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

FORM 10-Q

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

For the quarterly period ended **October 31, 2003**

OR

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

For the transition period from ____________________ to _________________________

Commission file number **0-22823**

QAD Inc.

(Exact name of Registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes _____ No __X__.

The number of shares outstanding of the issuer's common stock as of December 1, 2003 was 33,250,431.

QAD INC.
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PART I

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PART I

ITEM 1 – FINANCIAL STATEMENTS

QAD INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)
(Unaudited)

	October 31, 2003	January 31, 2003
Assets		
Current assets:		
Cash and equivalents	$ 47,843	$ 50,188
Restricted cash	—	1,016
Accounts receivable, net	46,700	57,340
Other current assets	11,145	15,340
Total current assets	105,688	123,884
Property and equipment, net	29,994	21,543
Capitalized software development costs, net	1,406	2,077
Other assets, net	14,243	14,802
Total assets	$ 151,331	$ 162,306
Liabilities and stockholders’ equity		
Current liabilities:		
Current portion of long-term debt	$ 9,249	$ 2,000
Accounts payable	11,351	12,280
Deferred revenue	52,499	65,860
Other current liabilities	32,064	36,927
Total current liabilities	105,163	117,067
Long-term debt	8,000	9,125
Other liabilities	297	42
Minority interest	460	329
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.001 par value. Authorized 5,000,000 shares; none issued	—	—
Common stock, $0.001 par value. Authorized 150,000,000 shares; issued 35,326,951 and 34,693,019 shares at October 31, 2003 and January 31, 2003, respectively	35	34
Additional paid-in capital	119,273	115,800
Treasury stock, at cost (2,148,260 shares at October 31, 2003)	(11,147)	—
Accumulated deficit	(64,301)	(73,244)
Accumulated other comprehensive loss	(6,449)	(6,847)
Total stockholders’ equity	37,411	35,743
Total liabilities and stockholders’ equity	$ 151,331	$ 162,306

See accompanying notes to condensed consolidated financial statements.

QAD INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
Revenue:				
License fees	$ 15,517	$ 14,041	$ 48,607	$ 37,194
Maintenance and other	28,617	26,844	85,358	78,534
Services	11,681	7,653	34,104	22,408
Total revenue	55,815	48,538	168,069	138,136
Costs and expenses:				
Cost of license fees	2,140	2,451	7,400	6,171
Cost of maintenance, service and other revenue	20,174	15,486	59,240	47,116
Sales and marketing	14,114	13,471	44,402	45,808
Research and development	8,991	7,994	27,325	25,207
General and administrative	5,965	4,804	18,153	15,910
Amortization of intangibles from acquisitions	279	263	826	840
Impairment loss	—	151	—	151
Restructuring	(346)	3,192	(346)	3,192
Total costs and expenses	51,317	47,812	157,000	144,395
Operating income (loss)	4,498	726	11,069	(6,259)
Other (income) expense:				
Interest income	(151)	(183)	(396)	(599)
Interest expense	328	426	874	1,295
Other (income) expense, net	(154)	(148)	(1,794)	416
Total other (income) expense	23	95	(1,316)	1,112
Income (loss) before income taxes and cumulative effect of accounting change	4,475	631	12,385	(7,371)
Income tax expense	900	300	2,400	900
Income (loss) before cumulative effect of accounting change	3,575	331	9,985	(8,271)
Cumulative effect of accounting change	—	—	—	1,051
Net income (loss)	$ 3,575	$ 331	$ 9,985	$ (9,322)
Basic net income (loss) per share:				
Before cumulative effect of accounting change	$ 0.11	$ 0.01	$ 0.30	$ (0.24)
Cumulative effect of accounting change	—	—	—	(0.03)
Basic net income (loss) per share	$ 0.11	$ 0.01	$ 0.30	$ (0.27)
Diluted net income (loss) per share:				
Before cumulative effect of accounting change	$ 0.10	$ 0.01	$ 0.29	$ (0.24)
Cumulative effect of accounting change	—	—	—	(0.03)
Diluted net income (loss) per share	$ 0.10	$ 0.01	$ 0.29	$ (0.27)

See accompanying notes to condensed consolidated financial statements.

QAD INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(Unaudited)

	Nine Months Ended October 31, 2003	Nine Months Ended October 31, 2002
Net cash provided by operating activities	$ 8,072	$ 4,323
Cash flows from investing activities:		
Purchase of property and equipment	(12,400)	(5,995)
Restricted cash under construction loan	1,016	—
Capitalized software development costs	(478)	(1,368)
Acquisition of businesses	(445)	—
Proceeds from sale of property and equipment	3,394	145
Net cash used in investing activities	(8,913)	(7,218)
Cash flows from financing activities:		
Proceeds from construction loan	7,749	—
Repayments of long-term debt	(1,625)	(1,699)
Issuance of common stock for cash	6,524	678
Repurchase of common stock	(15,239)	—
Net cash used in financing activities	(2,591)	(1,021)
Effect of exchange rates on cash and equivalents	1,087	1,273
Net decrease in cash and equivalents	(2,345)	(2,643)
Cash and equivalents at beginning of period	50,188	50,782
Cash and equivalents at end of period	$ 47,843	$ 48,139

See accompanying notes to condensed consolidated financial statements.

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

1. BASIS OF PRESENTATION

In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments necessary to present fairly the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States for annual financial statements and should be read in conjunction with the audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended January 31, 2003. The results of operations for the three and nine months ended October 31, 2003 are not necessarily indicative of the results to be expected for the year ending January 31, 2004.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 149 is effective for contracts entered into or modified after June 30, 2003, except for certain hedging relationships designated after June 30, 2003. Since we do not currently transact in such instruments nor undertake hedging transactions, the adoption of this statement did not have a material impact on our financial condition or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement did not have a material impact on our financial condition or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation No. 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The recognition and measurement provisions of Interpretation No. 46 are effective for newly created variable interest entities formed after January 31, 2003, and for existing variable interest entities, on the first interim or annual reporting period beginning after June 15, 2003. Since we have no existing variable interest entities as of October 31, 2003, the adoption of this statement did not have a material impact on our financial condition or results of operations.

