. These conditions may adversely affect the market price of our stock. Because of these and other factors affecting our operating results, past financial performance should not be considered as an indicator of future stock performance, and investors should not use historical trends to anticipate results or trends in future periods.

The market price of our common stock and the number of shares traded each day have varied greatly. Such fluctuations may continue due to numerous factors, including:

- quarterly fluctuations in operating results;
- announcements of new products by us or our competitors;
- gains or losses of significant customers;
- the presence of short-selling of our common stock;
- sales of a high volume of shares of our common stock by our large stockholders;
- events affecting other companies that the market deems comparable to us;
- general economic conditions in the United States and abroad.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

*Failure to maintain adequate internal control over financial reporting could have a material adverse effect upon our results of operations.* If we fail to maintain an effective system of internal controls we may not be able to accurately report our financial results. If we cannot provide reliable financial reports, our business and operating results could be harmed. As a result, current and potential stockholders could lose confidence in our financial reporting, which would harm our business and the trading price of our stock.

## PRINCIPAL STOCKHOLDERS

*Our principal stockholders are also directors.* As of March 31, 2005, Pamela and Karl Lopker jointly and beneficially owned approximately 53% of our outstanding common stock. Recovery Equity Investors II, L.P. (REI) owned approximately 9% of our outstanding common stock. Pamela and Karl Lopker currently constitute two of the seven members of the board of directors and are also officers of QAD in their capacity as President and CEO, respectively. A general partner of the general partner of REI is also on the QAD board of directors. On a combined basis, current directors and executive officers beneficially owned approximately 62% of the common stock.

Pamela and Karl Lopker are generally not prohibited from selling a controlling interest in us to a third party. Their concentrated control could discourage others from initiating any potential merger, takeover or other change of control transaction that might be beneficial to our business. As a result, the market price of our common stock could be adversely affected.

Because Pamela and Karl Lopker, as husband and wife, own a majority of our common stock, we are a "controlled company" within the meaning of the rules of the NASDAQ. As such, we are not required to comply with certain corporate governance rules of the NASDAQ that would otherwise apply to us as a listed company on the NASDAQ. These rules are generally intended to increase the likelihood that boards will make decisions in the best interests of shareholders.

Specifically, we are not required to have a majority of independent directors on our board of directors and we are not required to have nominating and corporate governance and compensation committees composed of independent directors. Should the interests of Pamela and Karl Lopker differ from those of other shareholders, the other shareholders will not be afforded the protections of having a majority of directors on the board who are independent from our principal shareholders or our management.

## IMPACT OF LEGISLATION

*Concern about corporate governance in the U.S. has caused government agencies to enact more stringent controls, primarily including requirements associated with the Sarbanes-Oxley Act of 2002.* These changes impact the public accounting profession, public companies, including corporate duties and responsibilities, and securities analysts. Some highlights include establishment of the Public Company Accounting Oversight Board, enhanced disclosure requirements for public companies and their insiders, required certification by CEO's and CFO's of SEC financial filings, prohibitions on certain loans to officers and directors, efforts to curb potential securities analysts' conflicts of interest, possible forfeiture of profits by certain insiders in the event financial statements are restated, enhanced board audit committee requirements, protections provided under a formal system to handle complaints to the audit committee, reporting on internal controls by management and independent auditors, and enhanced civil and criminal penalties for violations of securities laws. It is difficult to predict the full impact of these changes. However it has increased and will continue to increase the costs of securities law compliance for publicly traded companies such as ours.



These compliance requirements also impose a demand that our software provide the ability to enable our customers to meet these requirements. Any failure by us to keep pace with such requirements could impact our ability to continue to market our products. We are aware that our current and potential customers could choose another software vendor's solution, if they perceive greater benefit from a compliance perspective.

Like many companies, the cost and effort necessary to comply with the Sarbanes-Oxley Act, particularly Section 404 of the Act, has imposed a significant burden on us and still remains a potential risk.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Foreign Exchange.* In fiscal 2005, approximately 35% of our revenue was denominated in foreign currencies compared to 35% and 30% in fiscal years 2004 and 2003, respectively. We also incurred approximately 45% of our expenses in currencies other than the U.S. dollar in both fiscal 2005 and 2004, compared with approximately 40% in fiscal 2003. As a result, fluctuations in the values of the respective currencies relative to the currencies in which we generate revenue could adversely affect us.

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. In fiscal 2005, 2004 and 2003, foreign currency transaction and remeasurement (gains) and losses totaled \$(189,000), \$(36,000) and \$818,000, respectively, and are included in "Other (income) expense, net" in our Consolidated Statements of Operations. 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 invested in short-term time deposits with the 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 2006 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 2005 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 the next fiscal year.

#### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The response to this item is included in Item 15 of this Annual Report on Form 10-K.

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

#### **ITEM 9A. CONTROLS AND PROCEDURES**

*Evaluation of disclosure controls and procedures.* The Company's management evaluated, with the participation of the Chief Executive Officer and the Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period

covered by this Annual Report on Form 10-K. Based on this evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Management's Report on Internal Control Over Financial Reporting.* QAD's management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management has assessed the effectiveness of the Company's internal control system as of January 31, 2005 based on the criteria for effective internal control over financial reporting described in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of January 31, 2005, the company's system of internal control over financial reporting is effective.

The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on management's assessment of QAD's internal control over financial reporting.

*Limitations on the Effectiveness of Controls.* Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Report of Independent Registered Public Accounting Firm*

The Board of Directors and Stockholders  
QAD Inc.:

We have audited management's assessment, included in the accompanying report entitled "*Management's Report on Internal Control Over Financial Reporting*", that QAD Inc. maintained effective internal control over financial reporting as of January 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). QAD Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that QAD Inc. maintained effective internal control over financial reporting as of January 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, QAD Inc. maintained, in all material respects, effective internal control over financial reporting as of January 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of QAD Inc. and subsidiaries as of January 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended January 31, 2005, and the related financial statement schedule II, and our report dated April 15, 2005 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Los Angeles, California  
April 15, 2005

#### **ITEM 9B. OTHER INFORMATION**

None.

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information regarding QAD directors is set forth in the section entitled "Election of Directors" appearing in our Definitive Proxy Statement for the Annual Meeting of Stockholders (Proxy Statement) to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal 2005, which information is incorporated herein by reference.

In addition, information required by Item 10 with respect to our audit committee and our code of ethics applying to our principal executive officer(s) and principal financial and accounting officers, is incorporated by reference from the Proxy Statement.

Certain information with respect to persons who are or may be deemed to be executive officers of the Registrant is set forth under the caption "Executive Officers of the Registrant" in Part I of this Annual Report on Form 10-K.

#### **ITEM 11. EXECUTIVE COMPENSATION**

Information regarding executive compensation is set forth under the caption "Executive Compensation" in the Proxy Statement, which information is incorporated herein by reference.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

Information regarding security ownership of certain beneficial owners and management is set forth under the caption "Stock Ownership of Directors, Executive Officers and Certain Beneficial Owners" in the Proxy Statement, which information is incorporated herein by reference.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information regarding certain relationships and related transactions is set forth under the caption "Certain Transactions" in the Proxy Statement, which information is incorporated herein by reference.

#### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information regarding services performed by, and fees paid to, our independent auditors is set forth under the caption "Principal Accountant Fees and Services" in the Proxy Statement, which information is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

#### 1. FINANCIAL STATEMENTS

The following financial statements are filed as a part of this Annual Report on Form 10-K:

#### QAD INC. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

|  | PAGE |
|--|------|
| Report of Independent Registered Public Accounting Firm  | 51   |
| Consolidated Balance Sheets as of January 31, 2005 and 2004  | 52   |
| Consolidated Statements of Operations for the years ended January 31, 2005, 2004 and 2003  | 53   |
| Consolidated Statement of Stockholders' Equity and Comprehensive Income (Loss) for the years ended January 31, 2005, 2004 and 2003 | 54   |
| Consolidated Statements of Cash Flows for the years ended January 31, 2005, 2004 and 2003  | 55   |
| Notes to Consolidated Financial Statements   | 56   |

#### 2. INDEX TO FINANCIAL STATEMENT SCHEDULES

The following financial statement schedule is filed as a part of this Annual Report on Form 10-K:

|   | PAGE |
|---|------|
| SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS | 85   |

All other schedules are omitted because they are not required or the required information is presented in the financial statements or notes thereto.

#### 3. INDEX TO EXHIBITS

See the Index of Exhibits at page 87.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
QAD Inc.:

We have audited the accompanying consolidated balance sheets of QAD Inc. and subsidiaries as of January 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended January 31, 2005. In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule II. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of QAD Inc. and subsidiaries as of January 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended January 31, 2005, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule II, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of QAD Inc.'s internal control over financial reporting as of January 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 15, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Los Angeles, California  
April 15, 2005

**QAD INC.**

**CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

|   | January 31,       |                   |
|---|-------------------|-------------------|
|   | 2005              | 2004              |
| <b>Assets</b>   |                   |                   |
| Current assets:   |                   |                   |
| Cash and equivalents  | \$ 55,289         | \$ 46,784         |
| Marketable securities   | 13,000            | 13,000            |
| Accounts receivable, net of allowances of \$3.7 million and \$4.9 million at January 31, 2005 and 2004, respectively                                      | 63,145            | 65,455            |
| Other current assets  | 13,785            | 13,352            |
| <b>Total current assets</b>   | <b>145,219</b>    | <b>138,591</b>    |
| Property and equipment, net   | 39,701            | 34,485            |
| Capitalized software costs, net   | 2,791             | 2,966             |
| Goodwill  | 11,552            | 11,306            |
| Other assets, net   | 7,830             | 2,480             |
| <b>Total assets</b>   | <b>\$ 207,093</b> | <b>\$ 189,828</b> |
| <b>Liabilities and Stockholders' Equity</b>   |                   |                   |
| Current liabilities:  |                   |                   |
| Current portion of long-term debt   | \$ 1,725          | \$ 11,987         |
| Accounts payable  | 11,896            | 12,553            |
| Deferred revenue  | 70,805            | 69,252            |
| Other current liabilities   | 33,234            | 38,821            |
| <b>Total current liabilities</b>  | <b>117,660</b>    | <b>132,613</b>    |
| Long-term debt  | 23,911            | 7,720             |
| Other liabilities   | 892               | 1,882             |
| Minority interest   | 593               | 500               |
| Commitments and contingencies   |                   |                   |
| Stockholders' equity:   |                   |                   |
| Preferred stock, \$0.001 par value. Authorized 5,000,000 shares; none issued and outstanding  | —                 | —                 |
| Common stock, \$0.001 par value. Authorized 150,000,000 shares; issued 35,338,952 shares and 35,334,291 shares at January 31, 2005 and 2004, respectively | 35                | 35                |
| Additional paid-in capital  | 119,533           | 119,411           |
| Treasury stock, at cost (1,529,792 shares and 1,561,056 shares at January 31, 2005 and January 31, 2004, respectively)                                    | (9,668)           | (8,100)           |
| Accumulated deficit   | (40,154)          | (58,038)          |
| Unearned compensation—restricted stock  | (440)             | —                 |
| Accumulated other comprehensive loss  | (5,269)           | (6,195)           |
| <b>Total stockholders' equity</b>   | <b>64,037</b>     | <b>47,113</b>     |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 207,093</b> | <b>\$ 189,828</b> |

See accompanying notes to consolidated financial statements.

**QAD INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

|  | Years Ended January 31, |                  |                   |
|--|-------------------------|------------------|-------------------|
|  | 2005                    | 2004             | 2003              |
| Revenue:   |                         |                  |                   |
| License fees   | \$ 60,545               | \$ 69,029        | \$ 56,023         |
| Maintenance and other  | 113,729                 | 114,686          | 106,294           |
| Services   | 56,932                  | 46,937           | 32,931            |
| <b>Total revenue</b>   | <b>231,206</b>          | <b>230,652</b>   | <b>195,248</b>    |
| Costs and expenses:  |                         |                  |                   |
| Cost of license fees   | 8,628                   | 10,299           | 8,620             |
| Cost of maintenance, service and other revenue                               | 82,825                  | 81,215           | 66,378            |
| Sales and marketing  | 56,552                  | 60,183           | 61,723            |
| Research and development   | 33,229                  | 36,191           | 33,395            |
| General and administrative   | 26,070                  | 24,228           | 21,824            |
| Amortization of intangibles from acquisitions                                | 516                     | 887              | 1,165             |
| Impairment loss  | —                       | —                | 151               |
| Restructuring  | —                       | (346)            | 5,287             |
| <b>Total costs and expenses</b>  | <b>207,820</b>          | <b>212,657</b>   | <b>198,543</b>    |
| Operating income (loss)  | 23,386                  | 17,995           | (3,295)           |
| Other (income) expense:  |                         |                  |                   |
| Interest income  | (809)                   | (540)            | (752)             |
| Interest expense   | 1,889                   | 943              | 1,614             |
| Other (income) expense, net  | (120)                   | (1,803)          | 1,141             |
| <b>Total other (income) expense</b>  | <b>960</b>              | <b>(1,400)</b>   | <b>2,003</b>      |
| Income (loss) before income taxes and cumulative effect of accounting change | 22,426                  | 19,395           | (5,298)           |
| Income tax (benefit) expense   | (2,057)                 | 3,078            | 1,300             |
| Income (loss) before cumulative effect of accounting change                  | 24,483                  | 16,317           | (6,598)           |
| Cumulative effect of accounting change                                       | —                       | —                | 1,051             |
| <b>Net income (loss)</b>   | <b>\$ 24,483</b>        | <b>\$ 16,317</b> | <b>\$ (7,649)</b> |
| Basic net income (loss) per share:   |                         |                  |                   |
| Before cumulative effect of accounting change                                | \$ 0.72                 | \$ 0.49          | \$ (0.19)         |
| Cumulative effect of accounting change                                       | —                       | —                | 0.03              |
| <b>Basic net income (loss) per share</b>                                     | <b>\$ 0.72</b>          | <b>\$ 0.49</b>   | <b>\$ (0.22)</b>  |
| Diluted net income (loss) per share:   |                         |                  |                   |
| Before cumulative effect of accounting change                                | \$ 0.70                 | \$ 0.47          | \$ (0.19)         |
| Cumulative effect of accounting change                                       | —                       | —                | 0.03              |
| <b>Diluted net income (loss) per share</b>                                   | <b>\$ 0.70</b>          | <b>\$ 0.47</b>   | <b>\$ (0.22)</b>  |

See accompanying notes to consolidated financial statements.



**QAD INC.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND  
COMPREHENSIVE INCOME (LOSS)**

(in thousands)

|   | Common Stock<br>and Additional<br>Paid-in-Capital |            | Treasury Stock |            | Accumulated<br>Deficit | Unearned<br>Compensation—<br>Restricted<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity | Comprehensive<br>Income (Loss) |
|---|---|------------|----------------|------------|------------------------|--|---|----------------------------------|--------------------------------|
|   | Shares  | Amount     | Shares         | Amount     |                        |  |   |                                  |                                |
| <b>Balance, January 31, 2002</b>                          | 34,253  | \$ 114,945 | —              | \$ —       | \$ (65,595)            | \$ —   | \$ (7,214)                                    | \$ 42,136                        |                                |
| Comprehensive loss:                                       |   |            |                |            |                        |  |   |                                  |                                |
| Net loss  | —   | —          | —              | —          | (7,649)                | —  | —   | (7,649)                          | \$ (7,649)                     |
| Foreign currency translation adjustments                  | —   | —          | —              | —          | —                      | —  | 367   | 367                              | 367                            |
| <b>Total comprehensive loss</b>                           |   |            |                |            |                        |  |   |                                  | <b>\$ (7,282)</b>              |
| Stock activity:   |   |            |                |            |                        |  |   |                                  |                                |
| Under employee stock purchase plan                        | 417   | 804        | —              | —          | —                      | —  | —   | 804                              |                                |
| Under stock options                                       | 23  | 78         | —              | —          | —                      | —  | —   | 78                               |                                |
| Other   | —   | 7          | —              | —          | —                      | —  | —   | 7                                |                                |
| <b>Balance, January 31, 2003</b>                          | 34,693  | 115,834    | —              | —          | (73,244)               | —  | (6,847)                                       | 35,743                           |                                |
| Comprehensive income:                                     |   |            |                |            |                        |  |   |                                  |                                |
| Net income  | —   | —          | —              | —          | 16,317                 | —  | —   | 16,317                           | \$ 16,317                      |
| Foreign currency translation adjustments                  | —   | —          | —              | —          | —                      | —  | 652   | 652                              | 652                            |
| <b>Total comprehensive income</b>                         |   |            |                |            |                        |  |   |                                  | <b>\$ 16,969</b>               |
| Stock activity:   |   |            |                |            |                        |  |   |                                  |                                |
| Under employee stock purchase plan                        | 79  | 293        | 82             | 426        | (26)                   | —  | —   | 693                              |                                |
| Under stock options                                       | 562   | 1,580      | 1,375          | 6,765      | (1,085)                | —  | —   | 7,260                            |                                |
| Under stock warrants                                      | —   | 520        | 225            | 1,167      | —                      | —  | —   | 1,687                            |                                |
| Reclassification of prior years' treasury share purchases | —   | 1,219      | (306)          | (1,219)    | —                      | —  | —   | —                                |                                |
| Repurchase of common stock                                | —   | —          | (2,937)        | (15,239)   | —                      | —  | —   | (15,239)                         |                                |
| <b>Balance, January 31, 2004</b>                          | 35,334  | 119,446    | (1,561)        | (8,100)    | (58,038)               | —  | (6,195)                                       | 47,113                           |                                |
| Comprehensive income:                                     |   |            |                |            |                        |  |   |                                  |                                |
| Net income  | —   | —          | —              | —          | 24,483                 | —  | —   | 24,483                           | \$ 24,483                      |
| Foreign currency translation adjustments                  | —   | —          | —              | —          | —                      | —  | 926   | 926                              | 926                            |
| <b>Total comprehensive income</b>                         |   |            |                |            |                        |  |   |                                  | <b>\$ 25,409</b>               |
| Stock activity:   |   |            |                |            |                        |  |   |                                  |                                |
| Under employee stock purchase plan                        | —   | 94         | 81             | 425        | 107                    | —  | —   | 626                              |                                |
| Under stock options                                       | 5   | (423)      | 652            | 3,381      | (741)                  | —  | —   | 2,217                            |                                |
| Tax benefit from stock options                            | —   | 218        | —              | —          | —                      | —  | —   | 218                              |                                |
| Dividends declared (\$0.18 per share)                     | —   | —          | —              | —          | (5,965)                | —  | —   | (5,965)                          |                                |
| Restricted stock  | —   | 233        | 40             | 207        | —                      | —  | —   | 440                              |                                |
| Unearned compensation-restricted stock                    | —   | —          | —              | —          | —                      | (440)  | —   | (440)                            |                                |
| Repurchase of common stock                                | —   | —          | (742)          | (5,581)    | —                      | —  | —   | (5,581)                          |                                |
| <b>Balance, January 31, 2005</b>                          | 35,339  | \$ 119,568 | (1,530)        | \$ (9,668) | \$ (40,154)            | \$ (440)   | \$ (5,269)                                    | \$ 64,037                        |                                |

See accompanying notes to consolidated financial statements.

**QAD INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|  | Years Ended January 31, |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2005                    | 2004             | 2003             |
| <b>Cash flows from operating activities:</b>   |                         |                  |                  |
| Net income (loss)  | \$ 24,483               | \$ 16,317        | \$ (7,649)       |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:   |                         |                  |                  |
| Depreciation and amortization  | 7,541                   | 8,082            | 10,637           |
| Provision for doubtful accounts and sales adjustments                                      | 257                     | 137              | 836              |
| (Gain) loss on disposal of property and equipment  | 129                     | (1,542)          | 209              |
| Impairment loss  | —                       | —                | 151              |
| Tax benefit from reversal of deferred tax valuation allowance                              | (6,548)                 | —                | —                |
| Exit costs   | 687                     | —                | —                |
| Restructuring  | —                       | (346)            | 5,287            |
| Cumulative effect of accounting change   | —                       | —                | 1,051            |
| Tax benefit from stock options   | 218                     | —                | —                |
| Other, net   | (18)                    | 171              | (180)            |
| Changes in assets and liabilities, net of effects from acquisitions:                       |                         |                  |                  |
| Accounts receivable  | 2,995                   | (5,803)          | 10,447           |
| Other assets   | (311)                   | 2,450            | (2,119)          |
| Accounts payable   | (847)                   | (681)            | (1,667)          |
| Deferred revenue   | 866                     | 683              | 4,041            |
| Other liabilities  | (6,472)                 | 372              | (7,603)          |
| <b>Net cash provided by operating activities</b>   | <b>22,980</b>           | <b>19,840</b>    | <b>13,441</b>    |
| <b>Cash flows from investing activities:</b>   |                         |                  |                  |
| Purchase of property and equipment   | (10,577)                | (17,785)         | (9,261)          |
| Purchase of marketable securities  | —                       | (7,000)          | —                |
| Proceeds from sale of marketable securities  | —                       | 500              | 7,500            |
| Restricted cash under construction loan  | —                       | 1,016            | (1,016)          |
| Capitalized software costs   | (1,665)                 | (929)            | (1,446)          |
| Acquisitions of businesses, net of cash acquired   | (766)                   | (445)            | 785              |
| Proceeds from sale of property and equipment   | 29                      | 3,395            | 145              |
| <b>Net cash used in investing activities</b>   | <b>(12,979)</b>         | <b>(21,248)</b>  | <b>(3,293)</b>   |
| <b>Cash flows from financing activities:</b>   |                         |                  |                  |
| Proceeds from construction loan  | 3,870                   | 10,468           | —                |
| Repayments of long-term debt   | (1,604)                 | (2,005)          | (6,377)          |
| Repayments of construction loan  | (14,338)                | —                | —                |
| Proceeds from notes payable, net of fees   | 17,843                  | —                | —                |
| Dividends paid   | (5,121)                 | —                | —                |
| Proceeds from issuance of common stock   | 2,843                   | 9,640            | 882              |
| Repurchase of common stock   | (5,581)                 | (15,239)         | —                |
| <b>Net cash provided by (used in) financing activities</b>                                 | <b>(2,088)</b>          | <b>2,864</b>     | <b>(5,495)</b>   |
| Effect of exchange rates on cash and equivalents   | 592                     | 1,640            | 2,253            |
| <b>Net increase in cash and equivalents</b>  | <b>8,505</b>            | <b>3,096</b>     | <b>6,906</b>     |
| Cash and equivalents at beginning of period  | 46,784                  | 43,688           | 36,782           |
| <b>Cash and equivalents at end of period</b>   | <b>\$ 55,289</b>        | <b>\$ 46,784</b> | <b>\$ 43,688</b> |
| <b>Supplemental disclosure of cash flow information:</b>                                   |                         |                  |                  |
| Cash paid (received) during the period for:  |                         |                  |                  |
| Interest   | \$ 1,783                | \$ 1,061         | \$ 1,531         |
| Income taxes, net of refunds   | 1,904                   | (70)             | (100)            |
| <b>Supplemental disclosure of non-cash activities:</b>                                     |                         |                  |                  |
| Forgiveness of accounts receivable (payable) in connection with acquisitions of businesses | —                       | —                | (2,836)          |
| Realization of acquired deferred tax asset   | 342                     | 375              | 117              |
| Adjustments to goodwill acquired   | 47                      | 284              | —                |
| Future obligations associated with technology purchases                                    | 550                     | 1,400            | —                |
| Future obligations associated with dividend declaration                                    | 844                     | —                | —                |

See accompanying notes to consolidated financial statements.

## **QAD INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES**

##### **BUSINESS**

QAD Inc., a Delaware Corporation (the Company), was founded in 1979 and is a global provider of enterprise resource planning (ERP) software applications for multinational, large and mid-range manufacturing and distribution companies. QAD serves the specific needs of the automotive, consumer products, electronics, food and beverage, industrial and medical industries. The Company markets, distributes, implements and supports its products worldwide. QAD enterprise applications provide functionality for managing manufacturing resources and operations within and beyond the enterprise, enabling global manufacturers to collaborate with their customers, suppliers and partners to improve delivery performance and reduce production and inventory costs.

##### **PRINCIPLES OF CONSOLIDATION**

The consolidated financial statements include the accounts of QAD Inc. and all of its subsidiaries. All significant transactions among the consolidated entities have been eliminated from the financial statements.

##### **USE OF ESTIMATES**

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on informed estimates and judgments of management, with consideration given to materiality, that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Company's financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company considers certain accounting policies related to revenue recognition, accounts receivable allowances, impairment of long-lived assets, capitalized software costs, valuation of deferred tax assets and accounting for stock-based compensation to be critical policies due to the significance of these items to its operating results and the estimation processes and management's judgment involved in each.

##### **CASH AND EQUIVALENTS**

Cash and equivalents consist of cash and short-term investments with maturities less than 90 days. The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

##### **MARKETABLE SECURITIES**

The Company determines the appropriate classification of its marketable securities at the time of purchase and reevaluates such classification as of each balance sheet date. QAD classifies its marketable securities as available-for-sale and carries such securities at fair value, and, if applicable, unrealized gains and losses, net of tax, are reported in stockholders' equity until disposition or maturity.

Marketable securities consist of auction rate securities which are stated at fair value, are not restricted and are classified as current assets. The cost of the auction rate securities approximates

their fair value, with no unrealized or realized gains/losses recorded. Interest is paid when the auction rate notes renew, which is typically every seven days.

#### *Reclassification*

The Company reclassified its auction rate securities from cash and equivalents to marketable securities for both the current year ended January 31, 2005 and historical years included in this Annual Report on Form 10-K. Due to the liquidity and credit risks the auction rate securities are exposed to the Company believes the classification as marketable securities is more appropriate than its previous classification of cash and equivalents.

#### **REVENUE RECOGNITION**

QAD licenses its software under non-cancelable license agreements including third-party software sold in conjunction with QAD software, provides customer support and provides services including technical, implementation and training. 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." The Company's revenue recognition policy is as follows:

*License Revenue.* QAD recognizes 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. The Company's typical payment terms vary by region. While most of its arrangements are within its normal payment terms, the Company has provided extended terms on occasion. Terms granted are typically less than one year and the Company has established a history of collection, without concessions, on those receivables. Provided all other revenue recognition criteria have been met, the Company recognizes license revenue for these arrangements on delivery. The Company uses the residual method to recognize revenue when a license agreement includes one or more elements to be delivered at a future date if vendor-specific, objective evidence of the fair value of all undelivered elements exists and such items are not essential to the functionality of the software. The fair value of the undelivered elements is determined based on the historical evidence of stand-alone sales of these elements to customers. Under the residual method, the fair value of the undelivered elements is deferred 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 the Company has vendor-specific, objective evidence for undelivered elements or when delivery of all elements occurs.

Subscription license revenue from the Company's hosted product offerings is recognized ratably over the contract period. The Company's 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 the Company's license revenue recognition policy, such as the assessment of collectibility for which the

Company reviews a customer's credit worthiness and its 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, the Company does at times enter into fixed price services contracts for which the Company recognizes 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.

The Company believes that it is 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 the Company's business practices that could result in increased administrative costs, lengthened sales cycles and other changes that could affect the Company's results of operations.

## **ACCOUNTS RECEIVABLE ALLOWANCES**

The Company reviews the collectibility of its accounts receivable each period by analyzing balances based on age and records specific allowances for any balances that it determines may not be fully collectible. The Company also provides an additional reserve based on historical data including analysis of credit memo data and other known factors.

## **INCOME TAXES**

QAD recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities and expected benefits of utilizing net operating loss and credit carryforwards. In assessing whether there is a need for a valuation allowance on deferred tax assets, the Company determines whether it is more likely than not that it will realize tax benefits associated with deferred tax assets. In making this determination, the Company considers future taxable income and tax planning strategies that are both prudent and feasible. The impact on deferred taxes of changes in tax rates and laws, if any, are reflected in the financial statements in the period of enactment. No provision is made for taxes on unremitted earnings of foreign subsidiaries, which are or will be reinvested indefinitely in such operations.

## COMPUTATION OF NET INCOME OR LOSS PER SHARE

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

|  | Years Ended January 31,               |           |            |
|--|---------------------------------------|-----------|------------|
|  | 2005                                  | 2004      | 2003       |
|  | (in thousands, except per share data) |           |            |
| Net income (loss)  | \$ 24,483                             | \$ 16,317 | \$ (7,649) |
| Weighted average shares of common stock outstanding— <i>basic</i>                                | 33,952                                | 33,123    | 34,460     |
| Weighted average shares of common stock equivalents issued using the treasury stock method       | 1,246                                 | 1,759     | —          |
| Weighted average shares of common stock and common stock equivalents outstanding— <i>diluted</i> | 35,198                                | 34,882    | 34,460     |
| Basic net income (loss) per share  | \$ 0.72                               | \$ 0.49   | \$ (0.22)  |
| Diluted net income (loss) per share  | \$ 0.70                               | \$ 0.47   | \$ (0.22)  |

Common stock equivalent shares consist of the shares issuable upon the exercise of stock options and warrants using the treasury stock method. Shares of common stock equivalents of approximately 0.7 million, 0.4 million and 3.9 million for fiscal 2005, 2004 and 2003, respectively, were not included in the diluted calculation because they were anti-dilutive. Due to the net loss for fiscal 2003, basic and diluted per share amounts are the same.

## FOREIGN CURRENCY TRANSLATION

The financial position and results of operations of the Company's foreign subsidiaries are generally determined using the country's local currency as the functional currency. Assets and liabilities recorded in foreign currencies are translated at the exchange rates on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are charged or credited to other comprehensive income (loss), which is included in "Accumulated other comprehensive loss" within the Consolidated Balance Sheets.

Gains and losses resulting from foreign currency transactions and remeasurement adjustments of monetary assets and liabilities not held in an entity's functional currency are included in earnings. Foreign currency transaction and remeasurement (gains) and losses for fiscal 2005, 2004 and 2003 totaled \$(189,000), \$(36,000) and \$818,000, respectively, and are included in "Other (income) expense, net" in the accompanying Consolidated Statements of Operations.

## **FINANCIAL INSTRUMENTS AND CONCENTRATION OF CREDIT RISK**

At January 31, 2003, the Company had \$1.0 million in restricted cash in connection with securing its construction loan as described in note 7 within these Notes to Consolidated Financial Statements. During fiscal 2004, the Company fully utilized this cash to help fund the construction project, its intended use.

The carrying amounts of cash and equivalents, restricted cash, marketable securities, accounts receivable and accounts payable approximate fair value due to the short-term maturities of these instruments. The Company's debt instruments bear variable market interest rates, subject to certain minimum interest rates. The carrying values of these instruments reasonably approximate fair value. Concentration of credit risk with respect to trade receivables is limited due to the large number of customers comprising our customer base, and their dispersion across many different industries and locations throughout the world. No single customer accounted for 10% or more of the Company's total revenue in any of the last three fiscal years. Also, no single customer accounted for 10% or more of accounts receivable at January 31, 2005 or January 31, 2004.

## **LONG-LIVED ASSETS**

Property and equipment are stated at cost. Additions and significant renewals and improvements are capitalized, while maintenance and repairs are expensed. For financial reporting purposes, depreciation is generally provided on the straight-line method over the useful life of 3 years for computer equipment and software, 5 years for furniture and office equipment, and 39 years for buildings. Leasehold improvements are generally depreciated over the shorter of the lease term or the useful life of the asset.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS 144), the Company periodically reviews applicable assets for triggering events and, if necessary, for impairment in value based upon undiscounted future operating cash flows from those assets. If it is determined that the carrying amount of an asset may not be recovered, appropriate losses are recognized.

