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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **July 31, 2015**

OR

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

For the transition period from _____ to _____

Commission file number **0-22823**

QAD Inc.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

77-0105228

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

100 Innovation Place, Santa Barbara, California 93108

(Address of principal executive offices)

(805) 566-6000

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐.

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

Large accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Accelerated filer ☒

Smaller reporting company ☐

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

As of August 31, 2015, there were 15,553,704 shares of the Registrant's Class A common stock outstanding and 3,202,526 shares of the Registrant's Class B common stock outstanding.

QAD INC.
INDEX

PART I - FINANCIAL INFORMATION

Page

ITEM 1.	<u>Financial Statements (unaudited)</u>	
	<u>Condensed Consolidated Balance Sheets as of July 31, 2015 and January 31, 2015</u>	1
	<u>Condensed Consolidated Statements of Income and Comprehensive Income for the Three and Six Months Ended July 31, 2015 and 2014</u>	2
	<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended July 31, 2015 and 2014</u>	3
	<u>Notes to Condensed Consolidated Financial Statements</u>	4
ITEM 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
ITEM 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
ITEM 4.	<u>Controls and Procedures</u>	34
PART II - OTHER INFORMATION		
ITEM 1.	<u>Legal Proceedings</u>	35
ITEM 1A.	<u>Risk Factors</u>	35
ITEM 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
ITEM 3.	<u>Defaults Upon Senior Securities</u>	35
ITEM 4.	<u>Mine Safety Disclosure</u>	35
ITEM 5.	<u>Other Information</u>	35
ITEM 6	<u>Exhibits</u>	35
	<u>SIGNATURES</u>	36

PART I

ITEM 1 – FINANCIAL STATEMENTS

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

	<u>July 31, 2015</u>	<u>January 31, 2015</u>
Assets		
Current assets:		
Cash and equivalents	\$ 130,085	\$ 120,526
Accounts receivable, net of allowances of \$2,708 and \$2,524 at July 31, 2015 and January 31, 2015, respectively	45,957	78,887
Deferred tax assets, net	8,937	9,313
Other current assets	14,617	14,799
Total current assets	<u>199,596</u>	<u>223,525</u>
Property and equipment, net	32,685	33,154
Capitalized software costs, net	1,973	2,485
Goodwill	10,722	10,911
Deferred tax assets, net	10,298	9,680
Other assets, net	3,160	3,614
Total assets	<u>\$ 258,434</u>	<u>\$ 283,369</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 413	\$ 406
Accounts payable	8,047	12,872
Deferred revenue	82,505	102,721
Other current liabilities	27,237	35,765
Total current liabilities	<u>118,202</u>	<u>151,764</u>
Long-term debt	14,469	14,680
Other liabilities	4,200	5,219
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value. Authorized 5,000,000 shares; none issued or outstanding	—	—
Common stock:		
Class A, \$0.001 par value. Authorized 71,000,000 shares; issued 16,603,729 shares and 16,152,405 shares at July 31, 2015 and January 31, 2015, respectively	17	16
Class B, \$0.001 par value. Authorized 4,000,000 shares; issued 3,537,326 shares and 3,537,298 shares at July 31, 2015 and January 31, 2015, respectively	4	4
Additional paid-in capital	192,800	185,546
Treasury stock, at cost (1,394,152 shares and 1,609,958 shares at July 31, 2015 and January 31, 2015, respectively)	(19,220)	(22,977)
Accumulated deficit	(43,948)	(43,465)
Accumulated other comprehensive loss	(8,090)	(7,418)
Total stockholders' equity	<u>121,563</u>	<u>111,706</u>
Total liabilities and stockholders' equity	<u>\$ 258,434</u>	<u>\$ 283,369</u>

See Accompanying Notes to Condensed Consolidated Financial Statements.

QAD INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Revenue:				
License fees	\$ 8,560	\$ 8,963	\$ 15,411	\$ 15,615
Subscription fees	9,145	6,442	18,564	12,634
Maintenance and other	33,833	36,120	67,216	72,196
Professional services	19,753	21,525	39,365	41,090
Total revenue	<u>71,291</u>	<u>73,050</u>	<u>140,556</u>	<u>141,535</u>
Costs of revenue:				
License fees	972	1,153	1,901	2,053
Subscription fees	5,162	4,212	10,226	7,998
Maintenance and other	7,907	8,253	15,684	16,423
Professional services	18,587	19,601	36,915	38,176
Total cost of revenue	<u>32,628</u>	<u>33,219</u>	<u>64,726</u>	<u>64,650</u>
Gross profit	<u>38,663</u>	<u>39,831</u>	<u>75,830</u>	<u>76,885</u>
Operating expenses:				
Sales and marketing	16,982	17,421	34,127	33,898
Research and development	10,590	10,902	21,247	22,097
General and administrative	8,602	9,265	17,043	18,169
Amortization of intangibles from acquisitions	166	179	330	359
Total operating expenses	<u>36,340</u>	<u>37,767</u>	<u>72,747</u>	<u>74,523</u>
Operating income	2,323	2,064	3,083	2,362
Other (income) expense:				
Interest income	(87)	(56)	(144)	(113)
Interest expense	190	232	373	413
Other (income) expense, net	(413)	(118)	(532)	108
Total other (income) expense	<u>(310)</u>	<u>58</u>	<u>(303)</u>	<u>408</u>
Income before income taxes	2,633	2,006	3,386	1,954
Income tax expense	<u>1,002</u>	<u>1,021</u>	<u>1,206</u>	<u>1,045</u>
Net income	<u>\$ 1,631</u>	<u>\$ 985</u>	<u>\$ 2,180</u>	<u>\$ 909</u>
Basic net income per share				
Class A	\$ 0.09	\$ 0.06	\$ 0.12	\$ 0.06
Class B	\$ 0.08	\$ 0.05	\$ 0.10	\$ 0.05
Diluted net income per share				
Class A	\$ 0.09	\$ 0.06	\$ 0.12	\$ 0.06
Class B	\$ 0.07	\$ 0.05	\$ 0.10	\$ 0.05
Net income				
Other comprehensive income, net of tax:	\$ 1,631	\$ 985	\$ 2,180	\$ 909
Foreign currency translation adjustment	(745)	(346)	(672)	(207)
Total comprehensive income	<u>\$ 886</u>	<u>\$ 639</u>	<u>\$ 1,508</u>	<u>\$ 702</u>

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended July 31,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 2,180	\$ 909
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,887	2,841
Provision for doubtful accounts and sales adjustments	432	204
Stock compensation expense	3,737	2,585
Change in fair value of derivative instrument	(351)	107
Excess tax benefits from share-based payment arrangements	(1,078)	(133)
Other, net	—	32
Changes in assets and liabilities:		
Accounts receivable	31,283	18,476
Other assets	748	(252)
Accounts payable	(4,474)	(1,835)
Deferred revenue	(19,184)	(13,414)
Other liabilities	(7,023)	(4,055)
Net cash provided by operating activities	<u>9,157</u>	<u>5,465</u>
Cash flows from investing activities:		
Purchase of property and equipment	(1,653)	(1,473)
Capitalized software costs	(39)	(123)
Net cash used in investing activities	<u>(1,692)</u>	<u>(1,596)</u>
Cash flows from financing activities:		
Repayments of debt	(204)	(194)
Tax payments, net of proceeds, related to stock awards	(2,165)	(2,247)
Payment of contingent liability associated with acquisitions	(750)	(471)
Excess tax benefits from share-based payment arrangements	1,078	133
Proceeds from issuance of common stock, net of issuance costs	8,365	—
Cash dividends paid	(2,609)	(2,216)
Net cash provided by (used in) financing activities	<u>3,715</u>	<u>(4,995)</u>
Effect of exchange rates on cash and equivalents	<u>(1,621)</u>	<u>481</u>
Net increase (decrease) in cash and equivalents	9,559	(645)
Cash and equivalents at beginning of period	<u>120,526</u>	<u>75,984</u>
Cash and equivalents at end of period	<u>\$ 130,085</u>	<u>\$ 75,339</u>
Supplemental disclosure of non-cash activities:		
Obligations associated with dividend declaration	\$ —	\$ —

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

1. BASIS OF PRESENTATION AND RECENT ACCOUNTING PRONOUNCEMENTS

Basis of Presentation

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements fairly present the financial information contained therein. These statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In management's opinion, all necessary adjustments, consisting of normal, recurring and non-recurring adjustments, have been included in the accompanying Condensed Consolidated Financial Statements to present fairly the financial position and operating results of QAD Inc. ("QAD" or the "Company"). The Condensed Consolidated Financial Statements do not include all disclosures required by accounting principles generally accepted in the United States of America for annual financial statements and should be read in conjunction with the audited financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended January 31, 2015. The Condensed Consolidated Financial Statements include the results of the Company and its wholly owned subsidiaries. The results of operations for the three and six months ended July 31, 2015 are not necessarily indicative of the results to be expected for the year ending January 31, 2016.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 will be effective for the Company's fiscal year beginning February 1, 2018. Early adoption is permitted for the Company's fiscal year beginning February 1, 2017. The standard permits the use of either the retrospective or cumulative transition method. The Company is currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

2. COMPUTATION OF NET INCOME PER SHARE

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
	(in thousands, except per share data)		(in thousands, except per share data)	
Net income	\$ 1,631	\$ 985	\$ 2,180	\$ 909
Less: Dividends declared	(1,310)	(1,113)	(2,609)	(2,216)
Undistributed net income (loss)	<u>\$ 321</u>	<u>\$ (128)</u>	<u>\$ (429)</u>	<u>\$ (1,307)</u>
Net income per share – Class A Common Stock				
Dividends declared	\$ 1,118	\$ 922	\$ 2,225	\$ 1,835
Allocation of undistributed net income (loss)	<u>274</u>	<u>(106)</u>	<u>(365)</u>	<u>(1,081)</u>
Net income attributable to Class A common stock	<u>\$ 1,392</u>	<u>\$ 816</u>	<u>\$ 1,860</u>	<u>\$ 754</u>
Weighted average shares of Class A common stock outstanding— <i>basic</i>	15,467	12,768	15,367	12,700
Weighted average potential shares of Class A common stock	<u>794</u>	<u>737</u>	<u>793</u>	<u>772</u>
Weighted average shares of Class A common stock and potential common shares outstanding— <i>diluted</i>	<u>16,261</u>	<u>13,505</u>	<u>16,160</u>	<u>13,472</u>
Basic net income per Class A common share	<u>\$ 0.09</u>	<u>\$ 0.06</u>	<u>\$ 0.12</u>	<u>\$ 0.06</u>
Diluted net income per Class A common share	<u>\$ 0.09</u>	<u>\$ 0.06</u>	<u>\$ 0.12</u>	<u>\$ 0.06</u>
Net income per share – Class B Common Stock				
Dividends declared	\$ 192	\$ 191	\$ 384	\$ 381
Allocation of undistributed net income (loss)	<u>47</u>	<u>(22)</u>	<u>(64)</u>	<u>(226)</u>
Net income attributable to Class B common stock	<u>\$ 239</u>	<u>\$ 169</u>	<u>\$ 320</u>	<u>\$ 155</u>
Weighted average shares of Class B common stock outstanding— <i>basic</i>	3,201	3,181	3,198	3,175
Weighted average potential shares of Class B common stock	<u>83</u>	<u>92</u>	<u>84</u>	<u>98</u>
Weighted average shares of Class B common stock and potential common shares outstanding— <i>diluted</i>	<u>3,284</u>	<u>3,273</u>	<u>3,282</u>	<u>3,273</u>
Basic net income per Class B common share	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.10</u>	<u>\$ 0.05</u>
Diluted net income per Class B common share	<u>\$ 0.07</u>	<u>\$ 0.05</u>	<u>\$ 0.10</u>	<u>\$ 0.05</u>

Potential common shares consist of the shares issuable upon the release of restricted stock units (“RSUs”) and the exercise of stock options and stock appreciation rights (“SARs”). The Company’s unvested RSUs and unexercised SARs are not considered participating securities as they do not have rights to dividends or dividend equivalents prior to release or exercise.