3. ACCOUNTING FOR STOCK-BASED COMPENSATION

We account for our stock option grants in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." As such, compensation expense is generally recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price or in connection with the modification to outstanding awards and/or changes in grantee status. No employee stock option compensation expense is reflected in our results of operations, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

3. ACCOUNTING FOR STOCK-BASED COMPENSATION (Continued)

Compensation expense related to stock options granted to non-employees is accounted for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), which requires entities to recognize an expense, based on the fair value of the related awards. We are not required, and we currently do not intend to transition to use a fair value method of accounting for stock-based employee compensation. The following table illustrates the effect on net income (loss) and basic and diluted net income (loss) per share as if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income (loss), as reported	$ 3,575	$ 331	$ 9,985	$ (9,322)
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects	—	—	—	—
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	827	809	2,439	2,716
Pro forma net income (loss)	$ 2,748	$ (478)	$ 7,546	$ (12,038)
Basic and diluted net income (loss) per share:				
As reported				
Basic	$ 0.11	$ 0.01	$ 0.30	$ (0.27)
Diluted	0.10	0.01	0.29	(0.27)
Pro forma				
Basic	0.08	(0.01)	0.23	(0.35)
Diluted	0.08	(0.01)	0.22	(0.35)

The fair value of stock options and stock purchased under our employee stock purchase plan (ESPP) at date of grant was estimated using the Black-Scholes pricing model with the following assumptions for the nine months ended October 31, 2003 and 2002:

Stock–Based Compensation	Expected Life (in years)	Expected Volatility	Risk-Free Interest Rate	Dividend Yield
Options:				
2003	5.50	1.01	3.50%	—
2002	6.50	1.05	3.55%	—
ESPP:				
2003	0.25	1.01	1.10%	—
2002	0.25	1.05	1.75%	—

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

4. COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
	(in thousands)			
Net income (loss)	$ 3,575	$ 331	$ 9,985	$ (9,322)
Foreign currency translation adjustments	113	(297)	398	(202)
Comprehensive income (loss)	$ 3,688	$ 34	$ 10,383	$ (9,524)

5. COMPUTATION OF NET INCOME OR LOSS PER SHARE

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income (loss)	$ 3,575	$ 331	$ 9,985	$ (9,322)
Weighted average shares of common stock outstanding - *basic*	32,892	34,502	32,996	34,403
Weighted average shares of common stock equivalents issued using the treasury stock method	1,782	24	1,635	—
Weighted average shares of common stock and common stock equivalents outstanding - *diluted*	34,674	34,526	34,631	34,403
Basic net income (loss) per share	$ 0.11	$ 0.01	$ 0.30	$ (0.27)
Diluted net income (loss) per share	$ 0.10	$ 0.01	$ 0.29	$ (0.27)

Common stock equivalent shares consist of the shares issuable upon the exercise of stock options and warrants using the treasury stock method. For the three and nine months ended October 31, 2003 and 2002, shares of common stock equivalents of approximately 0.4 million, 0.8 million, 4.6 million and 4.1 million, respectively, were not included in the diluted calculation because to do so would have been anti-dilutive for the periods presented.

6. GOODWILL AND INTANGIBLE ASSETS

Goodwill

Goodwill is included in "Other assets, net" in our Condensed Consolidated Balance Sheets. For the applicable reporting units, the changes in the carrying amount of goodwill for the nine months ended October 31, 2003 were as follows (reporting unit regions are defined in note 12 within these Notes to Condensed Consolidated Financial Statements):

	EMEA	Asia Pacific	Latin America	Total
	(in thousands)			
Balances, January 31, 2003	$ 9,692	$ —	$ 810	$ 10,502
Adjustment to goodwill acquired	(650)	262	—	(388)
Impact of foreign currency translation	646	13	(8)	651
Balances, October 31, 2003	$ 9,688	$ 275	$ 802	$ 10,765

During the second quarter of fiscal 2004, the selling entity of an acquired business in Asia Pacific received an earnout payment of $262,000 based on financial performance under the purchase agreement. This final payment effectively served to increase the purchase price of the acquisition, thus adding to our goodwill balance. Based on the earnout payment, the Asia Pacific reporting unit was valued and tested for impairment as of July 31, 2003. The fair value of the Asia Pacific reporting unit was determined using a discounted cash flow approach and yielded no impairment.

We are required to analyze goodwill for impairment at least on an annual basis. We have chosen the fourth quarter of our fiscal year as our annual test period.

During the nine months ended October 31, 2003, we recorded purchase accounting adjustments of $650,000 related to the purchase price allocation for identifiable assets, liabilities and goodwill acquired in connection with the November 2002 acquisition of TRW Integrated Supply Chain Solutions (TRW ISCS). These adjustments were mainly due to certain liabilities deemed no longer necessary after analysis of additional information not available at the date of acquisition.

The purchase price allocation is preliminary and a final determination of required purchase accounting adjustments will be made during the fiscal 2004 fourth quarter, upon the completion of a final analysis of the total purchase cost and the fair value of the assets and liabilities assumed, including estimated involuntary termination and facility related costs.

