MORGAN STANLEY
Form 424B2
February 05, 2019

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities Offered	*Maximum Aggregate Offering Price*	*Amount of Registration Fee*
Contingent Income Auto-Callable Securities due 2022	$2,425,500	$293.97

February 2019

Pricing Supplement No. 1,509

Registration Statement Nos. 333-221595; 333-221595-01

Dated February 1, 2019

Filed pursuant to Rule 424(b)(2)

Morgan Stanley Finance LLC

Structured Investments

Opportunities in U.S. Equities

Contingent Income Auto-Callable Securities due February 4, 2022

Based on the Performance of the Common Stock of Apple Inc.

Fully and Unconditionally Guaranteed by Morgan Stanley

Principal at Risk Securities

Contingent Income Auto-Callable Securities do not guarantee the payment of interest or the repayment of principal. Instead, the securities offer the opportunity for investors to earn a contingent quarterly coupon at an annual rate of 9.35%, but only with respect to each determination date on which the determination closing price of the underlying stock is greater than or equal to 75% of the initial share price, which we refer to as the downside threshold price. In addition, if the determination closing price of the underlying stock is greater than or equal to the initial share price on any determination date, the securities will be automatically redeemed for an amount per security equal to the stated principal amount and the contingent quarterly coupon. However, if the securities are not automatically redeemed prior to maturity, the payment at maturity due on the securities will be as follows: (i) if the final share price is greater than or equal to the downside threshold price, the stated principal amount and the contingent quarterly coupon with respect to the final determination date, or (ii) if the final share price is less than the downside threshold price, investors will be exposed to the decline in the underlying stock on a 1-to-1 basis and will receive a payment at maturity that is less than 75% of the principal amount of the securities and could be zero. Moreover, if on any determination date the determination closing price of the underlying stock is less than the downside threshold price, you will not receive any contingent quarterly coupon for that quarterly period. As a result, investors must be willing to accept the risk of not receiving any contingent quarterly coupons and also the risk of receiving a payment at maturity that is significantly less than the stated principal amount of the securities and could be zero. **Accordingly, investors could lose their entire initial investment in the securities.** The securities are for investors who are willing to risk their principal and seek an opportunity to earn interest at a potentially above-market rate in exchange for the risk of receiving few or no contingent quarterly coupons over the 3-year term of the securities. Investors will not participate in any appreciation of the underlying stock. The securities are unsecured obligations of Morgan Stanley Finance LLC ("MSFL") and are fully and unconditionally guaranteed by Morgan Stanley. The securities are issued as part of MSFL's Series A Global Medium-Term Notes program.

All payments are subject to our credit risk. If we default on our obligations, you could lose some or all of your investment. These securities are not secured obligations and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.

FINAL Terms	
Issuer:	Morgan Stanley Finance LLC
Guarantor:	Morgan Stanley
Underlying stock:	Apple Inc. common stock
Aggregate principal amount:	$2,425,500
Stated principal amount:	$10 per security
Issue price:	$10 per security
Pricing date:	February 1, 2019
Original issue date:	February 6, 2019 (3 business days after the pricing date)
Maturity date:	February 4, 2022
Early redemption:	If, on any of the first eleven determination dates, the determination closing price of the underlying stock is greater than or equal to the initial share price, the securities will be automatically redeemed for an early redemption payment on the third business day following the related determination date. No further payments will be made on the securities once they have been redeemed.
Early redemption payment:	The early redemption payment will be an amount equal to (i) the stated principal amount *plus* (ii) the contingent quarterly coupon with respect to the related determination date.
Determination closing price:	The closing price of the underlying stock on any determination date other than the final determination date *times* the adjustment factor on such determination date.
Contingent quarterly coupon:	· If, on any determination date, the determination closing price or the

	final share price, as applicable, is greater than or equal to the downside threshold price, we will pay a contingent quarterly coupon at an annual rate of 9.35% (corresponding to approximately $0.23375 per quarter per security) on the related contingent payment date. · If, on any determination date, the determination closing price or the final share price, as applicable, is less than the downside threshold price, no contingent quarterly coupon will be paid with respect to that determination date.
Determination dates:	May 1, 2019, August 1, 2019, November 1, 2019, February 3, 2020, May 1, 2020, August 3, 2020, November 2, 2020, February 1, 2021, May 3, 2021, August 2, 2021, November 1, 2021 and February 1, 2022, subject to postponement for non-trading days and certain market disruption events. We also refer to February 1, 2022 as the final determination date.
Contingent payment dates:	With respect to each determination date other than the final determination date, the third business day after the related determination date. The payment of the contingent quarterly coupon, if any, with respect to the final determination date will be made on the maturity date.
Payment at maturity:	<table><tr><td>· If the final share price is **greater than or equal to** the downside threshold price:</td><td>(i) the stated principal amount *plus* (ii) the contingent quarterly coupon with respect to the final determination date</td></tr><tr><td>· If the final share price is **less than** the downside threshold</td><td>(i) the stated principal amount *multiplied by* (ii) the share performance factor</td></tr></table>