The following table sets forth the number of potential common shares not included in the calculation of diluted earnings per share because their effects were anti-dilutive:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Class A	504	312	478	159
Class B	95	40	78	24

3. FAIR VALUE MEASUREMENTS

When determining fair value, the Company uses a three-tier value hierarchy which prioritizes the inputs used in measuring fair value. Whenever possible, the Company uses observable market data. The Company relies on unobservable inputs only when observable market data is not available. Classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

- Level 1 - Money market mutual funds are recorded at fair value based upon quoted market prices.
- Level 2 - The asset or liability related to the interest rate swap is recorded at fair value based upon a valuation model that uses relevant observable market inputs at quoted intervals, such as forward yield curves.
- Level 3 - The contingent liability associated with the acquisition of CEBOS is recorded at fair value based on significant inputs that are not observable in the market. This measure includes an assessment of the probability of achieving certain milestones and discounting the amount of each potential payment based on expected timing of the payment. Key assumptions include a discount rate of 4.6%, probability of achieving profitability and probability of achieving product development goals. As of January 31, 2015, there was one remaining future payment due April 2015 which consisted of a guaranteed payment of \$0.3 million and \$0.5 million contingent upon certain milestones. The maximum contingent liability of \$0.8 million was paid in March 2015.

The following table sets forth the financial assets, measured at fair value, as of July 31, 2015 and January 31, 2015:

	Fair value measurement at reporting date using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)		
Money market mutual funds as of July 31, 2015	\$ 110,476		
Money market mutual funds as of January 31, 2015	\$ 98,294		
Liability related to the interest rate swap as of July 31, 2015		\$ (275)	
Liability related to the interest rate swap as of January 31, 2015		\$ (626)	
Contingent liability associated with acquisitions as of July 31, 2015			\$ -
Contingent liability associated with acquisitions as of January 31, 2015			\$ (750)

Money market mutual funds are classified as part of “Cash and equivalents” in the accompanying Condensed Consolidated Balance Sheets. In addition, the amount of cash and equivalents, including cash deposited with commercial banks, was \$20 million and \$22 million as of July 31, 2015 and January 31, 2015, respectively.

The Company’s line of credit and notes payable both bear a variable market interest rate commensurate with the Company’s credit standing. Therefore, the carrying amounts outstanding under the line of credit and note payable reasonably approximate fair value based on Level 2 inputs.

There have been no transfers between fair value measurements levels during the six months ended July 31, 2015.

Derivative Instruments

The Company entered into an interest rate swap in May 2012 to mitigate the exposure to the variability of one month LIBOR for its floating rate debt described in Note 6 “Debt” within these Notes to Condensed Consolidated Financial Statements. The fair value of the interest rate swap is reflected as an asset or liability in the Condensed Consolidated Balance Sheets and the change in fair value is reported in “Other (income) expense” in the Condensed Consolidated Statements of Income and Comprehensive Income. The fair value of the interest rate swap is estimated as the net present value of projected cash flows based upon forward interest rates at the balance sheet date.

The fair values of the derivative instrument at July 31, 2015 and January 31, 2015 were as follows (in thousands):

	(Liability) Derivative		
	Balance Sheet Location	Fair Value	
		July 31, 2015	January 31, 2015
Derivative instrument:			
Interest rate swap	Other liabilities	\$ (275)	\$ (626)
Total		<u>\$ (275)</u>	<u>\$ (626)</u>

The change in fair value of the interest rate swap recognized in the Condensed Consolidated Statements of Income and Comprehensive Income for the six months ended July 31, 2015 and 2014 was \$351,000 and \$(107,000), respectively.

4. CAPITALIZED SOFTWARE COSTS

Capitalized software costs and accumulated amortization at July 31, 2015 and January 31, 2015 were as follows:

	July 31, 2015	January 31, 2015
	(in thousands)	
Capitalized software costs:		
Acquired software technology	\$ 3,458	\$ 3,458
Capitalized software development costs (1)	<u>1,067</u>	<u>1,206</u>
	4,525	4,664
Less accumulated amortization	<u>(2,552)</u>	<u>(2,179)</u>
Capitalized software costs, net	<u>\$ 1,973</u>	<u>\$ 2,485</u>

- (1) Capitalized software development costs include the impact of foreign currency translation.

Acquired software technology costs relate to technology purchased as a result of the Company’s fiscal 2013 acquisitions of DynaSys and CEBOS. In addition to the acquired software technology, the Company has capitalized costs related to translations and localizations of QAD Enterprise Applications.

Amortization of capitalized software costs was \$0.5 million and \$0.6 million for the six months ended July 31, 2015 and 2014, respectively. Amortization of capitalized software costs is included in “Cost of license fees” in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income.

The following table summarizes the estimated amortization expense relating to the Company’s capitalized software costs as of July 31, 2015:

Fiscal Years	(in thousands)
2016 remaining	\$ 524
2017	917
2018	525
2019	7
	<u>\$ 1,973</u>

5. GOODWILL AND INTANGIBLE ASSETS*Goodwill*

The changes in the carrying amount of goodwill for the six months ended July 31, 2015 were as follows:

	Gross Carrying Amount	Accumulated Impairment (in thousands)	Goodwill, Net
Balance at January 31, 2015	\$ 26,519	\$ (15,608)	\$ 10,911
Impact of foreign currency translation	(189)	—	(189)
Balance at July 31, 2015	<u>\$ 26,330</u>	<u>\$ (15,608)</u>	<u>\$ 10,722</u>

The Company performed its annual goodwill impairment review during the fourth quarter of fiscal 2015. The analysis compared the Company's market capitalization to its net assets as of the test date, November 30, 2014. As the market capitalization significantly exceeded the Company's net assets, there was no indication of goodwill impairment for fiscal 2015. The Company monitors the indicators for goodwill impairment testing between annual tests. No adverse events occurred during the six months ended July 31, 2015, that would cause the Company to test goodwill for impairment.

Intangible Assets

	July 31, 2015	January 31, 2015
	(in thousands)	
Amortizable intangible assets		
Customer relationships (1)	\$ 2,749	\$ 2,793
Trade name	515	515
	<u>3,264</u>	<u>3,308</u>
Less: accumulated amortization	(1,863)	(1,558)
Net amortizable intangible assets	<u>\$ 1,401</u>	<u>\$ 1,750</u>

(1) Customer relationships include the impact of foreign currency translation.

The Company's intangible assets are related to the DynaSys and CEBOS acquisitions completed in fiscal 2013. Intangible assets are included in "Other assets, net" in the accompanying Condensed Consolidated Balance Sheets. As of July 31, 2015, all of the Company's intangible assets were determined to have finite useful lives, and therefore were subject to amortization.

Amortization of intangible assets was \$0.3 million and \$0.4 million for the six months ended July 31, 2015 and 2014, respectively. The following table summarizes the estimated amortization expense relating to the Company's intangible assets as of July 31, 2015:

Fiscal Years	(in thousands)
2016 remaining	\$ 328
2017	656
2018	417
	<u>\$ 1,401</u>

6. DEBT

	July 31, 2015	January 31, 2015
	(in thousands)	
Note payable	\$ 14,882	\$ 15,086
Less current maturities	(413)	(406)
Long-term debt	<u>\$ 14,469</u>	<u>\$ 14,680</u>

Note Payable

Effective May 30, 2012, QAD Ortega Hill, LLC entered into a variable rate credit agreement (the “2012 Mortgage”) with Rabobank, N.A., to refinance a pre-existing mortgage. The 2012 Mortgage has an original principal balance of \$16.1 million and bears interest at the one month LIBOR rate plus 2.25%. One month LIBOR was 0.19% at July 31, 2015. The 2012 Mortgage matures in June 2022 and is secured by the Company’s headquarters located in Santa Barbara, California. In conjunction with the 2012 Mortgage, QAD Ortega Hill, LLC entered into an interest rate swap with Rabobank, N.A. The swap agreement has an initial notional amount of \$16.1 million and a schedule matching that of the underlying loan that synthetically fixes the interest rate on the debt at 4.31% for the entire term of the 2012 Mortgage. The terms of the 2012 Mortgage provide for QAD Ortega Hill, LLC to make net monthly payments of \$88,100 consisting of principal and interest and one final payment of \$11.7 million. The unpaid balance as of July 31, 2015 was \$14.9 million.

Credit Facility

The Company has an unsecured credit agreement with Rabobank, N.A. (the “Facility”). The Facility provides a commitment through July 15, 2017 for a \$20 million line of credit for working capital or other business needs. The Company pays a commitment fee of 0.25% per annum of the daily average of the unused portion of the \$20 million Facility. Borrowings under the Facility bore interest at a rate equal to one month LIBOR plus 0.75%. At July 31, 2015, the effective borrowing rate would have been 0.94%.

The Facility provides that the Company maintain certain financial and operating ratios which include, among other provisions, minimum liquidity on a consolidated basis of \$25 million in cash and equivalents at all times, a current ratio (calculated using current liabilities excluding deferred revenue) of not less than 1.3 to 1.0 determined at the end of each fiscal quarter, a leverage ratio of not more than 1.5 to 1.0 determined at the end of each fiscal quarter, and a debt service coverage ratio of not less than 1.5 to 1.0 determined at the end of each fiscal year. The Facility also contains customary covenants that could restrict the Company’s ability to incur additional indebtedness.

As of July 31, 2015, there were no borrowings under the Facility and the Company was in compliance with all financial covenants.

7. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss, net of taxes, were as follows:

	Foreign Currency Translation Adjustments (in thousands)
Balance as of January 31, 2015	\$ (7,418)
Other comprehensive income	(672)
Amounts reclassified from accumulated other comprehensive loss	—
Net current period other comprehensive income	(672)
Balance as of July 31, 2015	<u>\$ (8,090)</u>

During the first six months of fiscal 2016 there were no reclassifications from accumulated other comprehensive loss.

8. INCOME TAXES

The gross amount of unrecognized tax benefits was \$1.8 million at July 31, 2015, including interest and penalties. During the first quarter of fiscal 2015 the Company adopted ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"), which requires an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, similar tax loss, or a tax credit carryforward. As a result of adoption of ASU 2013-11, the Company reduced its unrecognized tax benefits by \$1.3 million with an accompanying reduction of deferred tax assets by \$1.3 million. The entire amount of unrecognized tax benefits, if recognized, will impact the Company's effective tax rate. This liability is classified as long-term unless the liability is expected to conclude within twelve months of the reporting date. In the next twelve months, due to potential settlements with domestic tax authorities related to tax credits and lapse in statute of limitations, an estimated \$0.1 million of unrecognized tax benefits may be recognized.

The Company's policy is to recognize interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense. As of July 31, 2015, the Company has accrued approximately \$0.2 million of interest and penalty expense relating to unrecognized tax benefits.

The Company files U.S. federal, state, and foreign tax returns that are subject to audit by various tax authorities. The Company is currently under audit in:

- India for fiscal years ended March 31, 1998, 1999, 2009, 2010, 2012 and 2013
- Italy for the fiscal years ended 2011, 2012, 2013 and 2014

During the first six months of fiscal 2016, QAD has settled the following audits with immaterial or no adjustments made as a result of the settlements:

- India for the fiscal year ended March 31, 2008
- California for the fiscal year ended 2004
- Minnesota for the fiscal years ended 2010, 2011, 2012 and 2013

9. STOCKHOLDERS' EQUITY

Issuance of Common Stock

On January 22, 2015, the Company closed an offering of 2,000,000 shares of Class A common stock. The net proceeds to the Company from the sale of the stock were \$37.0 million after deducting underwriting discounts and commissions and offering expenses. On February 18, 2015 the offering underwriters exercised in full an option to purchase additional shares. As a result, 450,000 shares of Class A common stock were issued generating approximately \$8.4 million in additional net proceeds.