Intangible Assets

	October 31, 2003	January 31, 2003
	(in thousands)	
Amortizable intangible assets (various, principally intellectual property and customer contracts)	$ 11,424	$ 10,280
Less: accumulated amortization	(9,969)	(8,752)
Net amortizable intangible assets	$ 1,455	$ 1,528

Intangible assets are included in "Other assets, net" in our Condensed Consolidated Balance Sheets. The increase in amortizable intangible assets from January 31, 2003 to October 31, 2003 is due to the acquisition of certain intellectual property and the impact of foreign currency translation. During the fiscal 2004 third quarter, QAD

6. GOODWILL AND INTANGIBLE ASSETS (Continued)

acquired intellectual property comprised of certain software that is complementary to MFG/PRO and is part of our Customer Self-Service solution. The acquisition price includes a total of $750,000 in guaranteed payments, payable annually over three years, beginning with $250,000 paid upon acquisition. The agreement also sets forth maximum potential future contingent payments by QAD of $250,000 per year for three years commencing upon acquisition, based on future sales of the acquired software when used with certain versions of MFG/PRO.

As of October 31, 2003 and January 31, 2003, all of our intangible assets were determined to have definite useful lives, and therefore were subject to amortization. The aggregate amortization expense related to amortizable intangible assets was $0.3 million and $0.8 million for each of the three and nine months ended October 31, 2003 and 2002, respectively.

The estimated remaining amortization expense related to amortizable intangible assets for the years ended January 31, 2004, 2005, 2006 and 2007 is $0.2 million, $0.7 million, $0.4 million and $0.2 million, respectively. No additional amortization of these assets is estimated in fiscal 2008 and thereafter.

7. ACQUISITIONS

During the fourth quarter of fiscal 2003, we acquired TRW Integrated Supply Chain Solutions (TRW ISCS). In connection with the acquisition, we implemented a plan to eliminate redundant positions and facilities within TRW ISCS, and we recognized certain liabilities in accordance with EITF 95-3 "Recognition of Liabilities in Connection with a Purchase Business Combination." The related actions resulted in an anticipated $4.4 million increase to the acquisition cost, which included a reduction of approximately 40 employees across most functions (approximately $2.8 million) and facility consolidations related to certain former TRW ISCS locations (approximately $1.6 million). As of October 31, 2003, $3.2 million of the $4.4 million acquisition-related restructuring charge was utilized. The remaining balance of $1.2 million, consisting mainly of lease obligations, includes payments scheduled through fiscal 2016.

The following table presents the plan activities for the nine months ended October 31, 2003:

	Lease Obligations	Employee Termination Costs	Total Restructuring
		(in thousands)	
Balances, January 31, 2003	$ 1,518	$ 665	$ 2,183
Fiscal 2004 activity:			
Cash payments	(309)	(641)	(950)
Adjustments	(85)	46	(39)
Balances, October 31, 2003	$ 1,124	$ 70	$ 1,194

8. RESTRUCTURING CHARGES

We have implemented restructuring programs designed to strengthen operations and financial performance. Charges and adjustments related to restructurings are included in "Restructuring" in our Condensed Consolidated Statements of Operations. Below is a discussion of the active restructuring programs as of October 31, 2003.

During fiscal 2003, we implemented cost reduction programs aimed at reducing annualized operating expenses to better align them with current business levels. The related actions resulted in a $3.2 million and $1.2 million charge in the third quarter and fourth quarter, respectively. These charges included a reduction of approximately 130 employees across all regions and functions (approximately $4.1 million), facility consolidations ($0.1 million), and associated asset write-downs ($0.2 million). In addition, during the fourth quarter of fiscal 2003, we recorded an adjustment of $0.9 million as an increase to total costs and expenses, related to the fiscal 2002 restructuring accrual

8. RESTRUCTURING CHARGES (Continued)

as noted below. As of October 31, 2003, of the combined $4.4 million fiscal 2003 restructuring charges, $4.3 million was utilized and $0.1 million was adjusted downwards because employee termination costs were lower than originally estimated.

During fiscal 2002, we continued our fiscal 2001 initiative to strengthen operating and financial performance by sharpening the focus of our solutions for multi-national customers. The related actions resulted in a $0.7 million and $0.4 million charge in the second quarter and fourth quarter, respectively. These charges primarily related to the reduction of office space in three of our North American locations. In addition, during fiscal 2002, we recorded adjustments of $0.7 million and $0.3 million as reductions to total cost and expenses for the second quarter and third quarter, respectively. These adjustments, totaling $1.0 million, were to the fiscal 2001 restructuring accrual, which has been completely utilized. As noted above, during fiscal 2003, the fiscal 2002 restructuring accrual was increased $0.9 million due to the Company's inability to sublease certain office space as originally planned. During the fiscal 2004 third quarter, we recorded an adjustment of $0.3 million as a decrease to total costs and expenses related to the fiscal 2002 restructuring accrual to reflect a change in utilization related to a previously vacated leased office space. As of October 31, 2003, of the combined $1.7 million fiscal 2002 restructuring charges, $1.3 million had been utilized. The remaining balance of $0.4 million related to lease obligations is expected to be paid through fiscal 2005.

The following table presents the restructuring activities for the nine months ended October 31, 2003, resulting from the previously mentioned programs:

	Lease Obligations	Employee Termination Costs	Total Restructuring
		(in thousands)	
Balances, January 31, 2003	$ 1,092	$ 709	$ 1,801
Fiscal 2004 activity:			
Cash payments	(446)	(641)	(1,087)
Adjustments	(278)	(68)	(346)
Balances, October 31, 2003	$ 368	$ —	$ 368

9. LONG-TERM DEBT

	October 31, 2003	January 31, 2003
	(in thousands)	
Total Debt		
Credit facility	$ 9,500	$ 11,125
Construction loan	7,749	—
	17,249	11,125
Less current maturities	9,249	2,000
Long-term debt	$ 8,000	$ 9,125

As of October 31, 2003, in connection with the construction of our new company headquarters located in Summerland, California, and in accordance with the provisions of the construction loan, we received $7.7 million to fund qualified expenditures made during the nine months ended October 31, 2003. These borrowings under the construction loan are reported in "Current portion of long-term debt" in our Condensed Consolidated Balance Sheet at October 31, 2003.