	price:		
Share performance factor:	Final share price *divided* by the initial share price		
Adjustment factor:	1.0, subject to adjustment in the event of certain corporate events affecting the underlying stock		
Downside threshold price:	$124.89, which is equal to 75% of the initial share price		
Initial share price:	$166.52, which is equal to the closing price of the underlying stock on the pricing date		
Final share price:	The closing price of the underlying stock on the final determination date *times* the adjustment factor on such date		
CUSIP:	61768W863		
ISIN:	US61768W8635		
Listing:	The securities will not be listed on any securities exchange.		
Agent:	Morgan Stanley & Co. LLC ("MS & Co."), an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley. See "Supplemental information regarding plan of distribution; conflicts of interest."		
Estimated value on the pricing date:	$9.734 per security. See "Investment Summary" beginning on page 2.		

Commissions and issue price:	Price to public	Agent's commissions and fees	Proceeds to us(3)
Per security	$10	$0.20(1)	
		$0.05(2)	$9.75
Total	$2,425,500	$60,637.50	$2,364,862.50

(1) Selected dealers, including Morgan Stanley Wealth Management (an affiliate of the agent), and their financial advisors will collectively receive from the agent, MS & Co., a fixed sales commission of $0.20 for each security they sell. See "Supplemental information regarding plan of distribution; conflicts of interest." For additional information, see "Plan of Distribution (Conflicts of Interest)" in the accompanying product supplement.

(2) Reflects a structuring fee payable to Morgan Stanley Wealth Management by the agent or its affiliates of $0.05 for each security.

(3) See "Use of proceeds and hedging" on page 19.

The securities involve risks not associated with an investment in ordinary debt securities. See "Risk Factors" beginning on page 7.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this document or the accompanying product supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The securities are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.

You should read this document together with the related product supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see “Additional Terms of the Securities” and “Additional Information About the Securities” at the end of this document.

As used in this document, “we,” “us” and “our” refer to Morgan Stanley or MSFL, or Morgan Stanley and MSFL collectively, as the context requires.

Product Supplement for Auto-Callable Securities dated November 16, 2017   **Prospectus dated November 16, 2017**

Morgan Stanley Finance LLC

Contingent Income Auto-Callable Securities due February 4, 2022

Based on the Performance of the Common Stock of Apple Inc.

Principal at Risk Securities

Investment Summary

Contingent Income Auto-Callable Securities

Principal at Risk Securities

The Contingent Income Auto-Callable Securities due February 4, 2022 Based on the Performance of the Common Stock of Apple Inc., which we refer to as the securities, provide an opportunity for investors to earn a contingent quarterly coupon at an annual rate of 9.35% with respect to each quarterly determination date on which the determination closing price or the final share price, as applicable, is greater than or equal to 75% of the initial share price, which we refer to as the downside threshold price. It is possible that the closing price of the underlying stock could remain below the downside threshold price for extended periods of time or even throughout the term of the securities so that you may receive few or no contingent quarterly coupons. If the determination closing price is greater than or equal to the initial share price on any of the first eleven determination dates, the securities will be automatically redeemed for an early redemption payment equal to the stated principal amount *plus* the contingent quarterly coupon with respect to the related determination date. If the securities have not previously been redeemed and the final share price is greater than or equal to the downside threshold price, the payment at maturity will also be the sum of the stated principal amount and the contingent quarterly coupon with respect to the related determination date. However, if the securities have not previously been redeemed and the final share price is less than the downside threshold price, investors will be exposed to the decline in the closing price of the underlying stock, as compared to the initial share price, on a 1-to-1 basis. In this case, the payment at maturity will be less than 75% of the stated principal amount of the securities and could be zero. Investors in the securities must be willing to accept the risk of losing their entire principal and also the risk of not receiving any contingent quarterly coupon. In addition, investors will not participate in any appreciation of the underlying stock.

The original issue price of each security is $10. This price includes costs associated with issuing, selling, structuring and hedging the securities, which are borne by you, and, consequently, the estimated value of the securities on the pricing date is less than $10. We estimate that the value of each security on the pricing date is $9.734.

What goes into the estimated value on the pricing date?

In valuing the securities on the pricing date, we take into account that the securities comprise both a debt component and a performance-based component linked to the underlying stock. The estimated value of the securities is determined using our own pricing and valuation models, market inputs and assumptions relating to the underlying stock, instruments based on the underlying stock, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

What determines the economic terms of the securities?

In determining the economic terms of the securities, including the contingent quarterly coupon rate and the downside threshold price, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the securities would be more favorable to you.