Dividends

The following table sets forth the dividends that were declared by the Company during the first six months of fiscal 2016:

Declaration Date	Record Date	Payable	Dividend Class A	Dividend Class B	Amount
6/9/2015	6/23/2015	6/30/2015	\$ 0.072	\$ 0.06	\$ 1,310,000
4/15/2015	4/29/2015	5/6/2015	\$ 0.072	\$ 0.06	\$ 1,299,000

10. STOCK-BASED COMPENSATION

The Company's equity awards consist of SARs and RSUs. For a description of the Company's stock-based compensation plans, see Note 5 "Stock-Based Compensation" in Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended January 31, 2015.

Stock-Based Compensation

The following table sets forth reported stock-based compensation expense for the three and six months ended July 31, 2015 and 2014:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Cost of subscription	\$ 22	\$ 14	\$ 34	\$ 22
Cost of maintenance and other revenue	87	48	133	77
Cost of professional services	234	156	353	243
Sales and marketing	429	257	690	384
Research and development	290	176	438	268
General and administrative	1,369	1,058	2,089	1,591
Total stock-based compensation expense	<u>\$ 2,431</u>	<u>\$ 1,709</u>	<u>\$ 3,737</u>	<u>\$ 2,585</u>

SAR Information

The weighted average assumptions used to value SARs granted in the six months ended July 31, 2015 and 2014 are shown in the following table:

	Six Months Ended July 31,	
	2015	2014
Expected life in years ⁽¹⁾	5.00	4.98
Risk free interest rate ⁽²⁾	1.64%	1.58%
Volatility ⁽³⁾	41%	47%
Dividend rate ⁽⁴⁾	1.10%	1.32%

-
- (1) The expected life of SARs granted under the stock-based compensation plans is based on historical vested SAR exercise and post-vest forfeiture patterns and includes an estimate of the expected term for SARs that were fully vested and outstanding.
 - (2) The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of SARs in effect at the time of grant.
 - (3) The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of the Company's common stock for a period equivalent to the expected life of the SARs, which it believes is representative of the expected volatility over the expected life of the SARs.
 - (4) The Company expects to continue paying quarterly dividends at the same rate as the six months ending on July 31, 2015.

The following table summarizes the activity for outstanding SARs for the six months ended July 31, 2015:

	SARs (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 31, 2015	2,499	\$ 12.69		
Granted	380	25.34		
Exercised	(211)	10.85		
Expired	(10)	14.63		
Forfeited	(3)	12.10		
Outstanding at July 31, 2015	<u>2,655</u>	\$ 14.64	5.2	\$ 30,152
Vested and expected to vest at July 31, 2015 ⁽¹⁾	<u>2,646</u>	\$ 14.65	5.2	\$ 30,020
Vested and exercisable at July 31, 2015	<u>1,497</u>	\$ 11.49	4.2	\$ 21,697

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

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the aggregate difference between the closing stock price of the Company's common stock based on the last trading day as of July 31, 2015, and the exercise price for in-the-money SARs) that would have been received by the holders if all SARs had been exercised on July 31, 2015. The total intrinsic value of SARs exercised in the six months ended July 31, 2015 was \$2.9 million.

The number of SARs exercised includes shares withheld on behalf of employees to satisfy minimum statutory tax withholding requirements. During the three months ended July 31, 2015, the Company withheld 18,400 shares for payment of these taxes at a value of \$0.5 million. During the six months ended July 31, 2015, the Company withheld 34,100 shares for payment of these taxes at a value of \$0.9 million.

At July 31, 2015, there was approximately \$7.3 million of total unrecognized compensation cost related to unvested SARs. This cost is expected to be recognized over a weighted-average period of approximately 2.9 years.

RSU Information

The estimated fair value of RSUs was calculated based on the closing price of the Company's common stock on the date of grant, reduced by the present value of dividends foregone during the vesting period.

The following table summarizes the activity for RSUs for the six months ended July 31, 2015:

	RSUs (in thousands)	Weighted Average Grant Date Fair Value
Restricted stock at January 31, 2015	503	\$ 16.27
Granted	323	24.77
Released ⁽¹⁾	(183)	15.48
Forfeited	(13)	18.18
Restricted stock at July 31, 2015	<u>630</u>	\$ 20.84

(1) The number of RSUs released includes shares withheld on behalf of employees to satisfy the minimum statutory tax withholding requirements.

The Company withholds, at the employee's election, a portion of the released shares as consideration for the Company's payment of applicable employee income taxes. During the three months ended July 31, 2015, the Company withheld 48,800 shares for payment of these taxes at a value of \$1.3 million. During the six months ended July 31, 2015, the Company withheld 49,400 shares for payment of these taxes at a value of \$1.3 million.

Total unrecognized compensation cost related to RSUs was approximately \$10.9 million as of July 31, 2015. This cost is expected to be recognized over a weighted-average period of approximately 3.2 years.

11. DEFERRED REVENUES

Deferred revenues consisted of the following:

	July 31, 2015	January 31, 2015
	(in thousands)	
Deferred maintenance revenue	\$ 66,529	\$ 86,381
Deferred subscription revenue	12,073	11,563
Deferred services revenue	2,581	2,813
Deferred license revenue	1,266	1,890
Deferred other revenue	56	74
Deferred revenues, current	82,505	102,721
Deferred revenues, non-current (in Other liabilities)	1,869	2,361
Total deferred revenues	<u>\$ 84,374</u>	<u>\$ 105,082</u>

Deferred maintenance and subscription revenues represent customer payments made in advance for support and subscription contracts. Support and subscription are billed in advance with corresponding revenues being recognized ratably over the support and subscription periods. Support is typically billed annually while subscription is typically billed quarterly. Deferred license revenues result from undelivered products or specified enhancements, customer specific acceptance provisions and software license transactions that cannot be segmented from undelivered consulting or other services. Deferred services revenues represent both prepayments for our professional services where revenues for these services are generally recognized as the Company completes the performance obligations for the prepaid services; and services already provided but deferred due to software revenue recognition rules.

12. COMMITMENTS AND CONTINGENCIES

Indemnifications

The Company sells software licenses and services to its customers under written agreements. Each agreement contains the relevant terms of the contractual arrangement with the customer and generally includes certain provisions for indemnifying the customer against losses, expenses and liabilities from damages that may be awarded against the customer in the event the Company's software is found to infringe upon certain intellectual property rights of a third party. The agreements generally limit the scope of and remedies for such indemnification obligations in a variety of industry-standard respects.

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

Legal Actions

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

13. BUSINESS SEGMENT INFORMATION

The Company markets its products and services worldwide, primarily to companies in the manufacturing industry, including automotive, consumer products, food and beverage, high technology, industrial products and life sciences industries. The Company sells and licenses its products through its direct sales force in four geographic regions: North America; Europe, the Middle East and Africa ("EMEA"); Asia Pacific; and Latin America and through distributors where third parties can extend sales reach more effectively or efficiently. 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 Company's Chief Operating Decision Maker, the Chief Executive Officer, reviews the consolidated results within one operating segment.

License and subscription revenues are assigned to the geographic regions based on both the proportion of users in each region and sales effort. Maintenance revenue is allocated to the region where the end user customer is located. Services revenue is assigned based on the region where the services are performed.

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Revenue:				
North America ⁽¹⁾	\$ 33,529	\$ 30,907	\$ 63,751	\$ 60,046
EMEA	21,552	25,731	43,354	49,882
Asia Pacific	11,597	11,871	23,322	23,203
Latin America	4,613	4,541	10,129	8,404
	<u>\$ 71,291</u>	<u>\$ 73,050</u>	<u>\$ 140,556</u>	<u>\$ 141,535</u>

(1) Sales into Canada accounted for 2% of North America total revenue in each of the three and six months ended July 31, 2015 and 2014.

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

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Any statements contained herein that are not statements of historical fact should be construed as forward looking statements, including statements that are preceded or accompanied by such words as “may,” “believe,” “could,” “anticipate,” “would,” “might,” “plan,” “expect,” “intend” and words of similar meaning or the negative of these terms or other comparable terminology. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Part I, Item 1A entitled “Risk Factors” within our Annual Report on Form 10-K for the year ended January 31, 2015. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s opinions only as of the date hereof and are subject to risks, uncertainties and assumptions about our business. We undertake no obligation to revise or update or publicly release the results of any revision or update to these forward-looking statements except as required by applicable securities laws. 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 (“SEC”).

INTRODUCTION

The following discussion should be read in conjunction with the information included within our Annual Report on Form 10-K for the year ended January 31, 2015, and the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

CRITICAL ACCOUNTING POLICIES

Our condensed consolidated financial statements are prepared applying certain critical accounting policies. The SEC defines “critical accounting policies” as those that require application of management’s most difficult, subjective, or complex judgments. Critical accounting policies require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect our reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions, or estimates in any of these areas could have a material impact on our future financial condition and results of operations. Our financial statements are prepared in accordance with U.S. GAAP, and they conform to general practices in our industry. We apply critical accounting policies consistently from period to period and intend that any change in methodology occur in an appropriate manner. Accounting policies currently deemed critical, including a) revenue recognition; b) accounts receivable allowances for bad debt and sales returns; c) capitalized software development costs; d) impairment assessments on goodwill and intangible assets; e) business combinations; f) valuation of deferred tax assets and tax contingency reserves; and g) stock-based compensation are further discussed in the Annual Report on Form 10-K for the fiscal year ended January 31, 2015. There have been no significant changes to our accounting policies and estimates as discussed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015.

BUSINESS OVERVIEW

QAD Inc. (“QAD”, the “Company”, “we” or “us”) is a leading global provider of vertically-oriented, mission-critical enterprise software solutions for global manufacturing companies across the automotive, life sciences, consumer products, food and beverage, high technology and industrial products industries. Our mission is to deliver best-in-class software that enables our customers to operate more effectively on a global basis. QAD Enterprise Applications enables measurement and control of key business processes and supports operational requirements. We deliver our software solutions to our customers in a format that best meets their current and future needs - either in the cloud, on premise, or blended. Increasingly, our customers are selecting either a cloud-based deployment or a blended deployment, which is a combination of on-premise and cloud-based software, as they expand their businesses globally and as they recognize the benefits of full featured ERP cloud-based software.

At the core of our solutions is our enterprise resource planning (“ERP”) suite called QAD Enterprise Applications or MFG/PRO. Our ERP suite is also deployed in the cloud as QAD Cloud ERP. QAD Enterprise Applications supports the core business processes of our global manufacturing customers, including key functions in the following areas: financials, customer management, manufacturing, demand and supply chain planning, supply chain execution, transportation management, service and support, enterprise asset management, analytics, enterprise quality management, interoperability, process and performance, and internationalization. We also focus on the foundation and technology of our applications, such as user interface and usability.

We have four principal sources of revenue:

- License purchases of our Enterprise Applications;
- Subscription of our Enterprise Applications through our cloud offering in a Software as a Service (“SaaS”) model as well as other hosted Internet applications;
- Maintenance and support, including technical support, training materials, product enhancements and upgrades; and
- Professional services, including implementations, technical and application consulting, training, migrations and upgrades.

We operate primarily in the following four geographic regions: North America, Latin America, EMEA and Asia Pacific. In the first half of fiscal 2016, approximately 45% of our total revenue was generated in North America, 31% in EMEA, 17% in Asia Pacific and 7% in Latin America. The majority of our revenue is generated from global customers who have operations in multiple countries throughout the world. License and subscription revenues are assigned to the geographic regions based on both the proportion of users in each region and sales effort. Maintenance revenue is allocated to the region where the end user is located. Services revenue is assigned based on the region where the services are performed. A significant portion of our revenue and expenses are derived from international operations which are primarily conducted in foreign currencies. As a result, changes in the value of foreign currencies relative to the U.S. dollar have impacted our results of operations and may impact our future results of operations. At July 31, 2015, we employed approximately 1,690 employees worldwide, of which 640 employees were based in North America, 500 employees in EMEA, 470 employees in Asia Pacific and 80 employees in Latin America.