Goodwill represents the excess of acquisition costs over the fair value of net assets of purchased businesses. Other intangible assets include customer contracts, non-compete agreements and acquired intellectual property. Through January 31, 2002, goodwill and other intangible assets were amortized using the straight-line method over lives of 10 to 15 years and 2 to 5 years, respectively. Effective February 1, 2002, as required under Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), goodwill is no longer amortized. Instead, goodwill is assessed on at least an annual basis for impairment at the reporting unit level by applying a fair value-based test. For further discussion related to SFAS 142 and its adoption, see note 4 within these Notes to Consolidated Financial Statements.

## **CAPITALIZED SOFTWARE COSTS**

The Company capitalizes software development costs incurred in connection with the localization and translation of its products once technological feasibility has been achieved based on a working model. The Company also capitalizes software purchased from third parties or through business combinations as acquired software technology if the related software under



development 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 (usually identified as beta testing).

Capitalized software costs are amortized on a straight-line basis over three years. The Company periodically compares the unamortized capitalized software 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 Consolidated Statement of Operations.

#### **RESEARCH AND DEVELOPMENT**

All costs incurred to establish the technological feasibility of the Company's computer software products are expensed to research and development as incurred within its Consolidated Statements of Operations.

#### **COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) includes changes in the balances of items that are reported directly in a separate component of stockholders' equity on the Consolidated Balance Sheets. The components of comprehensive income (loss) are net income (loss) and foreign currency translation adjustments. The Company does not provide for income taxes on foreign currency translation adjustments since it does not provide for taxes on the unremitted earnings of its foreign subsidiaries. The changes in "Accumulated other comprehensive loss" are included in the Company's Consolidated Statement of Stockholders' Equity and Comprehensive Income (Loss).

#### **ACCOUNTING FOR STOCK-BASED COMPENSATION**

The Company accounts for its stock option grants in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." As such, compensation expense is generally recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price or in connection with the modification to outstanding awards or changes in grantee status. No employee stock option compensation expense is reflected in results of operations, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Stock compensation expense related to stock granted in conjunction with the acquisition of Oxford Consulting is included in the results of operations. For further description of the acquisition, see note 2 within these Notes to Consolidated Financial Statements.

The following table illustrates the effect on net income (loss) and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" (see Note 12, "Stock-Based Incentive Compensation Plans").

|   | Years Ended January 31,               |           |            |
|---|---------------------------------------|-----------|------------|
|   | 2005                                  | 2004      | 2003       |
|   | (in thousands, except per share data) |           |            |
| Net income (loss) as reported   | \$ 24,483                             | \$ 16,317 | \$ (7,649) |
| Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects                     | 52                                    | —         | —          |
| Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 2,885                                 | 1,985     | 2,180      |
| Pro forma net income (loss)   | \$ 21,650                             | \$ 14,332 | \$ (9,829) |
| Net income (loss) per share:  |                                       |           |            |
| As reported:  |                                       |           |            |
| Basic   | \$ 0.72                               | \$ 0.49   | \$ (0.22)  |
| Diluted   | 0.70                                  | 0.47      | (0.22)     |
| Pro forma:  |                                       |           |            |
| Basic   | \$ 0.64                               | \$ 0.43   | \$ (0.29)  |
| Diluted   | 0.62                                  | 0.41      | (0.29)     |

The fair value of stock options and stock purchased under the Company's employee stock purchase plan (ESPP) at date of grant was estimated using the Black-Scholes pricing model with the following assumptions for fiscal 2005, 2004 and 2003:

| Stock-Based Compensation | Expected Life<br>(in years) | Expected<br>Volatility | Risk-Free<br>Interest Rate | Dividend<br>Yield |
|--------------------------|-----------------------------|------------------------|----------------------------|-------------------|
| Options:                 |                             |                        |                            |                   |
| 2005                     | 5.38                        | 0.96                   | 3.87%                      | 0.9               |
| 2004                     | 5.50                        | 1.01                   | 3.49%                      | —                 |
| 2003                     | 6.50                        | 1.05                   | 3.55%                      | —                 |
| ESPP:                    |                             |                        |                            |                   |
| 2005                     | 0.25                        | 0.82                   | 1.61%                      | 0.9               |
| 2004                     | 0.25                        | 1.01                   | 1.39%                      | —                 |
| 2003                     | 0.25                        | 1.05                   | 1.73%                      | —                 |

## RECENT ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," or SFAS 123R. SFAS 123R revises Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," or SFAS 123, and supersedes Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" and related interpretations and Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." SFAS 123R requires compensation cost relating to all share-based payments to employees to be recognized in the financial statements based on their fair values in the first annual reporting period beginning after June 15, 2005. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. The Company is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on its consolidated financial position and results of operations. The Company has not determined the method of adoption and it has not determined whether the adoption will result in amounts recognized in the income statement that are similar to the current pro forma disclosures under SFAS 123.

## RECLASSIFICATIONS

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

## 2. BUSINESS COMBINATIONS

*Oxford Consulting Group, Inc.*

On April 30, 2004, the Company acquired certain assets and liabilities of Oxford Consulting Group, Inc. (Oxford) located in the United States. Oxford's business primarily focused on electronic data interchange (EDI) systems design, installation and services in connection with the MFG/PRO software owned and licensed by the Company.

Under the terms of the asset purchase agreement, the Company paid \$0.8 million in cash upon consummation and issued 40,000 shares of restricted common stock. The approximate value of the shares (\$0.4 million) at the date of acquisition was included as outstanding stock with an equal offset as "Unearned compensation—restricted stock," within stockholders' equity in the Company's Consolidated Balance Sheet at April 30, 2004. The shares vest ratably in equal portions over four years on each anniversary date of the acquisition. As such, the Company is expensing the unearned compensation straight-line over four years. An additional \$0.4 million in cash is payable to Oxford through February 2006. Both the potential future cash payments and vesting of common stock are contingent on the future employment of certain employees of Oxford. Therefore, and in accordance with accounting principles generally accepted in the United States of America, the cash payments and fair value of common stock are considered future compensation expense, not an increase to the purchase price.

The acquisition was accounted for as a business combination and, accordingly, the total purchase price was allocated to the acquired assets, including identifiable intangible assets and liabilities at their fair values as of April 30, 2004. The \$0.8 million purchase price was mainly allocated to intellectual property (\$0.6 million), a customer list (\$0.1 million) and customer

contracts (\$0.1 million). The Company is amortizing the intellectual property over three years and the customer list over one year and amortized the customer contracts over six months. The intellectual property was primarily comprised of certain EDI libraries developed by Oxford that are complimentary to MFG/PRO. Based on the purchase price allocation, no goodwill was recorded in connection with this transaction.

#### TRW ISCS

During the fourth quarter of fiscal 2003, the Company acquired TRW Integrated Supply Chain Solutions (TRW ISCS). In connection with the acquisition, the Company implemented a plan to eliminate redundant positions and facilities within TRW ISCS. Accordingly, the Company recognized certain liabilities in accordance with EITF 95-3 "Recognition of Liabilities in Connection with a Purchase Business Combination." The related actions resulted in a \$4.4 million increase to the acquisition cost, which included a reduction of approximately 40 employees across most functions (approximately \$2.8 million) and facility consolidations related to certain former TRW ISCS locations (approximately \$1.6 million). As of January 31, 2005, \$3.9 million of the \$4.4 million acquisition-related restructuring charge was utilized and \$0.2 million was adjusted downwards due to a change in estimate. The remaining balance of \$0.3 million, consisting of lease obligations, includes payments scheduled through fiscal 2017.

The following table presents the plan activities for the years ended January 31, 2004 and 2005:

|                            | Lease<br>Obligations | Employee<br>Termination<br>Costs | Total<br>Restructuring |
|----------------------------|----------------------|----------------------------------|------------------------|
|                            | (in thousands)       |                                  |                        |
| Balances, January 31, 2003 | \$ 1,518             | \$ 665                           | \$ 2,183               |
| Fiscal 2004 activity:      |                      |                                  |                        |
| Utilization                | (321)                | (635)                            | (956)                  |
| Adjustments                | (121)                | 20                               | (101)                  |
| Balances, January 31, 2004 | 1,076                | 50                               | 1,126                  |
| Fiscal 2005 activity:      |                      |                                  |                        |
| Utilization                | (786)                | —                                | (786)                  |
| Adjustments                | —                    | (50)                             | (50)                   |
| Balances, January 31, 2005 | \$ 290               | \$ —                             | \$ 290                 |

### 3. CAPITALIZED SOFTWARE COSTS

Capitalized software costs and accumulated amortization at January 31, 2005 and 2004 were as follows:

|  | January 31,    |          |
|--|----------------|----------|
|  | 2005           | 2004     |
|  | (in thousands) |          |
| Capitalized software costs:            |                |          |
| Capitalized software development costs | \$ 2,708       | \$ 2,309 |
| Acquired software technology           | 2,600          | 1,850    |
|  | 5,308          | 4,159    |
| Accumulated amortization               | (2,517)        | (1,193)  |
| Capitalized software costs, net        | \$ 2,791       | \$ 2,966 |

Amortization of capitalized software costs of \$1.6 million in fiscal 2005, \$1.5 million in fiscal 2004 and \$2.1 million in fiscal 2003 is included in "Cost of license fees" in the accompanying Consolidated Statements of Operations. The increase in acquired software technology is primarily attributable to intellectual property acquired in connection with the Oxford business combination during the fiscal 2005 first quarter. For further discussion of the business combination see note 2 within these Notes to Consolidated Financial Statements.

### 4. GOODWILL AND INTANGIBLE ASSETS

#### Goodwill

For the applicable reporting units, the changes in the carrying amount of goodwill were as follows (reporting unit regions are defined in note 11 within these Notes to Consolidated Financial Statements):

|  | EMEA           | Asia Pacific | Latin America | Total     |
|--|----------------|--------------|---------------|-----------|
|  | (in thousands) |              |               |           |
| Balances, January 31, 2003                 | \$ 9,692       | \$ —         | \$ 810        | \$ 10,502 |
| Fiscal 2004 activity:                      |                |              |               |           |
| Goodwill acquired                          | —              | 262          | —             | 262       |
| Adjustments to goodwill acquired           | (729)          | —            | —             | (729)     |
| Realization of acquired deferred tax asset | (375)          | —            | —             | (375)     |
| Impact of foreign currency translation     | 1,639          | 18           | (11)          | 1,646     |
| Balances, January 31, 2004                 | 10,227         | 280          | 799           | 11,306    |
| Fiscal 2005 activity:                      |                |              |               |           |
| Adjustments to goodwill acquired           | (47)           | —            | —             | (47)      |
| Realization of acquired deferred tax asset | (342)          | —            | —             | (342)     |
| Impact of foreign currency translation     | 639            | 5            | (9)           | 635       |
| Balances, January 31, 2005                 | \$ 10,477      | \$ 285       | \$ 790        | \$ 11,552 |

In connection with the adoption of SFAS 142 on February 1, 2002, all reporting units were valued and tested for impairment where goodwill existed. The fair value of the reporting units was determined using the income approach, which utilizes a discounted cash flow method to determine the present value of future benefits the reporting unit is expected to generate. In accordance with the transition provisions of SFAS 142, a \$1.1 million impairment loss related to Asia Pacific goodwill was recorded as a cumulative effect of accounting change and is included in the Company's Consolidated Statement of Operations for the fiscal year ended January 31, 2003. The impairment loss recorded for Asia Pacific related to anticipated trends in the manufacturing sector for that region.

During fiscal 2004 and 2003, the Company made earnout payments to the selling entity of an acquired business in Asia Pacific of \$0.3 million and \$0.2 million, respectively, based on financial performance under the purchase agreement. These payments effectively served to increase the purchase price of the acquisition, thus adding to the Company's goodwill balance. Based on these earnout payments, the Asia Pacific reporting unit was again valued and tested for impairment under SFAS 142. The fair value of the Asia Pacific reporting unit was determined using a discounted cash flow approach. The results of the fiscal 2004 test yielded no indication of impairment. However, in accordance with the provisions of SFAS 142, the fiscal 2003 additional \$0.2 million of goodwill in Asia Pacific was deemed to be fully impaired and the related impairment loss is included in the Company's Consolidated Statement of Operations for the fiscal year ended January 31, 2003.

In November 2002, the Company acquired \$2.2 million of goodwill in connection with the acquisition of TRW ISCS. This goodwill was allocated completely to the EMEA reporting unit. During fiscal 2005 and 2004, the Company recorded purchase accounting adjustments of \$47,000 and \$0.7 million, respectively, to the purchase price allocation for identifiable assets, liabilities and goodwill acquired in connection with the acquisition of TRW ISCS. These adjustments were mainly due to certain liabilities deemed no longer necessary after analysis of additional information not available at the date of acquisition. For further discussion of the TRW ISCS acquisition, see note 2 within these Notes to Consolidated Financial Statements.

SFAS 109 requires that management consider whether it is more likely than not that some portion or all of deferred tax assets will be realized. At the date of the TRW ISCS acquisition, management considered that it was more likely than not that the acquired TRW ISCS deferred tax assets would not be realized. However, during fiscal 2005, 2004 and 2003, \$0.3 million, \$0.4 million and \$0.1 million, respectively, of TRW ISCS deferred tax assets were realized, resulting in a corresponding decrease in goodwill.

SFAS 142 requires the Company to analyze goodwill for impairment at least on an annual basis. The Company has chosen the fourth quarter of its fiscal year as its annual test period. During the fourth quarter of fiscal year 2005, 2004 and 2003, in connection with the annual test, all reporting units containing goodwill were valued and tested for impairment. The fair value of each reporting unit was determined using an equally weighted income and market approach. The results of this test yielded no indication of impairment for each applicable reporting unit.

## Intangible Assets

|  | January 31,    |               |
|--|----------------|---------------|
|  | 2005           | 2004          |
|  | (in thousands) |               |
| Amortizable intangible assets<br>(various, principally customer contracts) | \$ 2,888       | \$ 11,175     |
| Less: accumulated amortization   | (2,568)        | (10,522)      |
| <b>Net amortizable intangible assets</b>                                   | <b>\$ 320</b>  | <b>\$ 653</b> |

Intangible assets are included in "Other assets, net" in the Company's Consolidated Balance Sheets. The change in amortizable intangible assets from January 31, 2004 to January 31, 2005 includes \$8.5 million of "amortizable intangible assets" being removed from the balance sheet. It is the Company's policy to write-off intangible assets once fully amortized. Accordingly, the corresponding \$8.5 million of "accumulated amortization" was also removed from the balance sheet. These write-offs do not impact "Net amortizable intangible assets", nor are they reflected as a charge to expense on the Consolidated Statements of Operations. This decrease in the gross intangible asset balance was partially offset by the acquisition of certain intangible assets related to the Oxford business combination. For further discussion of the business combination, see note 2 within these Notes to Consolidated Financial Statements.

As of January 31, 2005 and January 31, 2004, excluding goodwill, all of the Company's intangible assets were determined to have definite useful lives, and therefore were subject to amortization. The aggregate amortization expense related to amortizable intangible assets was \$0.5 million, \$0.9 million and \$1.2 million for fiscal 2005, 2004 and 2003, respectively.

The estimated remaining amortization expense related to amortizable intangible assets for the years ended January 31, 2006, 2007 and 2008 is \$273,000, \$42,000 and \$5,000, respectively. No additional amortization is estimated in fiscal 2009 and thereafter.

## 5. RESTRUCTURING CHARGES

In prior years, the Company implemented restructuring programs designed to strengthen operations and financial performance. Charges and adjustments related to restructurings are included in "Restructuring" in the Company's Consolidated Statements of Operations. Below is a discussion of recent restructuring programs and related activity through January 31, 2005.

During fiscal 2003, the Company implemented cost reduction programs aimed at reducing annualized operating expenses to better align them with then current business levels. The related actions resulted in a combined \$4.4 million charge that included a reduction of approximately 130 employees across all regions and functions (\$4.1 million), facility consolidations (\$0.1 million), and associated asset write-downs (\$0.2 million). In addition, during fiscal 2003, the Company recorded an adjustment of \$0.9 million as an increase to total costs and expenses, related to the fiscal 2002 restructuring accrual as noted below. As of January 31, 2004, of the combined \$4.4 million fiscal 2003 restructuring charges, \$4.3 million was utilized and \$0.1 million was adjusted downward because employee termination costs were lower than originally estimated.

During fiscal 2002, the Company continued its fiscal 2001 initiative to strengthen operating and financial performance by sharpening the focus of our solutions for multinational customers. As noted above, during fiscal 2003, the fiscal 2002 restructuring accrual was increased \$0.9 million due to the Company's inability to sublease certain office space as originally planned. During fiscal 2004, the Company recorded an adjustment of \$0.3 million as a decrease to total costs and expenses related to the fiscal 2002 restructuring accrual to reflect a change in utilization related to a previously vacated leased office space. As of January 31, 2005, the \$1.7 million fiscal 2002 restructuring charges, as adjusted, was utilized.

The following table presents the restructuring activities through January 31, 2005, resulting from the previously mentioned programs:

|                            | Lease<br>Obligations | Employee<br>Termination<br>Costs | Asset<br>Write-Downs | Total<br>Restructuring |
|----------------------------|----------------------|----------------------------------|----------------------|------------------------|
|                            | (in thousands)       |                                  |                      |                        |
| Balances, January 31, 2002 | \$ 984               | \$ 31                            | \$ —                 | \$ 1,015               |
| Fiscal 2003 activity:      |                      |                                  |                      |                        |
| Net charge                 | 79                   | 4,172                            | 161                  | 4,412                  |
| Utilization                | (855)                | (3,485)                          | (161)                | (4,501)                |
| Adjustments                | 884                  | (9)                              | —                    | 875                    |
| Balances, January 31, 2003 | 1,092                | 709                              | —                    | 1,801                  |
| Fiscal 2004 activity:      |                      |                                  |                      |                        |
| Utilization                | (509)                | (641)                            | —                    | (1,150)                |
| Adjustments                | (278)                | (68)                             | —                    | (346)                  |
| Balances, January 31, 2004 | 305                  | —                                | —                    | 305                    |
| Fiscal 2005 activity:      |                      |                                  |                      |                        |
| Utilization                | (305)                | —                                | —                    | (305)                  |
| Balances, January 31, 2005 | \$ —                 | \$ —                             | \$ —                 | \$ —                   |



## 6. COMPOSITION OF CERTAIN FINANCIAL STATEMENT CAPTIONS

|  | January 31,    |           |
|--|----------------|-----------|
|  | 2005           | 2004      |
|  | (in thousands) |           |
| Accounts receivable, net                       |                |           |
| Accounts receivable                            | \$ 66,827      | \$ 70,400 |
| Less allowance for:                            |                |           |
| Doubtful accounts                              | (1,093)        | (1,687)   |
| Sales adjustments                              | (2,589)        | (3,258)   |
|  | \$ 63,145      | \$ 65,455 |
| Other current assets                           |                |           |
| Deferred maintenance                           | \$ 6,802       | \$ 5,661  |
| Prepaid expenses                               | 5,643          | 6,011     |
| Other  | 1,340          | 1,680     |
|  | \$ 13,785      | \$ 13,352 |
| Property and equipment, net                    |                |           |
| Computer equipment and software                | \$ 38,251      | \$ 43,526 |
| Buildings                                      | 26,635         | 20,935    |
| Furniture and office equipment                 | 16,310         | 15,416    |
| Leasehold improvements                         | 6,753          | 6,819     |
| Land   | 3,850          | 3,000     |
| Automobiles (including under capital lease)    | 352            | 402       |
|  | 92,151         | 90,098    |
| Less accumulated depreciation and amortization | (52,450)       | (55,613)  |
|  | \$ 39,701      | \$ 34,485 |
| Deferred revenue                               |                |           |
| Deferred maintenance revenue                   | \$ 68,634      | \$ 65,960 |
| Other deferred revenue                         | 2,171          | 3,292     |
|  | \$ 70,805      | \$ 69,252 |
| Other current liabilities                      |                |           |
| Accrued compensation and related expenses      | \$ 14,556      | \$ 17,821 |
| Other current liabilities                      | 18,678         | 21,000    |
|  | \$ 33,234      | \$ 38,821 |

## 7. LONG-TERM DEBT

|                                | January 31,      |                 |
|--------------------------------|------------------|-----------------|
|                                | 2005             | 2004            |
|                                | (in thousands)   |                 |
| <b>Total debt</b>              |                  |                 |
| Notes payable                  | \$ 17,914        | \$ —            |
| Credit facility                | 7,625            | 9,125           |
| Construction loan              | —                | 10,468          |
| Capital lease obligations      | 97               | 114             |
|                                | 25,636           | 19,707          |
| <b>Less current maturities</b> | <b>1,725</b>     | <b>11,987</b>   |
|                                |                  |                 |
| <b>Long-term debt</b>          | <b>\$ 23,911</b> | <b>\$ 7,720</b> |

The aggregate maturities of long-term debt, for each of the next five fiscal years and thereafter are as follows: \$1.7 million in fiscal 2006; \$6.4 million in fiscal 2007; \$0.2 million in fiscal 2008; \$0.3 million in fiscal 2009; \$0.3 million in fiscal 2010; and \$16.7 million thereafter.

### *Notes Payable*

On July 28, 2004, QAD Ortega Hill, LLC, a wholly-owned subsidiary of QAD Inc. entered into a loan agreement with Mid-State Bank & Trust. The loan had an initial 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 on July 28, 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. Total proceeds were \$17.8 million, which was net of transaction fees of \$0.2 million. A portion of these proceeds was used to repay the then existing construction loan with Santa Barbara Bank and Trust. The balance of the note payable at January 31, 2005 was \$17.9 million.

### *Credit Facility*

In September 2000, the Company entered into a five-year senior credit facility (WFF Facility) with Foothill Capital Corporation, now known as Wells Fargo Foothill Inc. The maximum available amount of borrowings under the WFF Facility is \$30.0 million. The WFF Facility is secured by certain assets of QAD Inc., including certain cash, receivables, property, intellectual property rights, copyrights, and stock of subsidiary corporations. The Company pays an annual commitment fee of 0.375% calculated on the average unused portion of the \$30.0 million WFF Facility. The WFF Facility, as amended, provides that the Company will maintain certain financial and operating covenants which include, among other provisions, maintaining minimum 12-month trailing earnings before interest, taxes, depreciation and amortization (EBITDA) and tangible net worth balances, as well as a minimum cash coverage ratio. At January 31, 2005, the Company was in compliance with the applicable covenants under the WFF Facility, as amended.

The WFF Facility includes a \$15.0 million term loan with a five-year amortization schedule. Borrowings under the term loan portion of the WFF Facility bear interest at the greater of the bank's prime rate plus 3.75% or a minimum of 8%. As of January 31, 2005, the rate for the term

loan was 9%. On April 7, 2005, the Company transferred the debt to its new credit facility with Comerica Bank as described below. The Company has the intent and ability to pay a portion of the credit facility in the next 12 months, therefore, \$1.5 million is classified as a current liability and \$6.1 is classified as a long-term liability as of January 31, 2005.

The WFF Facility also includes a revolving credit facility. The maximum borrowings under the revolving portion of the WFF Facility are subject to a borrowing base calculation. Borrowings under the revolving portion of the WFF Facility bear interest at a floating rate based on either the London Interbank Offering Rate (LIBOR) or prime plus the corresponding applicable margins, ranging from 2.50% to 3.75% for the LIBOR option or 0.25% to 1.25% for the bank's prime option, depending on the Company's 12-month trailing EBITDA. The minimum rate is 8%. As of January 31, 2005, the rate for the revolving portion was 8% based on the minimum and approximately \$4.3 million was available and unused on the revolving portion of the WFF Facility.

During the fourth quarter of fiscal 2005, QAD entered into an agreement with Comerica Bank to begin due diligence on a new \$20 million unsecured credit facility (CB Facility). Also during the fourth quarter of fiscal 2005, QAD gave notice to Wells Fargo Foothill, Inc. of its intention to terminate the WFF Facility during the first quarter of fiscal 2006. The CB Facility replaced the WFF Facility effective April 7, 2005.

The CB Facility is a three year commitment, and expires in April 2008. The maximum available amount of borrowing under the CB Facility is \$20 million. The maximum amount that can be borrowed is subject to a borrowing base calculation of 1.5 times the trailing four quarter EBITDA. The CB Facility is unsecured. The Company shall pay an annual commitment fee of between 0.25% and 0.50% calculated on the average unused portion of the \$20 million CB Facility. The rate is determined by QAD's ratio of funded debt to its 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 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 bank's prime option, depending on the Company's funded debt to 12-month trailing EBITDA ratio. There is no minimum interest rate.

#### *Construction Loan*

In connection with the construction of the Company's new headquarters located in Summerland, California, and in accordance with the provisions of the construction loan agreement with Santa Barbara Bank and Trust, the Company received \$3.9 million to fund qualified expenditures made during the six months ended July 31, 2004. Total borrowings under the construction loan agreement were \$14.3 million. On July 28, 2004, the Company repaid the construction loan in full. Interest expense incurred through April 1, 2004 (the approximate date the Company moved into the new facility) was capitalized and included in "Property and equipment, net" on the Company's Consolidated Balance Sheet. Interest expense in the amount of \$0.2 million which was incurred from April 1, 2004 through July 28, 2004 was expensed to "Interest expense" on the Company's Consolidated Income Statement.

## 8. INCOME TAXES

Income tax expense (benefit) is summarized as follows:

| Years Ended January 31, |                |          |            |
|-------------------------|----------------|----------|------------|
|                         | 2005           | 2004     | 2003       |
|                         | (in thousands) |          |            |
| Current:                |                |          |            |
| Federal                 | \$ 23          | \$ (235) | \$ (1,151) |
| State                   | 163            | 103      | 108        |
| Foreign                 | 4,070          | 1,800    | 2,081      |
| Total                   | 4,256          | 1,668    | 1,038      |
| Deferred:               |                |          |            |
| Federal                 | (5,057)        | —        | —          |
| State                   | (523)          | —        | —          |
| Foreign                 | (951)          | 1,410    | 262        |
| Sub total               | (6,531)        | 1,410    | 262        |
| Equity                  | 218            | —        | —          |
| Total                   | \$ (2,057)     | \$ 3,078 | \$ 1,300   |

Actual income tax expense (benefit) differs from that obtained by applying the statutory Federal income tax rate of 34% to income (loss) before income taxes and cumulative effect of accounting change as follows:

| Years Ended January 31,                                   |                |          |            |
|---|----------------|----------|------------|
|   | 2005           | 2004     | 2003       |
|   | (in thousands) |          |            |
| Computed expected tax expense (benefit)                   | \$ 7,625       | \$ 6,594 | \$ (1,801) |
| State income taxes, net of Federal income tax expense     | 71             | 68       | 71         |
| Incremental tax expense (benefit) from foreign operations | (667)          | 979      | (960)      |
| Foreign withholding taxes                                 | 1,427          | 549      | 437        |
| Adjustments to deferred tax assets                        | (2,298)        | —        | —          |
| Net change in valuation allowance                         | (9,513)        | (4,916)  | 4,582      |
| Non-deductible expenses                                   | 264            | 271      | 137        |
| Tax payment (refund) related to prior years               | 1,090          | (341)    | (1,170)    |
| Other   | (56)           | (126)    | 4          |
|   | \$ (2,057)     | \$ 3,078 | \$ 1,300   |

Consolidated U.S. income (loss) before income taxes and cumulative effect of accounting change was \$9.8 million, \$11.1 million and \$(7.2) million for the fiscal years ended January 31, 2005, 2004 and 2003, respectively. The corresponding income before income taxes for foreign operations was \$12.6 million, \$8.3 million, and \$1.9 million for the fiscal years ended January 31, 2005, 2004 and 2003, respectively.

Withholding and U.S. income taxes have not been provided on approximately \$19.0 million of unremitted earnings of certain non-U.S. subsidiaries because such earnings are or will be reinvested in operations or will be offset by appropriate credits for foreign income taxes paid. Such earnings would become taxable upon the sale or liquidation of these non-U.S. subsidiaries or upon the remittance of dividends. Upon remittance, certain foreign countries impose withholding taxes that are then available, subject to certain limitations, for use as credits against our U.S. tax liability, if any. The determination of tax associated with the \$19.0 million of unremitted earnings is not practicable.

On October 22, 2004, the American Jobs Creation Act ("the AJCA") was signed into law. The AJCA includes a tax deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to qualifying earnings repatriations in fiscal 2006. The Company has started an evaluation of the effects of the repatriation provision; however, the Company does not expect to be able to complete this evaluation until after Congress or the Treasury Department provide additional clarifying language on key elements of the provision. The Company expects to complete its evaluation of the effects of the repatriation provision within a reasonable period of time following the publication of the additional clarifying language. The range of possible amounts that the Company is considering for repatriation under this provision is between zero and \$21.5 million. The related potential range of income tax, net of related AMT benefits, is between zero and \$0.8 million.

Significant components of the Company's deferred tax assets and liabilities are as follows:

|   | January 31,    |          |
|---|----------------|----------|
|   | 2005           | 2004     |
|   | (in thousands) |          |
| Deferred tax assets:                                  |                |          |
| Allowance for doubtful accounts and sales adjustments | \$ 415         | \$ 868   |
| Accrued vacation                                      | 1,040          | 1,185    |
| Accrued commissions                                   | 339            | 182      |
| Alternative minimum tax (AMT) credits                 | 443            | 416      |
| Research and development credits                      | 8,243          | 6,683    |
| Foreign tax credits                                   | 8              | 721      |
| Depreciation and amortization                         | —              | 125      |
| Deferred revenue                                      | 3,524          | 1,534    |
| Net operating loss carry forwards                     | 26,197         | 28,956   |
| Other   | 1,207          | 1,805    |
|   |                |          |
| Total deferred tax assets                             | 41,416         | 42,475   |
| Less valuation allowance                              | (33,626)       | (41,596) |
|   |                |          |
| Deferred tax assets, net of valuation allowance       | \$ 7,790       | \$ 879   |
|   |                |          |
| Deferred tax liabilities:                             |                |          |
| Capitalized software development costs                | \$ 170         | \$ 424   |
| Depreciation and amortization                         | 595            | —        |
| State income taxes                                    | —              | 35       |
| Unrecognized capital gain                             | 941            | 941      |
| Other   | 90             | 358      |
|   |                |          |
| Total deferred tax liabilities                        | 1,796          | 1,758    |
|   |                |          |
| Total net deferred tax asset (liability)              | \$ 5,994       | \$ (879) |
|   |                |          |
| Current portion of deferred taxes                     | 454            | \$ 107   |
| Non-current portion of deferred taxes                 | 5,540          | (986)    |
|   |                |          |
| Total net deferred tax asset (liability)              | \$ 5,994       | \$ (879) |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. At April 30, 2004 and January 31, 2005, the Company performed an assessment of the recoverability of its net deferred tax assets. Management determined that some 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, the Company recorded a tax benefit of \$1.2 million at April 30, 2004 and \$5.3 million at January 31, 2005, resulting from the reduction of previously recorded valuation allowances against net deferred tax assets.