What is the relationship between the estimated value on the pricing date and the secondary market price of the securities?

The price at which MS & Co. purchases the securities in the secondary market, absent changes in market conditions, including those related to the underlying stock, may vary from, and be lower than, the estimated value on the pricing date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the securities are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the securities in the secondary market, absent changes in market conditions, including those related to the underlying stock, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the securities, and, if it once chooses to make a market, may cease doing so at any time.

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Based on the Performance of the Common Stock of Apple Inc.

Principal at Risk Securities

Key Investment Rationale

The securities offer investors an opportunity to earn a contingent quarterly coupon at an annual rate of 9.35% with respect to each determination date on which the determination closing price or the final share price, as applicable, is greater than or equal to 75% of the initial share price, which we refer to as the downside threshold price. The securities may be redeemed prior to maturity for the stated principal amount per security *plus* the applicable contingent quarterly coupon, and the payment at maturity will vary depending on the final share price, as follows:

	On any of the first eleven determination dates, the determination closing price is *greater than or equal to* the initial share price.
Scenario 1	§ The securities will be automatically redeemed for (i) the stated principal amount *plus* (ii) the contingent quarterly coupon with respect to the related determination date.
	§ Investors will not participate in any appreciation of the underlying stock from the initial share price.
Scenario 2	**The securities are not automatically redeemed prior to maturity, and the final share price is *greater than or equal to* the downside threshold price.**
	§ The payment due at maturity will be (i) the stated principal amount *plus* (ii) the contingent quarterly coupon with respect to the final determination date.
	§ Investors will not participate in any appreciation of the underlying stock from the initial share price.

The securities are not automatically redeemed prior to maturity, and the final share price is *less than* the downside threshold price.

Scenario 3	§ The payment due at maturity will be equal to (i) the stated principal amount *multiplied by* (ii) the share performance factor. **Investors will lose a significant portion, and may lose all, of their principal in this scenario.**

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Based on the Performance of the Common Stock of Apple Inc.

Principal at Risk Securities

How the Securities Work

The following diagrams illustrate the potential outcomes for the securities depending on (1) the determination closing price and (2) the final share price.

Diagram #1: First Eleven Determination Dates

Diagram #2: Payment at Maturity if No Automatic Early Redemption Occurs

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Hypothetical Examples

The below examples are based on the following terms:

Hypothetical Initial Share Price:	$175.00
Hypothetical Downside Threshold Price:	$131.25, which is 75% of the hypothetical initial share price
Hypothetical Adjustment Factor:	1.0
Contingent Quarterly Coupon:	9.35% per annum (corresponding to approximately $0.23375 per quarter per security)[1]
Stated Principal Amount:	$10 per security

1 The actual contingent quarterly coupon will be an amount determined by the calculation agent based on the number of days in the applicable payment period, calculated on a 30/360 day count basis. The hypothetical contingent quarterly coupon of $0.23375 is used in these examples for ease of analysis.

In Examples 1 and 2, the closing price of the underlying stock fluctuates over the term of the securities and the determination closing price of the underlying stock is greater than or equal to the hypothetical initial share price of $175.00 on one of the first eleven determination dates. Because the determination closing price is greater than or equal to the initial share price on one of the first eleven determination dates, the securities are automatically redeemed following the relevant determination date. In Examples 3 and 4, the determination closing price on the first eleven determination dates is less than the initial share price, and, consequently, the securities are not automatically redeemed prior to, and remain outstanding until, maturity.

Determination Dates	Example 1 Hypothetical Determination Closing Price	Contingent Quarterly Coupon	Early Redemption Amount*	Example 2 Hypothetical Determination Closing Price	Contingent Quarterly Coupon	Early Redemption Amount
#1	$91.55	$0	N/A	$137.95	$0.23375	N/A
#2	$175.00	—*	$10.23375	$110.50	$0	N/A
#3	N/A	N/A	N/A	$140.25	$0.23375	N/A

#4	N/A	N/A	N/A	$102.55	$0	N/A
#5	N/A	N/A	N/A	$161.05	$0.23375	N/A
#6	N/A	N/A	N/A	$146.85	$0.23375	N/A
#7	N/A	N/A	N/A	$84.10	$0	N/A
#8	N/A	N/A	N/A	$158.15	$0.23375	N/A
#9	N/A	N/A	N/A	$169.55	$0.23375	N/A
#10	N/A	N/A	N/A	$210.00	—*	$10.23375
#11	N/A	N/A	N/A	N/A	N/A	N/A
Final Determination Date	N/A	N/A	N/A	N/A	N/A	N/A

* The Early Redemption Amount includes the unpaid contingent quarterly coupon with respect to the determination date on which the determination closing price is greater than or equal to the initial share price and the securities are redeemed as a result.