Our customer base and our target markets are global manufacturing companies; therefore, our results are heavily influenced by the state of the manufacturing economy on a global basis. As a result, our management team monitors several economic indicators, with particular attention to the Global and Country Purchasing Managers’ Indexes (“PMI”). The PMI is a survey conducted on a monthly basis by polling businesses that represent the makeup of respective sectors. Since most of our customers are manufacturers, our revenue has historically correlated with fluctuations in the manufacturing PMI. Global macro economic trends and manufacturing spending are important barometers for our business, and the health of the U.S., Western European and Asian economies have a meaningful impact on our financial results.

Our business model is evolving. We continue to assess current business offerings and introduce more flexible license and service offerings in the cloud which have ratable revenue streams. The accounting impact of these cloud offerings and other business decisions are expected to result in an increase in the percentage of our ratable revenue, making for more predictable revenue over time, while correspondingly reducing our up-front perpetual license revenue stream. Over time, we expect our business model transition to expand our customer base by eliminating higher up-front licensing costs and providing more flexibility in how customers gain access to and pay for our products. We expect this business model transition will increase our long-term revenue growth rate by increasing total subscriptions and customer value over time.

We remain diligent about managing our expenditures while making essential investments to drive growth. If we are unable to successfully achieve our major business initiatives we may not achieve our financial goals.

OVERVIEW OF THE FIRST SIX MONTHS OF FISCAL 2016

A significant portion of our business is conducted in currencies other than the U.S. dollar, particularly the euro. We operate in several geographical regions as described in Note 13 “Business Segment Information” within the Notes to Condensed Consolidated Financial Statements. In the first half of fiscal 2016, approximately 55% of our total revenue was generated outside of North America and we expect to continue generating a significant portion of our revenue outside the U.S. Weakening of the value of the U.S. dollar compared to foreign currency exchange rates generally has the effect of increasing our revenues but also increasing our expenses denominated in currencies other than the U.S. dollar. Similarly, strengthening of the U.S. dollar compared to foreign currency exchange rates generally has the effect of reducing our revenues but also reducing our expenses denominated in currencies other than the U.S. dollar. We plan our business accordingly by deploying additional resources to areas of expansion, while continuing to monitor our overall expenditures given the economic uncertainties of our target markets. In order to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency fluctuations, we compare the changes in results from one period to another period using constant currency. In order to calculate our constant currency results, we apply the current foreign currency exchange rates to the prior period results. In the table below, we present the change based on actual results in reported currency and in constant currency.

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported
<i>(in thousands)</i>					
Total revenue	\$ 71,291	\$ 73,050	\$ 3,814	\$ (5,573)	\$ (1,759)
Cost of revenue	32,628	33,219	(1,678)	2,269	591
Gross profit	38,663	39,831	2,136	(3,304)	(1,168)
Operating expenses	36,340	37,767	(714)	2,141	1,427
Income from operations	\$ 2,323	\$ 2,064	\$ 1,422	\$ (1,163)	\$ 259

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported
<i>(in thousands)</i>					
Total revenue	\$ 140,556	\$ 141,535	\$ 9,962	\$ (10,941)	\$ (979)
Cost of revenue	64,726	64,650	(4,493)	4,417	(76)
Gross profit	75,830	76,885	5,469	(6,524)	(1,055)
Operating expenses	72,747	74,523	(2,405)	4,181	1,776
Income from operations	\$ 3,083	\$ 2,362	\$ 3,064	\$ (2,343)	\$ 721

Operating Results. Our results were significantly impacted by foreign currency fluctuations. Total revenue for the first six months of fiscal 2016 decreased by 1%, to \$140.6 million, when compared to the same period last year. Currency had an adverse impact on total revenue of \$10.9 million. On a constant currency basis, total revenue increased by \$10.0 million, or 8%. The primary driver of our revenue growth was subscription revenue from our cloud offering.

While the impact of currency changes negatively affected our revenue, it also reduced our expenses. Total cost of revenue for the first six months of fiscal 2016 remained unchanged at \$64.7 million, when compared to the same period last year. Currency had a favorable impact on total cost of revenue of \$4.4 million. On a constant currency basis, total cost of revenue increased by \$4.5 million, or 7%. Similarly, operating expenses decreased by 2% to \$72.7 million. Currency had a favorable impact on operating expenses of \$4.2 million. On a constant currency basis operating expenses increased by \$2.4 million, or 3%. The net unfavorable impact of currency fluctuations on our income from operations was \$2.3 million for the first six months of fiscal 2016.

License Revenue. License revenue is primarily derived from software license fees that customers pay for our core product, QAD Enterprise Applications, and any add-on modules they purchase. In the first six months of fiscal 2016 and on a constant currency basis, license revenue increased by 8% to \$15.4 million compared to the same period last year. Currency had an adverse impact on license revenue of \$1.4 million. When we enter into a multi-element transaction with fixed fee services or when we sell licenses for additional users under a pricing model that does not satisfy vendor specific objective evidence (“VSOE”) requirements, we may be required to recognize license revenue ratably over the longer of the maintenance period or expected services implementation timeframe rather than recognizing license revenue at the time of sale. Additionally, if at the time of the license sale we have not finalized the services agreement, we will defer the entire arrangement until the services agreement is signed.

Our success in closing license deals for existing customers, new customers that are affiliates of existing customers and customers that have employees with historical experience working with QAD tends to be higher than with new customers that have no QAD affiliations. As a result, we place increased focus on these opportunities. A majority of our license revenue is generated from existing customers and their affiliates. We believe global economic volatility will continue to shape customers' and prospects' buying decisions, making it difficult to forecast sales cycles for our products and the timing of large software license sales. In addition, as we focus on our cloud sales we may experience a correspondingly negative effect on license revenue.

Subscription Revenue. Subscription revenue is generally billed on a quarterly basis and recognized ratably over the term of the agreement, typically 12 to 36 months. In the first six months of fiscal 2016 and on a constant currency basis, subscription revenue increased by 52% to \$18.6 million compared to the same period last year. Currency had an adverse impact on subscription revenue of \$0.4 million. Growing our cloud solution and offering our products as SaaS continues to be a key strategic and growth initiative for us. Our cloud customers include a mix of existing customers who have converted from our on-premise model and new user implementations of our cloud solution.

Maintenance Revenue. We offer support services 24 hours a day, seven days a week in addition to providing software upgrades, which include additional or improved functionality, when and if available. In the first six months of fiscal 2016 and on a constant currency basis, maintenance revenue increased by 1% to \$67.2 million when compared to the same period last year. Currency had an adverse impact on maintenance revenue of \$5.5 million. Maintenance revenue fluctuations are influenced by: (1) new license revenue growth; (2) annual renewal of support contracts; (3) increase in customers through acquisitions; (4) fluctuations in currency rates; (5) adjustments to revenue as a result of revenue recognition rules; and (6) customer conversions to QAD Cloud ERP. The vast majority of our customers renew their annual support contracts. Over the last three years, our annual revenue renewal rate of customers subscribing to maintenance has been greater than 90%. Maintenance revenue is generally billed on an annual basis and recognized ratably over the term of the agreement, typically twelve months. As we focus on our cloud sales we may experience a corresponding negative effect on maintenance revenue. When customers convert to QAD Cloud ERP they no longer pay for maintenance as those services are included as a component of the subscription offering.

Professional Services Revenue. Our services business consists of professional services, including consulting and training related to our solutions. In the first six months of fiscal 2016 and on a constant currency basis, professional services revenue increased by 5% to \$39.4 million compared to the same period last year. Currency had an adverse impact on professional services revenue of \$3.6 million. Our professional services organization provides our customers with expertise and assistance in planning and implementing our solutions whether in the cloud or on-premise. Consultants typically assist customers with the initial installation of a system, the conversion and transfer of the customer's historical data into our software, and ongoing training, education, and system upgrades. We believe our professional services enable customers to implement our software efficiently, support a customer's success with our solution, strengthen our customer relationships, and add to our industry-specific knowledge base for use in future implementations and product innovations. Our services margins tend to range from about breakeven to 10%. We believe we offer competitive rates and view our services organization as a department supporting the implementation and deployment of our products and improving the overall customer experience. Services margins lower our overall operating margin as services margins are inherently lower than margins for our license, maintenance and subscription revenues. We expect that our professional services revenue will grow only as fast as needed in order to complete our customer implementations and conversions to the cloud. Services revenue may be impacted by currency fluctuations; however, since we generally use local resources our costs are also impacted by similar currency fluctuations, providing a natural hedge. As a result, our margins tend to remain consistent.

Although our professional services are optional, many of our customers use these services for some of their planning, implementation, or related needs. Professional services are typically rendered under time and materials-based contracts with services typically billed on an hourly basis. Professional services are sometimes rendered under fixed-fee based contracts with payments due on specific dates or milestones.

[Index](#)

Professional services revenue growth is contingent upon license and subscription revenue growth and customer upgrade cycles, which are influenced by the strength of general economic and business conditions and the competitive position of our software products. We use our partners and subcontractors to supplement our internal resources. This allows us to quickly respond to demand fluctuations while somewhat mitigating low utilization in slow times. We believe this also helps us extend our global reach by keeping a higher number of partners engaged and knowledgeable about our product.

Our professional services business has competitive exposure to offshore providers which could create the risk of pricing pressure, fewer customer orders and reduced gross margins.

Cash Flow and Financial Condition. In fiscal 2015, we successfully closed a public offering of 2 million shares of our Class A stock resulting in net cash received of \$37.0 million after underwriting discounts and commissions and offering expenses. In the first quarter of fiscal 2016 the offering underwriters exercised in full an option to purchase additional shares. As a result, a further 450,000 shares of Class A common stock were issued generating approximately \$8.4 million in additional net proceeds. We also generated cash flow from operating activities of \$9.2 million during the first six months of fiscal 2016.

Our cash and equivalents at July 31, 2015 totaled \$130.1 million, with the only debt on our balance sheet of \$14.9 million related to the mortgage of our headquarters. Our primary uses of cash have been funding investment in research and development and funding operations to drive revenue and earnings growth. In addition, we use cash for acquisitions, dividend payments, share repurchase programs and other equity related transactions.

In fiscal 2016, we anticipate that our priorities for use of cash will be growing our cloud business in addition to developing sales and services resources and continued investment in research and development to drive and support growth and profitability. We will continue to evaluate acquisition opportunities that are complementary to our product footprint, solutions delivery and technology direction. We will also continue to assess share repurchases and dividend payments. We do not anticipate additional borrowing requirements in fiscal 2016.