9. LONG-TERM DEBT (Continued)

In connection with the sale of property owned by QAD in Carpinteria, California, and in accordance with the terms of our credit facility (Facility) with Foothill Capital Corporation, we paid $0.5 million towards the outstanding balance of the Facility in March 2003. This payment was in addition to our regularly scheduled quarterly payments under the terms of the Facility. For further discussion related to the sale of property, see note 13 within these Notes to Condensed Consolidated Financial Statements.

During March 2003, in order to facilitate the tender offer, as discussed in note 11 within these Notes to Condensed Consolidated Financial Statements, QAD amended its Facility with Foothill Capital Corporation to permit the purchase of up to $15 million of QAD Inc. common stock by no later than January 31, 2004. In that amendment, QAD agreed to maintain minimum cash coverage of 120% of the Facility's term loan balance on a fiscal quarterly basis and minimum cash coverage of 85% of the Facility's term loan balance on a daily basis. Minimum cash coverage is defined as the cash and cash equivalents in the QAD investment account in the United States plus the unused borrowing availability under the revolving portion of the Facility.

Effective April 29, 2003, QAD amended the Facility to adjust the EBITDA, minimum tangible net worth and maximum capital expenditure covenants based on current forecast, including the impact of the tender offer. As of October 31, 2003, we were in compliance with the covenants, as amended.

10. COMMITMENTS AND CONTINGENCIES

Indemnifications

We sell software licenses and services to our customers under a form of contract which we refer to as a Software License Agreement (SLA). Each SLA 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 our software is found to infringe upon certain intellectual property rights of a third party. The SLA generally limits the scope of and remedies for such indemnification obligations in a variety of industry-standard respects, including but not limited to, certain time- and geography-based scope limitations and a right to replace an infringing product.

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

11. STOCKHOLDERS' EQUITY

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

The aggregate cost, including fees and expenses associated with the tender offer, was approximately $15 million. The Company financed the tender offer from available cash. Shares acquired pursuant to the tender offer returned to the status of authorized but unissued common stock, and are available for issuance. Subsequent to the tender offer, common shares issued in connection with stock option exercises and ESPP purchases have been primarily made from treasury. The remaining balance of the acquired shares is included in "Treasury stock, at cost" in our Condensed Consolidated Balance Sheet at October 31, 2003.

11. STOCKHOLDERS' EQUITY (Continued)

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

12. BUSINESS SEGMENT INFORMATION

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

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
	(in thousands)			
Revenue:				
North America	$ 20,893	$ 22,450	$ 66,064	$ 60,008
EMEA	22,800	15,483	65,854	45,525
Asia Pacific	8,325	7,709	25,499	23,485
Latin America	3,797	2,896	10,652	9,118
	$ 55,815	$ 48,538	$ 168,069	$ 138,136
Operating income (loss):				
North America	$ 4,009	$ 5,359	$ 13,229	$ 10,203
EMEA	1,146	540	1,101	(1,869)
Asia Pacific	377	(569)	1,473	(3,125)
Latin America	(74)	(355)	(142)	(1,381)
Corporate	(1,306)	(906)	(4,938)	(6,744)
Impairment loss	—	(151)	—	(151)
Restructuring	346	(3,192)	346	(3,192)
	$ 4,498	$ 726	$ 11,069	$ (6,259)

	October 31, 2003	January 31, 2003
	(in thousands)	
Identifiable assets:		
North America	$ 77,480	$ 70,363
EMEA	49,193	67,709
Asia Pacific	17,856	18,659
Latin America	6,802	5,575
	$ 151,331	$ 162,306

13. OTHER (INCOME) EXPENSE, NET

In March 2003, QAD sold a 34-acre undeveloped parcel of property, in Carpinteria, California for $3.3 million, net of associated fees. The book value of this property was $1.8 million. The resulting gain of $1.5 million was recorded as a gain on disposal of property and is included in "Other (income) expense, net" in our Condensed Consolidated Statement of Operations for the nine months ended October 31, 2003.

14. SUBSEQUENT EVENT

In December 2003, Recovery Equity Investors II, L.P. (REI) exercised, in its entirety, a warrant to purchase 225,000 shares of QAD common stock at an exercise price of $7.50. QAD received $1.7 million in cash, which resulted in a reduction of "Treasury stock, at cost" in our Consolidated Balance Sheet during the fiscal 2004 fourth quarter.

REI acquired this warrant in December 1999 in conjunction with a private placement by QAD, in which REI received 2,333,333 shares of our common stock for net consideration of $9.6 million. The warrant included anti-dilution provisions, which were not applicable to this transaction. The warrant exercise period was set to expire in December 2003.

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

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements. These statements typically are preceded or accompanied by words like “believe,” “anticipate,” “expect” and words of similar meaning. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as other information detailed in our Annual Report on Form 10-K for the year ended January 31, 2003. These include, but are not limited to, evolving demand for the company's software products and products that operate with the company's products; the company’s ability to sustain strong licensing demand; the ability to sustain customer renewal rates at current levels; the publication of opinions by industry analysts about the company, its products and technology; the reliability of estimates of transaction and integration costs and benefits; the entry of new competitors and their technological advances; delays in localizing the company's products for new markets; delays in sales as a result of lengthy sales cycles; changes in operating expenses, pricing, timing of new product releases, the method of product distribution or product mix; general economic conditions, exchange rate fluctuations and the global political environment. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s opinions only as of the date hereof.

In addition, revenue and earnings in the enterprise resource planning (ERP), e-business and distributed order management software industries are subject to fluctuations. Software license revenue, in particular, is subject to variability with a significant proportion of revenue earned in the last month of each quarter. Given the high margins associated with license revenue, modest fluctuations can have a substantial impact on net income. Investors should not use any one quarter’s results as a benchmark for future growth. We undertake no obligation to revise, update or publicly release the results of any revision or update to these forward-looking statements. Readers should carefully review the risk factors described in other documents we file from time to time with the Securities and Exchange Commission.