§ In **Example 1**, the securities are automatically redeemed following the second determination date, as the determination closing price on the second determination date is equal to the initial share price. You receive the early redemption payment, calculated as follows:

stated principal amount + contingent quarterly coupon = $10.00 + $0.23375 = $10.23375

In this example, the early redemption feature limits the term of your investment to approximately 6 months, and you may not be able to reinvest at comparable terms or returns. If the securities are redeemed early, you will stop receiving contingent coupons.

§ In **Example 2**, the securities are automatically redeemed following the tenth determination date, as the determination closing price on the tenth determination date is greater than the initial share price. As the determination closing prices on the first, third, fifth, sixth, eighth, ninth and tenth determination dates are greater than or equal to the downside threshold price, you receive the contingent

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coupon of $0.23375 with respect to each such determination date. Following the tenth determination date, you receive an early redemption amount of $10.23375, which includes the contingent quarterly coupon with respect to the tenth determination date.

In this example, the early redemption feature limits the term of your investment to approximately 30 months, and you may not be able to reinvest at comparable terms or returns. If the securities are redeemed early, you will stop receiving contingent coupons. Further, although the underlying stock has appreciated by 20% from its initial share price as of the tenth determination date, you receive only $10.23375 per security and do not benefit from such appreciation.

Determination Dates	Example 3 Hypothetical Determination Closing Price / Final Share Price	Contingent Quarterly Coupon	Early Redemption Amount*	Example 4 Hypothetical Determination Closing Price / Final Share Price	Contingent Quarterly Coupon	Early Redemption Amount
#1	$91.55	$0	N/A	$110.20	$0	N/A
#2	$110.50	$0	N/A	$110.75	$0	N/A
#3	$102.55	$0	N/A	$82.30	$0	N/A
#4	$85.60	$0	N/A	$84.10	$0	N/A
#5	$79.40	$0	N/A	$99.55	$0	N/A
#6	$112.00	$0	N/A	$83.00	$0	N/A
#7	$110.30	$0	N/A	$108.15	$0	N/A
#8	$85.10	$0	N/A	$120.10	$0	N/A
#9	$98.60	$0	N/A	$111.85	$0	N/A
#10	$110.75	$0	N/A	$109.30	$0	N/A
#11	$100.60	$0	N/A	$110.10	$0	N/A
Final Determination Date	$105.00	$0	N/A	$148.75	—*	N/A
Payment at Maturity	**$6.00**			**$10.23375**		

*The final contingent quarterly coupon, if any, will be paid at maturity.

Examples 3 and 4 illustrate the payment at maturity per security based on the final share price.

§ In **Example 3**, the closing price of the underlying stock remains below the downside threshold price on every determination date. As a result, you do not receive any contingent coupons during the term of the securities and, at maturity, you are fully exposed to the decline in the closing price of the underlying stock. As the final share price is less than the downside threshold price, investors will receive a payment at maturity equal to the stated principal amount multiplied by the share performance factor, calculated as follows:

stated principal amount x share performance factor = $10.00 x ($105.00 / $175.00) = $6.00

In this example, the payment at maturity is significantly less than the stated principal amount.

§ In **Example 4**, the closing price of the underlying stock decreases to a final share price of $148.75. Although the final share price is less than the initial share price, because the final share price is still not less than the downside threshold price, you receive the stated principal amount plus a contingent quarterly coupon with respect to the final determination date. Your payment at maturity is calculated as follows:

$10.00 + $0.23375 = $10.23375

In this example, although the final share price represents a 15% decline from the initial share price, you receive the stated principal amount per security plus the final contingent quarterly coupon, equal to a total payment of $10.23375 per security at maturity, because the final share price is not less than the downside threshold price.

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Risk Factors

The following is a non-exhaustive list of certain key risk factors for investors in the securities. For further discussion of these and other risks, you should read the section entitled "Risk Factors" in the accompanying product supplement and prospectus. You should also consult your investment, legal, tax, accounting and other advisers in connection with your investment in the securities.

§ **The securities do not guarantee the return of any principal.** The terms of the securities differ from those of ordinary debt securities in that the securities do not guarantee the payment of regular interest or the return of any of the principal amount at maturity. Instead, if the securities have not been automatically redeemed prior to maturity and if the final share price is less than the downside threshold price, you will be exposed to the decline in the closing price of the underlying stock, as compared to the initial share price, on a 1-to-1 basis and you will receive a payment that will be less than 75% of the stated principal amount and could be zero.

§ **You will not receive any contingent quarterly coupon for any quarterly period where the determination closing price is less than the downside threshold price.** A contingent quarterly coupon will be paid with respect to a quarterly period only if the determination closing price is greater than or equal to the downside threshold price. If the determination closing price remains below the downside threshold price on each determination date over the term of the securities, you will not receive any contingent quarterly coupons.