RESULTS OF OPERATIONS

Revenue

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Revenue						
License fees	\$ 8,560	\$ 8,963	\$ 341	\$ (744)	\$ (403)	-4%
Percentage of total revenue	12%	12%				
Subscription fees	9,145	6,442	2,936	(233)	2,703	42%
Percentage of total revenue	13%	9%				
Maintenance and other	33,833	36,120	480	(2,767)	(2,287)	-6%
Percentage of total revenue	47%	50%				
Professional services	19,753	21,525	57	(1,829)	(1,772)	-8%
Percentage of total revenue	28%	29%				
Total revenue	<u>\$ 71,291</u>	<u>\$ 73,050</u>	<u>\$ 3,814</u>	<u>\$ (5,573)</u>	<u>\$ (1,759)</u>	-2%

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Revenue						
License fees	\$ 15,411	\$ 15,615	\$ 1,166	\$ (1,370)	\$ (204)	-1%
Percentage of total revenue	11%	11%				
Subscription fees	18,564	12,634	6,370	(440)	5,930	47%
Percentage of total revenue	13%	9%				
Maintenance and other	67,216	72,196	535	(5,515)	(4,980)	-7%
Percentage of total revenue	48%	51%				
Professional services	39,365	41,090	1,891	(3,616)	(1,725)	-4%
Percentage of total revenue	28%	29%				
Total revenue	<u>\$ 140,556</u>	<u>\$ 141,535</u>	<u>\$ 9,962</u>	<u>\$ (10,941)</u>	<u>\$ (979)</u>	-1%

Total Revenue. On a constant currency basis, total revenue was \$71.3 million and \$67.5 million for the second quarter of fiscal 2016 and 2015, respectively, representing a \$3.8 million, or 6%, increase from the same period last year. When comparing categories within total revenue at constant rates, our results for the second quarter of fiscal 2016 included increases in the license, subscription and maintenance and other revenue categories while professional services revenue was relatively flat. On a constant currency basis, total revenue increased in all regions except for EMEA, which remained relatively flat, during the second quarter of fiscal 2016 when compared to the same period last year. Our products are sold to manufacturing companies that operate mainly in the following six industries: automotive, consumer products, food and beverage, high technology, industrial products and life sciences. Given the similarities between food and beverage and consumer products as well as between high technology and industrial products, we aggregate them for management review. Revenue by industry for the second quarter of fiscal 2016 was approximately 33% in automotive, 20% in consumer products and food and beverage, 34% in high technology and industrial products and 13% in life sciences. In comparison, revenue by industry for the second quarter of fiscal 2015 was approximately 29% in automotive, 21% in consumer products and food and beverage, 32% in high technology and industrial products and 18% in life sciences. We believe the changes in the percentages of revenue by industry were primarily driven by higher revenue in the automotive industry due to the strength of the automotive economy and customers' desire to upgrade and expand their systems after a long period of low investment.

On a constant currency basis, total revenue was \$140.6 million and \$130.6 million for the first six months of fiscal 2016 and 2015, respectively, representing a \$10.0 million, or 8%, increase from the same period last year. When comparing categories within total revenue at constant rates, our results for the first six months of fiscal 2016 included increases across all revenue categories. On a constant currency basis, total revenue increased across all regions during the first six months of fiscal 2016 when compared to the same period last year. Revenue by industry for the first six months of fiscal 2016 was approximately 31% in automotive, 21% in consumer products and food and beverage, 33% in high technology and industrial products and 15% in life sciences. In comparison, revenue by industry for the first six months of fiscal 2015 was approximately 29% in automotive, 23% in consumer products and food and beverage, 33% in high technology and industrial products and 15% in life sciences.

License Revenue. On a constant currency basis, license revenue was \$8.6 million and \$8.2 million for the second quarter of fiscal 2016 and 2015, respectively, representing a \$0.4 million, or 5%, increase from the same period last year. License revenue increased in our North America and Latin America regions and decreased in our EMEA and Asia Pacific regions during the second quarter of fiscal 2016 when compared to the same period last year. One of the metrics that management uses to measure license revenue performance is the number of customers that have placed sizable license orders in the period. During the second quarter of fiscal 2016, eight customers placed license orders totaling more than \$0.3 million and no orders exceeded \$1.0 million. This compared to the second quarter of fiscal 2015 in which five customers placed license orders totaling more than \$0.3 million and no orders exceeded \$1.0 million.

On a constant currency basis, license revenue was \$15.4 million and \$14.2 million for the first six months of fiscal 2016 and 2015, respectively, representing a \$1.2 million, or 8%, increase from the same period last year. License revenue increased in our North America and Latin America regions and decreased in our EMEA and Asia Pacific regions during the first six months of fiscal 2016 when compared to the same period last year. During the first six months of fiscal 2016, 13 customers placed license orders totaling more than \$0.3 million and no orders exceeded \$1.0 million. This compared to the first six months of fiscal 2015 when seven customers placed license orders totaling more than \$0.3 million, and no orders exceeded \$1.0 million.

Subscription Revenue. On a constant currency basis, subscription revenue was \$9.1 million and \$6.2 million for the second quarter of fiscal 2016 and 2015, respectively, representing a \$2.9 million, or 47%, increase from the same period last year. Subscription revenue increased across all regions during the second quarter of fiscal 2016 when compared to the same period last year. The increase in subscription revenue was primarily due to sales of our QAD Cloud ERP product offering which represented over 80% of total subscription revenue in each of the second quarters of fiscal 2016 and 2015. QAD Cloud ERP revenue (“cloud revenue”) consists of new customers, customers converting from on-premise and additional users and modules purchased by our existing cloud customers. In the second quarter of fiscal 2016 and 2015 our North America region generated approximately 63% and 67%, respectively, of our global cloud revenue. Cloud revenue by industry for the second quarter of fiscal 2016 was approximately 42% in automotive, 17% in consumer products and food and beverage, 13% in high technology and industrial products and 28% in life sciences. In comparison, cloud revenue by industry for the second quarter of fiscal 2015 was approximately 41% in automotive, 20% in consumer products and food and beverage, 16% in high technology and industrial products and 23% in life sciences. We expect the growth rate of subscription revenue in the future to be primarily attributable to growth in sales of our QAD Cloud ERP product offering.

On a constant currency basis, subscription revenue was \$18.6 million and \$12.2 million for the first six months of fiscal 2016 and 2015, respectively, representing a \$6.4 million, or 52%, increase from the same period last year. Subscription revenue increased across all regions during the first six months of fiscal 2016 when compared to the same period last year. Included in our fiscal 2016 subscription revenue is \$0.9 million of subscription revenue in our Latin America region related to one customer where we had deferred revenue in previous periods due to a complex implementation. We recognized the revenue once the implementation and rollout of their users was completed and we received confirmation from the customer that the local requirements were being met by the service offering. Excluding the one-time recognition, on a constant currency basis subscription revenue growth would have been 45%. For the first six months of fiscal 2016 and 2015 our North America region generated approximately 60% and 67%, respectively, of our global cloud revenue. As cloud becomes more widely accepted globally, we expect to see the percentage of North America cloud revenue compared to all other regions similar to that of total revenue. Cloud revenue by industry for the first six months of fiscal 2016 was approximately 45% in automotive, 16% in consumer products and food and beverage, 14% in high technology and industrial products and 25% in life sciences. In comparison, cloud revenue by industry for the first six months of fiscal 2015 was approximately 43% in automotive, 20% in consumer products and food and beverage, 15% in high technology and industrial products and 22% in life sciences.

Maintenance and Other Revenue. On a constant currency basis, maintenance and other revenue was \$33.8 million and \$33.4 million for the second quarter of fiscal 2016 and 2015, respectively, representing a \$0.4 million, or 1%, increase compared to the same period last year. Maintenance and other revenue increased in all of our regions except North America, where it remained flat, during the second quarter of fiscal 2016 when compared to the same period last year. The increase in maintenance and other revenue was primarily attributable to price increases, new customers, new users and new modules partially offset by the impact of customers converting to QAD Cloud ERP and customer cancellations. When customers convert to QAD Cloud ERP they no longer pay for maintenance as those services are included as a component of the subscription offering.

On a constant currency basis, maintenance and other revenue was \$67.2 million and \$66.7 million for the first six months of fiscal 2016 and 2015, respectively, representing a \$0.5 million, or 1%, increase from the same period last year. Maintenance and other revenue increased in all of our regions except North America, where it decreased, during the first six months of fiscal 2016 when compared to the same period last year.

We track our rate of contract renewals by determining the number of customer sites with active contracts as of the end of the previous reporting period and compare this to the number of customers that renewed, or are in the process of renewing, their maintenance contracts as of the current period end. Our maintenance contract renewal rate has remained in excess of 90% for the second quarter and the first six months of both fiscal 2016 and 2015. Our deferred maintenance revenue was \$66.5 million as of July 31, 2015 compared to \$72.5 million as of July 31, 2014. We monitor our deferred maintenance revenue balance on a constant currency basis in order to gauge the health of our recurring revenue and track customer conversions from maintenance to subscription revenue. Deferred maintenance revenue was negatively impacted by foreign currency changes, particularly due to the changes in the euro compared to the U.S. dollar. On a constant currency basis, deferred maintenance revenue would have been \$5.7 million higher as of July 31, 2015, or \$72.2 million, consistent with July 31, 2014.

[Index](#)

Products are generally shipped as orders are received or within a short period thereafter. Accordingly, we have historically operated with little backlog. Because of the generally short cycle between order and shipment and the relatively small percentage of subscription revenue, we believe that our backlog as of any particular date is not currently significant. Our total short-term deferred revenue as of July 31, 2015 was \$82.5 million, which consisted of the following (in thousands):

Deferred maintenance revenue	\$ 66,529
Deferred subscription revenue	12,073
Deferred services revenue	2,581
Deferred license revenue	1,266
Deferred other revenue	56
Deferred revenues, current	<u>\$ 82,505</u>

Deferred maintenance will be recognized over the period of the maintenance support. Deferred subscription is primarily related to hosting and cloud services which we will provide over periods up to the next twelve months. Deferred services represents prepayments for our professional services where revenues for these services are recognized as we complete the performance obligations as well as services already provided but deferred due to U.S. GAAP revenue recognition rules. The deferred licenses are primarily due to U.S. GAAP revenue recognition rules.

Professional Services Revenue. On a constant currency basis, professional services revenue was \$19.8 million and \$19.7 million for the second quarter of fiscal 2016 and 2015, respectively, representing a \$0.1 million, or 1%, increase compared to the same period last year. Professional services revenue increased in our Asia Pacific and Latin America regions and decreased in our North America and EMEA regions during the second quarter of fiscal 2016 when compared to the same period last year. Professional services revenue increased period over period due to a higher number of engagements, which was offset by lower revenue per engagement. Services revenue recognized from cloud customers was between 15% and 20% of total services revenue in each period.

On a constant currency basis, professional services revenue was \$39.4 million and \$37.5 million for the first six months of fiscal 2016 and 2015, respectively, representing a \$1.9 million, or 5%, increase from the same period last year. Professional services revenue increased in all of our regions except North America, where it decreased, during the first six months of fiscal 2016 when compared to the same period last year. The increase in services revenue was primarily due to higher number of implementation and upgrade projects. Services revenue recognized from cloud customers was between 15% and 20% of total services revenue in each period.

Cost of Revenue

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Cost of revenue						
Cost of license fees	\$ 972	\$ 1,153	\$ 166	\$ 15	\$ 181	16%
Cost of subscription	5,162	4,212	(1,083)	133	(950)	-23%
Cost of maintenance and other	7,907	8,253	(78)	424	346	4%
Cost of professional services	18,587	19,601	(683)	1,697	1,014	5%
Total cost of revenue	<u>\$ 32,628</u>	<u>\$ 33,219</u>	<u>\$ (1,678)</u>	<u>\$ 2,269</u>	<u>\$ 591</u>	2%
Percentage of revenue	46%	45%				

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Cost of revenue						
Cost of license fees	\$ 1,901	\$ 2,053	\$ 129	\$ 23	\$ 152	7%
Cost of subscription	10,226	7,998	(2,433)	205	(2,228)	-28%
Cost of maintenance and other	15,684	16,423	(93)	832	739	4%
Cost of professional services	36,915	38,176	(2,096)	3,357	1,261	3%
Total cost of revenue	<u>\$ 64,726</u>	<u>\$ 64,650</u>	<u>\$ (4,493)</u>	<u>\$ 4,417</u>	<u>\$ (76)</u>	0%
Percentage of revenue	46%	46%				

Cost of license fees includes license royalties, amortization of capitalized software costs and fulfillment. Cost of subscription includes salaries, benefits and bonuses of our cloud operations group, located in the United States and India; stock-based compensation for those employees; hardware and hosting costs; royalties; professional fees; travel expense; and an allocation of information technology and facilities costs. Cost of maintenance and other includes salaries, benefits and bonuses of our support group located around the world; stock-based compensation for those employees; travel expense; professional fees; fulfillment; and an allocation of information technology and facilities costs. Cost of professional services includes salaries, benefits and bonuses of employees fulfilling service contracts; stock-based compensation for those employees; third-party contractor expense; travel expense for services employees; and an allocation of information technology and facilities costs.