The Company continues to evaluate the realizability of its net deferred tax assets and the need to record a valuation allowance. As of January 2004, the Company did not have objective verifiable evidence of future income and as a consequence fully valued its net deferred tax assets. As of January 2005, the Company had returned to cumulative profits in recent years. As a consequence, the Company considered a forecast of future income as objective and verifiable, resulting in a reduction of valuation allowance (see discussion above) resulting in a net deferred tax asset in the amount of \$6.0 million as of January 2005. In forecasting its future income, the Company considers the volatility of its industry and its relatively recent return to profit by discounting the projection of income in future periods. SFAS 123R is likely to reduce taxable income available for recognition of deferred tax assets when fully implemented.

The Company has net operating loss carryforwards of \$86.8 million and tax credit carryforwards of \$8.6 million as of January 31, 2005. This includes U.S. federal and state net operating loss carryforwards of \$29.6 million that expire from 2011 through 2024 and foreign net operating loss carryforwards of \$57.2 million that expire from 2006 to unlimited carryover. This also includes U.S. federal and state tax credit carryforwards of \$8.6 million that expire from 2011 through 2019 for federal and unlimited carryover for state. At January 31, 2005 and 2004, the valuation allowance attributable to deferred tax assets was \$33.6 million and \$41.6 million, respectively, representing an overall decrease of \$8.0 million. The decrease in the valuation allowance relates to a \$9.5 million realization of benefits primarily associated with net operating losses and to \$0.3 million of adjustments to goodwill related to the TRW ISCS acquisition completed in fiscal 2003, partially offset by an increase of \$1.9 million for stock option tax benefits not deemed realizable. Of the \$33.6 million valuation allowance as of January 31, 2005, \$0.7 million may reduce goodwill and intangible assets should the acquired TRW ISCS deferred tax assets be recognized in a subsequent period, and \$4.0 million may increase additional paid-in-capital should the net operating losses associated with stock options be recognized in a subsequent period.

## **9. EMPLOYEE BENEFIT PLANS**

The Company has a defined contribution 401(k) plan which is available to U.S. employees after 30 days of employment. Employees may contribute up to the maximum allowable by the Internal Revenue Code. The Company matches 75% of the employees' contributions up to the first four percent of the employee's salary. In addition, the Company can make additional contributions at the discretion of the board of directors. Participants are immediately vested in their employee contributions. Employer contributions vest over a five-year period. The employer contributions for fiscal 2005, 2004 and 2003 were \$1.0 million, \$1.1 million and \$1.2 million, respectively.

Various QAD foreign subsidiaries also contribute to what can be considered defined contribution pension plans. Employer contributions in these plans are generally based on employee salary and range from 5% to 16%. These plans are funded at various times throughout the year according to plan provisions with aggregate employer contributions of \$1.7 million, \$1.8 million and \$1.4 million during fiscal 2005, 2004 and 2003, respectively.

## 10. COMMITMENTS AND CONTINGENCIES

### *Lease Obligations*

The Company leases certain office facilities, office equipment and automobiles under operating lease agreements. Total rent expense was \$7.7 million for fiscal 2005 and \$7.5 million for both fiscal 2004 and 2003. Future minimum rental payments under non-cancelable operating lease commitments with terms of more than one year as of January 31, 2005 are as follows: \$5.8 million in fiscal 2006; \$4.3 million in fiscal 2007; \$2.0 million in fiscal 2008; \$1.6 million in fiscal 2009; \$1.4 million in fiscal 2010 and \$4.2 million in total thereafter.

### *Exit Costs*

On December 1, 2004, QAD entered into a sub-lease agreement to sublease approximately 60% of its leased office space in Carpinteria, California, which it vacated when the Company moved to its new offices in Summerland, California. The sublease commenced on December 1, 2004 and ends on the date QAD's lease terminates with the lessor in August 2011. Under the terms of the sublease agreement, the sublessee shall pay QAD a monthly rental amount which is less than the current monthly lease payment QAD pays to the lessor. In accordance with Financial Accounting Standards Board Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", the Company expensed the present value of the expected loss from the sublease arrangement. Expense of approximately \$0.6 million was incurred on December 1, 2004 and an additional \$0.1 million was expensed in January 2005 to account for the rent increase from the lessor. The expense is reflected in the Consolidated Statement of Operations during the period ended January 31, 2005.

### *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. The 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- and geography-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 or financial position.



## 11. BUSINESS SEGMENT INFORMATION

QAD 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 commission earned by each region, maintenance revenue is allocated to the region where the end user customer is located and services revenue is assigned based on the region where the services are performed.

Operating income (loss) attributable to each business segment is based on management's assignment of revenue and costs. Regional cost of revenue includes the cost of goods produced by QAD manufacturing operations at the price charged to the distribution operation. Income from manufacturing operations and research and development costs are included in the corporate operating segment.

Identifiable assets and capital expenditures are assigned by geographic region based on the location of each legal entity. This is in contrast to depreciation and amortization expense, which is allocated both to corporate and the geographic regions based on management's assignment of costs.

Capital expenditures within the North America region contain \$6.6 million, \$13.8 million and \$4.3 million in fiscal 2005, 2004 and 2003, respectively, related to the construction of the new

company headquarters. As the company headquarters are located in the United States, a significant amount of corporate assets are assigned to the North America region.

|                                | Years Ended January 31, |                   |                   |
|--------------------------------|-------------------------|-------------------|-------------------|
|                                | 2005                    | 2004              | 2003              |
|                                | (in thousands)          |                   |                   |
| Revenue:                       |                         |                   |                   |
| North America                  | \$ 97,726               | \$ 92,994         | \$ 84,018         |
| EMEA                           | 85,188                  | 88,951            | 67,595            |
| Asia Pacific                   | 34,638                  | 35,220            | 30,687            |
| Latin America                  | 13,654                  | 13,487            | 12,948            |
|                                | <u>\$ 231,206</u>       | <u>\$ 230,652</u> | <u>\$ 195,248</u> |
| Operating income (loss):       |                         |                   |                   |
| North America                  | \$ 19,300               | \$ 19,166         | \$ 14,896         |
| EMEA                           | 2,057                   | 624               | (1,658)           |
| Asia Pacific                   | 1,650                   | 1,849             | (4,228)           |
| Latin America                  | 79                      | (784)             | (1,144)           |
| Corporate                      | 300                     | (3,206)           | (5,723)           |
| Impairment loss                | —                       | —                 | (151)             |
| Restructuring                  | —                       | 346               | (5,287)           |
|                                | <u>\$ 23,386</u>        | <u>\$ 17,995</u>  | <u>\$ (3,295)</u> |
| Depreciation and amortization: |                         |                   |                   |
| North America                  | \$ 460                  | \$ 450            | \$ 537            |
| EMEA                           | 1,672                   | 2,234             | 2,558             |
| Asia Pacific                   | 648                     | 1,287             | 2,037             |
| Latin America                  | 225                     | 543               | 812               |
| Corporate                      | 4,536                   | 3,568             | 4,693             |
|                                | <u>\$ 7,541</u>         | <u>\$ 8,082</u>   | <u>\$ 10,637</u>  |
| Capital expenditures:          |                         |                   |                   |
| North America                  | \$ 9,210                | \$ 16,332         | \$ 6,406          |
| EMEA                           | 780                     | 885               | 2,092             |
| Asia Pacific                   | 457                     | 484               | 686               |
| Latin America                  | 130                     | 84                | 77                |
|                                | <u>\$ 10,577</u>        | <u>\$ 17,785</u>  | <u>\$ 9,261</u>   |

|                      | January 31,       |                   |
|----------------------|-------------------|-------------------|
|                      | 2005              | 2004              |
|                      | (in thousands)    |                   |
| Identifiable assets: |                   |                   |
| North America        | \$ 117,406        | \$ 104,371        |
| EMEA                 | 62,125            | 57,606            |
| Asia Pacific         | 20,757            | 21,575            |
| Latin America        | 6,805             | 6,276             |
|                      | <u>\$ 207,093</u> | <u>\$ 189,828</u> |

## 12. STOCK-BASED INCENTIVE COMPENSATION PLANS

### Employee Stock Option Agreements

As of January 31, 2005, options to purchase 4.5 million shares of common stock were outstanding under the 1997 Stock Incentive Program's Incentive Stock Option Plan. Outstanding options generally vest over a four-year period and have contractual lives of 8 years. Stock option activity is summarized in the following table.

|   | Stock Options | Weighted Average Exercise Price | Options Exercisable                   |                                 |
|---|---------------|---------------------------------|---------------------------------------|---------------------------------|
|   |               |                                 | Number Exercisable                    | Weighted Average Exercise Price |
|   |               |                                 | (in thousands, except exercise price) |                                 |
| Outstanding options at January 31, 2002 | 5,254         | \$ 4.57                         | 2,019                                 | \$ 5.89                         |
| Options issued                          | 1,321         | 3.09                            |                                       |                                 |
| Options exercised                       | (23)          | 3.13                            |                                       |                                 |
| Options expired and terminated          | (647)         | 4.00                            |                                       |                                 |
| Outstanding options at January 31, 2003 | 5,905         | \$ 4.29                         | 2,850                                 | \$ 5.21                         |
| Options issued                          | 760           | 6.04                            |                                       |                                 |
| Options exercised                       | (1,937)       | 3.75                            |                                       |                                 |
| Options expired and terminated          | (749)         | 5.74                            |                                       |                                 |
| Outstanding options at January 31, 2004 | 3,979         | \$ 4.61                         | 1,879                                 | \$ 5.19                         |
| Options issued                          | 1,502         | 10.21                           |                                       |                                 |
| Options exercised                       | (657)         | 3.38                            |                                       |                                 |
| Options expired and terminated          | (342)         | 6.40                            |                                       |                                 |
| Outstanding options at January 31, 2005 | 4,482         | \$ 6.53                         | 2,068                                 | \$ 4.99                         |

The following table summarizes information about stock options outstanding and exercisable at January 31, 2005:

| Range of Exercise Prices | Options Outstanding              |   |                                 | Options Exercisable               |                                 |
|--------------------------|----------------------------------|---|---------------------------------|-----------------------------------|---------------------------------|
|                          | Number of Options (in thousands) | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable (in thousands) | Weighted Average Exercise Price |
| \$1.38 - \$3.07          | 943                              | 4.52  | \$ 2.42                         | 649                               | \$ 2.27                         |
| 3.08 - 3.75              | 1,007                            | 5.25  | 3.32                            | 546                               | 3.39                            |
| 3.80 - 9.29              | 909                              | 4.11  | 6.08                            | 608                               | 5.15                            |
| 9.32 - 9.71              | 941                              | 7.30  | 9.65                            | —                                 | 9.40                            |
| 10.08 - 15.60            | 682                              | 5.12  | 13.25                           | 265                               | 14.58                           |
| Total                    | 4,482                            | 5.27  | \$ 6.53                         | 2,068                             | \$ 4.99                         |

#### 1997 Stock Incentive Program

The Company has adopted the 1997 Stock Incentive Program, which currently consists of seven parts:

- Incentive Stock Option Plan under which incentive stock options may be granted.
- Non-Qualified Stock Option Plan under which non-qualified stock options may be granted.
- Restricted Share Plan under which restricted shares of common stock may be granted.
- Employee Stock Purchase Plan (ESPP) that allows participating employees to purchase shares of common stock totaling up to 10% of an employee's compensation through payroll deductions. The price of common stock to be purchased is 85% of the lower of the fair market value of the common stock on the first or last day of each calendar quarter, defined as the purchase period. During the fiscal years ended January 31, 2005, 2004 and 2003, a total of 81,000 shares, 161,000 shares and 417,000 shares, respectively, were issued under the ESPP, generating total proceeds to the Company of \$0.6 million, \$0.7 million and \$0.8 million, respectively.
- Non-Employee Director Stock Option Plan under which grants of options to purchase shares of common stock may be made to non-employee directors of QAD.
- Stock Appreciation Rights Plan under which SARs (as defined in the plan) may be granted.
- Other Stock Rights Plan under which (1) units representing the equivalent shares of common stock may be granted; (2) payments of compensation in the form of shares of common stock may be granted; and (3) rights to receive cash or shares of common stock based on the value of dividends paid with respect to a share of common stock may be granted.

The maximum aggregate number of shares of common stock subject to the 1997 program is 12 million shares, as approved by the shareholders. The 1997 program expires 10 years from the date of adoption.

### **13. STOCKHOLDERS' EQUITY**

#### *Stock Repurchase*

On June 15, 2004, 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 twelve months ended January 31, 2005 the Company repurchased approximately 742,000 shares of its common stock at an average repurchase price of \$7.52 per share, including fees. As a result, stockholders' equity was reduced for the twelve months ended January 31, 2005 by \$5.6 million.

#### *Dividends*

On June 15, 2004, the Company's Board of Directors approved a one-time special dividend of \$0.10 per share of common stock payable August 10, 2004 to the Company's shareholders of record at the close of business on July 19, 2004. In addition, the Company's Board of Directors approved an initial quarterly cash dividend of \$0.025 per share of common stock payable September 20, 2004 to the Company's shareholders of record at the close of business on August 23, 2004. The one-time special dividend and the initial quarterly dividend, for a total of \$4.3 million, were paid during the third quarter of fiscal 2005.

On September 9, 2004, the Company's Board of Directors approved the payment of a quarterly cash dividend of \$0.025 per share of common stock to shareholders of record at the close of business on November 22, 2004, payable December 20, 2004. This quarterly dividend of \$0.8 million was paid during the fourth quarter of fiscal 2005.

On December 15, 2004, the Company's Board of Directors approved a fiscal 2005 fourth quarter cash dividend of \$0.025 per share of common stock payable on April 11, 2005 to shareholders of record at the close of business on March 14, 2005.

Total dividends declared for the year ended January 31, 2005 were \$6.0 million, of which \$5.1 million were paid by January 31, 2005.

#### *Warrants*

Recovery Equity Investors II, L.P. (REI) acquired a warrant in December 1999 in conjunction with a private placement by QAD, in which REI received 2,333,333 shares of the Company's common stock for net consideration of \$9.6 million. The warrant included anti-dilution provisions, which were not applicable to this transaction. The warrant exercise period was set to expire in December 2003. In December 2003, REI exercised, in its entirety, the warrant to purchase 225,000 shares of QAD common stock at an exercise price of \$7.50 per share for which QAD received \$1.7 million in cash.

#### *Tender Offer*

On March 20, 2003, QAD announced a plan to purchase up to 2.6 million shares of its common stock (subject to its rights under the securities laws to purchase additional shares representing up to 2% of its outstanding common stock) through a "Modified Dutch Auction" tender offer. The tender offer commenced on March 21, 2003, and consisted of an offer to purchase shares at a price between \$4.75 per share and \$5.25 per share, net to the seller in cash, without interest. The offer expired on April 21, 2003. Based on a final count by the depository for the tender offer, QAD accepted for payment 2.6 million shares and exercised its right to accept for payment an additional 0.3 million shares for a total of approximately 2.9 million shares, at a purchase price of \$5.00 per share.

The aggregate cost, including fees and expenses associated with the tender offer, was approximately \$15.2 million. The Company financed the tender offer from available cash. Shares acquired pursuant to the tender offer returned to the status of authorized but unissued common stock, and were available for issuance. Subsequent to the tender offer, common shares issued in connection with stock option and warrant exercises, and ESPP purchases have been primarily made from treasury.

#### *Reclassification*

During the fiscal 2004 first quarter, the Company adjusted its number of treasury shares to reflect treasury share purchases in fiscal 1999 and 2001, aggregating approximately 306,000 shares. These shares were removed from the Company's weighted average shares of common stock outstanding used in the computation of net income or loss per share beginning with the quarter ending April 30, 2003. Had such adjustment taken place earlier, it would not have caused a material impact to any of the Company's previously reported net income (loss) per share amounts. The related \$1.2 million value of these shares was reclassified from "Additional paid-in capital" to "Treasury stock, at cost" in the Consolidated Balance Sheet at April 30, 2003. During the fiscal 2004 second quarter, these shares were issued in connection with stock option exercises and ESPP purchases.

#### **14. OTHER (INCOME) EXPENSE, NET**

In March 2003, QAD sold a 34-acre undeveloped parcel of property, in Carpinteria, California for \$3.3 million, net of associated fees. The book value of this property was \$1.8 million. The resulting gain of \$1.5 million was recorded as a gain on disposal of property and is included in "Other (income) expense, net" in the Company's fiscal 2004 Consolidated Statement of Operations.

## 15. QUARTERLY INFORMATION (Unaudited)

|                              | Quarter Ended                         |           |           |           |
|------------------------------|---------------------------------------|-----------|-----------|-----------|
|                              | April 30                              | July 31   | Oct. 31   | Jan. 31   |
|                              | (in thousands, except per share data) |           |           |           |
| Fiscal 2005                  |                                       |           |           |           |
| Total revenue                | \$ 58,188                             | \$ 56,839 | \$ 55,453 | \$ 60,726 |
| Gross profit                 | 35,836                                | 32,945    | 32,967    | 38,005    |
| Operating income             | 5,263                                 | 2,909     | 5,178     | 10,036    |
| Net income <sup>(1)</sup>    | 5,562                                 | 1,997     | 3,116     | 13,808    |
| Basic net income per share   | \$ 0.16                               | \$ 0.06   | \$ 0.09   | \$ 0.41   |
| Diluted net income per share | 0.16                                  | 0.06      | 0.09      | 0.40      |
| Fiscal 2004                  |                                       |           |           |           |
| Total revenue                | \$ 56,276                             | \$ 55,978 | \$ 55,815 | \$ 62,583 |
| Gross profit                 | 34,600                                | 33,328    | 33,501    | 37,709    |
| Operating income             | 4,070                                 | 2,501     | 4,498     | 6,926     |
| Net income <sup>(2)</sup>    | 4,474                                 | 1,936     | 3,575     | 6,332     |
| Basic net income per share   | \$ 0.13                               | \$ 0.06   | \$ 0.11   | \$ 0.19   |
| Diluted net income per share | 0.13                                  | 0.06      | 0.10      | 0.18      |

(1) Fiscal 2005 first and fourth quarter results include tax benefits attributable to the reversal of deferred tax asset valuation allowances of \$1.2 million and \$5.3 million, respectively.

(2) Fiscal 2004 first quarter results include a \$1.5 million gain on the sale of a parcel of property owned by QAD, and is reflected in net income.

## 16. SUBSEQUENT EVENTS (Unaudited)

### *Purchased Software*

On February 11, 2005, the Company entered into an agreement with Soft Cell N.V. to purchase intellectual property comprised of certain software that is complementary to MFG/PRO. Specifically, the software purchased will enhance the Company's existing financial modules. In the fourth quarter of fiscal 2005, the Company paid a deposit of \$0.1 million. The remaining purchase price includes a total of \$3.6 million in payments due in four phases from February 2005 through May 2006.

### *Exit Activity*

On March 18, 2005, the Company moved its data center from leased office space in Carpinteria, California to its new headquarters in Summerland, California. Under SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities", a loss must be recognized for costs that will continue to be incurred under the lease agreement without economic benefit to the Company. Although the Company has not secured a sublease agreement with a tenant, it expects to do so by August 1, 2005. During the first quarter ended April 30, 2005, the Company will report expense of approximately \$0.9 million related to the present value of the estimated loss on the lease and related asset disposal costs.

#### *Credit Facility*

On April 7, 2005, the Company entered into a credit facility with Comerica Bank. The facility has a commitment for three years and expires in April 2008. The maximum available amount of borrowing under the facility is \$20 million. The facility with Comerica Bank will replace the existing Wells Fargo Foothill facility. For further details, see note 7 within these Notes to Consolidated Financial Statements.



**SCHEDULE II**

**SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS**

(in thousands)

|                                    | Balance at<br>Beginning<br>of Period | Charged<br>(Credited) to<br>Statement of<br>Operations | Deletions  | Acquisitions | Impact of<br>Foreign<br>Currency<br>Translation | Balance at<br>End of<br>Period |
|------------------------------------|--------------------------------------|--|------------|--------------|---|--------------------------------|
| <b>Year ended January 31, 2003</b> |                                      |  |            |              |   |                                |
| Allowance for doubtful<br>accounts | \$ 2,169                             | \$ 168   | \$ (1,362) | \$ 981       | \$ 229  | \$ 2,185                       |
| Allowance for sales<br>adjustments | 6,609                                | 668  | (3,627)    | —            | 257   | 3,907                          |
| Total allowances                   | \$ 8,778                             | \$ 836   | \$ (4,989) | \$ 981       | \$ 486  | \$ 6,092                       |
| <b>Year ended January 31, 2004</b> |                                      |  |            |              |   |                                |
| Allowance for doubtful<br>accounts | 2,185                                | (212)  | (437)      | —            | 151   | 1,687                          |
| Allowance for sales<br>adjustments | 3,907                                | 349  | (1,276)    | —            | 278   | 3,258                          |
| Total allowances                   | \$ 6,092                             | \$ 137   | \$ (1,713) | \$ —         | \$ 429  | \$ 4,945                       |
| <b>Year ended January 31, 2005</b> |                                      |  |            |              |   |                                |
| Allowance for doubtful<br>accounts | 1,687                                | (32)   | (625)      | —            | 63  | 1,093                          |
| Allowance for sales<br>adjustments | 3,258                                | 289  | (1,101)    | —            | 143   | 2,589                          |
| Total allowances                   | \$ 4,945                             | \$ 257   | \$ (1,726) | \$ —         | \$ 206  | \$ 3,682                       |

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on April 15, 2005.

QAD INC.

By:

/s/ DANIEL LENDER

Daniel Lender  
*Chief Financial Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

| Signature                   | Title  | Date           |
|-----------------------------|--|----------------|
| /s/ PAMELA M. LOPKER        | Chairman of the Board, and President   | April 15, 2005 |
| Pamela M. Lopker            |  |                |
| /s/ KARL F. LOPKER          | Director, Chief Executive Officer (Principal Executive Officer)                    | April 15, 2005 |
| Karl F. Lopker              |  |                |
| /s/ DANIEL LENDER           | Executive Vice President and Chief Financial Officer (Principal Financial Officer) | April 15, 2005 |
| Daniel Lender               |  |                |
| /s/ VALERIE J. MILLER       | Vice President, Corporate Controller (Principal Accounting Officer)                | April 15, 2005 |
| Valerie J. Miller           |  |                |
| /s/ JEFFREY A. LIPKIN       |  |                |
| Jeffrey A. Lipkin           | Director   | April 15, 2005 |
| /s/ A. J. MOYER             | Director   | April 15, 2005 |
| A. J. Moyer                 |  |                |
| /s/ BARRY PATMORE           | Director   | April 15, 2005 |
| Barry Patmore               |  |                |
| /s/ PETER R. VAN CUYLENBURG | Director   | April 15, 2005 |
| Peter R. van Cuylenburg     |  |                |
| /s/ LARRY WOLFE             | Director   | April 15, 2005 |
| Larry Wolfe                 |  |                |

## INDEX OF EXHIBITS

| EXHIBIT<br>NUMBER | EXHIBIT TITLE  |
|-------------------|--|
| 3.1               | Certificate of Incorporation of the Registrant, filed with the Delaware Secretary of State on May 15, 1997(1)  |
| 3.2               | Certificate of Amendment of Certificate of Incorporation of the Registrant, filed with the Delaware Secretary of State on June 19, 1997(1)   |
| 3.9               | Bylaws of the Registrant(1)  |
| 4.1               | Specimen Stock Certificate(1)  |
| 10.1              | QAD Inc. 1994 Stock Ownership Program(1)   |
| 10.2              | QAD Inc. 1997 Stock Incentive Program(1)   |
| 10.3              | Form of Indemnification Agreement with Directors and Executive Officers(1)   |
| 10.4              | Master License Agreement between the Registrant and Progress software Corporation dated June 30, 1995(1)†  |
| 10.5              | Lease Agreement between the Registrant and Matco Enterprises, Inc. for Suites I, K and L located at 5464 Carpinteria Ave., Carpinteria, California dated November 30, 1992(1)                                  |
| 10.6              | First Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suites C and H located at 5464 Carpinteria Ave., Carpinteria, California dated September 9, 1993(1)                     |
| 10.7              | Second Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suite J located at 5464 Carpinteria Ave., Carpinteria, California dated January 14, 1994(1)                            |
| 10.8              | Third Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suites B and C located at 5464 Carpinteria Ave., Carpinteria, California dated January 14, 1994(1)                      |
| 10.9              | Fourth Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suite H located at 5464 Carpinteria Ave., Carpinteria, California dated February 15, 1994(1)                           |
| 10.10             | Fifth Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. or Suites G and E located at 5464 Carpinteria Ave., Carpinteria, California dated September 12, 1994(1)                     |
| 10.11             | Sixth Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suites A, B, D, F and H, and Room A located at 5464 Carpinteria Ave., Carpinteria, California dated October 30, 1996(1) |
| 10.12             | Lease Agreement between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 3 through 8 located at 6430 Via Real, Carpinteria, California dated November 30, 1993(1)     |
| 10.13             | Addendum to Lease between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 3 through 8 located at 6430 Via Real, Carpinteria, California dated November 30, 1993(1)   |

- 10.14 Lease Agreement between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for 6450 Via Real, Carpinteria, California dated November 30, 1993(1)
- 10.15 Addendum to Lease between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for 6450 Via Real, Carpinteria, California dated November 30, 1993(1)
- 10.16 Lease Agreement between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 1 through 5 located at 6460 Via Real, Carpinteria, California dated November 30, 1993(1)
- 10.17 Addendum to Lease between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 1 through 5 located at 6460 Via Real, Carpinteria, California dated November 30, 1993(1)
- 10.18 Lease Agreement between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 7 and 8 located at 6440 Via Real, Carpinteria, California dated September 8, 1995(1)
- 10.19 Addendum to Lease between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 7 and 8 located at 6440 Via Real, Carpinteria, California dated September 8, 1995(1)
- 10.20 Lease Agreement between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 9 and 10 located at 6440 Via Real, Carpinteria, California dated September 8, 1995(1)
- 10.21 Addendum to Lease between the Registrant and William D. and Edna J. Wright dba South Coast Business Park for Suites 9 and 10 located at 6440 Via Real, Carpinteria, California dated September 8, 1995(1)
- 10.22 Multi-Tenant Office Lease Agreement between the Registrant and EDB Property Partners, LP III, successor to Laurel Larchmont Office, Inc. located at 10,000 Midlantic Drive, Mt. Laurel, New Jersey dated December 29, 1993(1)
- 10.23 Amendment to Multi-Tenant Office Lease Agreement between the Registrant and EDB Property Partners, LP III, successor to Laurel Larchmont Office, Inc. located at 10,000 Midlantic Drive, Mt. Laurel, New Jersey dated April 26, 1994(1)
- 10.24 Second Amendment to Multi-Tenant Lease Agreement between the Registrant and EDB Property Partners, LP III, dated May 30, 1995(1)
- 10.25 Third Amendment to Multi-Tenant Lease Agreement between the Registrant and EDB Property Partners L.P. I dated November 30, 1995(1)
- 10.26 Agreement and Plan of Merger between QAD California and the Registrant dated July 8, 1997(1)
- 10.27 Standard Industrial Commercial Multi-Tenant Lease—Modified Net dated as of December 29, 1997 between the Registrant and CITO Corp.(2)

- 10.28 Lease Agreement between the Registrant and Goodaston Limited for Unit 1 Phase 8 Business Park, The Waterfront Merry Hill, West Midlands, United Kingdom, dated April 30, 1996(2)
- 10.29 Eight Amendment to Office Lease between the Registrant and Matco Enterprises, Inc. for Suites I, K, L, C, J and Basement Room B located at 5464 Carpinteria Avenue, Carpinteria, California dated February 18, 1999(4)
- 10.30 Stock Purchase Agreement between the Registrant and Recovery Equity Investors II, L.P. dated December 23, 1999(5)
- 10.31 Registration Rights Agreement between the Registrant and Recovery Equity Investors II, L.P. dated December 23, 1999(5)
- 10.32 Stock Purchase Agreement between the Registrant and Enterprise Engines, Inc. dated December 15, 1999(5)
- 10.33 Non-Competition Agreement between the Registrant and David A. Taylor and Enterprise Engines, Inc. dated December 15, 1999(5)
- 10.34 Ninth Amendment to office lease between the Registrant and Matco Enterprises, Inc. for Suites G and E located at 5464 Carpinteria Avenue, Carpinteria, California dated August 23, 1999(5)
- 10.35 Third Amendment to Credit Agreement between QAD Inc. and Bank One, NA(6)
- 10.36 Fourth Amendment to Credit Agreement between QAD Inc. and Bank One, NA(6)
- 10.37 Fifth Amendment to Credit Agreement between QAD Inc. and Bank One, NA(6)
- 10.38 Tenth Amendment to the office lease between the Registrant and MATCO Enterprises, Inc. for Suites G and E located at 5464 Carpinteria Avenue, Carpinteria, California dated August 1, 2000(7)
- 10.39 Eleventh Amendment to the office lease between the Registrant and MATCO Enterprises, Inc. for Suites I, J, K and L located at 5464 Carpinteria Avenue, Carpinteria, California dated November 16, 2000(7)
- 10.40 Loan and Security Agreement between the Registrant and Foothill Capital Corporation dated September 8, 2000(7)
- 10.41 San Francisco Technology License Agreement between the Registrant and International Business Machines Corporation dated November 30, 1999(8)†
- 10.42 Lease Agreement between the Registrant and The Wright Family C Limited Partnership for Building A located at 6410 Via Real, Carpinteria, California dated February 10, 2001(9)
- 10.43 Lease Renewal Letter dated February 21, 2001, related to Multi-Tenant Office Lease Agreement between the Registrant and EDB Property Partners, LP III, successor to Laurel Larchmont Office, Inc. located at 10,000 Midlantic Drive, Mt. Laurel, New Jersey dated December 29, 1993(1)(9)
- 10.44 First Amendment to the Loan and Security Agreement between the Registrant and Foothill Capital Corporation dated December 13, 2001(10)

- 10.45 Lease Agreement between the Registrant and Vof Forward Erenha for office space located at Beechavenue 125, 1119 RB Schiphol Rijk, The Netherlands, dated December 24, 2001(11)
- 10.46 Architectural Services Agreement between the Registrant and Lenvik & Minor Architects dated May 29, 2002(12)
- 10.47 Master Services Agreement between the Registrant and Equant, Inc. dated June 6, 2002(†)(12)
- 10.48 Consulting Agreement between the Registrant and Ove Arup & Partners California dated June 12, 2002(12)
- 10.49 Second Amendment to the Loan and Security Agreement between the Registrant and Foothill Capital Corporation dated July 31, 2002(12)
- 10.50 Lease Termination Agreement between the Registrant and Brandywine Operating Partnership, L.P. dated September 19, 2002(13)
- 10.51 Contractor agreement between the Registrant and Melchiori Construction Company dated October 30, 2002(13)
- 10.52 Agreement for Interior Design Services between the Registrant and DMJM Rottet dated October 30, 2002(13)
- 10.53 Stock and Asset Purchase Agreement by and among BDM International, Inc., TRW Integrated Supply Chain Solutions GMBH, TRW Integrated Supply Chain Solutions, Inc. and TRW Inc. on the one hand and Pistach EMEA Holdings, B.V. and QAD Inc. on the other hand dated November 12, 2002(†)(14)
- 10.54 Agreement for Landscaping and Improvements between the Registrant and the County of Santa Barbara dated November 1, 2002(15)
- 10.55 Construction Loan Agreement between the Registrant and Santa Barbara Bank & Trust dated November 18, 2002(15)
- 10.56 Amendment to the Loan and Security Agreement between the Registrant and Foothill Capital Corporation dated March 18, 2003(15)
- 10.57 Amendment to the Loan and Security Agreement between the Registrant and Foothill Capital Corporation effective as of April 29, 2003(16)
- 10.58 Amendment to the Loan and Security Agreement between the Registrant and Wells Fargo Foothill, Inc. effective as of April 28, 2004(17)
- 10.59 Promissory Note between the Registrant and Mid-State Bank & Trust effective as of July 28, 2004(18)
- 10.60 Amendment to the Loan and Security Agreement between the Registrant and Wells Fargo Foothill, Inc. effective as of October 31, 2004
- 10.61 Sublease agreement between the Registrant and Somera Communications Inc. dated November 29, 2004
- 10.62 Amendment to the Loan and Security Agreement between the Registrant and Wells Fargo Foothill, Inc. effective as of March 21, 2005

|       |  |
|-------|--|
| 10.63 | Loan Agreement between the Registrant and Comerica Bank effective as of April 7, 2005  |
| 10.64 | Termination letter of the Loan and Security Agreement between the Registrant and Wells Fargo Foothill, Inc. effective as of April 6, 2005  |
| 21.1  | Subsidiaries of the Registrant   |
| 23.1  | Consent of Independent Registered Public Accounting Firm   |
| 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                                |

- 
- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (Commission File No. 333-28441)
  - (2) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended January 31, 1999 filed April 30, 1999 (Commission File No. 0-22823)
  - (3) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended April 30, 1999 filed June 14, 1999 (Commission No. 0-22823)
  - (4) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended July 31, 1999 filed September 14, 1999 (Commission No. 0-22823)
  - (5) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended January 31, 2000 (Commission No. 0-22823)
  - (6) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended April 30, 2000 filed June 13, 2000 (Commission No. 0-22823)
  - (7) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended October 31, 2000 filed December 15, 2000 (Commission No. 0-22823)
  - (8) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended January 31, 2001 (Commission No. 0-22823)
  - (9) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended April 30, 2001 filed June 14, 2001 (Commission No. 0-22823)
  - (10) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended October, 31, 2001 filed December 14, 2001 (Commission No. 0-22823)
  - (11) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended January 31, 2002 (Commission No. 0-22823)

- (12) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended July 31, 2002 filed September 15, 2002 (Commission No. 0-22823)
- (13) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended October 31, 2002 filed December 14, 2002 (Commission No. 0-22823)
- (14) Incorporated by reference to the Registrant's Current Report on Form 8-K filed November 27, 2002 (Commission No. 0-22823)
- (15) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended January 31, 2003 (Commission No. 0-22823)
- (16) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended April 30, 2003 Commission No. 0-22823)
- (17) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended April 30, 2004 (Commission No. 0-22823)
- (18) Incorporated by reference to the Registrant's Quarterly Report for the quarter ended July 31, 2004 (Commission No. 0-22823)
- (†) Certain portions of exhibit have been omitted based upon a request for confidential treatment. The omitted portions have been separately filed with the Securities and Exchange Commission.