INTRODUCTION

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

OVERVIEW

Founded in 1979, QAD has been recognized as a leading provider of enterprise resource planning (ERP) software applications for global manufacturing companies. Today, QAD enterprise applications leverage advances in Internet and enabling technologies to provide critical functionality for managing manufacturing resources and operations within and beyond the enterprise, enabling global manufacturers to collaborate with their customers, suppliers and partners to make and deliver the right product, at the right cost and at the right time.

QAD enterprise applications are focused and optimized for select manufacturing industry segments: automotive, consumer products, electronics, food and beverage, industrial and medical industries. Previously, QAD classified business-critical functions and processes across three levels within the global manufacturing enterprise: the Enterprise, the Extended Enterprise and the Community level. Based on a shift in the way the market – including both customers and analysts – organizes and describes the business-critical functions and processes of the global manufacturing enterprise, QAD will no longer use “Community” as a category to group business-critical functions, and instead will group those same capabilities under the Extended Enterprise level. Due to typical, periodic changes in marketing strategy, QAD may choose to recognize and/or define another business-critical function level to help differentiate our solutions in the future. QAD today classifies its functionality across two levels 1) the Enterprise, providing traditional ERP functionality for intra-enterprise functions; and 2) the Extended Enterprise, providing collaboration and supply chain execution systems for supplier-facing and customer-facing functions, including Distributed Order Management capabilities.

This reorganization does not change any existing or planned functionality, nor does it alter QAD's target markets. QAD continues to develop and market Distributed Order Management functionality, however it will no longer be marketed under the QAD eQ name. Instead, the majority of the functionality previously marketed under the QAD eQ product line will now be marketed using Distributed Order Management terminology to position various products in this area. During this quarter, QAD announced the November 1, 2003 general availability of a component application within its Distributed Order Management strategy called QAD Customer Self-Service (CSS). During this same quarter, QAD completed the purchase of application software technology that served as the foundation for QAD CSS. If deemed appropriate, QAD may continue technology purchases of this kind in the future.

Additionally, the component applications within QAD's Distributed Order Management strategy will now be built on the same technology foundation as other QAD products, including the company's flagship ERP solution, QAD MFG/PRO. Previously, the component applications within QAD's Distributed Order Management strategy were built on the IBM WebSphere platform. In order to capitalize on efficiencies and ensure tight integration and interoperability across all QAD solutions, the company has shifted the underlying technology of its Distributed Order Management strategy to the integrated development platform provided by Progress Software Corporation. In an effort to continue to further enhance our MFG/PRO functionality, we are committed to building the capability to run our MFG/PRO product line with IBM WebSphere Application Server (WAS).

QAD has built a solid customer base of global Fortune 1000 and mid-market manufacturers who are excellent prospects for QAD's enterprise applications. With a proven track record of more than 20 years of industry leadership, and approximately 5,200 licensed sites of our software around the world, QAD is ideally qualified to meet the business and technology requirements of global manufacturing companies worldwide. We develop our products with constant and direct input from leading global manufacturers within the vertical markets we serve. This vertical industry focus is a key differentiator for QAD, enabling our customers to implement QAD applications rapidly, realize a rapid return on investment, and achieve a low total cost of ownership compared with the product offerings of other vendors targeting the industries we serve.

Global service and support are an important component of our solutions. QAD offers service and support capabilities that are truly global in scope. We are one of a few select organizations with the capabilities and industry expertise required to implement our solutions around the globe and support them in multiple languages and currencies. Our geographic management structure ensures that our global practices meet local requirements and that our services are delivered effectively within each region around the globe. We support our customers' global operations through our network of regional support centers and online support, accessible 24 hours a day, seven days a week, all around the world.

At October 31, 2003, we had approximately 1,250 full-time employees worldwide.

CRITICAL ACCOUNTING POLICIES

We consider certain accounting policies related to revenue recognition, accounts receivable allowances, impairment of long-lived assets, capitalized software development costs, and valuation of deferred tax assets to be critical policies due to the significance of these items to our operating results and the estimation processes and management's judgment involved in each.

- *Revenue Recognition.* QAD licenses its software under non-cancelable license agreements including third-party software sold in conjunction with QAD software, provides customer support and provides services including technical, implementation and training. Revenue is recognized in accordance with Statement of Position (SOP) No. 97-2, "Software Revenue Recognition," as modified by SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions" and Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements." Our revenue recognition policy is as follows:

  License Revenue. We recognize revenue from license contracts when a non-cancelable, non-contingent license agreement has been signed, the software product has been delivered, no uncertainties exist surrounding product acceptance, fees from the agreement are fixed or determinable, and collection is probable. We use the residual method to recognize revenue when a license agreement includes one or more elements to be delivered at a future date if vendor-specific, objective evidence of the fair value of all undelivered elements exists. If evidence of the fair value of the undelivered elements does not exist, revenue is deferred and recognized when delivery occurs. Our standard products do not require significant production, modification or customization of software or services that are essential to the functionality of the software. Certain judgments affect the application of our license revenue recognition policy, such as the assessment of collectibility for which we review a customer's credit worthiness and our historical experience with that customer, if applicable.

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

Services Revenue. Revenue from technical and implementation services is recognized as the services are performed for time-and-materials contracts. Revenue from training services is recognized as the services are performed.

We believe that we are currently in compliance with SOP No. 97-2, SOP No. 98-9 and SAB No. 101. However, the accounting profession continues to discuss various provisions of these guidelines with the objective of providing additional guidance on their future application. These discussions and the issuance of new interpretations, once finalized, could lead to unanticipated changes in recognized revenue. They could also drive significant adjustments to our business practices that could result in increased administrative costs, lengthened sales cycles and other changes that could affect our results of operations.