Total Cost of Revenue. On a constant currency basis, total cost of revenue (combined cost of license fees, cost of subscription, cost of maintenance and other and cost of professional services) was \$32.6 million and \$31.0 million for the second quarter of fiscal 2016 and 2015, respectively, and as a percentage of total revenue was 46% for each of the second quarters of fiscal 2016 and 2015. The non-currency related increase in cost of revenue of \$1.6 million, or 5%, in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to higher personnel expenses and hosting costs associated with higher subscription revenue and higher personnel expenses associated with higher services headcount.

On a constant currency basis, total cost of revenue (combined cost of license fees, cost of maintenance, subscription and other and cost of professional services) was \$64.7 million and \$60.2 million for the first six months of fiscal 2016 and 2015, respectively, and as a percentage of total revenue was 46% for both the first six months of fiscal 2016 and 2015. The non-currency related increase in cost of revenue of \$4.5 million, or 7%, for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was primarily due to higher personnel and hosting costs associated with higher subscription revenue and higher personnel costs associated with higher professional services revenue.

Cost of License Fees. On a constant currency basis, cost of license fees was \$1.0 million and \$1.1 million for the second quarter of fiscal 2016 and 2015, respectively, representing a decrease of \$0.1 million, or 1%. The non-currency related decrease in cost of license fees of \$0.1 million for the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was due to lower royalties and fulfillment costs. Cost of license fees as a percentage of license revenue was 11% and 13% for the second quarter of fiscal 2016 and 2015, respectively.

On a constant currency basis, cost of license fees was \$1.9 million and \$2.0 million for the first six months of fiscal 2016 and 2015, respectively, representing a decrease of \$0.1 million, or 1%. The non-currency related decrease in cost of license fees of \$0.1 million for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was due to lower fulfillment costs. Cost of license fees as a percentage of license revenue was 12% and 13% for the first six months of fiscal 2016 and fiscal 2015, respectively.

Cost of Subscription. On a constant currency basis, cost of subscription was \$5.2 million and \$4.1 million for the second quarter of fiscal 2016 and 2015, respectively, representing an increase of \$1.1 million, or 27%. The non-currency related increase in cost of subscription of \$1.1 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to higher hosting costs of \$0.5 million and higher salaries and related costs of \$0.5 million as a result of higher headcount of approximately 20 people, both of which are to support the growth in our cloud business. We expect to continue investing in our cloud business and, as a result, we expect costs will continue to increase and margins may be impacted. Cost of subscription as a percentage of subscription revenue was 56% and 65% in the second quarter of fiscal 2016 and 2015, respectively. As we achieve efficiencies in our cloud operations we expect to see continued improvement in our subscription margin over the long term, but we also expect volatility in our subscription margin as a result of increased investment necessary to grow our cloud business.

[Index](#)

On a constant currency basis, cost of subscription was \$10.2 million and \$7.8 million for the first six months of fiscal 2016 and fiscal 2015, respectively, representing an increase of \$2.4 million, or 31%. The non-currency related increase in cost of subscription of \$2.4 million for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was primarily due to higher personnel costs of \$1.2 million as a result of increased headcount of 20 people and higher hosting costs of \$0.9 million, both of which are to support the growth in our cloud business, and higher information technology and facilities allocated costs of \$0.3 million. Cost of subscription as a percentage of subscription revenue was 55% and 63% in the first six months of fiscal 2016 and fiscal 2015, respectively. Excluding the one-time \$0.9 million subscription recognition, cost of subscription as a percentage of subscription revenue would have been 58% for the first six months of fiscal 2016.

Cost of Maintenance and Other. On a constant currency basis, cost of maintenance and other was \$7.9 million and \$7.8 million for the second quarter of fiscal 2016 and 2015, respectively, representing an increase of \$0.1 million, or 1%. The non-currency related increase in cost of maintenance and other of \$0.1 million for the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to higher salaries and related costs. Cost of maintenance and other as a percentage of maintenance and other revenue was 23% for both of the second quarters of fiscal 2016 and 2015.

On a constant currency basis, cost of maintenance and other was \$15.7 million and \$15.6 million for the first six months of fiscal 2016 and fiscal 2015, respectively, representing an increase of \$0.1 million, or 1%. The non-currency related increase in cost of maintenance and other of \$0.1 million for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was primarily due to higher salaries and related costs. Cost of maintenance and other as a percentage of maintenance and other revenues was 23% for the first six months of both fiscal 2016 and fiscal 2015.

Cost of Professional Services. On a constant currency basis, cost of professional services was \$18.6 million and \$17.9 million for the second quarter of fiscal 2016 and 2015, respectively, representing an increase of \$0.7 million, or 4%. The non-currency related increase in cost of professional services of \$0.7 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was due primarily to higher salaries and related costs of \$0.9 million as a result of higher headcount of approximately 35 people partially offset by lower third-party contractor costs of \$0.6 million. In addition, the increase in cost of professional services included \$0.2 million of personnel costs from other departments to help support the increase in services engagements. Cost of professional services as a percentage of professional services revenues was 94% and 91% for the second quarter of fiscal 2016 and 2015, respectively.

On a constant currency basis, cost of professional services was \$36.9 million and \$34.8 million for the first six months of fiscal 2016 and 2015, respectively, representing an increase of \$2.1 million, or 6%. The non-currency related increase in cost of professional services of \$2.1 million in the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was due to higher salaries and related costs of \$2.1 million as a result of increased headcount of 35 people, higher information technology and facilities allocated costs of \$0.3 million and higher severance of \$0.2 million, partially offset by lower third-party contractor costs of \$0.8 million. In addition, the increase in cost of professional services included \$0.3 million of personnel costs from other departments to help support the increase in services engagements. Cost of professional services as a percentage of professional services revenues was 94% and 93% for the first six months of fiscal 2016 and fiscal 2015, respectively.

Sales and Marketing

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Sales and marketing	\$ 16,982	\$ 17,421	\$ (767)	\$ 1,206	\$ 439	3%
Percentage of revenue	24%	24%				

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Sales and marketing	\$ 34,127	\$ 33,898	\$ (2,540)	\$ 2,311	\$ (229)	-1%
Percentage of revenue	25%	24%				

[Index](#)

Sales and marketing expense includes salaries, benefits, bonuses, stock-based compensation and travel expense for our sales and marketing employees in addition to costs of programs aimed at increasing revenue, such as trade shows, user group events, advertising and various sales and promotional programs. Sales and marketing expense also includes personnel costs of order processing, sales agent fees and an allocation of information technology and facilities costs.

On a constant currency basis, sales and marketing expense was \$17.0 million and \$16.2 million for the second quarter of fiscal 2016 and 2015, respectively, representing an increase of \$0.8 million, or 5%. The non-currency related increase in sales and marketing expense of \$0.8 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to higher salaries and related costs of \$0.4 million as a result of higher headcount of approximately 13 people, higher expenses of \$0.4 million related to our annual Explore user conference, higher bonuses of \$0.2 million, and higher stock compensation of \$0.2 million partially offset by lower commissions of \$0.4 million.

On a constant currency basis, sales and marketing expense was \$34.1 million and \$31.6 million for the first six months of fiscal 2016 and fiscal 2015, respectively, representing an increase of \$2.5 million, or 8%. The non-currency related increase in sales and marketing expense of \$2.5 million for first six months of fiscal 2016 compared to the first six months of fiscal 2015 was due primarily to higher salaries and related expense of \$1.2 million as a result of higher headcount of approximately 13 people, higher expenses of \$0.4 million related to our annual Explore user conference, higher travel expense of \$0.3 million, higher sales agent fees of \$0.3 million, higher stock compensation of \$0.3 million, higher professional fees of \$0.2 million and higher information technology and facilities allocated costs of \$0.2 million partially offset by lower commissions of \$0.3 million.

Research and Development

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Research and development	\$ 10,590	\$ 10,902	\$ (248)	\$ 560	\$ 312	3%
Percentage of revenue	15%	15%				

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
<i>(in thousands)</i>						
Research and development	\$ 21,247	\$ 22,097	\$ (302)	\$ 1,152	\$ 850	4%
Percentage of revenue	15%	15%				

Research and development is expensed as incurred and consists primarily of salaries, benefits, bonuses, stock-based compensation, training and travel expense for research and development employees and professional services, such as fees paid to software development firms and independent contractors. Research and development expense also includes an allocation of information technology and facilities costs, and is reduced by reimbursements from joint development projects. As part of our vertical focus we regularly seek joint development arrangements with our customers in order to enhance specific functionality and industry experience, although the number and size of joint development arrangements may fluctuate.

On a constant currency basis, research and development expense was \$10.6 million and \$10.4 million for the second quarter of fiscal 2016 and 2015, respectively, representing an increase of \$0.2 million, or 2%. Expense categories within research and development expense remained relatively consistent.

[Index](#)

On a constant currency basis, research and development expense was \$21.2 million and \$20.9 million for the first six months of fiscal 2016 and fiscal 2015, respectively, representing an increase of \$0.3 million, or 1%. The non-currency related increase in research and development expense of \$0.3 million for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was due primarily to higher salaries and wages of \$0.2 million, higher stock compensation of \$0.2 million and higher travel of \$0.1 million partially offset by lower bonuses of \$0.3 million.

General and Administrative

	Three Months Ended July 31, 2015	Three Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
(in thousands)						
General and administrative	\$ 8,602	\$ 9,265	\$ 302	\$ 361	\$ 663	7%
Percentage of revenue	12%	13%				

	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014	Change in Constant Currency	Change due to Currency Fluctuations	Total Change as Reported \$	%
(in thousands)						
General and administrative	\$ 17,043	\$ 18,169	\$ 438	\$ 688	\$ 1,126	6%
Percentage of revenue	12%	13%				

General and administrative expense includes salaries, benefits, bonuses, stock-based compensation and travel expense for our finance, human resources, legal and executive personnel, as well as professional fees for accounting and legal services, bad debt expense and an allocation of information technology and facilities costs.

On a constant currency basis, general and administrative expense was \$8.6 million and \$8.9 million for the second quarter of fiscal 2016 and 2015, respectively, representing a decrease of \$0.3 million, or 3%. The non-currency related decrease in general and administrative expense of \$0.3 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to lower professional fees of \$0.4 million and lower bad debt of \$0.1 million partially offset by higher stock compensation of \$0.3 million.

On a constant currency basis, general and administrative expense was \$17.0 million and \$17.5 million for the first six months of fiscal 2016 and fiscal 2015, respectively, representing a decrease of \$0.5 million, or 3%. The non-currency related decrease in general and administrative expense of \$0.5 million for first six months of fiscal 2016 compared to the first six months of fiscal 2015 was primarily due to lower professional fees of \$0.6 million and lower costs associated with an internal systems upgrade of \$0.3 million partially offset by higher stock compensation of \$0.5 million.

Amortization of Intangibles from Acquisitions

Amortization of intangibles from acquisitions was \$0.2 million in both the second quarter of fiscal 2016 and 2015, and \$0.3 million and \$0.4 million for the first six months of both fiscal 2016 and 2015, respectively. Amortization expense for all periods was due to the intangible assets acquired in our fiscal 2013 acquisitions of DynaSys and CEBOS.