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**AMENDMENT NUMBER 7 TO LOAN AND SECURITY AGREEMENT**

**THIS AMENDMENT NUMBER 7 TO LOAN AND SECURITY AGREEMENT** (this "Amendment"), is dated as of October 31, 2004, by and between **WELLS FARGO FOOTHILL, INC.**, a California corporation (formerly known as Foothill Capital Corporation) ("Lender") and QAD Inc., a Delaware corporation ("Borrower").

**W I T N E S S E T H**

WHEREAS, Borrower and Lender are parties to that certain Loan and Security Agreement, dated as of September 8, 2000 (as amended, restated, supplemented, or modified from time to time, the "Loan Agreement");

WHEREAS, Borrower has requested that Lender amend the Loan Agreement to provide for a reset of certain financial covenants;

WHEREAS, subject to the satisfaction of the conditions set forth herein, Lender is willing to so consent to the amendment of the Loan Agreement.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree to amend the Loan Agreement as follows:

1. **DEFINITIONS.** Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to them in the Loan Agreement, as amended hereby.
2. **AMENDMENT TO THE LOAN AGREEMENT.** Section 7.20(a)(ii) of the Loan Agreement is hereby amended and restated in its entirety as follows:

**"Tangible Net Worth.** Tangible Net Worth of at least the required amount set forth in the following table as of the applicable date set forth opposite thereto:

| Applicable Amount | Applicable Date   |
|-------------------|-------------------|
| \$ 16,700,000     | April 30, 2004    |
| \$ 22,300,000     | July 31, 2004     |
| \$ 23,000,000     | October 31, 2004  |
| \$ 22,000,000     | January 31, 2005" |

3. **CONDITIONS PRECEDENT TO THIS AMENDMENT.** The satisfaction of each of the following shall constitute conditions precedent to the effectiveness of this Amendment and each and every provision hereof:

(a) The representations and warranties of the Loan Agreement and the other Loan Documents shall be true and correct in all respects on and as of the date hereof, as though made on such date (except to the extent that such representations and warranties relate solely to an earlier date);

(b) No Default or Event of Default shall have occurred and be continuing; and

(c) No injunction, writ, restraining order, or other order of any nature prohibiting, directly or indirectly, the consummation of the transactions contemplated herein shall have been issued and remain in force by any Governmental Authority against Borrower or Lender.

4. **CONSTRUCTION.** THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAW OF THE STATE OF CALIFORNIA

APPLICABLE TO CONTRACTS MADE AND TO BE PERFORMED IN THE STATE OF CALIFORNIA.

5. **ENTIRE AMENDMENT; EFFECT OF AMENDMENT.** This Amendment, and terms and provisions hereof, constitute the entire agreement among the parties pertaining to the subject matter hereof and supersedes any and all prior or contemporaneous amendments relating to the subject matter hereof. Except for the amendment to the Loan Agreement expressly set forth in *Section 2* hereof, the Loan Agreement and other Loan Documents shall remain unchanged and in full force and effect. To the extent any terms or provisions of this Amendment conflict with those of the Loan Agreement or other Loan Documents, the terms and provisions of this Amendment shall control. This Amendment is a Loan Document.

6. **COUNTERPARTS; TELEFACSIMILE EXECUTION.** This Amendment may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument and any of the parties hereto may execute this Amendment by signing any such counterpart. Delivery of an executed counterpart of this Amendment by telefacsimile shall be equally as effective as delivery of an original executed counterpart of this Amendment. Any party delivering an executed counterpart of this Amendment by telefacsimile also shall deliver an original executed counterpart of this Amendment, but the failure to deliver an original executed counterpart shall not affect the validity, enforceability, and binding effect of this Amendment.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the date first written above.

WELLS FARGO FOOTHILL, INC.,  
a California corporation

By: /s/ KURT DUERFELDT

Name: Kurt Duerfeldt

Title: SVP

QAD INC.  
a Delaware corporation

By: /s/ DANIEL LENDER

Name: Daniel Lender

Title: EVP and Chief Financial Officer



STANDARD SUBLEASE MULTI-TENANT AIR COMMERCIAL REAL ESTATE ASSOCIATION

1. Basic Provisions ("Basic Provisions"),

1.1 **Parties:** This Sublease ("**Sublease**"), dated for reference purposes only November 4, 2004, is made by and between QAD Inc., a Delaware corporation ("**Sublessor**") and Somera Communications, Inc., a Delaware corporation ("**Sublessee**"), (collectively the "**Parties**", or individually a "**Party**").

1.2(a) **Premises:** That certain portion of the Project (as defined below), known as 6410 Via Real, Suite C & D, as shown on Exhibits A & B, consisting of approximately 15,252 square feet ("**Premises**"). The Premises are located at: 6410 Via Real, in the City of Carpinteria, County of Santa Barbara, State of California, with zip code 93013. In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have nonexclusive rights to the Common Areas (as defined below) as hereinafter specified, but shall not have any rights to the roof, the exterior walls, or the utility raceways of the building containing the Premises ("**Building**") or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "**Project**."

1.2(b) **Parking:** 60 unreserved and 0 reserved vehicle parking spaces.

1.3 **Term:** 6 years and 8.5 months commencing December 1, 2004 ("**Commencement Date**") and ending August 16, 2011 ("**Expiration Date**").

1.4 **Early Possession:** December 1, 2004 ("**Early Possession Date**").

1.5 **Base Rent:** \$17,844.84 per month ("**Base Rent**"), payable on the 1st day of each month commencing March 1, 2005.

☒ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted. The base rent shall be adjusted annually beginning on December 1, 2005, per the formula in paragraph 52.1 of the Master Lease, with the Base Rent for the first month of the term of this Sublease deemed for purposes of the first adjustment to be the Base Rent payable per paragraph 1.7(a) of this Sublease.

1.6 **SubLessee's Share of Operating Expenses:** fifty-nine percent (59%) ("**SubLessee's Share**").

1.7 **Base Rent and Other Monies Paid Upon Execution:**

(a) **Base Rent:** \$17,844.84 for the period March 1-31, 2005.

(b) **Security Deposit:** \$17,844.84 ("**Security Deposit**").

(c) **Other:** \$6,201.98 for February 1-28, 2005 (Sublessee's Share of Operating Expenses other than electrical +  $\$0.19 \text{ psf} \times 2,138 \text{ sf}$  for electrical for Suite C).

JR

KL

INITIALS

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INITIALS

FORM SBMT-0-4/01E

(d) **Total Due Upon Execution of this Lease:** \$41,891.66.

1.8 **Agreed Use:** general office use, and no other use without Sublessor's prior written consent. See Master Lease Addendum for additional terms.

1.9 **Real Estate Brokers:**

(a) **Representation:** The following real estate brokers (the "**Brokers**") and brokerage relationships exist in this transaction (check applicable boxes):

- ☐ represents Sublessor exclusively ("**Lessor's Broker**");
- ☐ represents Sublessee exclusively ("**Lessee's Broker**"); or
- ☒ Leider Hayes Commercial represents both Sublessor and Sublessee ("**Dual Agency**").

(b) **Payment to Brokers:** Upon execution and delivery of this Sublease by both Parties, Sublessor shall pay to the Brokers the brokerage fee agreed to in a separate written agreement (or if there is no such agreement the sum of \_\_\_\_\_ or \_\_\_\_\_ % of the total Base Rent for the brokerage services rendered by the Brokers).

1.10 **Guarantor.** The obligations of the Sublessee under this Sublease shall be guaranteed by \_\_\_\_\_  
(**"Guarantor"**).

1.11 **Attachments.** Attached hereto are the following, all of which constitute a part of this Sublease:

- ☐ an Addendum consisting of Paragraphs \_\_\_\_\_ through \_\_\_\_\_ :
- ☒ a plot plan depicting the Premises and/or Project;
- ☐ a current set of the Rules and Regulations;
- ☐ a Work Letter;
- ☒ a copy of the Master Lease and the Addendum to Lease;
- ☒ other (specify): Building Common Area—Exhibit C

2. **Premises.**

2.1 **Letting.** Sublessor hereby subleases to Sublessee, and Sublessee hereby subleases from Sublessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Sublease. Unless otherwise provided herein, any statement of size set forth in this Sublease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less. **Note: Sublessee is advised to verify the actual size prior to executing this Sublease.**

2.2 **Condition.** Sublessor shall deliver the Premises to Sublessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs ("**Start Date**"), and warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems ("**HVAC**"), ~~and any items which the Lessor is obligated to construct pursuant to the Work Letter attached hereto, if any,~~ other than those constructed by Lessee, shall be in good operating condition on said date. If a noncompliance with such warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fail within the appropriate warranty period, Sublessor shall, as Sublessor's sole obligation with respect to such matter, except as otherwise provided in this Sublease, promptly after receipt of written notice from Sublessee setting forth with specificity the nature and extent of such noncompliance, malfunction or failure, rectify same at Sublessor's expense. The warranty periods shall be as follows: (i) 6 months as to the HVAC systems, and (ii) 30 days as to the remaining systems and other elements. If Sublessee does not give Sublessor the

required notice within the appropriate warranty period, correction of any such noncompliance, malfunction or failure shall be the obligation of Sublessee at Sublessee's sole cost and expense.

**2.3 Compliance.** Sublessor warrants that any improvements, alterations or utility installations made or installed by or on behalf of Sublessor to or on the Premises comply with all applicable covenants or restrictions of record and applicable building codes, regulations and ordinances ("**Applicable Requirements**") in effect on the date that they were made or installed. Sublessor makes no warranty as to the use to which Sublessee will put the Premises or to modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Sublessee's use. **NOTE: Sublessee is responsible for determining whether or not the zoning and other Applicable Requirements are appropriate for Sublessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed.** If the Premises do not comply with said warranty, Sublessor shall, except as otherwise provided, promptly after receipt of written notice from Sublessee setting forth with specificity the nature and extent of such noncompliance, rectify the same.

**2.4 Acknowledgements.** Sublessee acknowledges that: (a) it has been advised by Sublessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements and the Americans with Disabilities Act), and their suitability for Sublessee's intended use, (b) Sublessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and (c) neither Sublessor, Sublessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Sublease. In addition, Sublessor acknowledge that: (i) Brokers have made no representations, promises or warranties concerning Sublessee's ability to honor the Sublease or suitability to occupy the Premises, and (ii) it is Sublessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

**2.5 Americans with Disabilities Act.** In the event that as a result of Sublessee's use, or intended use, of the Premises the Americans with Disabilities Act or any similar law requires modifications or the construction or installation of improvements in or to the Premises, Building, Project and/or Common Areas, the Parties agree that such modifications, construction or improvements shall be made at: ☐ Sublessor's expense ☒ Sublessee's expense.

**2.6 Vehicle Parking.** Sublessee shall be entitled to use the number of Unreserved Parking Spaces and Reserved Parking Spaces that have been assigned to Sublessor under the Master Lease specified in Paragraph 1.2(b) on those portions of the Common Areas designated from time to time for parking. Sublessee shall not use more parking spaces than said number. ~~Said parking spaces shall be used for parking by vehicles no larger than fullsize passenger automobiles or pickup trucks, herein called "Permitted Size Vehicles." Sublessor may regulate the leading and unloading of vehicles by adopting Rules and Regulations as provided in Paragraph 2.9. No Vehicles other than Permitted Size Vehicles may be parked in the Common Area without the prior written permission of Sublessor.~~

~~(a) Sublessee shall not permit or allow any vehicles that belong to or are controlled by Sublessee or Sublessee's employees, suppliers, shippers, customers, contractors or invitees to be loaded, unloaded, or parked in areas other than those designated by Sublessor for such activities.~~

~~(b) Sublessee shall not service or store any vehicles in the Common Areas.~~

~~(c) If Sublessee permits or allows any of the prohibited activities described in this Paragraph 2.6, then Sublessor shall have the right without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Sublessee, which cost shall be immediately payable upon demand by Sublessor.~~

**2.7 Common Areas—Definition.** The term "**Common Areas**" is defined as set forth in the Master Lease, all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility raceways and installations within the Premises that are provided and designated by the Sublessor from time to time for the general nonexclusive use of Sublessor, Sublessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, leading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.



**2.8 Common Areas—Sublessee's Rights.** Sublessor grants to Sublessee, for the benefit of Sublessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Sublease, the nonexclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Sublessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Sublessor or Sublessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Sublessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost of Sublessee, which cost shall be immediately payable upon demand by Sublessor.

**2.9 Common Areas—Rules and Regulations.** Sublessor or such other person(s) as Sublessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable rules and regulations ("**Rules and Regulations**") for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. Sublessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Sublessor shall not be responsible to Sublessee for the noncompliance with said Rules and Regulations by other tenants of the Project.

**2.10 Common Areas—Changes.** Sublessor shall have the right, in Sublessor's sole discretion from time to time:

- (a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;
- (b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;
- (c) To add additional buildings and improvements to the Common Areas;
- (d) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof; and
- (e) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and project as Sublessor may, in the exercise of sound business judgment, deem to be appropriate.

### **3. Possession.**

**3.1 Early Possession.** If Sublessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Sublease (including but not limited to the obligations to pay Sublessee's Share of Common Area Operating Expenses, Real Property Taxes and insurance premiums and to maintain the Premises) shall, however, be in effect during such period. Any such early possession shall not affect the Expiration Date.

**3.2 Delay in Commencement.** ~~Sublessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises by the Commencement Date. If, despite said efforts, Sublessor is unable to deliver possession as agreed, the rights and obligations of Sublessor and Sublessee shall be as set forth in Paragraph 3.3 of the Master Lease (as modified by Paragraph 7.3 of this Sublease).~~

**3.4 Sublessee Compliance.** Sublessor shall not be required to tender possession of the Premises to Sublessee until Sublessee complies with its obligation to provide evidence of insurance. Pending delivery of such evidence, Sublessee shall be required to perform all of its obligations under this Sublease from and after the Start Date, including the payment of Rent, notwithstanding Sublessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Sublessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Sublessor may elect to withhold possession until such conditions are satisfied.

#### **4. Rent and Other Charges.**

**4.1 Rent Defined.** All monetary obligations of Sublessee to Sublessor under the terms of this Sublease (except for the Security Deposit) are deemed to be rent ("**Rent**"). Rent shall be payable in lawful money of the United States to Sublessor at the address stated herein or to such other persons or at such other places as Sublessor may designate in writing.

**4.2 Common Area Operating Expenses.** ~~Beginning February 1, 2005,~~ Sublessee shall pay to Sublessor during the term hereof, in addition to the Base Rent, Sublessee's Share of Sublessor's share of all Common Area Operating Expenses, as hereinafter defined, during each calendar year of the term of this Sublease, in accordance with the following provisions:

(a) "**Common Area Operating Expenses**" are defined, for purposes of this Sublease, as defined in the Master Lease. ~~as all costs incurred by Sublessor relating to the operation of the Project, including, but not limited to, the following:~~

- ~~(i) The operation, repair and maintenance, in neat, clean, good order and condition, but not the replacement (see paragraph (a)), of the following:
  - ~~(aa) The Common Areas and Common Area improvements, including parking areas, loading and unloading areas, trash areas, roadways, parkways, walkways, driveways, landscaped areas, bumpers, irrigation systems, Common Area lighting facilities, fences and gates, elevators, roofs, and roof drainage systems.~~
  - ~~(bb) Exterior signs and any tenant directories.~~
  - ~~(cc) Any fire sprinkler systems.~~~~
- ~~(ii) The cost of water, gas, electricity and telephone to service the Common Areas and any utilities not separately metered.~~
- ~~(iii) Trash disposal, pest control services, property management, security services, and the costs of any environmental inspections.~~
- ~~(iv) Reserves set aside for maintenance and repair of Common Areas.~~
- ~~(v) Real Property Taxes.~~
- ~~(vi) Insurance premiums.~~
- ~~(vii) Any deductible portion of an insured loss concerning the Building or the Common Areas.~~

(b) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(a) shall not be deemed to impose an obligation upon Sublessor to either have said improvements or facilities or to provide these services unless Sublessor already provide the services, or Sublessor has agreed elsewhere in this Sublease to provide the same or some of them.

(c) Sublessee's Share of Common Area Operating Expenses shall be payable by Sublessee within 10 days after a reasonably detailed statement of actual expenses is presented to Sublessee. At Sublessor's option, however, an amount may be estimated by Sublessor from time to time of Sublessee's Share of annual Common Area Operating Expenses and the same shall be payable monthly or quarterly, as Sublessor shall designate, during each 12 month period of the Sublease term, on the same day as the Base Rent is due hereunder. Sublessor shall deliver to Sublessee within 60 days after the expiration of each calendar year a reasonably detailed statement showing Sublessee's Share of the actual Common Area Operating Expenses incurred during the preceding year. If Sublessee's payments under this Paragraph 4.2(c) during the preceding year exceed Sublessee's Share as indicated on such statement, Sublessor shall credit the amount of such overpayment against Sublessee's Share of Common Area Operating Expenses next becoming due. If Sublessee's payments under this Paragraph 4.2(c) during the preceding year were less than Sublessee's Share as indicated on such statement, Sublessee shall pay to Sublessor the amount of the deficiency within 10 days after delivery by Sublessor to Sublessee of the statement.

4.3 **Utilities.** Beginning February 1, 2005, Sublessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. ~~Notwithstanding the provisions of Paragraph 4.2,~~ if at any time in Sublessor's ~~sole~~ reasonable judgment, Sublessor determines that Sublessee is using a disproportionate amount of water, electricity or other commonly metered utilities, or that Sublessee is generating such a large volume of trash as to require an increase in the size of the dumpster and/or an increase in the number of times per month that the dumpster is emptied, then Sublessor may increase Sublessee's Base Rent by an amount equal to such increased costs.

5. **Security Deposit.** The rights and obligations of Sublessor and Sublessee as to said Security Deposit shall be as set forth in Paragraph 5 of the Master Lease (as modified by Paragraph 7.3 of this Sublease).

6. **Agreed Use.** The Premises shall be used and occupied only for \_\_\_\_\_ and for no other purpose.

7. **Master Lease.**

7.1 Sublessor is the lessee of the Premises by virtue of a lease, hereinafter the "**Master Lease**" attached hereto, wherein

The Wright Family C Limited Partnership, a California limited partnership is the lessor, hereinafter the "**Master Lessor**".

7.2 This Sublease is and shall be at all times subject and subordinate to the Master Lease.

7.3 The terms, conditions and respective obligations of Sublessor and Sublessee to each other under this Sublease shall be the terms and conditions of the Master Lease except for those provisions of the Master Lease which are directly contradicted by this Sublease in which event the terms of this Sublease document shall control over the Master Lease. Therefore, for the purposes of this Sublease, wherever in the Master Lease the word "Lessor" is used it shall be deemed to mean the Sublessor herein and wherever in the Master Lease the word "Lessee" is used it shall be deemed to mean the Sublessee herein.

7.4 During the term of this Sublease and for all periods subsequent for obligations which have arisen prior to the termination of this Sublease, Sublessee does hereby expressly assume and agree to perform and comply with, for the benefit of Sublessor and Master Lessor, each and every obligation of Sublessor under the Master Lease except for the following paragraphs which are excluded therefrom: 51 (Option to Extend Term of Lease), 60.2 (Tenant Improvements) and 62 (Data Center). Sublessee shall have no option to extend the term of this Sublease.

7.5 The obligations that Sublessee has assumed under paragraph 7.4 hereof are hereinafter referred to as the "**Sublessee's Assumed Obligations**". The obligations that sublessee has not assumed under paragraph 7.4 hereof are hereinafter referred to as the "**Sublessor's Remaining Obligations**".

7.6 Sublessee shall hold Sublessor free and harmless from all liability, judgments, costs, damages, claims or demands, including reasonable attorneys fees, arising out of Sublessee's failure to comply with or perform Sublessee's Assumed Obligations.

7.7 Sublessor agrees to maintain the Master Lease during the entire term of this Sublease, subject, however, to any earlier termination of the Master Lease without the fault of the Sublessor, and to comply with or perform Sublessor's Remaining Obligations and to hold Sublessee free and harmless from all liability, judgments, costs, damages, claims or demands arising out of Sublessor's failure to comply with or perform Sublessor's Remaining Obligations.

7.8 Sublessor represents to Sublessee that the Master Lease is in full force and effect and that no default exists on the part of any Party to the Master Lease.

#### **8. Assignment of Sublease and Default.**

8.1 Sublessor hereby assigns and transfers to Master Lessor the Sublessor's interest in this Sublease, subject however to the provisions of Paragraph 8.2 hereof.

8.2 Master Lessor, by executing this document, agrees that until a Default shall occur in the performance of Sublessor's Obligations under the Master Lease, that Sublessor may receive, collect and enjoy the Rent accruing under this Sublease. However, if Sublessor shall Default in the performance of its obligations to Master Lessor then Master Lessor may, at its option, receive and collect, directly from Sublessee, all Rent owing and to be owed under this Sublease. Master Lessor shall not, by reason of this assignment of the Sublease nor by reason of the collection of the Rent from the Sublessee, be deemed liable to Sublessee for any failure of the Sublessor to perform and comply with Sublessor's Remaining Obligations.

8.3 Sublessor hereby irrevocably authorizes and directs Sublessee upon receipt of any written notice from the Master Lessor stating that a Default exists in the performance of Sublessor's obligations under the Master Lease, to pay to Master Lessor the Rent due and to become due under the Sublease. Sublessor agrees that Sublessee shall have the right to rely upon any such statement and request from Master Lessor, and that Sublessee shall pay such Rent to Master Lessor without any obligation or right to inquire as to whether such Default exists and notwithstanding any notice from or claim from Sublessor to the contrary and Sublessor shall have no right or claim against Sublessee for any such Rent so paid by Sublessee.

8.4 No changes or modifications shall be made to this Sublease without the consent of Master Lessor.

#### **9. Consent of Master Lessor.**

9.1 In the event that the Master Lease requires that Sublessor obtain the consent of Master Lessor to any subletting by Sublessor then, this Sublease shall not be effective unless, within 10 days of the date hereof, Master Lessor signs this Sublease thereby giving its consent to this Subletting.

9.2 In the event that the obligations of the Sublessor under the Master Lease have been guaranteed by third parties then neither this Sublease, nor the Master Lessor's consent, shall be effective unless, within 10 days of the date hereof, said guarantors sign this Sublease thereby giving their consent to this Sublease.

9.3 In the event that Master Lessor does give such consent then:

(a) Such consent shall not release Sublessor of its obligations or alter the primary liability of Sublessor to pay the Rent and perform and comply with all of the obligations of Sublessor to be performed under the Master Lease.

(b) The acceptance of Rent by Master Lessor from Sublessee or any one else liable under the Master Lease shall not be deemed a waiver by Master Lessor of any provisions of the Master Lease.

(c) The consent to this Sublease shall not constitute a consent to any subsequent subletting or assignment.

(d) In the event of any Default of Sublessor under the Master Lease, Master Lessor may proceed directly against Sublessor, any guarantors or any one else liable under the Master Lease or this Sublease without first exhausting Master Lessor's remedies against any other person or entity liable thereon to Master Lessor.

~~(e) Master Lessor may consent to subsequent sublettings and assignments of the Master Lease or this Sublease or any amendments or modifications thereto without notifying Sublessor or any one else liable under the Master Lease and without obtaining their consent and such action shall not relieve such persons from liability.~~

(f) In the event that Sublessor shall Default in its obligations under the Master Lease, then Master Lessor, at its option and without being obligated to do so, may require Sublessee to atton to Master Lessor in which event Master Lessor shall undertake the obligations of Sublessor under this Sublease from the time of the exercise of said option to termination of this Sublease but Master Lessor shall not be liable for any prepaid Rent nor any Security Deposit paid by Sublessee, nor shall Master Lessor be liable for any other Defaults of the Sublessor under the Sublease.

9.4 The signatures of the Master Lessor and any Guarantors of Sublessor at the end of this document shall constitute their consent to the terms of this Sublease.

9.5 Master Lessor acknowledges that, to the best of actual Master Lessor's knowledge, no Default presently exists under the Master Lease of obligations to be performed by Sublessor and that the Master Lease is in full force and effect

~~9.6 In the event that Sublessor Defaults under its obligations to be performed under the Master Lease by Sublessor, Master Lessor agrees to deliver to Sublessee a copy of any such notice of default. Sublessee shall have the right to cure any Default of Sublessor described in any notice of default within ten days after service of such notice of default on Sublessee. If such Default is cured by Sublessee then Sublessee shall have the right of reimbursement and offset from and against Sublessor.~~

#### 10. Additional Brokers Commissions.

~~10.1 Sublessor agrees that if Sublessee exercises any option or right of first refusal as granted by Sublessor herein, or any option or right substantially similar thereto, either to extend the term of this Sublease, to renew this Sublease, to purchase the Premises, or to lease or purchase adjacent property which Sublessor may own or in which Sublessor has an interest, then Sublessor shall pay to Broker a fee in accordance with the schedule of Broker in effect at the time of the execution of this Sublease. Notwithstanding the foregoing, Sublessor's obligation under this Paragraph is limited to a transaction in which Sublessor is acting as a Sublessor, lessor or seller.~~

~~10.2. Master Lessor agrees that if Sublessee shall exercise any option or right of first refusal granted to Sublessee by Master Lessor in connection with this Sublease, or any option or right substantially similar thereto, either to extend or renew the Master Lease, to purchase the Premises or any part thereof, or to lease or purchase adjacent property which Master Lessor may own or in which Master Lessor has an interest, or if Broker is the procuring cause of any other lease or sale entered into between Sublessee and Master Lessor pertaining to the Premises, any part thereof, or any adjacent property which Master Lessor owns or in which it has an interest, then as to any of said transactions. Master Lessor shall pay to Broker a fee, in cash, in accordance with the schedule of Broker in effect at the time of the execution of this Sublease.~~

~~10.3. Any fee due from Sublessor or Master Lessor hereunder shall be due and payable upon the exercise of any option to extend or renew, upon the execution of any new lease, or, in the event of a purchase, at the close of escrow.~~

~~10.4. Any transferee of Sublessor's interest in this Sublease, or of Master Lessor's interest in the Master Lease, by accepting an assignment thereof, shall be deemed to have assumed the respective obligations of Sublessor or Master Lessor under this Paragraph 10. Broker shall be deemed to be a third party beneficiary of this paragraph 10.~~

**11. Representations and Indemnities of Broker Relationships.** The Parties each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Sublease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Sublessee and Sublessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorney's fees reasonably incurred with respect thereto.

**12. Attorney's fees.** If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "**Prevailing Party**" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Sublessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach (\$200 is a reasonable minimum per occurrence for such services and consultation).

**13. No Prior or Other Agreements; Broker Disclaimer.** This Sublease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Sublessor and Sublessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Sublease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party. The liability (including court costs and attorneys' fees), of any Broker with respect to negotiation, execution, delivery or performance by either Sublessor or Sublessee under this Sublease or any amendment or modification hereto shall be limited to an amount up to the fee received by such Broker pursuant to this Sublease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

14. **Tenant Improvements:** Sublessee shall be responsible for all improvements, subject to the terms and conditions of this Sublease and the Master Lease and Sublessor's reasonable approval.

15. **Signs:** Sublessee shall have the exclusive right to install prominent building signage, subject to the terms and conditions of this Sublease and the Master Lease and Sublessor's reasonable approval.

16. **Building Common Area:** In addition to the Common Area that is defined in the Master Lease, the Building of which the Premises are a part has the following first floor common area ("Building Common Area"): main entrance, interior hallway, two stairways, electrical room and restroom. The Building Common Area is shown on Exhibit C. Sublessor agrees that Sublessee shall have the nonexclusive right to use the Building Common Area on all the same terms and conditions as set forth in the Master Lease pertaining to Common Area. Sublessor agrees to maintain the Building Common Area. As additional common area charges, Sublessee shall pay Sublessee's Share of Common Area Expenses as defined in Paragraph 1.6 multiplied by QAD's actual expenses for maintaining the Building Common Area. All Sublessor billing for Common Area expenses, and any disputes regarding those charges and the charges set forth in paragraph 17 below, shall be resolved as provided in the Master Lease for Common Area Expenses.

17. **Building Utilities:** In addition to the Other charges set forth in Paragraph 1.7(c), Sublessee will pay for all electrical utilities to the second floor of the Building, which are separately metered.

**ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AIR COMMERCIAL REAL ESTATE ASSOCIATION OR BY ANY REAL ESTATE BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS SUBLEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:**

1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS SUBLEASE.

2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PROPERTY, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, AND THE SUITABILITY OF THE PREMISES FOR SUBLESSEE'S INTENDED USE.