§ **The contingent quarterly coupon, if any, is based solely on the determination closing price or the final share price, as applicable.** Whether the contingent quarterly coupon will be paid with respect to a determination date will be based on the determination closing price or the final share price, as applicable. As a result, you will not know whether you will receive the contingent quarterly coupon until the related determination date. Moreover, because the contingent quarterly coupon is based solely on the determination closing price on a specific determination date or the final share price, as applicable, if such determination closing price or final share price is less than the downside threshold price, you will not receive any contingent quarterly coupon with respect to such determination date, even if the closing price of the underlying stock was higher on other days during the term of the securities.

§ **Investors will not participate in any appreciation in the price of the underlying stock.** Investors will not participate in any appreciation in the price of the underlying stock from the initial share price, and the return on the securities will be limited to the contingent quarterly coupon, if any, that is paid with respect to each determination date on which the determination closing price or the final share price, as applicable, is greater than or equal to the downside threshold price. It is possible that the closing price of the underlying stock could be below the downside threshold price on most or all of the determination dates so that you will receive few or no contingent quarterly coupons. If you do not earn sufficient contingent quarterly coupons over the term of the securities, the overall return on the securities may be less than the amount that would be paid on a conventional debt security of ours of comparable maturity.

§ **The automatic early redemption feature may limit the term of your investment to approximately three months. If the securities are redeemed early, you may not be able to reinvest at comparable terms or returns.** The term of your investment in the securities may be limited to as short as approximately three months by the automatic early redemption feature of the securities. If the securities are redeemed prior to maturity, you will receive no more contingent quarterly coupons and may be forced to invest in a lower interest rate environment and may not be able to reinvest at comparable terms or returns.

§ **The market price will be influenced by many unpredictable factors.** Several factors will influence the value of the securities in the secondary market and the price at which MS & Co. may be willing to purchase or sell the securities in the secondary market. Although we expect that generally the closing price of the underlying stock on any day will affect the value of the securities more than any other single factor, other factors that may influence the value of the securities include:

o the trading price and volatility (frequency and magnitude of changes in value) of the underlying stock,

o whether the determination closing price has been below the downside threshold price on any determination date,

o dividend rates on the underlying stock,

o interest and yield rates in the market,

o time remaining until the securities mature,

o geopolitical conditions and economic, financial, political, regulatory or judicial events that affect the underlying stock and which may affect the final share price of the underlying stock,

o the occurrence of certain events affecting the underlying stock that may or may not require an adjustment to the adjustment factor, and

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o any actual or anticipated changes in our credit ratings or credit spreads.

The price of the underlying stock may be, and has recently been, volatile, and we can give you no assurance that the volatility will lessen. See "Apple Inc. Overview" below. You may receive less, and possibly significantly less, than the stated principal amount per security if you try to sell your securities prior to maturity.

§ **The securities are subject to our credit risk, and any actual or anticipated changes to our credit ratings or credit spreads may adversely affect the market value of the securities.** You are dependent on our ability to pay all amounts due on the securities on each contingent payment date, upon automatic redemption or at maturity, and therefore you are subject to our credit risk. If we default on our obligations under the securities, your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the securities prior to maturity will be affected by changes in the market's view of our creditworthiness. Any actual or anticipated decline in our credit ratings or increase in the credit spreads charged by the market for taking our credit risk is likely to adversely affect the market value of the securities.

§ **As a finance subsidiary, MSFL has no independent operations and will have no independent assets.** As a finance subsidiary, MSFL has no independent operations beyond the issuance and administration of its securities and will have no independent assets available for distributions to holders of MSFL securities if they make claims in respect of such securities in a bankruptcy, resolution or similar proceeding. Accordingly, any recoveries by such holders will be limited to those available under the related guarantee by Morgan Stanley and that guarantee will rank *pari passu* with all other unsecured, unsubordinated obligations of Morgan Stanley. Holders will have recourse only to a single claim against Morgan Stanley and its assets under the guarantee. Holders of securities issued by MSFL should accordingly assume that in any such proceedings they would not have any priority over and should be treated *pari passu* with the claims of other unsecured, unsubordinated creditors of Morgan Stanley, including holders of Morgan Stanley-issued securities.

§ **Investing in the securities is not equivalent to investing in the common stock of Apple Inc.** Investors in the securities will not have voting rights or rights to receive dividends or other distributions or any other rights with respect to the underlying stock.

§ **No affiliation with Apple Inc.** Apple Inc. is not an affiliate of ours, is not involved with this offering in any way, and has no obligation to consider your interests in taking any corporate actions that might affect the value of the securities. We have not made any due diligence inquiry with respect to Apple Inc. in connection with this offering.