Other Expense (Income)

	Three Months Ended July 31, 2015	Increase (Decrease) Compared to Prior Period		Three Months Ended July 31, 2014	Six Months Ended July 31, 2015	Increase (Decrease) Compared to Prior Period		Six Months Ended July 31, 2014
		\$	%			\$	%	
(in thousands)								
Other (income) expense								
Interest income	\$ (87)	\$ (31)	-55%	\$ (56)	\$ (144)	\$ (31)	-27%	\$ (113)
Interest expense	190	(42)	-18%	232	373	(40)	-10%	413
Other (income) expense, net	(413)	(295)	-250%	(118)	(532)	(640)	-593%	108
Total other (income) expense	<u>\$ (310)</u>	<u>\$ (368)</u>	<u>%</u>	<u>\$ 58</u>	<u>\$ (303)</u>	<u>\$ (711)</u>	<u>%</u>	<u>\$ 408</u>
Percentage of revenue	-1%			0%	0%			0%

[Index](#)

Total other (income) expense was \$(0.3) million and \$0.1 million for the second quarter of fiscal 2016 and fiscal 2015, respectively. The difference was due primarily to a favorable change of \$0.2 million related to the fair market value of the interest rate swap associated with the mortgage on our headquarters and a government incentive funding paid to one of our subsidiaries of \$0.2 million.

Total other (income) expense was \$(0.3) million and \$0.4 million for the first six months of fiscal 2016 and 2015, respectively. The difference was due primarily to a favorable change of \$0.5 million related to the fair market value of the interest rate swap associated with the mortgage on our headquarters and a government incentive funding paid to one of our subsidiaries of \$0.2 million.

Interest rate swap valuations and foreign exchange gains and losses are subject to changes which are inherently unpredictable. Our interest rate swap is accounted for using mark-to-market accounting. Accordingly, changes in the fair value of the swap each reporting period are adjusted through earnings, subjecting us to non-cash volatility in our results of operations. The swap fixes the interest rate on our mortgage to 4.31% over the entire term of the mortgage and effectively lowered our interest rate from the previous mortgage rate of 6.5%. Although the agreement allows us to prepay the loan and exit the agreement early, we have no intention of doing so. As a result, we will have non-cash adjustments through earnings each reporting period. Over the term of the mortgage, however, the net impact of these mark-to-market adjustments on earnings will be zero.

Income Tax Expense

	Three Months Ended July 31, 2015		Increase (Decrease) Compared to Prior Period		Three Months Ended July 31, 2014		Six Months Ended July 31, 2015		Increase (Decrease) Compared to Prior Period		Six Months Ended July 31, 2014			
			\$	%					\$	%				
(in thousands)														
Income tax expense	\$	1,002	\$	(19)	-2%	\$	1,021	\$	1,206	\$	161	15%	\$	1,045
Percentage of revenue		2%					2%		1%					1%
Effective tax rate		38%					51%		36%					53%

Non-GAAP Financial Measures

Regulation S-K Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings," defines and prescribes the conditions for use of non-GAAP financial information. Our measures of adjusted EBITDA, adjusted EBITDA margins, non-GAAP net income and non-GAAP earnings per diluted share each meet the definition of a non-GAAP financial measure.

We define the non-GAAP measures as follows:

- Non-GAAP adjusted EBITDA - EBITDA is GAAP net income before net interest expense, income tax expense, depreciation and amortization. Non-GAAP adjusted EBITDA is EBITDA less stock-based compensation expense and the change in the fair value of the interest rate swap.
- Non-GAAP adjusted EBITDA margins - Calculated by dividing non-GAAP adjusted EBITDA by total revenue.
- Non-GAAP net income - GAAP net income before stock-based compensation expense, amortization of purchased intangible assets, the change in fair value of the interest rate swap and certain income tax adjustments.
- Non-GAAP earnings per diluted share - Non-GAAP net income allocated to Class A and Class B shares divided by the weighted average diluted shares outstanding of each class.

QAD's management uses non-GAAP measures internally to evaluate the business and believes that presenting non-GAAP measures provides useful information to investors regarding the underlying business trends and performance of our ongoing operations as well as useful metrics for monitoring our performance and evaluating it against industry peers. The non-GAAP financial measures presented should be used in addition to, and in conjunction with, results presented in accordance with GAAP, and should not be relied upon to the exclusion of GAAP financial measures. Management strongly encourages investors to review our consolidated financial statements in their entirety and not to rely on any single financial measure in evaluating QAD.

QAD non-GAAP measures reflect adjustments based on the following items:

EBITDA: We report EBITDA as a non-GAAP metric by excluding the effect of net interest expense, income tax expense, depreciation and amortization from net income because doing so makes internal comparisons to our historical operating results more consistent. In addition, we believe providing an EBITDA calculation is a useful comparison of our operating results to the operating results of our peers.

Stock-based compensation expense: We have excluded the effect of stock-based compensation expense from the non-GAAP net income and non-GAAP earnings per diluted share calculations. Although stock-based compensation expense is calculated in accordance with current GAAP and constitutes an ongoing and recurring expense, such expense is excluded from non-GAAP results because it is not an expense which generally requires cash settlement by QAD, and therefore is not used by us to assess the profitability of our operations. We also believe the exclusion of stock-based compensation expense provides a useful comparison of our operating results to the operating results of our peers.

Amortization of purchased intangibles: We amortize purchased intangibles in connection with our acquisitions. We have excluded the effect of amortization of purchased intangibles which includes purchased technology, customer relationships, trade names and other intangibles from non-GAAP net income and non-GAAP earnings per diluted share calculations, because doing so makes internal comparisons to our historical operating results more consistent. In addition, we believe excluding amortization of purchased intangibles provides a useful comparison of our operating results to the operating results of our peers.

Change in fair value of the interest rate swap: We entered into an interest rate swap to mitigate our exposure to the variability of one month LIBOR for the floating rate debt related to the mortgage of our headquarters. We have excluded the gain/loss adjustments to record the interest rate swap at fair value from non-GAAP net income and non-GAAP earnings per diluted share calculations. We believe that these fluctuations are not indicative of our operational costs or meaningful in evaluating comparative period results because we currently have no intention of exiting the debt agreement early; and therefore over the life of the debt the sum of the fair value adjustments will be zero.

[Index](#)

Income tax adjustments: Beginning in fiscal 2016, we began to compute and utilize a fixed long-term projected non-GAAP tax rate in order to provide better consistency across the interim reporting periods by eliminating the effects of non-recurring and period-specific items such as changes in the tax valuation allowance and tax effects of acquisition-related costs, since each of these can vary in size and frequency. When projecting the long-term rate we evaluated four years of historical and expected results excluding the impact of the following non-cash items: stock-based compensation expense, amortization of purchased intangibles and the change in fair value of the interest rate swap. The projected rate assumes no new acquisitions and takes into account other factors including our current operational structure, our existing tax positions in various jurisdictions and key legislation in major jurisdictions where we operate. The non-GAAP tax rate is 25%. We intend to re-evaluate this long-term rate on an annual basis or if any significant events that may materially affect this long-term rate occur. This long-term rate could be subject to change for a variety of reasons, for example, significant changes in the geographic earnings mix, acquisition activity or fundamental tax law changes in major jurisdictions where we operate.

Our reconciliation of the non-GAAP financial measures of adjusted EBITDA, adjusted EBITDA margins, non-GAAP net income and non-GAAP earnings per diluted share to the most comparable GAAP measures for the three and six months ended July 31, 2015 and 2014 are as follows (in thousands, except per share data):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Total revenue	\$ 71,291	\$ 73,050	\$ 140,556	\$ 141,535
Net income	1,631	985	2,180	909
Add back:				
Net interest expense	103	176	229	300
Depreciation	974	927	1,973	1,851
Amortization	456	492	908	984
Income taxes	1,002	1,021	1,206	1,045
EBITDA	\$ 4,166	\$ 3,601	\$ 6,496	\$ 5,089
Add back:				
Non-cash stock-based compensation	2,431	1,709	3,737	2,585
Change in fair value of interest rate swap	(106)	61	(351)	107
Adjusted EBITDA	\$ 6,491	\$ 5,371	\$ 9,882	\$ 7,781
Adjusted EBITDA margin	9%	7%	7%	5%
Non-GAAP net income reconciliation				
Net income	\$ 1,631	\$ 985	\$ 2,180	\$ 909
Add back:				
Non-cash stock-based compensation	2,431	1,709	3,737	2,585
Amortization of purchased intangible assets	345	378	689	756
Change in fair value of interest rate swap	(106)	61	(351)	107
Income tax adjustments	(668)	(537)	(1,019)	(862)
Non-GAAP net income	\$ 3,633	\$ 2,596	\$ 5,236	\$ 3,495
Non-GAAP earnings per diluted Class A share reconciliation				
Earnings per diluted Class A share	\$ 0.09	\$ 0.06	\$ 0.12	\$ 0.06
Add back:				
Non-cash stock-based compensation	0.13	0.11	0.20	0.16
Amortization of purchased intangible assets	0.02	0.02	0.03	0.04
Change in fair value of interest rate swap	(0.01)	0.00	(0.02)	0.00
Income tax adjustments	(0.04)	(0.03)	(0.05)	(0.05)
Non-GAAP earnings per diluted Class A share	\$ 0.19	\$ 0.16	\$ 0.28	\$ 0.21
Shares used in computing earnings per diluted Class A share	16,261	13,505	16,160	13,472
Non-GAAP earnings per diluted Class B share reconciliation				
Earnings per diluted Class B share	\$ 0.07	\$ 0.05	\$ 0.10	\$ 0.05
Add back:				
Non-cash stock-based compensation	0.11	0.09	0.17	0.13
Amortization of purchased intangible assets	0.01	0.02	0.03	0.04
Change in fair value of interest rate swap	(0.00)	0.00	(0.02)	0.01
Income tax adjustments	(0.03)	(0.03)	(0.05)	(0.05)
Non-GAAP earnings per diluted Class B share	\$ 0.16	\$ 0.13	\$ 0.23	\$ 0.18
Shares used in computing earnings per diluted Class B share	3,284	3,273	3,282	3,273

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of cash is from the sale of licenses, subscription, maintenance and professional services to our customers. Our primary use of cash is payment of our operating expenses which mainly consist of employee-related expenses, such as compensation and benefits, as well as general operating expenses for facilities and overhead costs. In addition to operating expenses, we may also use cash for capital expenditures, payment of dividends and stock repurchases, and to invest in our growth initiatives, which include acquisitions of products, technologies and businesses.

At July 31, 2015, our principal sources of liquidity were cash and equivalents totaling \$130.1 million and net accounts receivable of \$46.0 million. During fiscal 2015 we closed an offering of 2,000,000 shares of Class A common stock. The net proceeds to us from the sale of the stock were \$37.0 million after deducting underwriting discounts and commissions and offering expenses. Subsequent to year end, we closed an additional offering of 450,000 shares of Class A common stock with net proceeds to us of \$8.4 million after offering expenses. At July 31, 2015, our cash and equivalents consisted of current bank accounts, registered money market funds and time delineated deposits. Approximately 90% of our cash and equivalents were held in U.S. dollar denominated accounts as of July 31, 2015.

Our primary commercial banking relationship is with Bank of America and its global affiliates. Our cash and equivalents are held by diversified financial institutions globally, and as of July 31, 2015 the portion of our cash and equivalents held by or invested through Bank of America was approximately 95%. Our largest cash concentrations are in the United States and Ireland. The majority of our cash and equivalents are held in investment accounts which are predominantly placed in money market mutual funds and in U.S. Treasury and government securities funds. The remaining cash and equivalents are held in deposit accounts and certificates of deposit.

Our cash and equivalents are concentrated in a few locations around the world, with substantial amounts held outside of the U.S. The percentage of cash and equivalents held by foreign subsidiaries was approximately 60% as of July 31, 2015 and 73% as of January 31, 2015. Subject to local law restrictions, certain amounts held outside the U.S. could be repatriated to the U.S. These repatriated amounts would likely be subject to U.S. income taxes under current U.S. tax law. We have provided for the U.S. income tax liability on foreign earnings, except for foreign earnings that are considered permanently reinvested outside the U.S. Our intent is that foreign permanently reinvested earnings will remain outside the U.S. Our U.S. liquidity needs will be met through ongoing cash flows from operations or through alternative means of cash flow such as the sale of stock or external borrowing. We regularly review our capital structure to ensure we have the proper liquidity available in the locations in which it is needed.