**WARNING: IF THE SUBJECT PROPERTY IS LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE SUBLEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PROPERTY IS LOCATED.**

Execute at: \_\_\_\_\_  
On: \_\_\_\_\_

**By SUBLESSOR:**

QAD Inc., a Delaware corporation

By: /s/ KARL LOPKER  
Name Printed: KARL LOPKER  
Title: CHIEF EXECUTIVE OFFICER  
By: \_\_\_\_\_  
Name Printed: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
Telephone: ( )  
Facsimile: ( )  
Federal ID No. \_\_\_\_\_

**BROKER:**

Leider Hayes Commercial

Attn: Francois DeJohn  
Title: Partner  
Address: 3700 State Street, Suite 240  
Santa Barbara, CA 93105  
Telephone: (805) 563-2111  
Facsimile: (805) 898-4360  
Federal ID No. \_\_\_\_\_

Consent to the above Sublease is hereby given.

Executed at: \_\_\_\_\_  
On: \_\_\_\_\_

Executed at: Santa Barbara, CA  
On: Nov. 29, 2004

**By SUBLESSEE:**

Somera Communications, Inc.,

a Delaware corporation

By: /s/ JEREMY ROSSEN  
Name Printed: Jeremy Rossen  
Title: Vice President  
By: \_\_\_\_\_  
Name Printed: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: 5383 Hollister Ave  
Santa Barbara, CA 93111  
Telephone: ( )  
Facsimile: ( )  
Federal ID No. \_\_\_\_\_

**BROKER:**

Attn: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
Telephone: ( )  
Facsimile: ( )  
Federal ID No. \_\_\_\_\_

Executed at: \_\_\_\_\_  
On: \_\_\_\_\_



**By MASTER LESSOR:**

See attached Addendum

By:

Name Printed:

Title:

By:

Name Printed:

Title:

Address:

Telephone:

(    )

Facsimile:

(    )

Federal ID No.

**By GUARANTOR(S):**

By:

Name Printed:

Address:

By:

Name Printed:

Address:

**NOTE: These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: AIR COMMERCIAL REAL ESTATE ASSOCIATION, 700 So. Flower St., Suite 600, Los Angeles, CA 90017. (213) 687-8777.**

**Addendum to Standard Sublease  
Consent of Master Lessor**

Master Lessor hereby consents to the subleasing of the Premises to Sublessee pursuant to the terms of the Sublease: provided, however, that Master Lessor specifically does not consent to any provision of the Sublease which: (i) purports to amend provisions of the Master Lease, (ii) provides rights or benefits to Sublessee beyond those specifically set forth in the Master Lease, or (iii) imposes obligations on Master Lessor. The consent given by the Master Lessor to the subleasing of the Premises, shall not include consent to any specific actions on the part of Sublessor or Sublessee (including, without limitation, the making of any alterations or improvements to the Premises or the further subleasing of the Premises or assignment of the Master Lease by Sublessor) for which the separate approval of Master Lessor is otherwise required under the Master Lease. Master Lessor's consent shall not release Sublessor of any of its obligations under the Master Lease or release or alter the liability of Sublessor to pay rent and all other sums due under the Master Lease and to perform and comply with all other obligations of Sublessor under the Master Lease. As between Master Lessor and Sublessor, the Sublease shall not alter, amend or otherwise modify any provisions of the Master Lease. Master Lessor shall have no obligations to any party in connection with the Premises other than those obligations set forth in the Master Lease.

"Master Lessor"

THE WRIGHT FAMILY C LIMITED  
PARTNERSHIP, a California limited  
partnership

By: /s/ JEANNE M. BORTOLAZZO, G.P.

\_\_\_\_\_  
Jeanne M. Bortolazzo, *General Partner*

QuickLinks

[Addendum to Standard Sublease Consent of Master Lessor](#)

**AMENDMENT NUMBER 8 AND WAIVER  
TO LOAN AND SECURITY AGREEMENT**

**THIS AMENDMENT NUMBER 8 AND WAIVER TO LOAN AND SECURITY AGREEMENT** (this "Amendment"), is dated as of March 21, 2005, by and between **WELLS FARGO FOOTHILL, INC.**, a California corporation (formerly known as Foothill Capital Corporation) ("Lender") and **QAD INC.**, a Delaware corporation ("Borrower").

**W I T N E S S E T H**

WHEREAS, Borrower and Lender are parties to that certain Loan and Security Agreement, dated as of September 8, 2000 (as amended, restated, supplemented, or modified from time to time, the "Loan Agreement");

WHEREAS, Borrower has requested that Lender (a) amend the Loan Agreement to provide for a reset of certain financial covenants, and (b) consent to Borrower entering into certain specified written obligations;

WHEREAS, subject to the satisfaction of the conditions set forth herein, Lender is willing to so consent to the amendment of the Loan Agreement and to Borrower entering into certain written obligations.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree to amend the Loan Agreement as follows:

1. **DEFINITIONS.** Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to them in the Loan Agreement, as amended hereby.

2. **AMENDMENTS TO THE LOAN AGREEMENT.**

(a) *Section 7.20(a)(i)* of the Loan Agreement is hereby amended and restated in its entirety as follows:

**"Minimum EBITDA.** EBITDA, measured on a fiscal quarter-end basis, of not less than the required amount set forth in the following table for the applicable period set forth opposite thereto:

| Applicable Amount | Applicable Period                                |
|-------------------|--|
| \$ 22,880,000     | For the 12 month period ending April 30, 2005    |
| \$ 23,680,000     | For the 12 month period ending July 31, 2005     |
| \$ 24,240,000     | For the 12 month period ending October 31, 2005  |
| \$ 24,320,000     | For the 12 month period ending January 31, 2006" |

(b) Section 7.20(a)(iii) of the Loan Agreement is hereby amended and restated in its entirety as follows:

**"Tangible Net Worth.** Tangible Net Worth of at least the required amount set forth in the following table as of the applicable date set forth opposite thereto:

| Applicable Amount | Applicable Date   |
|-------------------|-------------------|
| \$ 27,600,000     | April 30, 2005    |
| \$ 29,280,000     | July 31, 2005     |
| \$ 29,040,000     | October 31, 2005  |
| \$ 32,080,000     | January 31, 2006" |

3. **WAIVERS.** Lender grants to Borrower a limited one-time waiver of the negative covenants set forth in Sections 7.1, 7.2, and 7.6 of the Loan Agreement and any other provision of the Loan Agreement which would otherwise prohibit the following: (a) Borrower's execution and delivery to Bank of America, N.A. of a continuing guaranty substantially in the form attached hereto as *Exhibit A* ("Bank of America Guaranty"); (b) Borrower's execution and delivery to Comerica Bank of an unsecured credit agreement ("Comerica Credit Agreement") for the purpose, among others, of borrowing sums to directly pay all Obligations in full; and (c) Borrower's execution and delivery to Comerica Bank of such ancillary instruments and loan documents as may be called for pursuant to the Comerica Credit Agreement ("Comerica Loan Documents") in order to evidence Borrower's Indebtedness thereunder, together with the Comerica Credit Agreement. Notwithstanding any provision to the contrary herein contained, Borrower shall not borrow any sums or otherwise incur any Indebtedness under the Comerica Credit Agreement except in connection with Borrower's concurrent payment of all Obligations in full, which payment shall be made, if at all, no later than April 21, 2005. The foregoing waiver is not a waiver of any subsequent Default or Event of Default of the same provisions of the Loan Agreement, nor is it a waiver of any other current or future Default or Event of Default. Lender is not obligated to provide this or any other waiver of its Default rights.

4. **CONDITIONS PRECEDENT TO THIS AMENDMENT.** The satisfaction of each of the following shall constitute conditions precedent to the effectiveness of this Amendment and each and every provision hereof:

(a) The representations and warranties of the Loan Agreement and the other Loan Documents shall be true and correct in all respects on and as of the date hereof, as though made on such date (except to the extent that such representations and warranties relate solely to an earlier date);

(b) No Default or Event of Default shall have occurred and be continuing; and

(c) No injunction, writ, restraining order, or other order of any nature prohibiting, directly or indirectly, the consummation of the transactions contemplated herein shall have been issued and remain in force by any Governmental Authority against Borrower or Lender.

5. **CONSTRUCTION.** THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAW OF THE STATE OF CALIFORNIA APPLICABLE TO CONTRACTS MADE AND TO BE PERFORMED IN THE STATE OF CALIFORNIA.

6. **ENTIRE AMENDMENT; EFFECT OF AMENDMENT; LENDER EXPENSE.** This Amendment, and terms and provisions hereof, constitute the entire agreement among the parties pertaining to the subject matter hereof and supersedes any and all prior or contemporaneous amendments relating to the subject matter hereof. Except for the amendment to the Loan Agreement expressly set forth in Section 2 hereof and the waiver in Section 3 hereof, the Loan

Agreement and other Loan Documents shall remain unchanged and in full force and effect. To the extent any terms or provisions of this Amendment conflict with those of the Loan Agreement or other Loan Documents, the terms and provisions of this Amendment shall control. This Amendment is a Loan Document. Borrower agrees that all of Lender's attorneys' fees and costs in drafting and negotiating this Amendment are part of the Lender Expenses and are payable on demand.

**7. COUNTERPARTS; TELEFACSIMILE EXECUTION.** This Amendment may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument and any of the parties hereto may execute this Amendment by signing any such counterpart. Delivery of an executed counterpart of this Amendment by telefacsimile shall be equally as effective as delivery of an original executed counterpart of this Amendment. Any party delivering an executed counterpart of this Amendment by telefacsimile also shall deliver an original executed counterpart of this Amendment, but the failure to deliver an original executed counterpart shall not affect the validity, enforceability, and binding effect of this Amendment.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the date first written above.

WELLS FARGO FOOTHILL, INC.,  
a California corporation

By: /s/ NICHOL S SHUART

Name: Nichol S Shuart

Title: VP

QAD INC.  
a Delaware corporation

By: /s/ DANIEL LENDER

Name: Daniel Lender

Title: EVP and Chief Financial Officer

## CONTINUING GUARANTY

FOR VALUE RECEIVED, the sufficiency of which is hereby acknowledged, and in consideration of credit and/or financial accommodation heretofore or hereafter from time to time made or granted to the subsidiaries of the undersigned Guarantor (the "*Guarantor*") identified on Schedule A hereto, as amended or supplemented or deemed amended or supplemented from time to time in accordance with Paragraph 18 below (each a "*Borrower*" and collectively, the "*Borrowers*") by BANK OF AMERICA, N.A. and any other subsidiaries or affiliates of Bank of America Corporation and its successors and assigns (collectively the "*Lender*"), the Guarantor hereby furnishes its guaranty of the Guaranteed Obligations (as hereinafter defined) as follows:

1. **Guaranty.** The Guarantor hereby absolutely and unconditionally guarantees, as a guaranty of payment and performance and not merely as a guaranty of collection, prompt payment in the currency in which denominated when due, whether at stated maturity, by required prepayment, upon acceleration, demand or otherwise, and at all times thereafter, of any and all existing and future indebtedness and liabilities of every kind, nature and character, direct or indirect, absolute or contingent, liquidated or unliquidated, voluntary or involuntary and whether for principal, interest, premiums, fees indemnities, damages, costs, expenses or otherwise, of each Borrower to the Lender associated with any credit or other financial accommodation arising out of any treasury management services provided by the Lender for the benefit of or otherwise in respect of the Borrowers, including, without limitation, intraday credit, Automated Clearing House (ACH) services, foreign exchange services, daylight overdrafts and zero balance arrangements and any instruments, agreements and other documents of every kind executed in connection with such services (including all renewals, extensions, amendments, refinancings and other modifications thereof and all reasonable costs, attorneys' fees and expenses incurred by the Lender in connection with the collection or enforcement thereof), and whether recovery upon such indebtedness and liabilities may be or hereafter become unenforceable or shall be an allowed or disallowed claim under any proceeding or case commenced by or against the Guarantor or any Borrower under the Bankruptcy Code (Title 11, United States Code), any successor statute or any other liquidation, conservatorship, bankruptcy, assignment for the benefit of creditors, moratorium, rearrangement, receivership, insolvency, reorganization, or similar debtor relief laws of the United States or other applicable jurisdictions from time to time in effect and affecting the rights of creditors generally (collectively, "*Debtor Relief Laws*"), and including interest that accrues after the commencement by or against any Borrower of any proceeding under any Debtor Relief Laws (collectively, the "*Guaranteed Obligations*"). The Lender's books and records shall be admissible as prima facie evidence in any action or proceeding for the purpose of establishing the amount of the Guaranteed Obligations. This Guaranty shall not be affected by the genuineness, validity, regularity or enforceability of the Guaranteed Obligations or any instrument or agreement evidencing any Guaranteed Obligations, or by the existence, validity, enforceability, perfection, non-perfection or extent of any collateral therefor, or by any fact or circumstance relating to the Guaranteed Obligations which might otherwise constitute a defense to the obligations of the Guarantor under this Guaranty, and the Guarantor hereby irrevocably waives any defenses it may now have or hereafter acquire in any way relating to any or all of the foregoing other than the loss of enforceability of a Guaranteed Obligation caused by the willful misconduct or gross negligence of the Bank.

2. **No Setoff or Deductions; Taxes; Payments.** The Guarantor represents and warrants that it is organized and resident in the United States of America. The Guarantor shall make all payments hereunder without setoff or counterclaim and free and clear of and without deduction for any taxes, levies, imposts, duties, charges, fees, deductions, withholdings, compulsory loans, restrictions or conditions of any nature now or hereafter imposed or levied by any jurisdiction or any political subdivision thereof or taxing or other authority therein unless the Guarantor is

compelled by law to make such deduction or withholding. If any such obligation to deduct or withhold (other than one arising with respect to taxes based on or measured by the income or profits of the Lender) is imposed upon any amount payable by the Guarantor hereunder, the Guarantor will nonetheless pay to the Lender, on the date on which such amount is due and payable hereunder, the full amount of the Guaranteed Obligation to be paid and any additional amount in U.S. dollars as may be necessary to enable the Lender to receive the same net amount which the Lender would have received on such due date had no such obligation been imposed upon the Guarantor. The Guarantor will deliver promptly to the Lender such certificates or other valid vouchers as will evidence the payment of all taxes or other charges deducted from or paid with respect to payments made by the Guarantor hereunder. The obligations of the Guarantor under this paragraph shall survive the payment in full of the Guaranteed Obligations and termination of this Guaranty. At the Lender's option, all payments under this Guaranty shall be made in the United States. The obligations hereunder shall not be affected by any acts of any legislative body or governmental authority affecting any Borrower, including but not limited to, any restrictions on the conversion of currency or repatriation or control of funds or any total or partial expropriation of any Borrower's property, or by economic, political, regulatory or other events in the countries where any Borrower is located.

3. **Rights of Lender.** The Guarantor consents and agrees that the Lender may, at any time and from time to time, without notice or demand, and without affecting the enforceability or continuing effectiveness hereof: (a) amend, extend, renew, compromise, discharge, accelerate or otherwise change the time for payment or the terms of the Guaranteed Obligations or any part thereof; (b) take, hold, exchange, enforce, waive, release, fail to perfect, sell, or otherwise dispose of any security for the payment of this Guaranty or any Guaranteed Obligations; (c) apply such security and direct the order or manner of sale thereof as the Lender in its sole discretion may determine; and (d) release or substitute one or more of any endorsers or other guarantors of any of the Guaranteed Obligations. Without limiting the generality of the foregoing, the Guarantor consents to the taking of, or failure to take, any action which might in any manner or to any extent vary the risks of the Guarantor under this Guaranty or which, but for this provision, might operate as a discharge of the Guarantor.

4. **Certain Waivers.** The Guarantor waives (a) any defense arising by reason of any disability or other defense of any Borrower or any other guarantor, or the cessation from any cause whatsoever (including any act or omission of the Lender) of the liability of any Borrower; (b) any defense based on any claim that the Guarantor's obligations exceed or are more burdensome than those of any Borrower; (c) the benefit of any statute of limitations affecting the Guarantor's liability hereunder; (d) any right to proceed against any Borrower, proceed against or exhaust any security for the Indebtedness, or pursue any other remedy in the Lender's power whatsoever; (e) any benefit of and any right to participate in any security now or hereafter held by the Lender; and (f) to the fullest extent permitted by law, any and all other defenses or benefits that may be derived from or afforded by applicable law limiting the liability of or exonerating guarantors or sureties. The Guarantor expressly waives all setoffs and counterclaims and all presentments, demands for payment or performance, notices of nonpayment or nonperformance, protests, notices of protest, notices of dishonor and all other notices or demands of any kind or nature whatsoever with respect to the Guaranteed Obligations, and all notices of acceptance of this Guaranty or of the existence, creation or incurrence of new or additional Guaranteed Obligations.

5. **Obligations Independent.** The obligations of the Guarantor hereunder are those of primary obligor, and not merely as surety, and are independent of the Guaranteed Obligations and the obligations of any other guarantor, and a separate action may be brought against the Guarantor to enforce this Guaranty whether or not any Borrower or any other person or entity is joined as a party.



6. **Subrogation.** The Guarantor shall not exercise any right of subrogation, contribution, indemnity, reimbursement or similar rights with respect to any payments it makes under this Guaranty until all of the Guaranteed Obligations and any amounts payable under this Guaranty have been indefeasibly paid and performed in full and any commitments of the Lender or facilities provided by the Lender with respect to the Guaranteed Obligations are terminated. If any amounts are paid to the Guarantor in violation of the foregoing limitation, then such amounts shall be held in trust for the benefit of the Lender and shall forthwith be paid to the Lender to reduce the amount of the Guaranteed Obligations, whether matured or unmatured.

7. **Termination; Reinstatement.** This Guaranty is a continuing and irrevocable guaranty of all Guaranteed Obligations now or hereafter existing and shall remain in full force and effect until all Guaranteed Obligations and any other amounts payable under this Guaranty are indefeasibly paid in full in cash and any commitments of the Lender or facilities provided by the Lender with respect to the Guaranteed Obligations are terminated. Notwithstanding the foregoing, this Guaranty shall continue in full force and effect or be revived, as the case may be, if any payment by or on behalf of any Borrower or the Guarantor is made, or the Lender exercises its right of setoff, in respect of the Guaranteed Obligations and such payment or the proceeds of such setoff or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by the Lender in its discretion) to be repaid to a trustee, receiver or any other party, in connection with any proceeding under any Debtor Relief Laws or otherwise, all as if such payment had not been made or such setoff had not occurred and whether or not the Lender is in possession of or has released this Guaranty and regardless of any prior revocation, rescission, termination or reduction. The obligations of the Guarantor under this paragraph shall survive termination of this Guaranty.

8. **Subordination.** The Guarantor hereby subordinates the payment of all obligations and indebtedness of the Borrowers owing to the Guarantor, whether now existing or hereafter arising, including but not limited to any obligation of the Borrowers to the Guarantor as subrogee of the Lender or resulting from the Guarantor's performance under this Guaranty, to the indefeasible payment in full in cash of all Guaranteed Obligations. If the Lender so requests, any such obligation or indebtedness of the Borrowers to the Guarantor shall be enforced and performance received by the Guarantor as trustee for the Lender and the proceeds thereof shall be paid over to the Lender on account of the Guaranteed Obligations, but without reducing or affecting in any manner the liability of the Guarantor under this Guaranty.

9. **Stay of Acceleration.** In the event that acceleration of the time for payment of any of the Guaranteed Obligations is stayed, in connection with any case commenced by or against the Guarantor or any Borrower under any Debtor Relief Laws, or otherwise, all such amounts shall nonetheless be payable by the Guarantor immediately upon demand by the Lender.

10. **Expenses.** The Guarantor shall pay on demand all reasonable out-of-pocket expenses (including attorneys' fees and expenses and the allocated cost and disbursements of internal legal counsel) in any way relating to the enforcement or protection of the Lender's rights under this Guaranty or in respect of the Guaranteed Obligations, including any incurred during any "workout" or restructuring in respect of the Guaranteed Obligations and any incurred in the preservation, protection or enforcement of any rights of the Lender in any proceeding any Debtor Relief Laws. The obligations of the Guarantor under this paragraph shall survive the payment in full of the Guaranteed Obligations and termination of this Guaranty.

11. **Miscellaneous.** No provision of this Guaranty may be waived, amended, supplemented or modified, except by a written instrument executed by the Lender and the Guarantor. No failure by the Lender to exercise, and no delay in exercising, any right, remedy or power hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, remedy or power

hereunder preclude any other or further exercise thereof or the exercise of any other right, power or remedy. The remedies herein provided are cumulative and not exclusive of any remedies provided by law or in equity. The unenforceability or invalidity of any provision of this Guaranty shall not affect the enforceability or validity of any other provision herein. Unless otherwise agreed by the Lender and the Guarantor in writing, this Guaranty is not intended to supersede or otherwise affect any other guaranty now or hereafter given by the Guarantor for the benefit of the Lender or any term or provision thereof.

12. **Condition of Borrowers.** The Guarantor acknowledges and agrees that it has the sole responsibility for, and has adequate means of, obtaining from each Borrower and any other guarantor such information concerning the financial condition, business and operations of such Borrower and any such other guarantor as the Guarantor requires, and that the Lender has no duty, and the Guarantor is not relying on the Lender at any time, to disclose to the Guarantor any information relating to the business, operations or financial condition of any Borrower or any other guarantor (the guarantor waiving any duty on the part of the Lender to disclose such information and any defense relating to the failure to provide the same).

13. **Setoff.** If and to the extent any payment is not made when due hereunder, the Lender may setoff and charge from time to time any amount so due against any or all of the Guarantor's accounts or deposits with the Lender.

14. **Representations and Warranties.** The Guarantor represents and warrants that (a) it is duly organized and in good standing under the laws of the jurisdiction of its organization and has full capacity and right to make and perform this Guaranty, and all necessary authority has been obtained; (b) this Guaranty constitutes its legal, valid and binding obligation enforceable in accordance with its terms; (c) the making and performance of this Guaranty does not and will not violate the provisions of any applicable law, regulation or order, and does not and will not result in the breach of, or constitute a default or require any consent under, any material agreement, instrument, or document to which it is a party or by which it or any of its property may be bound or affected; and (d) all consents, approvals, licenses and authorizations of, and filings and registrations with, any governmental authority required under applicable law and regulations for the making and performance of this Guaranty have been obtained or made and are in full force and effect.

15. **Indemnification and Survival.** Without limitation on any other obligations of the Guarantor or remedies of the Lender under this Guaranty, the Guarantor shall, to the fullest extent permitted by law, indemnify, defend and save and hold harmless the Lender from and against, and shall pay on demand, any and all damages, losses, liabilities and reasonable expenses (including attorneys' fees and expenses and the allocated cost and disbursements of internal legal counsel) that may be suffered or incurred by the Lender in connection with or as a result of any failure of any Guaranteed Obligations to be the legal, valid and binding obligations of the Borrowers enforceable against the Borrowers in accordance with their respective terms. The obligations of the Guarantor under this paragraph shall survive the payment in full of the Guaranteed Obligations and termination of this Guaranty.

16. **GOVERNING LAW; Assignment; Jurisdiction; Notices.** THIS GUARANTY SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF NEW YORK. This Guaranty shall (a) bind the Guarantor and its successors and assigns, provided that the Guarantor may not assign its rights or obligations under this Guaranty without the prior written consent of the Lender (and any attempted assignment without such consent shall be void), and (b) inure to the benefit of the Lender and its successors and assigns and the Lender may, without notice to the Guarantor and without affecting the Guarantor's obligations hereunder, assign, sell or grant participations in the Guaranteed

Obligations and this Guaranty, in whole or in part. The Guarantor hereby irrevocably (i) submits to the non-exclusive jurisdiction of any United States Federal or State court sitting in the Borough of Manhattan, New York, New York, in any action or proceeding arising out of or relating to this Guaranty, and (ii) waives to the fullest extent permitted by law any defense asserting an inconvenient forum in connection therewith. Service of process by the Lender in connection with such action or proceeding shall be binding on the Guarantor if sent to the Guarantor by registered or certified mail at its address specified below or such other address as from time to time notified by the Guarantor. The Guarantor agrees that the Lender may disclose to any assignee of or participant in, or any prospective assignee of or participant in, any of its rights or obligations of all or part of the Guaranteed Obligations any and all information in the Lender's possession concerning the Guarantor, this Guaranty and any security for this Guaranty. All notices and other communications to the Guarantor under this Guaranty shall be in writing and shall be delivered by hand or overnight courier service, mailed by certified or registered mail or sent by telecopier to the Guarantor at its address set forth below or at such other address in the United States as may be specified by the Guarantor in a written notice delivered to the Lender at such office as the Lender may designate for such purpose from time to time in a written notice to the Guarantor.

**17. WAIVER OF JURY TRIAL; FINAL AGREEMENT.** TO THE EXTENT ALLOWED BY APPLICABLE LAW, THE GUARANTOR AND THE LENDER EACH IRREVOCABLY WAIVES TRIAL BY JURY WITH RESPECT TO ANY ACTION, CLAIM, SUIT OR PROCEEDING ON, ARISING OUT OF OR RELATING TO THIS GUARANTY OR THE GUARANTEED OBLIGATIONS. THIS GUARANTY REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS BETWEEN THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

**18. Amending Schedule A.** From time to time the Guarantor and the Lender may amend or supplement Schedule A hereto to add or delete Borrowers or to change other information thereon by a written instrument executed by the Lender and the Guarantor. Any such amended Schedule A shall be deemed to replace or supplement, as applicable, the prior Schedule A without further action by any party hereto; *provided* that (i) Schedule A shall be deemed amended to include any credit previously extended by the Lender to any subsidiary of the Guarantor in reliance on this Guaranty, (ii) no amendment shall terminate this Guaranty as to Guaranteed Obligations which remain outstanding or to extensions of credit made pursuant to existing commitments which would have been Guaranteed Obligations but for such amendment (including, in each case, all renewals, compromises, extensions and modifications of such Guaranteed Obligations), (iii) no amendment shall limit the rights of the Lender under paragraph 7 hereof, and (iv) no amendment shall in itself be deemed a commitment by the Lender to extend any credit.

**19. Special Agreement With Respect To Debt Restructuring.** Notwithstanding any limitation on liability set forth in Paragraph 1 to the contrary, if the Guaranteed Obligations are made subject to a debt restructuring arrangement between a country and its creditors or creditors of persons or entities of such country, and as a result thereof the Lender, as holder of such Guaranteed Obligations and other credit facilities to such country, persons or entities of such country, shall agree to provide any new credit facilities, the Guarantor shall fund (and be the beneficial owner of) that amount of such new credit facilities which is calculated by (i) dividing the face value of such Guaranteed Obligations by the aggregate amount of the Lender's credit facilities made part of the restructuring arrangement and (ii) multiplying the result by the amount of such new credit facilities. The Guarantor agrees to execute and deliver such documents and take such actions as may be requested by the Lender to effect the purposes of this paragraph. The Lender agrees to provide the Guarantor with copies of the relevant documents governing its participation

in the restructuring arrangement and new credit facilities and shall provide the Guarantor with the basis on which it has calculated the Guarantor's portion of such new credit facilities, which calculations shall be conclusive absent manifest error.

20. **Foreign Currency.** If the Lender so notifies the Guarantor in writing, at the Lender's sole and absolute discretion, payments under this Guaranty shall be the U.S. Dollar equivalent of the Guaranteed Obligations or any portion thereof, determined as of the date payment is made. If any claim arising under or related to this Guaranty is reduced to judgment denominated in a currency (the "*Judgment Currency*") other than the currencies in which the Guaranteed Obligations are denominated or the currencies payable hereunder (collectively the "*Obligations Currency*"), the judgment shall be for the equivalent in the Judgment Currency of the amount of the claim denominated in the Obligations Currency included in the judgment, determined as of the date of judgment. The equivalent of any Obligations Currency amount in any Judgment Currency shall be calculated at the spot rate for the purchase of the Obligations Currency with the Judgment Currency quoted by the Lender in the place of the Lender's choice at or about 8:00 a.m. on the date for determination specified above. The Guarantor shall indemnify the Lender and hold the Lender harmless from and against all loss or damage resulting from any change in exchange rates between the date any claim is reduced to judgment and the date of payment thereof by the Guarantor or any failure of the amount of any such judgment to be calculated as provided in this paragraph.

Executed this 21st day of March, 2005.

QAD Inc.

By: \_\_\_\_\_

Name: Daniel Lender  
Title: EVP and Chief Financial Officer

By: \_\_\_\_\_

Name: Mark Rasmussen  
Title: Vice President Tax and Treasurer

Address: 6450 Via Real  
Carpinteria, California 93013

**SCHEDULE A TO  
MASTER CONTINUING GUARANTY**

Subject to Paragraph 18 of the Master Continuing Guaranty to which this Schedule is or will be attached, all obligations of the following entities to Bank of America, N.A., its affiliates and subsidiaries, shall constitute Guaranteed Obligations guaranteed pursuant to the Master Continuing Guaranty.

**BORROWERS**

QAD EUROPE B.V.

QAD EUROPE GMBH

QAD EUROPE NV/SA

QAD EUROPE SA

QAD EUROPE SAS

QAD IRELAND LIMITED

QAD NETHERLANDS B.V.

QAD EUROPE LIMITED

[MODEL LETTER AMENDING SCHEDULE A]

(May be sent from Bank to the Guarantor or *vice versa*)

\_\_\_\_\_, 200

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Att:

Re: Master Continuing Guaranty dated as of \_\_\_\_\_, 2005

Ladies and Gentleman:

We refer to that certain Master Continuing Guaranty dated as of \_\_\_\_\_, 2005 made by \_\_\_\_\_ (the "Guarantor") in favor of Bank of America, N.A. and affiliates (as amended from time to time, the "Guaranty;" terms not defined herein have the meanings assigned to them in the Guaranty), pursuant to which the Guarantor guarantees the obligations of certain of its subsidiaries and affiliates of Guarantor.

Subject to Paragraph 18 of the Guaranty, the undersigned hereby confirm their agreement that Schedule A to the Guaranty is hereby amended and restated as set forth in Schedule A hereto and all references in the Guaranty and any other documents evidencing the Obligations shall refer to the Guaranty as amended hereby. This letter may be executed in any number of counterparts and all of such counterparts taken together shall be deemed to constitute but one and the same instrument.

Very truly yours,

By \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

***Agreed and Accepted:***

\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_

**SCHEDULE A TO MASTER GUARANTY**

Subject to Paragraph 18 of the Master Continuing Guaranty to which this Schedule is or will be attached, all obligations of the following entities to Bank of America, N.A., its affiliates and subsidiaries, shall constitute Guaranteed Obligations guaranteed pursuant to the Master Continuing Guaranty.

**BORROWERS**

*[REFER TO ORIGINAL SCHEDULE A FOR FORMAT]*





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**EXHIBIT 10.63**

**QAD INC.**

**LOAN AGREEMENT**

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This LOAN AGREEMENT is entered into as of April 7, 2005, by and between COMERICA BANK ("Bank") and QAD INC. ("Borrower").

## RECITALS

Borrower wishes to obtain credit from time to time from Bank, and Bank desires to extend credit to Borrower. This Agreement sets forth the terms on which Bank will advance credit to Borrower, and Borrower will repay the amounts owing to Bank.

## AGREEMENT

The parties agree as follows:

### 1. DEFINITIONS AND CONSTRUCTION.

1.1 *Definitions.* As used in this Agreement, the following terms shall have the following definitions:

"Accounts" means all presently existing and hereafter arising accounts, contract rights, payment intangibles, and all other forms of obligations owing to Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by Borrower, whether or not earned by performance, and Borrower's Books relating to any of the foregoing.