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

- *Impairment of Long-Lived Assets.* Our long-lived assets include goodwill, intangible assets, and other assets. At October 31, 2003, we had $12.2 million of goodwill and other intangible assets, accounting for 8% of our total assets. In assessing the recoverability of our intangibles, excluding goodwill, we must make assumptions regarding estimated future cash flows to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment losses for these assets. We account for goodwill under Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), which requires us to analyze goodwill for impairment on at least an annual basis. We have chosen the fourth quarter of our fiscal year as our annual test period. For a further discussion of goodwill and intangible assets, see note 6 within the Notes to Condensed Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

- *Capitalized Software Development Costs.* We capitalize software development costs incurred in connection with the localization and translation of our products once technological feasibility has been achieved based on a working model. A working model is defined as an operative version of the computer software product that is completed in the same software language as the product to be ultimately marketed, performs all the major functions planned for the product, and is ready for initial customer testing (usually identified as beta testing). At October 31, 2003, we had $1.4 million of net capitalized software development costs, accounting for 1% of our total assets. Capitalized software development costs are amortized on a straight-line basis over three years and charged to cost of license fees. We periodically compare the unamortized capitalized software development costs to the estimated net realizable value of the associated product. The amount by which the unamortized capitalized software development costs of a particular software product exceed the estimated net realizable value of that asset would be reported as a charge to the statement of operations. This review requires management's judgment regarding future cash flows. If these estimates or their related assumptions require updating in the future, we may be required to recognize losses for these assets not previously recorded.

- *Valuation of Deferred Tax Assets.* Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes", requires that the carrying value of our net deferred tax assets reflect an amount that is more likely than not to be realized. At October 31, 2003, we had $0.2 million of net deferred tax assets, current and non-current. In assessing the likelihood of realizing tax benefits associated with deferred tax assets and the need for a valuation allowance, we consider future taxable income and tax planning strategies that are both prudent and feasible. Should we determine that we would be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to deferred tax assets would decrease tax expense in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of the net deferred tax asset in the future, an adjustment to deferred tax assets would increase tax expense in the period such determination was made.

RESULTS OF OPERATIONS

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2003	2002	2003	2002
Revenue:				
License fees	28%	29%	29%	27%
Maintenance and other	51	55	51	57
Services	21	16	20	16
Total revenue	100	100	100	100
Costs and expenses:				
Cost of license fees	4	5	5	5
Cost of maintenance, service and other revenue	36	32	35	34
Sales and marketing	25	28	27	33
Research and development	16	16	16	18
General and administrative	11	10	11	12
Amortization of intangibles from acquisitions	—	1	—	1
Impairment loss	—	—	—	—
Restructuring	—	6	—	2
Total costs and expenses	92	98	94	105
Operating income (loss)	8	2	6	(5)
Other (income) expense	—	—	(1)	1
Income (loss) before income taxes and cumulative effect of accounting change	8	2	7	(6)
Income tax expense	2	1	1	—
Income (loss) before cumulative effect of accounting change	6	1	6	(6)
Cumulative effect of accounting change	—	—	—	1
Net income (loss)	6%	1%	6%	(7)%

Total Revenue. Total revenue for the third quarter of fiscal 2004 was $55.8 million, an increase of $7.3 million, or 15%, from $48.5 million in the third quarter of fiscal 2003. Total revenue for the nine months ended October 31, 2003 was $168.1 million, an increase of approximately $30.0 million, or 22%, from $138.1 million in the comparable prior year period. The increases in total revenue on both a quarter-to-quarter and year-to-year basis were driven by increases in all revenue categories.

License revenue increased $1.5 million to $15.5 million for the third quarter of fiscal 2004 from $14.0 million for the same period last year. For the nine months ended October 31, 2003, license revenue was $48.6 million, an $11.4 million increase over $37.2 million for the same period last year. While the pricing of license sales was comparable to last year, the volume of our license sales in the current year has increased.

Maintenance and other revenue increased $1.8 million to $28.6 million for the current quarter, when compared to $26.8 million for the third quarter of last year. On a year-to-date basis, maintenance and other revenue increased approximately $6.9 million to $85.4 million for the current fiscal year from $78.5 million for the first nine months of last year. These increases were due primarily to additional maintenance on new license sales, partially offset by cancellations within our existing customer base. Maintenance revenue growth rates are affected by the overall license revenue growth rates as well as annual maintenance contract renewal rates.

Third quarter services revenue increased $4.0 million to $11.7 million for the current year when compared to $7.7 million for the same period last year. For the nine months ended October 31, 2003, services revenue increased approximately $11.7 million to $34.1 million when compared to $22.4 million for the first nine months of last year. These increases primarily relate to the TRW Integrated Supply Chain Solutions (TRW ISCS) acquisition that was completed in November 2002.

Total Cost of Revenue. Total cost of revenue (combined cost of license fees and cost of maintenance, service and other revenue) as a percentage of total revenue increased to 40% in the third quarter of fiscal 2004 from 37% in the third quarter of fiscal 2003. This increase primarily relates to a shift in revenue mix toward services, which carry lower margins than license and maintenance revenue.

For the first nine months, total cost of revenue as a percentage of total revenue was relatively flat to last year at 40% and 39% for fiscal 2004 and 2003, respectively. The slight decrease in margins related to the shift in revenue mix to a higher proportion of services revenue, which carry lower margins than license and maintenance revenue. This decrease in margins was partially offset by an improvement in services margins primarily due to increased utilization of service consultants.

Sales and Marketing. Sales and marketing expense increased 5% to $14.1 million for the third quarter of fiscal 2004 from $13.5 million in the comparable prior year period. This increase was primarily due to higher employee commissions and bonuses on higher revenue and improved performance metrics, and increased marketing and promotional activities. These increases were partially offset by lower distributor and sales agent commissions.

On a year-to-date basis, sales and marketing expense decreased 3%, or $1.4 million, to $44.4 million for the first nine months of fiscal 2004, compared to $45.8 million for the same period last year. This year-to-date decrease was primarily due to decreased personnel and associated expenses, due in part to our cost containment programs and a lower level of distributor and sales agent commissions. These decreases were partially offset by higher employee commissions and bonuses and increased marketing and promotional activities.