[Index](#)

We have a U.S. line of credit facility with Rabobank that permits unsecured short-term borrowings of up to \$20 million. Our line of credit agreement contains customary covenants that could restrict our ability to incur additional indebtedness. Our line of credit is available for working capital or other business needs. We have not drawn on the line of credit during any of the last three fiscal years nor do we expect to draw on the line of credit during fiscal 2016.

The following table summarizes our cash flows for the six months ended July 31, 2015 and 2014, respectively.

<i>(in thousands)</i>	Six Months Ended July 31, 2015	Six Months Ended July 31, 2014
Net cash provided by operating activities	\$ 9,157	\$ 5,465
Net cash used in investing activities	(1,692)	(1,596)
Net cash provided by (used in) financing activities	3,715	(4,995)
Effect of foreign exchange rates on cash and equivalents	(1,621)	481
Net increase (decrease) in cash and equivalents	<u>\$ 9,559</u>	<u>\$ (645)</u>

Typical factors affecting our cash provided by operating activities include our level of revenue and earnings for the period, the timing and amount of employee bonus payments and income tax payments, and the timing of cash collections from our customers, which is our largest source of operating cash flow. Net cash flows provided by operating activities was \$9.2 million for the first six months of fiscal 2016 compared to \$5.5 million for the first six months of fiscal 2015. The increase in net cash flows provided by operating activities was primarily attributable to the positive effect of changes in accounts receivable due to higher collections, partially offset by the negative impact of changes in deferred revenue, other liabilities and accounts payable. In addition, net income increased by \$1.3 million.

Net cash used in investing activities consisted primarily of capital expenditures of \$1.7 million for the first six months of fiscal 2016 compared to \$1.5 million for the first six months of fiscal 2015. Capital expenditures in the first half of fiscal 2016 primarily consisted of computer equipment, leasehold improvements and capitalized software related to our internal ERP system upgrade. We continue to monitor our capital spending and do not believe we are delaying critical capital expenditures required to run our business.

In the first six months of fiscal 2016 and 2015 we made dividend payments consisting of \$2.6 million and \$2.2 million, respectively. On a regular basis the Board of Directors evaluates our ability to continue to pay dividends as well as the structure of any potential dividend payments.

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

DSO under the countback method was 55 days and 58 days at July 31, 2015 and 2014, respectively. DSO using the average method, which is calculated utilizing the accounts receivable balance and earned revenue for the most recent quarter, was 58 days and 65 days at July 31, 2015 and 2014, respectively. The aging of our accounts receivable remained consistent when compared with the same period last year. We believe our reserve methodology is adequate, our reserves are properly stated as of July 31, 2015 and the quality of our receivables remains good.

There have been no material changes in our contractual obligations or commercial commitments outside the ordinary course of business. Cash requirements for items other than normal operating expenses are anticipated for capital expenditures, dividend payments and other equity transactions. We may require cash for acquisitions of new businesses, software products or technologies complementary to our business.

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

Our revenue, earnings, cash flows, receivables and payables are subject to fluctuations due to changes in foreign currency exchange rates. See Part I, Item 3, “Quantitative and Qualitative Disclosures about Market Risk” for further discussion.

CONTRACTUAL OBLIGATIONS

A summary of future obligations under our various contractual obligations and commitments as of January 31, 2015 was disclosed in our Annual Report on Form 10-K for the year ended January 31, 2015. During the quarter and six months ended July 31, 2015 there have been no material changes in our contractual obligations or commercial commitments outside the ordinary course of business.

Credit Facility

We have an unsecured credit agreement with Rabobank, N.A. (the “Facility”). The Facility provides a commitment through July 15, 2017 for a \$20 million line of credit for working capital or other business needs. We pay a commitment fee of 0.25% per annum of the daily average of the unused portion of the \$20 million Facility. Borrowings under the Facility bore interest at a rate equal to one month LIBOR plus 0.75%. At July 31, 2015, the effective borrowing rate would have been 0.94%.

The Facility provides that we maintain certain financial and operating ratios which include, among other provisions, minimum liquidity on a consolidated basis of \$25 million in cash and equivalents at all times, a current ratio (calculated using current liabilities excluding deferred revenue) of not less than 1.3 to 1.0 determined at the end of each fiscal quarter, a leverage ratio of not more than 1.5 to 1.0 determined at the end of each fiscal quarter, and a debt service coverage ratio of not less than 1.5 to 1.0 determined at the end of each fiscal year. The Facility also contains customary covenants that could restrict our ability to incur additional indebtedness.

As of July 31, 2015, there were no borrowings under the Facility and we were in compliance with all financial covenants.

Notes Payable

Effective May 30, 2012, QAD Ortega Hill, LLC entered into a variable rate credit agreement (the “2012 Mortgage”) with Rabobank, N.A., to refinance a pre-existing mortgage. The 2012 Mortgage has an original principal balance of \$16.1 million and bears interest at the one month LIBOR rate plus 2.25%. One month LIBOR was 0.19% at July 31, 2015. The 2012 Mortgage matures in June 2022 and is secured by our headquarters located in Santa Barbara, California. In conjunction with the 2012 Mortgage, QAD Ortega Hill, LLC entered into an interest rate swap with Rabobank, N.A. The swap agreement has an initial notional amount of \$16.1 million and a schedule matching that of the underlying loan that synthetically fixes the interest rate on the debt at 4.31% for the entire term of the 2012 Mortgage. The terms of the 2012 Mortgage provide for QAD Ortega Hill, LLC to make net monthly payments of \$88,100 consisting of principal and interest and one final payment of \$11.7 million. The unpaid balance as of July 31, 2015 was \$14.9 million.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Rates. We have operations in foreign locations around the world and we are exposed to risk resulting from fluctuations in foreign currency exchange rates. We have experienced significant foreign currency fluctuations during the fourth quarter of fiscal 2015 and in fiscal 2016 due primarily to the volatility of the euro in relation to the U.S. dollar. However, while strengthening of the U.S. dollar compared to foreign currency exchange rates generally has the effect of reducing revenues it also has the effect of reducing expenses denominated in currencies other than the U.S. dollar. The foreign currencies for which we currently have the most significant exposure are the euro, Brazilian real, Mexican peso and British pound. These foreign currency exchange rate movements could create a foreign currency gain or loss that could be realized or unrealized for us. Unfavorable movements in foreign currency exchange rates between the U.S. dollar and other foreign currencies may have an adverse impact on our operations. We did not have any foreign currency forward or option contracts or other material foreign currency denominated derivatives or other financial instruments open as of July 31, 2015.

We face two risks related to foreign currency exchange rates—translation risk and transaction risk. Translation risk relates to amounts invested in our foreign operations that are translated into U.S. dollars using period-end exchange rates. The resulting translation adjustments are recorded as a component of accumulated other comprehensive loss in the Condensed Consolidated Balance Sheets. Revenues and expenses in foreign currencies translate into higher or lower revenues and expenses in U.S. dollars as the U.S. dollar weakens or strengthens against other currencies. Furthermore, we have exposure to foreign exchange fluctuations arising from the remeasurement of non-functional currency assets, liabilities and intercompany balances into U.S. dollars for financial reporting purposes. Transaction risk is related to our international subsidiaries holding non-local currency net monetary accounts subject to revaluation into their local currency, which results in realized or unrealized foreign currency gains or losses.

For the six months ended July 31, 2015 and 2014, 52% and 56%, respectively, of our revenue was generated in foreign currencies. We also incurred a significant portion of our expenses in currencies other than the U.S. dollar, 40% and 43% for the six months ended July 31, 2015 and 2014, respectively. Based on a hypothetical 10% strengthening of the U.S. dollar against all foreign currencies, our revenue would be adversely affected by approximately 5% partially offset by a positive effect on our expenses of approximately 4%, and our operating income would be adversely affected by approximately 56%.

For the six months ended July 31, 2015 and 2014, foreign currency transaction and remeasurement (gains) / losses totaled \$(26,000) and \$9,000, respectively, and are included in “Other (income) expense, net” in our Condensed Consolidated Statements of Income and Comprehensive Income. We performed a sensitivity analysis on the net U.S. dollar and euro-based monetary accounts subject to revaluation that are held by our international subsidiaries and on the non-functional currency assets, liabilities and intercompany balances that are remeasured into U.S. dollars. A hypothetical 10% adverse movement in all foreign currency exchange rates would result in foreign currency transaction and remeasurement losses of approximately \$1.2 million.

These estimates assume adverse shifts in all foreign currency exchange rates against the U.S. dollar, which do not always move in the same direction or in the same degrees. Actual results may differ materially from the hypothetical analysis.

Interest Rates. We invest our surplus cash in a variety of financial instruments, consisting principally of short-term marketable securities with maturities of less than 90 days at the date of purchase. Our investment securities are held for purposes other than trading. Cash balances held by subsidiaries are invested primarily in registered money market funds with local operating banks. Based on an interest rate sensitivity analysis of our cash and equivalents we estimate that a 10% adverse change in interest rates from the 2015 fiscal year-end rates would not have a material adverse effect on our cash flows or financial condition for the next fiscal year.

Our debt is comprised of a loan agreement, secured by real property, which bears interest at the one month LIBOR rate plus 2.25%. In conjunction with the loan agreement, we entered into an interest rate swap. The swap agreement has an initial notional amount and schedule matching that of the underlying loan that synthetically fixes the interest rate on the debt at 4.31%. Additionally, we have an unsecured line of credit which bears interest at the one month LIBOR rate plus 0.75%. As of July 31, 2015 there were no borrowings under our unsecured line of credit.

Our interest rate swap is accounted for using mark-to-market accounting. Accordingly, changes in the fair value of the swap each reporting period are adjusted through earnings, subjecting us to non-cash volatility in our results of operations. We prepared a sensitivity analysis using a modeling technique that measures the change in the fair values arising from a hypothetical 10% adverse movement in levels of interest rates across the entire yield curve, with all other variables held constant. Based upon the results of this analysis a 10% adverse change in interest rates from the July 31, 2015 rates would cause a \$0.2 million reduction in our results of operations. We believe it is prudent to hedge the expected volatility of the variable rate mortgage on our corporate headquarters. The swap fixes the interest rate on our mortgage to 4.31% over the entire term of the mortgage and effectively lowers our interest rate from the previous mortgage rate of 6.5%. Although the agreement allows us to prepay the loan and exit the agreement early, we have no intention of doing so. As a result, we will have non-cash adjustments through earnings each reporting period. However, over the term of the mortgage, the net impact of these mark-to-market adjustments on earnings will be zero.

ITEM 4 – CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Quarterly Report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in internal control over financial reporting. There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent limitations of internal controls. QAD's management does not expect that its disclosure controls and procedures or its internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within QAD have been detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors reported in Item 1A within the Company's Annual Report on Form 10-K for the year ended January 31, 2015.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits

31.1	Certification by the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by the Chief Executive Officer and 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
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Signatures

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

Date: September 4, 2015

QAD Inc.
(Registrant)

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

By: /s/ KARA BELLAMY
Kara Bellamy
Senior Vice President, Corporate Controller
(Chief Accounting Officer)

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

I, Karl F. Lopker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QAD Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-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: September 4, 2015

/s/ KARL F. LOPKER

Karl F. Lopker
Chief Executive Officer
QAD Inc.

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

I, Daniel Lender, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QAD Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-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: September 4, 2015

/s/ DANIEL LENDER

Daniel Lender
Chief Financial Officer
QAD Inc.

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

In connection with the Quarterly Report of QAD Inc. (the "Company") on Form 10-Q for the period ending July 31, 2015 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: September 4, 2015

/s/ KARL F. LOPKER

Karl F. Lopker
Chief Executive Officer
QAD Inc.

In connection with the Quarterly Report of QAD Inc. (the "Company") on Form 10-Q for the period ending July 31, 2015 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: September 4, 2015

/s/ DANIEL LENDER

Daniel Lender
Chief Financial Officer
QAD Inc.