§ **We may engage in business with or involving Apple Inc. without regard to your interests.** We or our affiliates may presently or from time to time engage in business with Apple Inc. without regard to your interests and thus may acquire non-public information about Apple Inc. Neither we nor any of our affiliates undertakes to disclose any such information to you. In addition, we or our affiliates from time to time have published and in the future may publish research reports with respect to Apple Inc., which may or may not recommend that investors buy or hold the underlying stock.

§ **The antidilution adjustments the calculation agent is required to make do not cover every corporate event that could affect the underlying stock.** MS & Co., as calculation agent, will adjust the adjustment factor for certain corporate events affecting the underlying stock, such as stock splits and stock dividends, and certain other corporate actions involving the issuer of the underlying stock, such as mergers. However, the calculation agent will not make an adjustment for every corporate event that can affect the underlying stock. For example, the calculation agent is not required to make any adjustments if the issuer of the underlying stock or anyone else makes a partial tender or partial exchange offer for the underlying stock, nor will adjustments be made following the final determination date. If an event occurs that does not require the calculation agent to adjust the adjustment factor, the market price of the securities may be materially and adversely affected.

§ **The securities will not be listed on any securities exchange and secondary trading may be limited.** The securities will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the securities. MS & Co. may, but is not obligated to, make a market in the securities and, if it once chooses to make a market, may cease doing so at any time. When it does make a market, it will generally do so for transactions of routine secondary market size at prices based on its estimate of the current value of the securities, taking into account its bid/offer spread, our credit spreads, market volatility, the notional size of the proposed sale, the cost of unwinding any related hedging positions, the time remaining to maturity and the likelihood that it will be able to resell the securities. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the securities easily. Since other broker-dealers may not participate significantly in the secondary market for the securities, the price at which you may be able to trade your securities is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were to cease making a market in the securities, it is likely that there would be no secondary market for the securities. Accordingly, you should be willing to hold your securities to maturity.

§ **The rate we are willing to pay for securities of this type, maturity and issuance size is likely to be lower than the rate implied by our secondary market credit spreads and advantageous to us. Both the lower rate and the inclusion of costs ssociated with issuing, selling, structuring and hedging the securities in the original issue price reduce the economic terms of the securities, cause the estimated value of the securities to be less than the original issue price and will adversely affect secondary market prices.** Assuming no change in market conditions or any other relevant factors, the prices,

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Principal at Risk Securities

if any, at which dealers, including MS & Co., may be willing to purchase the securities in secondary market transactions will likely be significantly lower than the original issue price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the original issue price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the securities in the original issue price and the lower rate we are willing to pay as issuer make the economic terms of the securities less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the securities are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the securities in the secondary market, absent changes in market conditions, including those related to the underlying stock, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect that those higher values will also be reflected in your brokerage account statements.

§ **The estimated value of the securities is determined by reference to our pricing and valuation models, which may differ from those of other dealers and is not a maximum or minimum secondary market price.** These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the securities than those generated by others, including other dealers in the market, if they attempted to value the securities. In addition, the estimated value on the pricing date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your securities in the secondary market (if any exists) at any time. The value of your securities at any time after the date of this document will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also "The market price will be influenced by many unpredictable factors" above.

§ **Hedging and trading activity by our affiliates could potentially adversely affect the value of the securities.** One or more of our affiliates and/or third-party dealers have carried out, and will continue to carry out, hedging activities related to the securities (and to other instruments linked to the underlying stock), including trading in the underlying stock. As a result, these entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the final determination date approaches. Some of our affiliates also trade the underlying stock and other financial instruments related to the underlying stock on a regular basis as part of their general broker-dealer and other businesses. Any of these hedging or trading activities on or prior to the pricing date could have increased the initial share price, and, as a result, could have increased the downside threshold price, which is the price at or above which the underlying stock must close on each determination date in order for you to earn a contingent quarterly coupon, and, if the securities are not called prior to maturity, in order for you to avoid being exposed to the negative price performance of the underlying stock at maturity. Additionally, such hedging or trading activities during the term of the securities could potentially affect the price of the underlying stock on the determination dates, and, accordingly, whether the securities are automatically called prior to maturity, and, if the securities are not called prior to maturity, the payout to you at maturity, if any.

§ **The calculation agent, which is a subsidiary of Morgan Stanley and an affiliate of MSFL, will make determinations with respect to the securities.** As calculation agent, MS & Co. has determined the initial share price and the downside threshold price and will determine the final share price, whether the contingent quarterly coupon will be paid on each contingent payment date, whether the securities will be redeemed following any determination date, whether a market disruption event has occurred, whether to make any adjustments to the adjustment factor and the payment that you will receive upon an automatic early redemption or at maturity, if any. Moreover, certain determinations made by MS & Co., in its capacity as calculation agent, may require it to exercise discretion and make subjective judgments, such as with respect to the occurrence or nonoccurrence of market disruption events and certain adjustments to the adjustment factor. These potentially subjective determinations may affect the payout to you upon an automatic early redemption or at maturity, if any. For further information regarding these types of determinations, see “Description of Auto-Callable Securities—Auto-Callable Securities Linked to Underlying Shares” and “—Calculation Agent and Calculations” in the accompanying product supplement. In addition, MS & Co. has determined the estimated value of the securities on the pricing date.