Research and Development. Research and development expense increased $1.0 million, or 12%, to $9.0 million, for the third quarter of fiscal 2004 when compared to the same quarter last year at $8.0 million. During the nine months ended October 31, 2003, research and development expense increased $2.1 million, or 8%, to $27.3 million from $25.2 million in the same prior year period. These increases were primarily due to increased personnel and related costs as we continue to invest and realign our resources to optimize the development of our new and existing products.

General and Administrative. General and administrative expense increased $1.2 million to $6.0 million for the current quarter from $4.8 million for the same quarter last year, and increased approximately $2.3 million on a year-to-date basis at $18.2 million and $15.9 million for fiscal 2004 and 2003, respectively. These increases were primarily due to incrementally higher personnel and associated costs and professional fees related to the integration of the acquired TRW ISCS business.

Amortization of Intangibles from Acquisitions. Amortization of intangibles from acquisitions was flat to the corresponding periods last year at $0.3 million and $0.8 million, for the three and nine months ended October 31, 2003, respectively.

Impairment Loss. During the third quarter of fiscal 2003, the selling entity of an acquired business in our Asia Pacific reporting unit received an earnout payment of $151,000 based on financial performance under the purchase agreement. The payment effectively served to increase the purchase price of the acquisition, thus adding to our goodwill balance. Based on the earnout payment, under SFAS 142, the Asia Pacific reporting unit was valued and tested for impairment. In accordance with the provisions of SFAS 142, the additional $151,000 of goodwill in Asia Pacific was fully impaired and the related impairment loss is included in our Condensed Consolidated Statement of Operations for the three and nine months ended October 31, 2002.

SFAS 142 also requires us to analyze goodwill for impairment at least on an annual basis. We have chosen the fourth quarter of our fiscal year as our annual test period. Based on the results of this analysis, the potential impact if any, would be recorded as an impairment loss in the 2004 fiscal fourth quarter.

Restructuring. During the third quarter of fiscal 2004, we recorded a $0.3 million credit adjustment to the fiscal 2002 restructuring accrual primarily due to a change in estimate related to a leased office space.

During the third quarter of fiscal 2003, we implemented a cost reduction program aimed at reducing annualized operating expenses by better aligning expenses with current business levels. The related actions resulted in a $3.2 million charge and included a reduction of approximately 100 employees across all regions and functions ($2.9 million), associated asset write-downs ($0.2 million) and facility consolidations ($0.1 million).

Operating Income (Loss). Operating income for the current quarter was $4.5 million, a $3.8 million improvement over the $0.7 million operating income for the same quarter last year. For the first nine months of the current year, operating income was $11.1 million, an approximate $17.4 million improvement over the $6.3 million operating loss for the comparable prior year period. These improvements are primarily attributable to the reasons described above. It should be noted that certain revenue and expenses related to our operations can be significantly impacted by fluctuations in currency exchange rates.

Other (Income) Expense. Net other expense was nearly flat at $23,000 and $95,000 for the third quarter of fiscal 2004 and 2003, respectively. For the first nine months of the current year, we reported net other income of $1.3 million, compared to $1.1 million of net other expense for the comparable prior year period. The $2.4 million improvement over last year primarily related to the $1.5 million gain on the sale of a parcel of property in Carpinteria, California, in the first quarter of the current year and to favorable exchange (gains) losses.

Income Taxes. We recorded income tax expense of $0.9 million and $0.3 million for the third quarter and $2.4 million and $0.9 million for the first nine months of fiscal 2004 and 2003, respectively. These amounts include taxes in jurisdictions that were profitable during these periods. We have not provided a benefit for the jurisdictions in loss positions due to management's determination regarding the uncertainty of the realization of these benefits.

Cumulative Effect of Accounting Change. In the first quarter of fiscal 2003, we adopted SFAS 142 related to impairment tests for goodwill resulting in a charge reported as a cumulative effect of a change in accounting principle of $1.1 million.

LIQUIDITY AND CAPITAL RESOURCES

We have historically financed our operations and met our capital expenditure requirements through cash flows from operations, sales of equity securities and borrowings. Cash and equivalents were $47.8 million and $50.2 million at October 31, 2003, and January 31, 2003, respectively.

We had working capital of $0.5 million as of October 31, 2003, compared to $6.8 million as of January 31, 2003. The decrease in working capital mainly relates to a reduction in accounts receivable and other current assets, and an increase in the current portion of long-term debt primarily related to borrowings under our construction loan. The decrease in working capital was partially offset by a decline in other current liabilities partly due to payments in the current year against prior year-end accruals related to commissions, bonuses and royalties, and by a seasonal decline in deferred support revenue. As described below, we anticipate entering into a permanent loan agreement upon completion of the construction project. The impact of this loan conversion would primarily be a reclassification of debt from short-term to long-term, resulting in a corresponding increase in working capital.

Accounts receivable, net of allowances, declined to $46.7 million at October 31, 2003, from $57.3 million at January 31, 2003. This decrease is due primarily to the high volume of annual maintenance renewals processed in the fourth quarter that come due in the subsequent fiscal year. Accounts receivable days sales outstanding, using the countback method, increased to 80 days as of October 31, 2003, compared to 55 days at January 31, 2003. The increase over the prior year-end is partly related to a number of significant sales transactions, which carried longer payment terms.

Net cash provided by operating activities was $8.1 million and $4.3 million for the nine months ended October 31, 2003 and 2002, respectively. The year-over-year increase relates mainly to our change from a net loss position last year to a net income position in the current year and a decrease in other assets, partially offset by a smaller decline in accounts receivable and a larger decline in deferred revenue in the current year.