"Advance" or "Advances" means a cash advance or cash advances under the Revolving Line.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, any Person that controls or is controlled by or is under common control with such Person, and each of such Person's senior executive officers, directors, and partners.

"Applicable Margin" means, from time to time, the following percentages per annum, based upon the ratio of Borrower's Funded Debt to Trailing Four Quarter EBITDA (each as defined below) as determined by Bank with reference to the most recent financial statements and Compliance Certificate delivered by the Borrower pursuant to Section 6.2(b) hereof:

| Ratio of Funded Debt to<br>Trailing Four Quarter<br>EBITDA | Prime Rate | LIBOR Rate | Commitment Fee |
|--|------------|------------|----------------|
| Less than 0.75:1.00  | (0.25)%    | 0.75%      | 0.25%          |
| Less than 1.25:1.00<br>but greater than 0.75:1.00          | 0.00%      | 1.25%      | 0.375%         |
| Greater than 1.25:1.00                                     | 0.25%      | 1.75%      | 0.50%          |

Bank's determination of the Applicable Margin shall be conclusive absent manifest error. Any change in the Applicable Margin shall be given prospective effect only, effective on the fifth (5<sup>th</sup>) Business Day after receipt of the most recent financial statements and Compliance Certificate, in each case with no retroactivity or clawback; *provided, however*, that if Borrower shall fail timely to deliver such financial statements and Compliance Certificate for any period, then the Applicable Margin shall be based on the highest level set forth above until the fifth (5<sup>th</sup>) Business Day after Borrower shall deliver such financial statements and Compliance Certificate to Bank.

"Bank Expenses" means all: reasonable costs or expenses (including reasonable attorneys' fees and expenses, whether generated in-house or by outside counsel) incurred in connection with the preparation, negotiation, administration, and enforcement of the Loan Documents; reasonable collateral audit fees; and Bank's reasonable attorneys' fees and expenses (whether generated in-house or by outside counsel) incurred in amending, enforcing or defending the Loan Documents (including fees and expenses of appeal), incurred before, during and after an Insolvency Proceeding, whether or not suit is brought.

"Borrower State" means Delaware, the state under whose laws Borrower is organized.

"Borrower's Books" means all of Borrower's books and records including: ledgers; records concerning Borrower's assets or liabilities, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

"Borrowing Base" means an amount equal to one hundred fifty percent (150%) of Borrower's Trailing Four Quarter EBITDA, as determined by Bank with reference to the most recent financial statements and Compliance Certificate delivered by Borrower.

"Business Day" means any day that is not a Saturday, Sunday, or other day on which banks in the State of California are authorized or required to close.

"Cash" means, as of any applicable date, in accordance with GAAP, unrestricted cash and cash equivalents that should be included on the consolidated balance sheet of Borrower and its Subsidiaries.

"Change in Control" shall mean a transaction in which any "person" or "group" (within the meaning of Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) becomes the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, of a sufficient number of shares of all classes of stock then outstanding of Borrower ordinarily entitled to vote in the election of directors, empowering such "person" or "group" to elect a majority of the Board of Directors of Borrower, who did not have such power before such transaction.

"Chief Executive Office State" means California, where Borrower's chief executive office is located.

"Closing Date" means the date of this Agreement.

"Code" means the California Uniform Commercial Code, as amended or supplemented from time to time.

"Consolidated Accounts" means all presently existing and hereafter arising accounts, contract rights, payment intangibles, and all other forms of obligations owing to Borrower and its Subsidiaries arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by Borrower and its Subsidiaries, whether or not earned by performance, and Borrower and its Subsidiaries' books relating to any of the foregoing.

"Consolidated Net Income (or Deficit)" means the consolidated net income (or deficit) of any Person and its Subsidiaries, after deduction of all expenses, taxes, and other proper charges, determined in accordance with GAAP, after eliminating therefrom all extraordinary nonrecurring items of income.

"Consolidated Total Interest Expense" means with respect to any Person for any period, the aggregate amount of interest required to be paid or accrued by a Person and its Subsidiaries during such period on all Indebtedness of such Person and its Subsidiaries outstanding during all or any part of such period, whether such interest was or is required to be reflected as an item of expense or capitalized, including payments consisting of interest in respect of any capitalized lease or any synthetic lease, and including commitment fees, agency fees, facility fees, balance deficiency fees and similar fees or expenses in connection with the borrowing of money.

"Contingent Obligation" means, as applied to any Person, any direct or indirect liability, contingent or otherwise, of that Person with respect to (i) any indebtedness, capital lease, dividend, letter of credit or other obligation of another, including, without limitation, any such obligation directly or indirectly guaranteed, endorsed, co-made or discounted or sold with recourse by that Person, or in respect of which that Person is otherwise directly or indirectly liable; (ii) any obligations with respect to undrawn letters of credit, corporate credit cards, or merchant services issued for the account of that Person; and (iii) all obligations arising under any interest rate, currency or commodity swap agreement, interest rate cap agreement, interest rate collar agreement, or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; provided, however, that the term "Contingent Obligation" shall not include endorsements for collection or deposit in the ordinary course of business. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by such Person in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

"Credit Extension" means each Advance, or any other extension of credit by Bank to or for the benefit of Borrower hereunder.

"Current Liabilities" means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current liabilities on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date, plus, to the extent not already included therein, undrawn Letters of Credit, but specifically excluding any cash-secured Obligations.

"EBITDA" means with respect to any fiscal period an amount equal to the sum of (a) Consolidated Net Income of the Borrower and its Subsidiaries for such fiscal period, plus (b) in each case to the extent deducted in the calculation of the Borrower's Consolidated Net Income and without duplication, (i) depreciation and amortization for such period, plus (ii) income tax expense for such period, plus (iii) Consolidated Total Interest Expense paid or accrued during such period, plus (iv) non-cash expense associated with granting stock options, all as determined in accordance with GAAP.

"Environmental Laws" means all laws, rules, regulations, orders and the like issued by any federal state, local foreign or other governmental or quasi-governmental authority or any agency pertaining to the environment or to any hazardous materials or wastes, toxic substances, flammable, explosive or radioactive materials, asbestos or other similar materials.

"Equipment" means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder.

"Event of Default" has the meaning assigned in Article 8.

"Funded Debt" means all Indebtedness of Borrower outstanding as of any date of determination.

"GAAP" means generally accepted accounting principles, consistently applied, as in effect from time to time in the United States.

"Indebtedness" means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including without limitation reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations, and (d) all Contingent Obligations.

"Insolvency Proceeding" means any proceeding commenced by or against any Person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extension generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

"Inventory" means all present and future inventory in which Borrower has any interest.

"Investment" means any beneficial ownership of (including stock, partnership or limited liability company interest other securities) any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Letter of Credit" means a commercial or standby letter of credit or similar undertaking issued by Bank at Borrower's request in accordance with Section 2.1(b)(iii).

"Letter of Credit Sublimit" means a sublimit for Letters of Credit under the Revolving Line not to exceed Two Million Dollars (\$2,000,000).

"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance securing Indebtedness.

"Liquidity Ratio" means, as of any date of determination, the ratio of (a) the sum of (i) Cash plus (ii) net trade Consolidated Accounts receivable, to (b) the sum of (i) Current Liabilities (excluding deferred revenues) plus (ii) all Obligations outstanding under this Agreement, as of such date.

"Loan Documents" means, collectively, this Agreement, any note or notes executed by Borrower, and any other document, instrument or agreement entered into among the parties in connection with this Agreement, all as amended or extended from time to time.

"Material Adverse Effect" means a material adverse effect on (i) the business operations, condition (financial or otherwise) or prospects of Borrower and its

Subsidiaries taken as a whole, or (ii) the ability of Borrower to repay the Obligations or otherwise perform its obligations under the Loan Documents.

"Obligations" means all debt, principal, interest, Bank Expenses and other amounts owed to Bank by Borrower pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding and including any debt, liability, or obligation owing from Borrower to others that Bank may have obtained by assignment or otherwise.

"Periodic Payments" means all installments or similar recurring payments that Borrower may now or hereafter become obligated to pay to Bank pursuant to the terms and provisions of any instrument, or agreement now or hereafter in existence between Borrower and Bank.

"Permitted Indebtedness" means:

- (a) Indebtedness of Borrower in favor of Bank arising under this Agreement or any other Loan Document;
- (b) Indebtedness existing on the Closing Date and disclosed in the Schedule;
- (c) Indebtedness to Borrower by majority-owned or wholly-owned Subsidiaries of Borrower, in the ordinary course of Borrower's business.
- (d) Indebtedness, without duplication for any other item of "Permitted Indebtedness" hereunder, not to exceed Five Million Dollars (\$5,000,000) in the aggregate at any time during the term hereof;
- (e) Subordinated Debt;
- (f) Indebtedness to trade creditors incurred in the ordinary course of business;
- (g) Extensions, refinancings and renewals of any items of Permitted Indebtedness, provided that the principal amount is not increased or the terms modified to impose more burdensome terms upon Borrower or its Subsidiary, as the case may be; and
- (h) Indebtedness under a Guarantee from Borrower to Bank of America, N.A not to exceed Six Million Dollars (\$6,000,000) in the aggregate at any time during the term hereof;

"Permitted Investment" means:

- (a) Investments existing on the Closing Date disclosed in the Schedule; and
- (b) (i) Marketable direct obligations issued or unconditionally guaranteed or by the United States of America or any agency or any State thereof maturing within one (1) year from the date of acquisition thereof or securities which are secured or collateralized by these obligations, (ii) commercial paper maturing no more than one (1) year from the date of creation thereof, (iii) certificates of deposit maturing no more than one year from the date of investment therein and issued by a bank organized under the laws of the United States of any state thereof; (iv) money market accounts with a financial institution; and (v) money market funds, in each case of (ii) through (v) above, having a rating of A or A2 or better from Standard & Poor's Corporation or Moody's Investors Service;
- (c) Investments permitted under Section 7.3;

(d) Repurchases of stock in accordance with Section 7.6;

(e) Investments accepted in connection with Permitted Transfers;

(f) Investments not to exceed One Million Dollars (\$1,000,000) in the aggregate in any fiscal year consisting of (i) travel advances and employee relocation loans and other employee loans and advances in the ordinary course of business, and (ii) loans to employees, officers or directors relating to the purchase of equity securities of Borrower or its Subsidiaries pursuant to employee stock purchase plan agreements approved by Borrower's Board of Directors;

(g) Investments (including debt obligations) received (x) in connection with the bankruptcy or reorganization of customers or suppliers and (y) in settlement of delinquent obligations of, and other disputes with, customers or suppliers arising in the ordinary course of Borrower's business;

(h) Investments consisting of notes receivable of, or prepaid royalties and other credit extensions, to customers and suppliers who are not Affiliates, in the ordinary course of business, provided that this subparagraph (h) shall not apply to Investments of Borrower in any Subsidiary;

(i) Joint ventures or strategic alliances in the ordinary course of Borrower's business consisting of the non-exclusive licensing of technology, the development of technology or the providing of technical support, provided that any cash Investments by Borrower do not exceed One Million Dollars (\$1,000,000) in the aggregate in any fiscal year; and

(j) Investments by Borrower in majority-owned Subsidiaries of Borrower, in the ordinary course of Borrower's business which do not include a cash advance. Investments in majority-owned Subsidiaries which do include a cash advance will not exceed Ten Million Dollars (\$10,000,000) in the aggregate in any fiscal year, including net cash distributions permitted by Section 7.10 hereof.

"Permitted Liens" means the following:

(a) Any Liens existing on the Closing Date and disclosed in the Schedule (excluding Liens to be satisfied with the proceeds of the Advances);

(b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings and for which Borrower maintains adequate reserves;

(c) Liens incurred in connection with Indebtedness permitted under item (c) of the defined term "Permitted Indebtedness;"

(d) Liens incurred in connection with the extension, renewal or refinancing of the Indebtedness secured by Liens of the type described in clauses (a) through (c) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and any additional property acquired or leased with the proceeds of such Indebtedness and the principal amount of the indebtedness being extended, renewed or refinanced does not increase; and

(e) Liens arising from judgments, decrees or attachments in circumstances not constituting an Event of Default under Sections 8.5 or 8.9.

"Permitted Transfer" means the conveyance, sale, license, lease, transfer or disposition by Borrower or any Subsidiary of:

- (a) Inventory in the ordinary course of business;
- (b) licenses and similar arrangements for the use of the property of Borrower or its Subsidiaries in the ordinary course of business;
- (c) worn-out or obsolete Equipment; or
- (d) other assets of Borrower or its Subsidiaries that do not in the aggregate exceed One Million Dollars (\$1,000,000) during any fiscal year.

"Person" means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

"Prime Rate" means the variable rate of interest, per annum, most recently announced by Bank, as its "prime rate," whether or not such announced rate is the lowest rate available from Bank.

"Responsible Officer" means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer and the Controller of Borrower.

"Revolving Line" means a Credit Extension of up to Twenty Million Dollars (\$20,000,000) in the aggregate (inclusive of any amounts outstanding under the Letter of Credit Sublimit).

"Revolving Maturity Date" means April 7, 2008.

"Schedule" means the schedule of exceptions attached hereto and approved by Bank, if any.

"SOS Reports" means the official reports from the Secretaries of State of each Chief Executive Office State and the Borrower State and other applicable federal, state or local government offices identifying all current security interests filed in the Borrower's assets and Liens of record as of the date of such report.

"Subordinated Debt" means any debt incurred by Borrower that is subordinated in writing to the debt owing by Borrower to Bank on terms reasonably acceptable to Bank (and identified as being such by Borrower and Bank).

"Subsidiary" means any corporation, partnership or limited liability company or joint venture in which (i) any general partnership interest or (ii) more than fifty percent (50%) of the stock, limited liability company interest or joint venture of which by the terms thereof has the ordinary voting power to elect the Board of Directors, managers or trustees of the entity, at the time as of which any determination is being made, is owned by Borrower, either directly or through an Affiliate.

"Trailing Four Quarter EBITDA" means, as of any date of determination, Borrower's EBITDA for the preceding four (4) quarters.

1.2 *Accounting Terms.* Any accounting term not specifically defined herein shall be construed in accordance with GAAP and all calculations shall be made in accordance with GAAP. The term "financial statements" shall include the accompanying notes and schedules.



## 2. LOAN AND TERMS OF PAYMENT.

### 2.1 Credit Extensions.

(a) *Promise to Pay.* Borrower promises to pay to Bank, in lawful money of the United States of America, the aggregate unpaid principal amount of all Credit Extensions made by Bank to Borrower, together with interest on the unpaid principal amount of such Credit Extensions at rates in accordance with the terms hereof.

(b) *Advances Under Revolving Line.*

(i) *Amount.* Subject to and upon the terms and conditions of this Agreement (1) Borrower may request Advances in an aggregate outstanding amount not to exceed the lesser of (A) the Revolving Line or (B) the Borrowing Base, less any amounts then outstanding under the Letter of Credit Sublimit, and (2) amounts borrowed pursuant to this Section 2.1(b) may be repaid and reborrowed at any time prior to the Revolving Maturity Date, at which time all Advances under this Section 2.1(b) shall be immediately due and payable. Except as set forth in the LIBOR Addendum (as defined below) Borrower may prepay any Advances without penalty or premium.

(ii) *Form of Request.* Whenever Borrower desires an Advance, Borrower will notify Bank by facsimile transmission or telephone no later than 3:00 p.m. Pacific time (1:00 p.m. Pacific time for wire transfers), on the Business Day that the Advance is to be made. Each such notification shall be promptly confirmed by a Payment/Advance Form in substantially the form of Exhibit A hereto. Bank is authorized to make Advances under this Agreement, based upon instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions if in Bank's reasonable discretion such Advances are necessary to meet Obligations which have become due and remain unpaid (provided Bank shall provide notice of the same to Borrower). Bank shall be entitled to rely on any telephonic notice given by a person who Bank reasonably believes to be a Responsible Officer or a designee thereof, and Borrower shall indemnify and hold Bank harmless for any damages or loss suffered by Bank as a result of such reliance, except for damages or losses caused by Bank's gross negligence and willful misconduct. Bank will credit the amount of Advances made under this Section 2.1(b) to Borrower's deposit account.

(iii) *Letter of Credit Sublimit.* Subject to the availability under the Revolving Line, and in reliance on the representations and warranties of Borrower set forth herein, at any time and from time to time from the date hereof through the Business Day immediately prior to the Revolving Maturity Date, Bank shall issue for the account of Borrower such Letters of Credit as Borrower may request by delivering to Bank a duly executed letter of credit application on Bank's standard form; provided, however, that the outstanding and undrawn amounts under all such Letters of Credit (i) shall not at any time exceed the Letter of Credit Sublimit, and (ii) shall be deemed to constitute Advances for the purpose of calculating availability under the Revolving Line. Any drawn but unreimbursed amounts under any Letters of Credit shall be charged as Advances against the Revolving Line. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's form application and letter of credit agreement. Borrower will pay any standard issuance and other fees that Bank notifies Borrower it will charge for issuing and processing Letters of Credit.

(iv) *Collateralization of Obligations Extending Beyond Maturity.* If Borrower has not secured to Bank's satisfaction its obligations with respect to any Letters of Credit by the Revolving Maturity Date, then, effective as of such date, the balance in any deposit accounts held by Bank and the certificates of deposit or time deposit accounts issued by Bank in Borrower's name (and any interest paid thereon or proceeds thereof, including any amounts payable upon the maturity or liquidation of such certificates or accounts), shall automatically secure such obligations to the extent of the then continuing or outstanding and undrawn Letters of Credit. Borrower authorizes Bank to hold such balances in pledge and to decline to honor any drafts thereon or any requests by Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Letters of Credit are outstanding or continue.

2.2 *Overadvances.* If the aggregate amount of the outstanding Advances exceeds the lesser of the Revolving Line or the Borrowing Base at any time, Borrower shall promptly pay to Bank, in cash, the amount of such excess.

2.3 *Interest Rates, Payments, and Calculations.*

(a) *Interest Rates.* Except as set forth in Section 2.3(b), the Advances shall bear interest, on the outstanding daily balance thereof, as set forth in the LIBOR Addendum to Loan Agreement (the "LIBOR Addendum") attached as Appendix I.

(b) *Late Fee; Default Rate.* If any payment is not made within ten (10) days after the date such payment is due, Borrower shall pay Bank a late fee equal to the lesser of (i) five percent (5%) of the amount of such unpaid amount or (ii) the maximum amount permitted to be charged under applicable law. All Obligations shall bear interest, from and after the occurrence and during the continuance of an Event of Default, at a rate equal to five (5) percentage points above the interest rate applicable immediately prior to the occurrence of the Event of Default.

(c) *Payments.* Interest hereunder shall be due and payable on the last calendar day of each month during the term hereof. Bank shall, at its option, charge such interest, all Bank Expenses, and all Periodic Payments against any of Borrower's deposit accounts or against the Revolving Line, in which case those amounts shall thereafter accrue interest at the rate then applicable hereunder. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder.

(d) *Computation.* In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased, effective as of the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate. All interest chargeable under the Loan Documents shall be computed on the basis of a three hundred sixty (360) day year for the actual number of days elapsed.

2.4 *Crediting Payments.* Prior to the occurrence of an Event of Default, Bank shall credit a wire transfer of funds, check or other item of payment to such deposit account or Obligation as Borrower directs Bank. After the occurrence of an Event of Default, Bank shall have the right, in its sole discretion, to immediately apply any wire transfer of funds, check, or other item of payment to conditionally reduce Obligations, but such applications of funds shall not be considered a payment on account unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Bank after 12:00 noon Pacific time shall be deemed to have

been received by Bank as of the opening of business on the immediately following Business Day. Whenever any payment to Bank under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

2.5 *Fees.* Borrower shall pay to Bank the following:

(a) *Facility Fee.* On the Closing Date, a fee equal to Sixty-Two Thousand Five Hundred Dollars (\$62,500), which shall be nonrefundable (receipt of which hereby is acknowledged); and

(b) *Commitment Fee.* A fee equal to the Applicable Margin per annum divided by 360 then multiplied by the actual amount of days, multiplied by the difference between the amount then available under the Revolving Line and the average daily balance outstanding thereunder during such period, paid quarterly in arrears, commencing May 1, 2005, which shall be nonrefundable; and

(c) *Bank Expenses.* On the Closing Date, all Bank Expenses incurred through the Closing Date, and, after the Closing Date, all Bank Expenses as and when they become due.

2.6 *Term.* This Agreement shall become effective on the Closing Date and, subject to Section 13.7, shall continue in full force and effect for so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions under this Agreement. Notwithstanding the foregoing, Bank shall have the right to terminate its obligation to make Credit Extensions under this Agreement immediately and without notice upon the occurrence and during the continuance of an Event of Default.

3. *CONDITIONS OF LOANS.*

3.1 *Conditions Precedent to Initial Credit Extension.* The obligation of Bank to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance reasonably satisfactory to Bank, the following:

- (a) this Agreement;
- (b) an officer's certificate of Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Agreement;
- (c) satisfaction in full and termination of the credit facility provided Borrower by Foothill Capital;
- (d) current SOS Reports for the California and Delaware Secretaries of State, indicating that except for Permitted Liens, there are no other security interests or Liens of record in the Borrower's assets;
- (e) agreement to provide insurance;
- (f) payment of the fees and Bank Expenses then due specified in Section 2.5 hereof;
- (g) current financial statements, including audited statements for Borrower's most recently ended fiscal year, together with an unqualified opinion, company prepared consolidated and consolidating balance sheets and income statements for the most recently ended month in accordance with Section 6.2, and such other updated financial information as Bank may reasonably request;
- (h) current Compliance Certificate in accordance with Section 6.2; and

(i) such other documents or certificates, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 *Conditions Precedent to all Credit Extensions.* The obligation of Bank to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

(a) timely receipt by Bank of the Payment/Advance Form as provided in Section 2.1; and

(b) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and be continuing, or would exist after giving effect to such Credit Extension (provided, however, that those representations and warranties expressly referring to another date shall be true and correct in all material respects as of such date). The making of each Credit Extension shall be deemed to be a representation and warranty by Borrower on the date of such Credit Extension as to the accuracy of the facts referred to in this Section 3.2.

4. *OPTION TO CONVERT FACILITY.* Borrower shall have the option, upon no less than sixty (60) days prior written notice to Bank, provided an Event of Default has not occurred and is not continuing prior thereto, to convert this unsecured facility, to a secured Accounts receivable/formula-based facility. Upon such conversion, Borrower shall execute for the benefit of Bank an amendment to (or amendment and restatement of) this Agreement in form and content reasonably satisfactory to Bank, including (but not limited to) with respect to the definitions and determinations of the "Borrowing Base," "Eligible Accounts," and the "Collateral" (which shall be "all assets") and the security interest granted the Bank thereunder. Further, any such amendment (or amendment and restatement) shall be subject to an audit of Borrower's Accounts, the results of which must be satisfactory to Bank in its reasonable discretion.

#### 5. *REPRESENTATIONS AND WARRANTIES.*

Borrower represents and warrants as follows:

5.1 *Due Organization and Qualification.* Borrower and each Subsidiary is duly existing under the laws of the jurisdiction in which it is organized and qualified and licensed to do business in any jurisdiction in which the conduct of its business or its ownership of property requires that it be so qualified, except where the failure to do so could not reasonably be expected to cause a Material Adverse Effect.

5.2 *Due Authorization; No Conflict.* The execution, delivery, and performance of the Loan Documents are within Borrower's powers, have been duly authorized, and are not in conflict with nor constitute a breach of any provision contained in Borrower's Certificate of Incorporation or Bylaws, nor will they constitute an event of default under any material agreement by which Borrower is bound. Borrower is not in default under any agreement by which it is bound, except to the extent such default could not reasonably be expected to cause a Material Adverse Effect.

5.3 *Name; Location of Chief Executive Office.* Except as disclosed in the Schedule, Borrower has not done business under any name other than that specified on the signature page hereof, and its exact legal name is as set forth in the first paragraph of this Agreement. The chief executive office of Borrower is located in the Chief Executive Office State at the address indicated in Section 10 hereof.

5.4 *Litigation.* Except as set forth in the Schedule, there are no actions or proceedings pending by or against Borrower or any Subsidiary before any court or administrative agency in

which a likely adverse decision could reasonably be expected to have a Material Adverse Effect.

5.5 *No Material Adverse Change in Financial Statements.* All consolidated and consolidating financial statements related to Borrower and any Subsidiary that are delivered by Borrower to Bank fairly present in all material respects Borrower's consolidated and consolidating financial condition as of the date thereof and Borrower's consolidated and consolidating results of operations for the period then ended. There has not been a material adverse change in the consolidated or in the consolidating financial condition of Borrower since the date of the most recent of such financial statements submitted to Bank.

5.6 *Solvency, Payment of Debts.* Borrower is able to pay its debts (including trade debts) as they mature; the fair saleable value of Borrower's assets (including goodwill minus disposition costs) exceeds the fair value of its liabilities; and Borrower is not left with unreasonably small capital after the transactions contemplated by this Agreement.

5.7 *Compliance with Laws and Regulations.* To the best of their knowledge, Borrower and each Subsidiary have met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. No event has occurred resulting from Borrower's failure to comply with ERISA that is reasonably likely to result in Borrower's incurring any liability that could have a Material Adverse Effect. Borrower is not an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Borrower is not engaged principally, or as one of the important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations T and U of the Board of Governors of the Federal Reserve System). To the best of its knowledge, Borrower has complied in all material respects with all the provisions of the Federal Fair Labor Standards Act. To the best of its knowledge, Borrower is in compliance with all applicable environmental laws, regulations and ordinances except where the failure to comply is not reasonably likely to have a Material Adverse Effect. To the best of its knowledge, Borrower has not violated any statutes, laws, ordinances or rules applicable to it, the violation of which could reasonably be expected to have a Material Adverse Effect. To the best of their knowledge Borrower and each Subsidiary have filed or caused to be filed all tax returns required to be filed, and have paid, or have made adequate provision for the payment of, all taxes reflected therein except those being contested in good faith with adequate reserves under GAAP or where the failure to file such returns or pay such taxes could not reasonably be expected to have a Material Adverse Effect.

5.8 *Subsidiaries.* Borrower does not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.9 *Government Consents.* To the best of their knowledge, Borrower and each Subsidiary have obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental authorities that are necessary for the continued operation of Borrower's business as currently conducted, except where the failure to do so could not reasonably be expected to cause a Material Adverse Effect.

5.10 *Full Disclosure.* To the best of their knowledge, no representation, warranty or other statement made by Borrower in any certificate or written statement furnished to Bank taken together with all such certificates and written statements furnished to Bank contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained in such certificates or statements not misleading it being recognized by Bank that the projections and forecasts provided by Borrower in good faith and based upon reasonable assumptions are not to be viewed as facts and that actual results

during the period or periods covered by any such projections and forecasts may differ from the projected or forecasted results.

6. **AFFIRMATIVE COVENANTS.**

Borrower covenants and agrees that, until payment in full of all outstanding Obligations, and for so long as Bank may have any commitment to make a Credit Extension hereunder, Borrower shall do all of the following:

6.1 *Good Standing and Government Compliance.* Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in the applicable jurisdiction, shall maintain qualification and good standing in each other jurisdiction in which the failure to so qualify could have a Material Adverse Effect, and shall furnish to Bank the organizational identification number issued to Borrower by the authorities of the state in which Borrower is organized, if applicable. To the extent applicable, the Borrower shall meet, and shall cause each Subsidiary to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. Borrower shall comply in all material respects with all applicable Environmental Laws, and maintain all material permits, licenses and approvals required thereunder where the failure to do so could reasonably be expected to have a Material Adverse Effect. To the extent that failure to comply could reasonably be expected to have a Material Adverse Effect, Borrower shall comply, and shall cause each Subsidiary to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, and shall maintain, and shall cause each of its Subsidiaries to maintain, in force all licenses, approvals and agreements.

6.2 *Financial Statements, Reports, Certificates.* Borrower shall deliver the following to Bank: (i) as soon as available, but in any event within thirty (30) days after the end of each quarter, a company prepared consolidated and consolidating balance sheet and income statement covering Borrower's operations during such period, in a form reasonably acceptable to Bank and certified by a Responsible Officer; (ii) as soon as available, but in any event within ninety (90) days after the end of Borrower's fiscal year, audited consolidated and consolidating financial statements of Borrower prepared in accordance with GAAP, consistently applied, together with an opinion which is unqualified or otherwise consented to in writing by Bank on such financial statements of an independent certified public accounting firm reasonably acceptable to Bank, which shall reflect no material changes from the company-prepared financial statements for the periods covered thereby; (iii) copies of all statements, reports and notices sent or made available generally by Borrower to its security holders or to any holders of Subordinated Debt and all reports on Forms 10-K and 10-Q filed with the Securities and Exchange Commission, within fifteen (15) days of filing; (iv) promptly upon receipt of notice thereof, a report of any legal actions pending or threatened against Borrower or any Subsidiary that could reasonably be expected to result in damages or costs to Borrower or any Subsidiary of One Million Dollars (\$1,000,000) or more; (v) promptly upon receipt, each management letter prepared by Borrower's independent certified public accounting firm regarding Borrower's management control systems; (vi) such budgets, sales projections, operating plans or other financial information as Bank may reasonably request from time to time, including Borrower's annual operating budget no later than thirty (30) days prior to the beginning of Borrower's fiscal year and (vii) a detailed listing of all net cash distributions to Subsidiaries, within thirty (30) days after the end of each quarter and within ninety (90) days after the end of the Borrower's fiscal year.

(a) Within twenty (20) days after the last day of each quarter, Borrower shall deliver to Bank a Borrowing Base Certificate in substantially the form of *Exhibit B* hereto.

(b) Within (20) days after the last day of each quarter, Borrower shall deliver to Bank with the quarterly financial statements, a Compliance Certificate certified as of the last day of the applicable quarter and signed by a Responsible Officer in substantially the form of *Exhibit C* hereto.

(c) As soon as possible and in any event within thirty (30) calendar days after becoming aware of the occurrence or existence of an Event of Default hereunder, a written statement of a Responsible Officer setting forth details of the Event of Default, and the action which Borrower has taken or proposes to take with respect thereto.

(d) Within thirty (30) days after the last day of each fiscal year, Borrower shall deliver to Bank aged listings by invoice date of accounts receivable and accounts payable, signed by a Responsible Officer.

(e) Bank shall have a right from time to time hereafter to audit Borrower's Accounts at Borrower's expense, provided that such audits will be conducted no more often than annually unless an Event of Default has occurred and is continuing.

Borrower may deliver to Bank on an electronic basis any certificates, reports or information required pursuant to this Section 6.2, and Bank shall be entitled to rely on the information contained in the electronic files, provided that Bank in good faith believes that the files were delivered by a Responsible Officer. If Borrower delivers this information electronically, it shall also deliver to Bank by U.S. Mail, reputable overnight courier service, hand delivery, facsimile or pdf file within five (5) Business Days of submission of the unsigned electronic copy the certification of monthly financial statements, the intellectual property report, the Borrowing Base Certificate and the Compliance Certificate, each bearing the physical signature of the Responsible Officer.