§ **The U.S. federal income tax consequences of an investment in the securities are uncertain.** There is no direct legal authority as to the proper treatment of the securities for U.S. federal income tax purposes, and, therefore, significant aspects of the tax treatment of the securities are uncertain.

Please read the discussion under “Additional Information—Tax considerations” in this document concerning the U.S. federal income tax consequences of an investment in the securities. We intend to treat a security for U.S. federal income tax purposes as a single financial contract that provides for a coupon that will be treated as gross income to you at the time received or accrued, in accordance with your regular method of tax accounting. Under this treatment, the ordinary income treatment of the coupon payments, in conjunction with the capital loss treatment of any loss recognized upon the sale, exchange or settlement of

Morgan Stanley Finance LLC

Contingent Income Auto-Callable Securities due February 4, 2022

Based on the Performance of the Common Stock of Apple Inc.

Principal at Risk Securities

the securities, could result in adverse tax consequences to holders of the securities because the deductibility of capital losses is subject to limitations. We do not plan to request a ruling from the Internal Revenue Service (the "IRS") regarding the tax treatment of the securities, and the IRS or a court may not agree with the tax treatment described herein. If the IRS were successful in asserting an alternative treatment for the securities, the timing and character of income or loss on the securities might differ significantly from the tax treatment described herein. For example, under one possible treatment, the IRS could seek to recharacterize the securities as debt instruments. In that event, U.S. Holders (as defined below) would be required to accrue into income original issue discount on the securities every year at a "comparable yield" determined at the time of issuance (as adjusted based on the difference, if any, between the actual and the projected amount of any contingent payments on the securities) and recognize all income and gain in respect of the securities as ordinary income. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the securities, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features.

Non-U.S. Holders (as defined below) should note that we currently intend to withhold on any coupon paid to Non-U.S. Holders generally at a rate of 30%, or at a reduced rate specified by an applicable income tax treaty under an "other income" or similar provision, and will not be required to pay any additional amounts with respect to amounts withheld.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. While it is not clear whether the securities would be viewed as similar to the prepaid forward contracts described in the notice, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. The notice focuses on a number of issues, the most relevant of which for holders of the securities are the character and timing of income or loss and the degree, if any, to which income realized by non-U.S. investors should be subject to withholding tax. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments, the issues presented by this notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Accounts receivable	1,990	480
Due from American Software, Inc.	235	116
Prepaid expenses and other assets	119	69
Increase (decrease) in liabilities:		
Accounts payable, accrued costs and other accrued liabilities	(1,118)	(709)
Deferred revenues	(722)	(894)
Net cash provided by operating activities	2,532	2,288
Cash flows from investing activities:		
Additions to capitalized computer software development costs	(1,489)	(1,635)
Additions to purchased computer software costs	(10)	(30)
Proceeds from maturities of investments	53,487	20,516
Purchases of investments	(49,710)	(12,420)
Purchases of furniture and equipment	(28)	(42)
Net cash provided by investing activities	2,250	6,389
Cash flows from financing activities:		
Repurchases of common stock	(79)	(52)
Proceeds from exercise of stock options	5	19
Net cash used in financing activities	(74)	(33)
Net change in cash and cash equivalents	4,708	8,644
Cash and cash equivalents at beginning of period	7,721	5,376
Cash and cash equivalents at end of period	$ 12,429	$ 14,020

See accompanying notes to condensed combined financial statements.

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Item 1. Financial Statements (continued)

NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS (UNAUDITED)

A. Basis of Presentation

The accompanying condensed combined financial statements of Logility, Inc. (the Company), are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been Condensed Combined or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The financial information presented in the condensed combined financial statements reflects all normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the periods indicated. These financial statements should be read in conjunction with the Company s Form 10-K for the fiscal year ended April 30, 2002 as filed with the SEC on July 26, 2002. The interim results reflected in the condensed combined financial statements are not necessarily indicative of the results to be expected for the full year or for any other future period.

We are an approximately 86% owned subsidiary of American Software, Inc. (the Parent), a publicly held provider of enterprise resource planning solutions (NASDAQ AMSWA).

B. Industry Segments

We have adopted Statement of Financial Accounting Standards No. 131, *Disclosures About Segments of an Enterprise and Related Information*. The Company operates and manages its business in one segment, providing business-to-business collaborative commerce solutions to optimize supply chain operations for manufacturers, distributors and retailers.