Net cash used in investing activities for the nine months ended October 31, 2003 and 2002 was $8.9 million and $7.2 million, respectively. The current year activity primarily relates to the purchase of property and equipment, including the continued construction of a new company headquarters on property owned by QAD in Summerland, California. These purchases were partially offset by the proceeds from the sale of a parcel of property located in Carpinteria, California. Net cash used in investing activities for the comparable period last year primarily related to the purchase of property and equipment.

In fiscal 2003, the board approved a $21.5 million construction budget for the new headquarters, which is being funded through a combination of cash and additional debt financing. As a result of this activity, we expect to consolidate QAD Santa Barbara area operations. In November 2002, QAD entered into a construction loan agreement with Santa Barbara Bank and Trust (SBB&T) to finance a maximum of $18 million, which is secured by the property and guaranteed by QAD. The current construction schedule is set to complete the effort so that it coincides with the lease termination of the existing company headquarters in nearby Carpinteria, California. As of October 31, 2003, we have reported the $7.7 million of borrowings under the construction loan within "Current portion of long-term debt" in our Condensed Consolidated Balance Sheet. We anticipate entering into a permanent loan agreement upon completion of the construction project. In fiscal 2003, SBB&T executed a commitment letter for a permanent loan with QAD, subject to a number of conditions. QAD has the right to terminate this commitment any time before funding of the permanent loan, subject to the loss of any fees, deposits, and reasonable costs incurred by SBB&T on behalf of QAD.

Net cash used in financing activities totaled $2.6 million and $1.0 million for the nine months ended October 31, 2003 and 2002, respectively. The current year activity includes approximately $15 million in expenditures related to a "Modified Dutch Auction" tender offer, in which QAD purchased approximately 2.9 million shares of its common stock at a price of $5.00 per share. Proceeds from the issuance of common stock were $6.5 million and $0.7 million for the first nine months of fiscal 2004 and 2003, respectively. The current year also includes proceeds from the construction loan related to the building of our new headquarters in Summerland, California. In connection with the sale of another parcel of property owned by QAD in Carpinteria, California, and in accordance with terms of the applicable loan, the current year includes a $0.5 million repayment of borrowings under the Facility described below. Both the current and prior year activity includes regularly scheduled repayments of borrowings.

We maintain a five-year senior credit facility with Foothill Capital Corporation (Facility). The Facility, as amended, provides that we will maintain certain financial and operating covenants which include, among other provisions, maintaining minimum 12-month trailing earnings before interest, taxes, depreciation and amortization (EBITDA), minimum tangible net worth and minimum cash coverage ratios. The Facility, which expires in September 2005, currently provides that the term loan shall be repaid in quarterly principal installments ranging from $375,000 to $750,000 based on our aggregate unrestricted cash and equivalents balance at the end of each quarter.

During March 2003, in order to facilitate the tender offer, QAD amended its Facility with Foothill Capital Corporation to permit the purchase of up to $15 million of QAD Inc. common stock by no later than January 31, 2004. In that amendment, QAD agreed to maintain minimum cash coverage of 120% of the Facility's term loan balance on a fiscal quarterly basis and minimum cash coverage of 85% of the Facility's term loan balance on a daily basis. Minimum cash coverage is defined as the cash and cash equivalents in the QAD investment account in the United States plus the unused borrowing availability under the revolving portion of the Facility.

Effective April 29, 2003, QAD amended the Facility to adjust the EBITDA, minimum tangible net worth and maximum capital expenditure covenants based on current forecast, including the impact of the tender offer. As of October 31, 2003, we were in compliance with the covenants, as amended.

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

RECENT ACCOUNTING STANDARDS

In April 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 149 is effective for contracts entered into or modified after June 30, 2003, except for certain hedging relationships designated after June 30, 2003. Since we do not currently transact in such instruments nor undertake hedging transactions, the adoption of this statement did not have a material impact on our financial condition or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement did not have a material impact on our financial condition or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation No. 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The recognition and measurement provisions of Interpretation No. 46 are effective for newly created variable interest entities formed after January 31, 2003, and for existing variable interest entities, on the first interim or annual reporting period beginning after June 15, 2003. Since we have no existing variable interest entities as of October 31, 2003, the adoption of this statement did not have a material impact on our financial condition or results of operations.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange. For each of the nine months ended October 31, 2003 and 2002, approximately 30% of our revenue was denominated in foreign currencies. We also incur a significant portion of our expenses in currencies other than the United States dollar. As a result, fluctuations in the values of the respective currencies relative to the currencies in which we generate revenue could adversely impact our results.

Fluctuations in currencies relative to the United States dollar have affected and will continue to affect period-to-period comparisons of our reported results of operations. For the nine months ended October 31, 2003 and 2002, foreign currency transaction (gains) losses totaled ($0.1) million and $0.4 million, respectively. Due to constantly changing currency exposures and the volatility of currency exchange rates, we may experience currency losses in the future, and we cannot predict the effect of exchange rate fluctuations upon future operating results. Although we do not currently undertake hedging transactions, we may choose to hedge a portion of our currency exposure in the future, as we deem appropriate.

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

We prepared sensitivity analyses of our interest rate exposure and our exposure from anticipated investment and borrowing levels for fiscal 2004 to assess the impact of hypothetical changes in interest rates. Based upon the results of these analyses, a 10% adverse change in interest rates from the 2003 fiscal year-end rates would not have a material adverse effect on the fair value of investments and would not materially impact our results of operations or financial condition for fiscal 2004.

ITEM 4 – CONTROLS AND PROCEDURES

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

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

PART II

ITEM 6 – EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits

31.1	Certification by the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b) Reports on Form 8-K

On August 20, 2003, QAD Inc. filed a Current Report on Form 8-K reporting under Item 12 related to the Registrant's press release announcing fiscal 2004 second quarter results and guidance for the fiscal 2004 third quarter and full year.

Signatures

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

QAD Inc.
(Registrant)

Date: December 12, 2003

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

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