6.3 *Taxes.* To the extent that failure so to do could reasonably be expected to have a Material Adverse Effect, Borrower shall make, and cause each Subsidiary to make, due and timely payment or deposit of all federal, state, and local taxes, assessments, or contributions required of it by law, including, but not limited to, those laws concerning income taxes, F.I.C.A., F.U.T.A. and state disability, and will execute and deliver to Bank, on demand, proof satisfactory to Bank indicating that Borrower or a Subsidiary has made such payments or deposits and any appropriate certificates attesting to the payment or deposit thereof; provided that Borrower or a Subsidiary need not make any payment if the amount or validity of such payment is contested in good faith by appropriate proceedings, if applicable, and is reserved against (to the extent required by GAAP) by Borrower or such Subsidiary.

#### 6.4 *Insurance.*

(a) Borrower, at its expense, shall keep its property insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where Borrower's business is conducted on the date hereof. Borrower shall also maintain liability and other insurance in amounts and of a type that are customary to businesses similar to Borrower's.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as are reasonably satisfactory to Bank. All policies of property insurance shall be in a form reasonably satisfactory to Bank, and all liability insurance policies shall specify that the insurer must give at least 20 days notice to Bank before canceling its policy for any reason. Upon Bank's request, Borrower shall deliver to Bank certified copies of the policies of insurance and evidence of all premium payments.

6.5 *Accounts.* Borrower shall establish with Bank, as quickly as is reasonably practical and in no event later than sixty (60) days from the Closing Date, primary depositary, operating and other accounts with Bank as are reasonably required by Borrower to establish and maintain Borrower's U.S. domestic treasury management activities. Bank shall provide such services on substantially the same terms as are provided by Bank to companies in similar businesses as Borrower. Borrower shall be permitted to maintain at other institutions such domestic accounts as are necessary to facilitate its international treasury management activities. Notwithstanding the foregoing, Borrower and its Subsidiaries formed in the United States shall at all times maintain at least the aggregate amount of Ten Million Dollars (\$10,000,000) in Cash in accounts located in the Continental United States.

6.6 *Financial Covenants.* Borrower shall at all times maintain the following financial ratios and covenants:

(a) *Liquidity Ratio.* A Liquidity Ratio of not less than 1.30 to 1.00.

(b) *Trailing Four Quarter EBITDA.* A Trailing Four Quarter EBITDA of not less than Ten Million Dollars (\$10,000,000).

6.7 *Further Assurances.* At any time and from time to time Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

## 7. *NEGATIVE COVENANTS.*

Borrower covenants and agrees that, so long as any credit hereunder shall be available and until the outstanding Obligations are paid in full or for so long as Bank may have any commitment to make any Credit Extensions, Borrower will not do any of the following without Bank's prior written consent, which shall not be unreasonably withheld:

7.1 *Dispositions.* Convey, sell, lease, license, transfer or otherwise dispose of (collectively, to "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, including its intellectual property, or move cash balances on deposit with Bank to accounts opened at another financial institution, other than Permitted Transfers and Permitted Investments.



*7.2 Change in Name, Location, Executive Office, or Executive Management; Change in Business; Change in Fiscal Year; Change in Control.* Change its name or the Borrower State or relocate its chief executive office without thirty (30) days prior written notification to Bank; replace its chief executive officer or chief financial officer without written notification to Bank within thirty (30) days after the termination date; engage in any business, or permit any of its Subsidiaries to engage in any business, other than or reasonably related or incidental to the businesses currently engaged in by Borrower; change its fiscal year end; suffer or permit a Change in Control.

*7.3 Mergers or Acquisitions.* Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization (other than mergers or consolidations of a Subsidiary into another Subsidiary or into Borrower), or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person except where (i) such transactions do not individually exceed cash consideration of Three Million Dollars (\$3,000,000), or Ten Million Dollars (\$10,000,000) in the aggregate, (ii) no Event of Default has occurred, is continuing or would exist after giving effect to such transactions, (iii) such transactions do not result in a Change in Control, and (iv) Borrower is the surviving entity.

*7.4 Indebtedness.* Create, incur, assume, guarantee or be or remain liable with respect to any Indebtedness, or permit any Subsidiary so to do, other than Permitted Indebtedness, or prepay any Indebtedness or take any actions which impose on Borrower an obligation to prepay any Indebtedness if the prepayment (x) could not reasonably be expected to have a Material Adverse Effect, and (y) an Event of Default would not occur as a result of such prepayment, except Indebtedness to Bank.

*7.5 Encumbrances.* Create, incur, assume or allow any Lien with respect to any of its property, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens. Agree with any Person other than Bank not to grant a security interest in, or otherwise encumber, any of its, or covenant to any other Person that Borrower in the future will refrain from creating, incurring, assuming or allowing any Lien with respect to any of Borrower's property, or permit any Subsidiary to do so.

*7.6 Distributions.* Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock, except that Borrower may (i) repurchase stock in the aggregate cash amount of Twenty Million Dollars (\$20,000,000) in any trailing four (4) quarter period (commencing from and after the Closing Date), and (ii) pay cash dividends not to exceed Two and One Half Cents (\$0.025) per share per quarter; in each case, as long as an Event of Default does not exist prior to such repurchase or dividend, or would not exist after giving effect to such repurchase or dividend.

*7.7 Investments.* Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries so to do, other than Permitted Investments, or suffer or permit any Subsidiary to be a party to, or be bound by, an agreement that restricts such Subsidiary from paying dividends or otherwise distributing property to Borrower.

*7.8 Transactions with Affiliates.* Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person.

7.9 *Subordinated Debt.* Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except in compliance with the terms of such Subordinated Debt, or amend any provision affecting Bank's rights contained in any documentation relating to the Subordinated Debt without Bank's prior written consent.

7.10 *Net Cash Distributions.* Make net cash distributions (including dividends and other repayments) by Borrower to wholly owned or majority owned Subsidiaries exceeding Ten Million Dollars (\$10,000,000) in the aggregate at any time during any fiscal year.

7.11 *No Investment Company; Margin Regulation.* Become or be controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Credit Extension for such purpose.

## 8. *EVENTS OF DEFAULT.*

Any one or more of the following events shall constitute an Event of Default by Borrower under this Agreement:

8.1 *Payment Default.* If Borrower fails to pay any of the Obligations within two (2) Business Days of the date when due;

8.2 *Covenant Default.*

(a) If Borrower fails to perform any obligation under Sections 6.2 (*provided*, that any breach of Section 6.2(a) shall be cured within two (2) Business Days of notice or knowledge thereof), 6.4, 6.5 or 6.6, or violates any of the covenants contained in Article 7 of this Agreement; or

(b) If Borrower fails or neglects to perform or observe any other material term, provision, condition, covenant contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between Borrower and Bank and as to any default under such other term, provision, condition or covenant that can be cured, has failed to cure such default within ten (10) days after Borrower receives notice thereof or any Responsible Officer obtains actual knowledge thereof; provided, however, that if the default cannot by its nature be cured within the ten (10) day period or cannot after diligent attempts by Borrower be cured within such ten (10) day period, and such default is likely to be cured within a reasonable time, then Borrower shall have an additional reasonable period (which shall not in any case exceed forty-five (45) days) to attempt to cure such default, and within such reasonable time period the failure to have cured such default shall not be deemed an Event of Default but no Credit Extensions will be made;

8.3 *Material Adverse Effect.* If there occurs any circumstance or circumstances that could reasonably be expected to have a Material Adverse Effect;

8.4 *Attachment.* If any material portion of Borrower's assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within fifteen (15) days, or if Borrower is enjoined, restrained, or in any way prevented by court order from continuing to conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of Borrower's assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of Borrower's assets by the United States Government, or any department, agency, or instrumentality thereof, or by

any state, county, municipal, or governmental agency, and the same is not paid within fifteen (15) days after Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by Borrower (provided that no Credit Extensions will be made during such cure period);

8.5 *Insolvency.* If Borrower becomes insolvent, or if an Insolvency Proceeding is commenced by Borrower, or if an Insolvency Proceeding is commenced against Borrower and is not dismissed or stayed within forty-five (45) days (provided that no Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding);

8.6 *Other Agreements.*

(a) If there is a default or other failure to perform in any agreement to which Borrower is a party with a third party or parties resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of One Million Dollars (\$1,000,000) or that could reasonably be expected to have a Material Adverse Effect;

(b) Notwithstanding any other provision of this Agreement, if there is a default or other failure to perform in any agreement between Borrower and Bank, other than this Agreement, resulting in a right by Bank, whether or not exercised, to accelerate the maturity of any Indebtedness owing thereunder in an amount in excess of One Million Dollars (\$1,000,000) or that could reasonably be expected to have a Material Adverse Effect;

8.7 *Subordinated Debt.* If Borrower makes any payment on account of Subordinated Debt, except to the extent such payment is allowed under any subordination agreement entered into with Bank;

8.8 *Judgments.* If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least One Million Dollars (\$1,000,000) shall be rendered against Borrower and shall remain unsatisfied and unstayed for a period of fifteen (15) days (provided that no Credit Extensions will be made prior to the satisfaction or stay of such judgment); or

8.9 *Misrepresentations.* If any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth herein or in any certificate delivered to Bank by any Responsible Officer pursuant to this Agreement or to induce Bank to enter into this Agreement or any other Loan Document.

9. *BANK'S RIGHTS AND REMEDIES.*

9.1 *Rights and Remedies.* Upon the occurrence and during the continuance of an Event of Default, Bank may, at its election, without notice of its election and without demand, do any one or more of the following, all of which are authorized by Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.5, all Obligations shall become immediately due and payable without any action by Bank);

(b) Demand that Borrower (i) deposit cash with Bank in an amount equal to the amount of any Letters of Credit remaining undrawn, as collateral security for the repayment of any future drawings under such Letters of Credit, and (ii) pay in advance

all Letter of Credit fees scheduled to be paid or payable over the remaining term of the Letters of Credit, and Borrower shall promptly deposit and pay such amounts; and

(c) Cease advancing money or extending credit to or for the benefit of Borrower under this Agreement or under any other agreement between Borrower and Bank.

9.2 *Remedies Cumulative.* Bank's rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Bank shall have all other rights and remedies not inconsistent herewith as provided, by law, or in equity. No exercise by Bank of one right or remedy shall be deemed an election, and no waiver by Bank of any Event of Default on Borrower's part shall be deemed a continuing waiver. No delay by Bank shall constitute a waiver, election, or acquiescence by it. No waiver by Bank shall be effective unless made in a written document signed on behalf of Bank and then shall be effective only in the specific instance and for the specific purpose for which it was given. Borrower expressly agrees that this Section may not be waived or modified by Bank by course of performance, conduct, estoppel or otherwise.

9.3 *Demand; Protest.* Except as otherwise provided in this Agreement, Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment and any other notices relating to the Obligations.

9.4 *Bank Expenses.* If Borrower fails to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Bank may do any or all of the following after reasonable notice to Borrower and an opportunity to cure the same (within two (2) Business Days of the date of such notice): (a) make payment of the same or any part thereof; (b) set up such reserves under the Revolving Line as Bank reasonably deems necessary to protect Bank from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.4 of this Agreement, and take any action with respect to such policies as Bank reasonably deems prudent. Any amounts so paid or deposited by Bank shall constitute Bank Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided. Any payments made by Bank shall not constitute an agreement by Bank to make similar payments in the future or a waiver by Bank of any Event of Default under this Agreement.

#### 10. *NOTICES.*

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery

service, certified mail, postage prepaid, return receipt requested, or by telefacsimile to Borrower or to Bank, as the case may be, at its addresses set forth below:

If to Borrower: QAD INC.  
6450 Via Real  
Carpinteria, CA 93013  
Attn: Chief Financial Officer  
FAX: (805) 565-4202

If to Bank: Comerica Bank  
2321 Rosecrans Ave., Suite 5000  
El Segundo, CA 90245  
Attn: Manager  
FAX: (310) 297-2290

with a copy to: Comerica Bank  
611 Anton Blvd., Suite 400  
Costa Mesa, CA 92626  
Attn: Bonnie E. Kehe, Senior Vice President  
FAX: (714) 433-3280

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other.

11. *CHOICE OF LAW AND VENUE; JURY TRIAL WAIVER.*

This Agreement shall be governed by, and construed in accordance with, the internal laws of the State of California, without regard to principles of conflicts of law. Each of Borrower and Bank hereby submits to the exclusive jurisdiction of the state and Federal courts located in the County of Los Angeles, State of California. BANK AND BORROWER EACH ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL ONE, BUT THAT IT MAY BE WAIVED. EACH OF THEM, AFTER CONSULTING OR HAVING HAD THE OPPORTUNITY TO CONSULT, WITH COUNSEL OF THEIR CHOICE, KNOWINGLY, VOLUNTARILY AND INTENTIONALLY WAIVES ANY RIGHT ANY OF THEM MAY HAVE TO A TRIAL BY JURY IN ANY LITIGATION BASED UPON OR ARISING OUT OF THIS AGREEMENT OR ANY RELATED INSTRUMENT OR LOAN DOCUMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT OR ANY COURSE OF CONDUCT, DEALING, STATEMENTS (WHETHER ORAL OR WRITTEN), OR ACTION OF ANY OF THEM. THESE PROVISIONS SHALL NOT BE DEEMED TO HAVE BEEN MODIFIED IN ANY RESPECT OR RELINQUISHED BY BANK OR BORROWER, EXCEPT BY A WRITTEN INSTRUMENT EXECUTED BY EACH OF THEM.

12. *REFERENCE PROVISION.*

The parties prefer that any dispute between them be resolved in litigation subject to a Jury Trial Waiver as set forth in Section 11 of this Agreement, but the availability of that process is in doubt because of the opinion of the California Court of Appeal in *Grafton Partners LP v. Superior Court*, 9 Cal.Rptr.3d 511. This Reference Provision will be applicable until the California Supreme Court completes its review of that case, and will continue to be applicable if either that court or a California Court of Appeal publishes a decision holding that a pre-dispute Jury Trial Waiver provision similar to that contained in the Loan Documents is invalid or unenforceable. Delay in requesting appointment of a referee pending review of any such decision, or participation in litigation pending review, will not be deemed a waiver of this Reference Provision.

## 12.1 *Mechanics.*

(a) Other than (i) nonjudicial foreclosure of security interests in real or personal property, (ii) the appointment of a receiver or (iii) the exercise of other provisional remedies (any of which may be initiated pursuant to applicable law), any controversy, dispute or claim (each, a "Claim") between the parties arising out of or relating to this Agreement or any other document, instrument or agreement between the Bank and the undersigned (collectively in this Section, the "Loan Documents"), will be resolved by a reference proceeding in California in accordance with the provisions of Section 638 et seq. of the California Code of Civil Procedure ("CCP"), or their successor sections, which shall constitute the exclusive remedy for the resolution of any Claim, including whether the Claim is subject to the reference proceeding. Except as otherwise provided in the Loan Documents, venue for the reference proceeding will be in the Superior Court or Federal District Court in the County or District where venue is otherwise appropriate under applicable law (the "Court").

(b) The referee shall be a retired Judge or Justice selected by mutual written agreement of the parties. If the parties do not agree, the referee shall be selected by the Presiding Judge of the Court (or his or her representative). A request for appointment of a referee may be heard on an *ex parte* or expedited basis, and the parties agree that irreparable harm would result if *ex parte* relief is not granted. The referee shall be appointed to sit with all the powers provided by law. Each party shall have one peremptory challenge pursuant to CCP §170.6. Pending appointment of the referee, the Court has power to issue temporary or provisional remedies.

(c) The parties agree that time is of the essence in conducting the reference proceedings. Accordingly, the referee shall be requested to (a) set the matter for a status and trial-setting conference within fifteen (15) days after the date of selection of the referee, (b) if practicable, try all issues of law or fact within ninety (90) days after the date of the conference and (c) report a statement of decision within twenty (20) days after the matter has been submitted for decision. Any decision rendered by the referee will be final, binding and conclusive, and judgment shall be entered pursuant to CCP §644.

(d) The referee will have power to expand or limit the amount and duration of discovery. The referee may set or extend discovery deadlines or cutoffs for good cause, including a party's failure to provide requested discovery for any reason whatsoever. Unless otherwise ordered, no party shall be entitled to "priority" in conducting discovery, depositions may be taken by either party upon seven (7) days written notice, and all other discovery shall be responded to within fifteen (15) days after service. All disputes relating to discovery which cannot be resolved by the parties shall be submitted to the referee whose decision shall be final and binding.

12.2 *Procedures.* Except as expressly set forth in this Agreement, the referee shall determine the manner in which the reference proceeding is conducted including the time and place of hearings, the order of presentation of evidence, and all other questions that arise with respect to the course of the reference proceeding. All proceedings and hearings conducted before the referee, except for trial, shall be conducted without a court reporter, except that when any party so requests, a court reporter will be used at any hearing conducted before the referee, and the referee will be provided a courtesy copy of the transcript. The party making such a request shall have the obligation to arrange for and pay the court reporter. Subject to the referee's power to award costs to the prevailing party, the parties will equally share the cost of the referee and the court reporter at trial.

12.3 *Application of Law.* The referee shall be required to determine all issues in accordance with existing case law and the statutory laws of the State of California. The rules of evidence applicable to proceedings at law in the State of California will be applicable to the reference proceeding. The referee shall be empowered to enter equitable as well as legal relief, provide all temporary or provisional remedies, enter equitable orders that will be binding on the parties and rule on any motion which would be authorized in a trial, including without limitation motions for summary judgment or summary adjudication. The referee shall issue a decision at the close of the reference proceeding which disposes of all claims of the parties that are the subject of the reference. The referee's decision shall be entered by the Court as a judgment or an order in the same manner as if the action had been tried by the Court. The parties reserve the right to appeal from the final judgment or order or from any appealable decision or order entered by the referee. The parties reserve the right to findings of fact, conclusions of laws, a written statement of decision, and the right to move for a new trial or a different judgment, which new trial, if granted, is also to be a reference proceeding under this provision.

12.4 *Repeal.* If the enabling legislation which provides for appointment of a referee is repealed (and no successor statute is enacted), any dispute between the parties that would otherwise be determined by reference procedure will be resolved and determined by arbitration. The arbitration will be conducted by a retired judge or Justice, in accordance with the California Arbitration Act §1280 through §1294.2 of the CCP as amended from time to time. The limitations with respect to discovery set forth above shall apply to any such arbitration proceeding.

12.5 THE PARTIES RECOGNIZE AND AGREE THAT ALL DISPUTES RESOLVED UNDER THIS REFERENCE PROVISION WILL BE DECIDED BY A REFEREE AND NOT BY A JURY, AND THAT THEY ARE IN EFFECT WAIVING THEIR RIGHT TO TRIAL BY JURY IN AGREEING TO THIS REFERENCE PROVISION. AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF THEIR OWN CHOICE, EACH PARTY KNOWINGLY AND VOLUNTARILY AND FOR THEIR MUTUAL BENEFIT AGREES THAT THIS REFERENCE PROVISION WILL APPLY TO ANY DISPUTE BETWEEN THEM WHICH ARISES OUT OF OR IS RELATED TO THIS AGREEMENT OR THE LOAN DOCUMENTS.

### 13. GENERAL PROVISIONS.

13.1 *Successors and Assigns.* This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties and shall bind all Persons who become bound as a debtor to this Agreement; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrower without Bank's prior written consent, which consent may be granted or withheld in Bank's sole discretion. Bank shall have the right without the consent of or notice to Borrower to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights and benefits hereunder; *provided* that, as long as an Event of Default has not occurred and is not continuing, Bank shall not grant participations or partial assignments of Bank's obligations, rights or benefits hereunder without Borrower's prior written consent, which shall not be unreasonably withheld or delayed.

13.2 *Indemnification.* Borrower shall defend, indemnify and hold harmless Bank and its officers, employees, and agents against: (a) all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with the transactions contemplated by this Agreement; and (b) all losses or Bank Expenses in any way suffered, incurred, or paid by

Bank, its officers, employees and agents as a result of or in any way arising out of, following, or consequential to transactions between Bank and Borrower whether under this Agreement, or otherwise (including without limitation reasonable attorneys' fees and expenses), except for losses arising out of Bank's gross negligence or willful misconduct.

13.3 *Time of Essence.* Time is of the essence for the performance of all obligations set forth in this Agreement.

13.4 *Severability of Provisions.* Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision.

13.5 *Amendments in Writing, Integration.* All amendments to or terminations of this Agreement or the other Loan Documents must be in writing. All prior agreements, understandings, representations, warranties, and negotiations between the parties hereto with respect to the subject matter of this Agreement and the other Loan Documents, if any, are merged into this Agreement and the Loan Documents.

13.6 *Counterparts.* This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

13.7 *Survival.* All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding or Bank has any obligation to make any Credit Extension to Borrower. The obligations of Borrower to indemnify Bank with respect to the expenses, damages, losses, costs and liabilities described in Section 13.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Bank have run.

**[Balance of Page Intentionally Left Blank]**



IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

QAD INC.

By: /s/ DANIEL LENDER

Title: Daniel Lender, Chief Financial Officer

COMERICA BANK

By: /s/ BONNIE E KEHL

Title: Senior Vice President

***[Signature Page to Loan Agreement]***

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DEBTOR

QAD INC.

SECURED PARTY:

COMERICA BANK

EXHIBIT A

TECHNOLOGY & LIFE SCIENCES DIVISION

LOAN ANALYSIS

LOAN ADVANCE/PAYDOWN REQUEST FORM

DEADLINE FOR SAME DAY PROCESSING IS [3:00\* P.M., Pacific Time/ 3:30 P.M. Eastern Time]

DEADLINE FOR EQUIPMENT ADVANCES IS [3:00 P.M., Pacific Time/ 3:30 P.M. Eastern Time]\*\*

DEADLINE FOR WIRE TRANSFERS IS [1:30 P.M., Pacific Time/ 3:30 P.M. Eastern Time]

[\*At month end and the day before a holiday, the cut off time is 1:30 P.M., Pacific Time]

\*\*Subject to 3 day advance notice.

To: Loan Analysis  
FAX #: (650) 846-6840

DATE:

TIME:

FROM:

QAD INC.

TELEPHONE REQUEST (For Bank Use Only):

FROM:

Borrower's Name

The following person is authorized to request the loan  
payment transfer/loan advance on the designated account  
and is known to me.

FROM:

Authorized Signer's Name

PHONE #:

Authorized Signer's Name

Authorized Request & Phone #

Received by (Bank) & Phone #

FROM ACCOUNT#:

(please include Note number, if applicable)

TO ACCOUNT #:

(please include Note number, if applicable)

Authorized Signature (Bank)

REQUESTED TRANSACTION TYPE

REQUESTED DOLLAR AMOUNT

For Bank Use Only

PRINCIPAL INCREASE\* (ADVANCE)

\$

PRINCIPAL PAYMENT (ONLY)

\$

Date Rec'd:

Time:

Comp. Status: YES NO

Status Date:

Time:

Approval:

OTHER INSTRUCTIONS:

All representations and warranties of Borrower stated in the Loan Agreement are true and correct in all material respects as of the date of the telephone request for and advance confirmed by this Borrowing Certificate, provided, however, that those representations and warranties the date expressly referring to another date shall be true and correct in all material respects as of such date, any exceptions are attached in Exhibit B.

\*IS THERE A WIRE REQUEST TIED TO THIS LOAN ADVANCE? (PLEASE CIRCLE ONE) YES NO

If YES, the Outgoing Wire Transfer Instructions must be completed below.

OUTGOING WIRE TRANSFER INSTRUCTIONS

Fed Reference Number

Bank Transfer Number

The items marked with an asterisk (\*) are required to be completed.

|                                |                 |
|--------------------------------|-----------------|
| *Beneficiary Name              |                 |
| *Beneficiary Account Number    |                 |
| *Beneficiary Address           |                 |
| Currency Type                  | US DOLLARS ONLY |
| *ABA Routing Number (9 Digits) |                 |
| *Receiving Institution Name    |                 |
| *Receiving Institution Address |                 |
| *Wire Account                  | \$              |

EXHIBIT B

BORROWING BASE CERTIFICATE

Borrower: QAD INC.

Lender: Comerica Bank

Commitment Amount: \$20,000,000

EBITDA

- |    |  |          |          |
|----|--|----------|----------|
| 1. | Immediately Preceding Quarter (ended _____)        | \$ _____ |          |
| 2. | Second Immediately Preceding Quarter (ended _____) | \$ _____ |          |
| 3. | Third Immediately Preceding Quarter (ended _____)  | \$ _____ |          |
| 4. | Fourth Immediately Preceding Quarter (ended _____) | \$ _____ |          |
| 5. | TOTAL Trailing Four Quarter EBITDA (as of _____)   |          | \$ _____ |
| 6. | LOAN VALUE OF EBITDA (150% of #6)                  |          | \$ _____ |

BALANCES

- |     |   |              |
|-----|---|--------------|
| 7.  | Maximum Loan Amount                                   | \$20,000,000 |
| 8.  | Total Funds Available [Lesser of #6 or #7]            | \$ _____     |
| 9.  | Present balance owing on Line of Credit               | \$ _____     |
| 10. | Outstanding under Sublimits (e.g., Letters of Credit) | \$ _____     |
| 11. | RESERVE POSITION (#8 minus #9 and #10)                | \$ _____     |

*The undersigned represents and warrants that the foregoing is true and correct, and that the information reflected in this Borrowing Base Certificate complies with the representations and warranties set forth in the Loan Agreement between the undersigned and Comerica Bank.*

QAD INC.

By:

\_\_\_\_\_  
Authorized Signer

**EXHIBIT C**  
**COMPLIANCE CERTIFICATE**

TO: COMERICA BANK

FROM: QAD INC.

The undersigned authorized officer of QAD INC. hereby certifies that in accordance with the terms and conditions of the Loan Agreement between Borrower and Bank (the "Agreement"), (i) Borrower is in complete compliance for the period ending \_\_\_\_\_ with all required covenants except as noted below and (ii) all representations and warranties of Borrower stated in the Agreement are true and correct as of the date hereof. Attached herewith are the required documents supporting the above certification. The Officer further certifies that these are prepared in accordance with Generally Accepted Accounting Principles (GAAP) and are consistently applied from one period to the next except as explained in an accompanying letter or footnotes.

**Please indicate compliance status by circling Yes/No under "Complies" column.**

| Reporting Covenant   | Required                 | Complies |    |
|--|--------------------------|----------|----|
| Quarterly financial statements   | Quarterly within 30 days | Yes      | No |
| Annual (CPA Audited)   | FYE within 90 days       | Yes      | No |
| 10K and 10Q  | Within 15 days of filing | Yes      | No |
| Borrowing Base Cert.   | Quarterly within 20 days | Yes      | No |
| Compliance Cert.   | Quarterly within 30 days | Yes      | No |
| Operating Plan/Budget  | Annually within 30 days  | Yes      | No |
| Total amount of Borrower's cash and investments  | Amount: \$_____          |          |    |
| Total amount of Borrower's (and domestic Subsidiaries') cash and investments maintained in the Continental United States | Amount: \$_____          |          |    |
| Total amount of Borrower's cash and investments maintained with Bank   | Amount: \$_____          |          |    |

| Financial Covenant                   | Required        | Actual  | Complies |    |
|--------------------------------------|-----------------|---------|----------|----|
| Measured on a Quarterly Basis:       |                 |         |          |    |
| Minimum Trailing 4 Quarter EBITDA    | \$10,000,000    | \$_____ | Yes      | No |
| Minimum Liquidity Ratio              | 1.30:1.00       | __:1.00 | Yes      | No |
| Minimum Cash in the Continental U.S. | \$10,000,000(1) | \$_____ | Yes      | No |

(1) Detail of cash infusions by Borrower and cash repayments to Borrower to be provided to Bank as and when made.

**Comments Regarding Exceptions:** See Attached.

**BANK USE ONLY**

Sincerely,

Received by:

AUTHORIZED SIGNER

Date:

Verified:

AUTHORIZED SIGNER

Date:

SIGNATURE

TITLE

Compliance Status

Yes No

DATE

**APPENDIX I**  
**(LIBOR Addendum to Loan Agreement)**

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## SCHEDULE OF EXCEPTIONS

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### Permitted Indebtedness (Section 1.1)

The following agreement(s) evidence Permitted Indebtedness\* against QAD Inc.:

| Agreement   | Borrower | Lender                       | Original Principal Amount of Indebtedness   |
|---|----------|------------------------------|---|
| Loan and Security Agreement, dated as of September 8, 2000, together with all amendments thereto* | QAD Inc. | Foothill Capital Corporation | Term Loan Amount—\$15,000,000<br><br>Maximum Revolver Amount—\$30,000,000 less outstanding principal balance of the Term Loan |

\* This Agreement shall be terminated substantially contemporaneously with the Closing Date.



## Permitted Investments (Section 1.1)

### Marketable Securities as of 02-28-05

|   | Principal     | Maturity |
|---|---------------|----------|
| Auction Preferred                       |               |          |
| CHELA FINL USA INC CA STUD LOAN         | \$ 7,000,000  | 03-03-05 |
| Auction Preferred                       |               |          |
| EDUCATIONL FDG SOUTH INC                | 6,000,000     | 03-03-05 |
| Citi Institutional Liquid Reserves      | 24,806,299    | None     |
| Smith Barney Money Funds Cash Portfolio | 1,419,905     | None     |
| UBS Money Funds                         | 35,648        | None     |
| Total                                   | \$ 39,261,852 |          |

Employee loans aggregate amount as of 01-31-05—\$560,684

### Equities related to customer reorganizations as of 01-31-05

|                                    |                |
|------------------------------------|----------------|
| Restricted Stock Henley Healthcare | 283,333 shares |
| Common Stock Tripath Imaging, Inc. | 80 shares      |

In the course of the Borrower's business, it makes capital contributions and advances to Subsidiaries which Investments as of 12-31-04 are reflected on the consolidating balance sheet attached hereto as Exhibit A.

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**EXHIBIT A**  
**(to Schedule of Exceptions, Section 1.1 (Permitted Investments))**  
**[hard copy to be inserted]**

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**Permitted Liens (Section 1.1)**

The following Uniform Commercial Code filings evidence Permitted Liens\* against QAD Inc.:

| Debtor   | Secured Party                | Jurisdiction | Collateral  | Filing Date      | Filing No.  |
|----------|------------------------------|--------------|---|------------------|-------------|
| QAD Inc. | Foothill Capital Corporation | Delaware     | Collateral set forth in Exhibit A to UCC-1 Financing Statement                          | August 2, 2000   | 0049304*    |
| QAD Inc. | Foothill Capital Corporation | Delaware     | Collateral set forth in Exhibit A to UCC-1 Financing Statement                          | June 14, 2002    | 21464340*   |
| QAD Inc. | Ameritech Credit Corporation | California   | All security systems and other equipment and items subject to Lease No. 001-0019681-001 | January 18, 2000 | 0002260335  |
| QAD Inc. | Foothill Capital Corporation | California   | Collateral set forth in Exhibit A to UCC-1 Financing Statement                          | August 1, 2000   | 0021660955* |

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The following agreement(s) evidence Permitted Liens against QAD Inc.:

| Agreement  | Debtor   | Secured Party                 |
|--|----------|-------------------------------|
| Loan and Security Agreement, dated September 8, 2000, together with all amendments thereto   | QAD Inc. | Foothill Capital Corporation* |
| Intellectual Property Security Agreement, dated September 8, 2000  | QAD Inc. | Foothill Capital Corporation* |
| Security Interest in Copyrights, dated September 8, 2000   | QAD Inc. | Foothill Capital Corporation* |
| Security Interest in Trademarks, dated September 8, 2000   | QAD Inc. | Foothill Capital Corporation* |
| Stock Pledge and Security Agreement, dated September 8, 2000   | QAD Inc. | Foothill Capital Corporation* |
| Deed of Trust With Absolute Assignment of Leases and Rents, Security Agreement and Fixture Filing, dated September 8, 2000   | QAD Inc. | Foothill Capital Corporation* |
| Subordination Agreement, dated September 8, 2000 (governs subordination of Foothill Capital Corporation's interest to that of Brown Investments, Inc.)                                       | QAD Inc. | Foothill Capital Corporation* |
| Real Estate Management and Put Option Agreement, dated November 18, 1994, as modified by a First Amendment dated as of January 27, 2000, by and between QAD Inc. and Brown Investments, Inc. | N/A      | N/A                           |
| Account Control Agreement, dated September 8, 2000 (with Salomon Smith Barney Inc.)  | QAD Inc. | Foothill Capital Corporation* |
| Account Control Agreement, dated October 2, 2000 (with PaineWebber Incorporated)   | QAD Inc. | Foothill Capital Corporation* |
| Clearing Account Agreement, dated December 4, 2000 (with Commerce Bank, N.A.)  | QAD Inc. | Foothill Capital Corporation* |

\* These liens shall be terminated substantially contemporaneously with the Closing Date.



None.

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**Corporation Resolutions and Incumbency Certification**  
**Authority to Procure Loans**

I certify that I am the duly elected and qualified Secretary of QAD INC.; that the following is a true and correct copy of resolutions duly adopted by the Board of Directors of the Corporation in accordance with its bylaws and applicable statutes.

**Copy of Resolutions:**

**RESOLVED:** that management is hereby authorized to replace the existing loan facility with Foothill Financial with any of the proposed alternatives as presented at the meeting at management's discretion but not before the current termination fee commitment with Foothill Financial expires in March, 2005.

As secretary, I certify that the authority granted under this Resolution includes:

1. Any one (1) of the following three (3) (E.V.P. and Chief Financial Officer, V.P. Tax and Treasurer and V.P. and Controller) officers of the Corporation is authorized, for, on behalf of, and in the name of the Corporation to:
  - (a) Negotiate and procure loans, letters of credit and other credit or financial accommodations from Comerica Bank ("Bank"), a Michigan banking corporation, including, without limitation, that certain Loan Agreement dated as of April 7, 2005 as may subsequently be amended from time to time.
  - (b) Execute and deliver in form and content as may be required by the Bank any and all notes, evidences of Indebtedness, applications for letters of credit, guaranties, subordination agreements, loan and security agreements, financing statements, assignments, liens, deeds of trust, mortgages, trust receipts and other agreements, instruments or documents to carry out the purposes of this Resolution, any or all of which may relate to all or to substantially all of the Corporation's property and assets.
2. Said Bank be and it is authorized and directed to pay the proceeds of any such loans or discounts as directed by the persons so authorized to sign.
3. Any and all agreements, instruments and documents previously executed and acts and things previously done to carry out the purposes of this Resolution are ratified, confirmed and approved as the act or acts of the Corporation.
4. This Resolution shall continue in force, and the Bank may consider the holders of said offices and their signatures to be and continue to be as set forth in a certified copy of this Resolution delivered to the Bank, until notice to the contrary in writing is duly served on the Bank (such notice to have no effect on any action previously taken by the Bank in reliance on this Resolution).
5. Any person, corporation or other legal entity dealing with the Bank may rely upon a certificate signed by an officer of the Bank to effect that this Resolution and any agreement, instrument or document executed pursuant to them are still in full force and effect and binding upon the Corporation.
6. The Bank may consider the holders of the offices of the Corporation and their signatures, respectively, to be and continue to be as set forth in the Certificate of the Secretary of the Corporation until notice to the contrary in writing is duly served on the Bank.

I further certify that the above Resolution is in full force and effect as of the date of this Certificate; that this Resolution and any borrowings or financial accommodations under this Resolution have been properly noted in the corporate books and records, and have not been rescinded, annulled, revoked or modified; that neither the foregoing Resolution nor any actions to be taken pursuant to it is

or will be in contravention of any provision of the articles of incorporation or bylaws of the Corporation or of any agreement, indenture or other instrument to which the Corporation is a party or by which it is bound; and that neither the articles of incorporation nor bylaws of the Corporation nor any agreement, indenture or other instrument to which the Corporation is a party or by which it is bound require the vote or consent of shareholders of the Corporation to authorize any act, matter or thing described in the foregoing Resolution.

I further certify that the following named persons have been duly elected to the offices set opposite their respective names, that they continue to hold these offices at the present time, and that the signatures which appear below are the genuine, original signatures of each respectively:

**(PLEASE SUPPLY GENUINE SIGNATURES OF AUTHORIZED SIGNERS BELOW)**

| NAME (Type or Print) | TITLE                  | SIGNATURE |
|----------------------|------------------------|-----------|
| Daniel Lender        | E.V.P. and CFO         |           |
| Mark Rasmussen       | V.P. Tax and Treasurer |           |
| Valerie Miller       | V.P. and Controller    |           |
|                      |                        |           |

In Witness Whereof, I have affixed my name as Secretary and have caused the corporate seal (where available) of said Corporation to be affixed on April , 2005.

\_\_\_\_\_  
Roland Desilets, Secretary, QAD Inc.

The Above Statements are  
Correct.

\_\_\_\_\_  
SIGNATURE OF OFFICER OR DIRECTOR OR, IF NONE. A SHAREHOLDER  
OTHER THAN SECRETARY WHEN SECRETARY IS AUTHORIZED TO SIGN  
ALONE.

Failure to complete the above when the Secretary is authorized to sign alone shall constitute a certification by the Secretary that the Secretary is the sole Shareholder, Director and Officer of the Corporation.



**ATTN: QAD INC.**

**USA PATRIOT ACT  
NOTICE  
OF  
CUSTOMER IDENTIFICATION**

**IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT**

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

WHAT THIS MEANS FOR YOU: when you open an account, we will ask your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

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COMERICA BANK  
Member FDIC

ITEMIZATION OF AMOUNT FINANCED  
DISBURSEMENT INSTRUCTIONS  
(Revolver)

Name(s): QAD INC.

Date: April 7, 2005

\$20,000,000 credited to deposit account No. 1892038165 when Advances are requested by Borrower

Amounts paid to others on your behalf:

\$ to Comerica Bank for Loan Fee  
\$ to Comerica Bank for Document Fee  
\$ to Comerica Bank for accounts receivable audit (estimate)  
\$ to Bank counsel fees and expenses  
\$ to \_\_\_\_\_

\$ to \_\_\_\_\_

\$ TOTAL (AMOUNT FINANCED)

Upon consummation of this transaction, this document will also serve as the authorization for Comerica Bank to disburse the loan proceeds as stated above.

/s/ DANIEL LENDER

Signature

Signature

**AGREEMENT TO PROVIDE INSURANCE**

TO: COMERICA BANK  
Attn: Deni M. Snider, MC 4770  
75 E. Trimble Road  
San Jose, CA 95131

Date: April 7, 2005

Borrower: QAD INC.

In consideration of a loan in the amount of \$20,000,000:

I/We agree to obtain adequate insurance coverage to remain in force during the term of the loan.

I/We also agree to advise the below named agent to furnish Bank at above address with a copy of said policy/endorsements and any subsequent renewal policies.

I/We understand that the policy must contain:

1. Fire and extended coverage in an amount sufficient to cover:

(a) The amount of the loan, OR

(b) All existing encumbrances, whichever is greater,

But not in excess of the replacement value of the improvements on the real property.

2. Lender's "Loss Payable" Endorsement Form 438 BFU in favor of Comerica Bank, or any other form acceptable to Bank.

**INSURANCE INFORMATION**

Insurance Co./Agent

Telephone No.:

Agent's Address:

Signature of Obligor:

/s/ Daniel Lender

Signature of Obligor:

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FOR BANK USE ONLY

INSURANCE VERIFICATION: Date:

Person Spoken to:

Policy Number:

Effective From: \_\_\_\_\_ To:

Verified by:

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**COMERICA BANK**

**Member FDIC**

**AUTOMATIC DEBIT AUTHORIZATION**

To: **Comerica Bank**

Re: **Loan #**

You are hereby authorized and instructed to charge account No. 1892038165 in the name of QAD INC. for principal, interest and other payments due on above referenced loan as set forth below and credit the loan referenced above.

- ☒ Debit each interest payment as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.
- ☒ Debit each principal payment as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.
- ☒ Debit each payment for Bank Expenses as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.

This Authorization is to remain in full force and effect until revoked in writing.

Borrower Signature

Date

/s/ Daniel Lender

April 7, 2005

April 7, 2005

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**COMERICA BANK**

**Member FDIC**

**AUTOMATIC DEBIT AUTHORIZATION**

To: **Comerica Bank**

Re: **Loan #**

You are hereby authorized and instructed to charge account No. 1892038165 in the name of QAD INC. for principal, interest and other payments due on above referenced loan as set forth below and credit the loan referenced above.

- ☒ Debit each interest payment as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.
- ☒ Debit each principal payment as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.
- ☒ Debit each payment for Bank Expenses as it becomes due according to the terms of the Loan Agreement and any renewals or amendments thereof.

This Authorization is to remain in full force and effect until revoked in writing.

Borrower Signature

Date

April 7, 2005

April 7, 2005

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COMERICA BANK

COMERICA BANK  
CLIENT AUTHORIZATION

Fax (714) 433-3280

**General Authorization**

I hereby authorize Comerica Bank to use my company name, logo, and information relating to our banking relationship in its marketing and advertising campaigns which is intended for Comerica Bank's customers, prospects and shareholders.

Comerica Bank will forward any advertising or article including client for prior review and approval.

/s/ Daniel Lender

Signature

Daniel Lender

Chief Financial Officer

Printed Name

Title

QAD, Inc.

Company

6450 Via Real

Mailing Address

Carpinteria, CA  
93013

City, State, Zip Code

(805) 566-6000

Phone Number

(805) 566-4479

Fax Number

E-Mail

April 7, 2005

**LIBOR**  
**Addendum To Loan Agreement**

This Addendum to Loan Agreement (this "Addendum") is entered into as of this April 7, 2005, by and between Comerica Bank ("Bank") and QAD INC. ("Borrower"). This Addendum supplements the terms of the Loan Agreement of even date herewith.

14. *Definitions.*

(a) *Advance.* As used herein, "Advance" means a borrowing requested by Borrower and made by Bank under the Loan Agreement, including a LIBOR Option Advance and/or a Prime Rate Option Advance.

(b) *Business Day.* As used herein, "Business Day" means any day except a Saturday, Sunday or any other day designated as a holiday under Federal or California statute or regulation.

(c) *LIBOR.* As used herein, "LIBOR" means the rate per annum (rounded upward if necessary, to the nearest whole  $\frac{1}{8}$  of 1%) and determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(1) "Base LIBOR" means the rate per annum determined by Bank at which deposits for the relevant LIBOR Period would be offered to Bank in the approximate amount of the relevant LIBOR Option Advance in the inter-bank LIBOR market selected by Bank, upon request of Bank at 10:00 a.m. California time, on the day that is the first day of such LIBOR Period.

(2) "LIBOR Reserve Percentage" means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for "Eurocurrency Liabilities" (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Bank for expected changes in such reserve percentage during the applicable LIBOR Period.

(d) *LIBOR Business Day.* As used herein, "LIBOR Business Day" means a Business Day on which dealings in U.S. Dollar deposits may be carried out in the interbank LIBOR market.

(e) *LIBOR Period.* As used herein, "LIBOR Period" means, with respect to a LIBOR Option Advance:

(1) initially, the period commencing on, as the case may be, the date the Advance is made or the date on which the Advance is converted to a LIBOR Option Advance, and continuing for, in every case, a 30, 60 or 90-day period thereafter so long as the LIBOR Option is quoted for such period in the applicable interbank LIBOR market, as such period is selected by Borrower in the notice of Advance as provided in the Loan Agreement or in the notice of conversion as provided in this Addendum; and

(2) thereafter, each period commencing on the last day of the next preceding LIBOR Period applicable to such LIBOR Option Advance and continuing for, in every case, a 30, 60 or 90-day thereafter so long as the LIBOR Option is quoted for such period in the applicable interbank LIBOR market, as such period is selected by Borrower in the notice of continuation as provided in this Addendum.

(f) *Regulation D.* As used herein, "Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as amended or supplemented from time to time.

(g) *Regulatory Development.* As used herein, "Regulatory Development" means any or all of the following: (i) any change in any law, regulation or interpretation thereof by any

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public authority (whether or not having the force of law); (ii) the application of any existing law, regulation or the interpretation thereof by any public authority (whether or not having the force of law); and (iii) compliance by Bank with any request or directive (whether or not having the force of law) of any public authority.

Capitalized terms used herein without definition shall have the definition ascribed in the Loan Agreement.

15. *Interest Rate Options.* Borrower shall have the following options regarding the interest rate to be paid by Borrower on the Advance under the Loan Agreement:

(a) A rate equal to the Applicable Margin above Bank's LIBOR (the "LIBOR Option"), which LIBOR Option shall be in effect during the relevant LIBOR Period; or

(b) A rate equal to the Applicable Margin above or below (as appropriate) the Prime Rate (the "Prime Rate Option").

16. *LIBOR Option Advance.* The minimum LIBOR Option Advance will not be less than One Million Dollars (\$1,000,000) for any LIBOR Option Advance.

17. *Payment of Interest on LIBOR Option Advances.* Interest on each LIBOR Option Advance shall be payable pursuant to the terms of the Loan Agreement. Interest on such LIBOR Option Advance shall be computed on the basis of a 360-day year and shall be assessed for the actual number of days elapsed from the first day of the LIBOR Period applicable thereto but not including the last day thereof.

18. *Bank's Records Re: LIBOR Option Advances.* With respect to each LIBOR Option Advance, Bank is hereby authorized to note the date, principal amount, interest rate and LIBOR Period applicable thereto and any payments made thereon on Bank's books and records (either manually or by electronic entry) and/or on any schedule attached to the Loan Agreement, which notations shall be prima facie evidence of the accuracy of the information noted, absent manifest error.

19. *Selection/Conversion of Interest Rate Options.* At the time any Advance is requested under the Loan Agreement and/or Borrower wishes to select the LIBOR Option for all or a portion of the outstanding principal balance of the Loan Agreement, and at the end of each LIBOR Period, Borrower shall give Bank notice specifying (a) the interest rate option selected by Borrower; b) the principal amount subject thereto; and (c) if the LIBOR Option is selected, the length of the applicable LIBOR Period. Any such notice may be given by telephone so long as, with respect to each LIBOR Option selected by Borrower, (i) Bank receives written confirmation from Borrower not later than three (3) LIBOR Business Days after such telephone notice is given; and (ii) such notice is given to Bank prior to 10:00 a.m., California time, on the first day of the LIBOR Period. For each LIBOR Option requested hereunder, Bank will quote the applicable fixed LIBOR Rate to Borrower at approximately 10:00 a.m., California time, on the first day of the LIBOR Period. If Borrower does not immediately accept the rate quoted by Bank, any subsequent acceptance by Borrower shall be subject to a redetermination of the rate by Bank; provided, however, that if Borrower fails to accept any such quotation given, then the quoted rate shall expire and Bank shall have no obligation to permit a LIBOR Option to be selected on such day. If no specific designation of interest is made at the time any Advance is requested under the Loan Agreement or at the end of any LIBOR Period, Borrower shall be deemed to have selected the Prime Rate Option for such Advance or the principal amount to which such LIBOR Period applied. At any time the LIBOR Option is in effect, Borrower may, at the end of the applicable LIBOR Period, convert to the Prime Rate Option. At any time the Prime Rate Option is in effect, Borrower may convert to the LIBOR Option, and shall designate a LIBOR Period.

20. *Prepayment.* In the event that the LIBOR Option is the applicable interest rate for all or any part of the outstanding principal balance of the Loan Agreement, and any payment or prepayment of any such outstanding principal balance of the Loan Agreement shall occur on any

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day other than the last day of the applicable LIBOR Period (whether voluntarily, by acceleration, required payment, or otherwise), or if Borrower elects the LIBOR Option as the applicable interest rate for all or any part of the outstanding principal balance of the Loan Agreement in accordance with the terms and conditions hereof, and, subsequent to such election, but prior to the commencement of the applicable LIBOR Period, Borrower revokes such election for any reason whatsoever, or if the applicable interest rate in respect of any outstanding principal balance of the Loan Agreement hereunder shall be changed, for any reason whatsoever, from the LIBOR Option to the Prime Rate Option prior to the last day of the applicable LIBOR Period, or if Borrower shall fail to make any payment of principal or interest hereunder at any time that the LIBOR Option is the applicable interest rate hereunder in respect of such outstanding principal balance of the Loan Agreement, Borrower shall reimburse Bank, on demand, for any resulting documented loss, cost or expense incurred by Bank as a result thereof, including, without limitation, any such loss, cost or expense incurred in obtaining, liquidating, employing or redeploying deposits from third parties. Such amount payable by Borrower to Bank may include, without limitation, an amount equal to the excess, if any, of (a) the amount of interest which would have accrued on the amount so prepaid, or not so borrowed, refunded or converted, for the period from the date of such prepayment or of such failure to borrow, refund or convert, through the last day of the relevant LIBOR Period, at the applicable rate of interest for such outstanding principal balance of the Loan Agreement, as provided under this Loan Agreement, over (b) the amount of interest (as reasonably determined by Bank) which would have accrued to Bank on such amount by placing such amount on deposit for a comparable period with leading banks in the interbank LIBOR market. Calculation of any amounts payable to Bank under this paragraph shall be made as though Bank shall have actually funded or committed to fund the relevant outstanding principal balance of the Loan Agreement hereunder through the purchase of an underlying deposit in an amount equal to the amount of such outstanding principal balance of the Loan Agreement and having a maturity comparable to the relevant LIBOR Period; provided, however, that Bank may fund the outstanding principal balance of the Loan Agreement hereunder in any manner it deems fit and the foregoing assumptions shall be utilized only for the purpose of the calculation of amounts payable under this paragraph. Upon the written request of Borrower, Bank shall deliver to Borrower a certificate setting forth the basis for determining such losses, costs and expenses, which certificate shall be conclusively presumed correct, absent manifest error. Any prepayment hereunder shall also be accompanied by the payment of all accrued and unpaid interest on the amount so prepaid. Any outstanding principal balance of the Loan Agreement which is bearing interest at such time at the Prime Rate Option may be prepaid without penalty or premium. Partial prepayments hereunder shall be applied to the installments hereunder in the inverse order of their maturities.

BY INITIALING BELOW, BORROWER ACKNOWLEDGE(S) AND AGREE(S) THAT: (A) THERE IS NO RIGHT TO PREPAY ANY LIBOR OPTION ADVANCE, IN WHOLE OR IN PART, WITHOUT PAYING THE PREPAYMENT AMOUNT, EXCEPT AS OTHERWISE REQUIRED UNDER APPLICABLE LAW; (B) BORROWER SHALL BE LIABLE FOR PAYMENT OF THE PREPAYMENT AMOUNT IF BANK EXERCISES ITS RIGHT TO ACCELERATE PAYMENT OF ANY LIBOR OPTION ADVANCE AS PART OR ALL OF THE OBLIGATIONS OWING UNDER THE LOAN AGREEMENT, INCLUDING WITHOUT LIMITATION, ACCELERATION UNDER A DUE-ON-SALE PROVISION; (C) BORROWER WAIVES ANY RIGHTS UNDER SECTION 2954.10 OF THE CALIFORNIA CIVIL CODE, OR ANY SUCCESSOR STATUTE; AND (D) BANK HAS MADE EACH LIBOR OPTION ADVANCE PURSUANT TO THE LOAN AGREEMENT IN RELIANCE ON THESE AGREEMENTS.

MR

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BORROWER'S INITIALS

21. *Hold Harmless and Indemnification.* Borrower agrees to indemnify Bank and to hold Bank harmless from, and to reimburse Bank on demand for, all losses and expenses which Bank sustains or incurs as a result of (i) any payment of a LIBOR Option Advance prior to the last day

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of the applicable LIBOR Period for any reason, including, without limitation, termination of the Loan Agreement, whether pursuant to this Addendum or the occurrence of an Event of Default; (ii) any termination of a LIBOR Period prior to the date it would otherwise end in accordance with this Addendum; or (iii) any failure by Borrower, for any reason, to borrow any portion of a LIBOR Option Advance.

22. *Funding Losses.* The indemnification and hold harmless provisions set forth in this Addendum shall include, without limitation, all losses and expenses arising from interest and fees that Bank pays to lenders of funds it obtains in order to fund the loans to Borrower on the basis of the LIBOR Option(s) and all losses incurred in liquidating or re-deploying deposits from which such funds were obtained and loss of profit for the period after termination. A written statement by Bank to Borrower of such losses and expenses shall be conclusive and binding, absent manifest error, for all purposes. This obligation shall survive the termination of this Addendum and the payment of the Loan Agreement.

23. *Regulatory Developments Or Other Circumstances Relating To Illegality or Impracticability of LIBOR.* If any Regulatory Development or other circumstances relating to the interbank Euro-dollar markets shall, at any time, in Bank's reasonable determination, make it unlawful or impractical for Bank to fund or maintain, during any LIBOR Period, to determine or charge interest rates based upon LIBOR, Bank shall give notice of such circumstances to Borrower and:

(i) In the case of a LIBOR Period in progress, Borrower shall, if requested by Bank, promptly pay any interest which had accrued prior to such request and the date of such request shall be deemed to be the last day of the term of the LIBOR Period; and

(ii) No LIBOR Period may be designated thereafter until Bank determines that such would be practical.

24. *Additional Costs.* Borrower shall pay to Bank from time to time, upon Bank's request, such amounts as Bank determines are needed to compensate Bank for any costs it incurred which are attributable to Bank having made or maintained a LIBOR Option Advance or to Bank's obligation to make a LIBOR Option Advance, or any reduction in any amount receivable by Bank hereunder with respect to any LIBOR Option or such obligation (such increases in costs and reductions in amounts receivable being herein called "Additional Costs"), resulting from any Regulatory Developments, which (i) change the basis of taxation of any amounts payable to Bank hereunder with respect to taxation of any amounts payable to Bank hereunder with respect to any LIBOR Option Advance (other than taxes imposed on the overall net income of Bank for any LIBOR Option Advance by the jurisdiction where Bank is headquartered or the jurisdiction where Bank extends the LIBOR Option Advance); (ii) impose or modify any reserve, special deposit, or similar requirements relating to any extensions of credit or other assets of, or any deposits with or other liabilities of, Bank (including any LIBOR Option Advance or any deposits referred to in the definition of LIBOR); or (iii) impose any other condition affecting this Addendum (or any of such extension of credit or liabilities). Bank shall notify Borrower of any event occurring after the date hereof which entitles Bank to compensation pursuant to this paragraph as promptly as practicable after it obtains knowledge thereof and determines to request such compensation. Determinations by Bank for purposes of this paragraph, shall be conclusive, provided that such determinations are made in good faith on a reasonable basis.

25. *Legal Effect.* Except as specifically modified hereby, all of the terms and conditions of the Loan Agreement remain in full force and effect.

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IN WITNESS WHEREOF, the parties have agreed to the foregoing as of the date first set forth above.

QAD INC.

COMERICA BANK

By: Mark Rasmussen

By:

Title: VP Tax and Treasurer

Title:

QuickLinks

[EXHIBIT A](#)

[EXHIBIT B BORROWING BASE CERTIFICATE](#)

[EXHIBIT C COMPLIANCE CERTIFICATE](#)

[APPENDIX I \(LIBOR Addendum to Loan Agreement\)](#)

[SCHEDULE OF EXCEPTIONS](#)

[EXHIBIT A \(to Schedule of Exceptions, Section 1.1 \(Permitted Investments\)\) \[hard copy to be inserted\]](#)

April 6, 2005

QAD Inc.  
 6450 Via Real  
 Carpinteria, California 93103  
 Attn: Daniel Lender, Chief Financial Officer

Re: Termination of Loan and Security Agreement between Wells Fargo Foothill, Inc. (formerly known as Foothill Capital Corporation) and QAD Inc. (the "Company"), dated as of September 8, 2000

Gentlemen:

You have requested that Wells Fargo Foothill, Inc. (formerly known as Foothill Capital Corporation) ("Foothill") provide you with a statement of the total amount necessary to settle the Company's obligations under the above Loan and Security Agreement, as amended (the "Loan Agreement"), which is scheduled to terminate on April 7, 2005 (the "Termination Date"). Except as otherwise defined in this letter, all capitalized terms used in this letter have the meanings assigned to them in the Loan Agreement.

The following estimated amount of the Company's Obligations, net of any and all credits in the Company's favor, is projected to be due and owing to Foothill as of the Termination Date:

|                             |    |              |
|-----------------------------|----|--------------|
| Advances                    | \$ | 44,902.79    |
| Advances Discount           | \$ | (21,197.95)  |
| Term Loan                   | \$ | 7,625,000.00 |
| Servicing Fee               | \$ | 400.00       |
| Unused Line Fee             | \$ | 1,392.49     |
| Accrued interest            | \$ | 12,199.78    |
| Clearance or Float Charges  | \$ | 16.75        |
| Reserve for Lender Expenses | \$ | 7,500.00     |
|                             |    | <hr/>        |
| Total Payoff Amount:        | \$ | 7,670,213.86 |
|                             |    | <hr/>        |

Interest accrues thereafter at the per diem rate of \$2,388.07.

The above figures include a contingency reserve for estimated Lender Expenses associated with the termination and payoff settlement, including, without limitation, official fees for filing UCC termination statements and attorneys' fees and related costs.

The Company agrees that the above payoff amount, and any and all amounts that may be added to the Company's Obligations on and after the date of this letter pursuant to the Loan Agreement, shall be paid to Foothill on the Termination Date by wire transfer in immediately available funds using the following wire transfer instructions:

JPMorgan Chase Bank  
 Funds Transfer Services  
 4 New York Plaza, 15<sup>th</sup> Floor  
 New York, NY 10004  
 Attention: Operations Manager  
 ABA# 021000021  
 Credit to: Wells Fargo Foothill, Inc.  
 Account No. 323-266193  
 Re: QAD Inc. Payoff

Any unused portion of the payoff amount remaining as of 60 days following the Termination Date will be refunded to the Company.

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The payoff amount will remain in effect through the Termination Date, provided that there are no additional borrowings or other Obligations incurred by the Company under the Loan Agreement after the date of this letter.

The Company hereby confirms and agrees that, as of the Termination Date: (a) the commitments of Foothill to make loans under the Loan Agreement are terminated; (b) the guaranty by Foothill of the Company's obligations to Wells Fargo under the MasterCard Agreement is terminated; and (c) Foothill has no further obligation to make loans to the Company. Notwithstanding termination of the Loan Agreement, all obligations of the Company under the Loan Agreement which by their terms are intended to survive termination shall continue in full force and effect. The Company acknowledges that the payoff amounts referred to above are due and owing pursuant to the provisions of the Loan Agreement and confirms its agreement to the terms and provisions of this letter by returning to Foothill a signed counterpart of this letter.

Foothill hereby confirms and agrees that upon receipt of the payoff amount referenced above, confirmation of which promptly shall be provided the Company, Foothill hereby authorizes the Company or any of its agents, representatives or designees, to file such termination (or similar) statements as may be required to evidence termination of the security interest(s) granted Foothill by the Company.

Sincerely,

Wells Fargo Foothill, Inc.

By: /s/ Nichol S Shuart

Name: Nichol S Shuart  
Title: VP

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**CONFIRMATION BY COMPANY**

The undersigned hereby confirms its agreement to the terms and provisions of the foregoing letter.

QAD Inc.

By: /s/ Mark Rasmussen

Name: Mark Rasmussen

Title: VP Tax and Treasurer

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**QAD Inc.**  
**SUBSIDIARIES OF QAD INC.**

| Name  | Place of Incorporation |
|---|------------------------|
| QAD Asia Limited  | Hong Kong              |
| QAD Australia Pty Ltd.  | Australia              |
| QAD (Bermuda) Ltd.  | Bermuda                |
| QAD Bilgisayar Yazilim Ltd.                                       | Turkey                 |
| QAD Brasil Ltda.  | Brazil                 |
| QAD Brazil Inc.   | Delaware               |
| QAD Canada ULC  | Canada                 |
| QAD Holdings Inc.   | Delaware               |
| QAD China Ltd.  | China                  |
| QAD EMEA Holdings B.V.  | Netherlands            |
| QAD Europe AG   | Switzerland            |
| QAD Europe B.V.   | Netherlands            |
| QAD Europe GmbH   | Germany                |
| QAD Lusitana Lda.   | Portugal               |
| QAD Europe Limited  | United Kingdom         |
| QAD Europe NV/SA  | Belgium                |
| QAD Europe SI   | Spain                  |
| QAD Europe SAS  | France                 |
| QAD I&I Co., Ltd.   | Thailand               |
| QAD India Inc.  | Delaware               |
| QAD Ireland Limited   | Ireland                |
| QAD Italy S.r.l.  | Italy                  |
| QAD Japan Inc.  | Delaware               |
| QAD Korea Limited   | Korea                  |
| QAD Netherlands B.V.  | Netherlands            |
| QAD NZ Limited  | New Zealand            |
| QAD Ortega Hill, LLC  | Delaware               |
| QAD Polska Sp. zo.o.  | Poland                 |
| QAD Singapore Private Ltd.  | Singapore              |
| QAD Mexicana, S.A. de C.V.  | Mexico                 |
| QAD Sistemas Integrados Servicios de Consultoria,<br>S.A. de C.V. | Mexico                 |
| QAD Software South Africa (Pty) Ltd.                              | South Africa           |
| QAD United Kingdom Ltd.   | United Kingdom         |



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**EXHIBIT 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
QAD Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-66610, 333-48381 and 333-35367) on Form S-8 of QAD Inc. of our reports dated April 15, 2005, with respect to the consolidated balance sheets of QAD Inc. as of January 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended January 31, 2005, and the related financial statement schedule II, management's assessment of the effectiveness of internal control over financial reporting as of January 31, 2005 and the effectiveness of internal control over financial reporting as of January 31, 2005, which reports appear in the January 31, 2005 Annual Report on Form 10-K of QAD Inc.

/s/ KPMG LLP

Los Angeles, California  
April 15, 2005

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[EXHIBIT 23.1](#)

[CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM](#)

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

I, Karl F. Lopker, certify that:

1. I have reviewed this Annual Report on Form 10-K 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: April 15, 2005

/s/ KARL F. LOPKER

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Karl F. Lopker  
*Chief Executive Officer*  
QAD Inc.

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[Exhibit 31.1](#)

[CERTIFICATIONS UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002](#)

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

I, Daniel Lender, certify that:

1. I have reviewed this Annual Report on Form 10-K 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
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- 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: April 15, 2005

/s/ DANIEL LENDER

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Daniel Lender  
*Chief Financial Officer*  
QAD Inc.

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[Exhibit 31.2](#)

[CERTIFICATIONS UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002](#)

**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 Annual Report of QAD Inc. (the "Company") on Form 10-K for the period ending January 31, 2005 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: April 15, 2005

/s/ KARL F. LOPKER

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Karl F. Lopker  
Chief Executive Officer  
QAD Inc.

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[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](#)

**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 Annual Report of QAD Inc. (the "Company") on Form 10-K for the period ending January 31, 2005 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: April 15, 2005

/s/ DANIEL LENDER

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Daniel Lender  
*Chief Financial Officer*  
QAD Inc.

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[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](#)