C. Comprehensive Income

We have adopted Statement of Financial Accounting Standards No. 130 (SFAS No. 130), *Reporting Comprehensive Income*. SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. No statements of comprehensive income (loss) have been included in the accompanying condensed combined financial statements since comprehensive income (loss) and net income (loss) presented in the accompanying condensed combined statements of operations would be the same.

D. Revenue Recognition

We recognize revenue in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition,* and SOP 98-9, *Software Revenue Recognition With Respect to Certain Transactions.*

License. We recognize license revenues in connection with license agreements for standard proprietary and tailored software upon delivery of the software, provided we consider collection to be probable, the fee is fixed or determinable, there is evidence of an arrangement, and vendor-specific evidence exists to defer any revenue related to undelivered elements of the arrangement.

Services. Revenues derived from services primarily include consulting, implementation, and training. We bill under both time and materials and fixed fee arrangements and recognize revenues as we perform the services.

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Item 1. Financial Statements (continued)

NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

We utilize the percentage-of-completion method of accounting to recognize revenue on service implementation projects for fixed amounts. We measure progress under the percentage-of-completion method based on our best estimate of the cost of work completed in relation to the total cost of work to be performed under the contract. We recognize immediately in our condensed combined consolidated financial statements any estimated losses on services or implementation projects for fixed amounts.

Maintenance. Revenues we derive from maintenance contracts primarily include telephone consulting, product updates and releases of new versions of products that the customer previously purchased, as well as error reporting and correction services. Typically, we enter into maintenance contracts for a separate fee, with initial contractual periods ranging from one to three years, with renewal for additional periods thereafter. Generally, we bill maintenance fees annually in advance and recognize the resulting revenues ratably over the term of the maintenance agreement. In situations where we bundle the maintenance fee with the license fee, we determine Vendor Specific Objective Evidence (VSOE) for maintenance based on stated renewal rates in the contract.

Deferred Revenues. Deferred revenues represent advance payments or billings for software licenses, services, and maintenance billed in advance of the time we recognize revenues.

Indirect Channel Revenues. We recognize revenues from sales we make through indirect channels only when the distributor makes a sale to an end-user. Revenues from indirect channels are recognized upon delivery of the software to the end-user assuming we meet all other conditions of SOP 97-2 and SOP 98-9.

E. Net Earnings (Loss) Per Common Share

Basic earnings (loss) per common share available to common shareholders is based on the weighted-average number of common shares outstanding. Diluted earnings (loss) per common share available to common shareholders is based on the weighted-average number of common shares outstanding and dilutive potential common shares, such as dilutive stock options.

The numerator in calculating both basic and diluted earnings (loss) per common share for each period is the same as net earnings (loss). The denominator is based on the following number of common shares:

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Item 1. Financial Statements (continued)

NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

	Three Months ended October 31,		Six Months ended October 31,	
	2002	2001	2002	2001
	(in thousands)		(in thousands)	
Common Shares:				
Weighted average common shares outstanding	13,199	13,247	13,206	13,252
Dilutive effect of outstanding stock options	5	8	8	28
Total	13,204	13,255	13,214	13,280
Net earnings:	$ 214	$ 360	$ 123	$ 953
Net earnings per common share:				
Basic	$ 0.02	$ 0.03	$ 0.01	$ 0.07
Diluted	$ 0.02	$ 0.03	$ 0.01	$ 0.07

For both the three and six months ended October 31, 2002 we excluded options to purchase 709,945 shares of common stock from the computation of diluted earnings per share. For the three months ended October 31, 2001 we excluded options to purchase 784,048 shares of common stock from that computation, and for the six months ended October 31, 2001 we excluded options to purchase 455,168 shares of common stock. We excluded these option share amounts because the exercise prices of those options were greater than the average market price of the common stock. As of October 31, 2002 we had a total of 736,445 options outstanding and as of October 31, 2001 we had a total of 809,548 options outstanding.

F. Agreements with American Software, Inc. (ASI)

We have entered into certain contractual arrangements with ASI, as described below. Because ASI owns a majority of our shares, the terms of these agreements do not reflect arm s length negotiation.

Tax Sharing Agreement We compute a separate, stand-alone income tax provision and settle balances due to or from ASI on this basis. The Tax Sharing Agreement allocated all benefits derived from deferred tax assets as defined in the Agreement (which include net operating loss and tax credit carryforwards) that arose prior to our October 1997 initial public offering ($5,768,000) to ASI. Accordingly, we will not receive any benefit from the $5,768,000 of contributed gross deferred tax assets. In addition, the agreement allocates certain deferred tax liabilities that arose prior to the initial public offering to us (which gives rise to our net deferred tax liability of $2,882,000 at July 31, 2002). To the extent the tax computation produces a tax benefit for us, ASI is required to pay such amounts to us only if and when ASI realizes a reduction in income taxes payable with respect to the current tax period. At April 30, 2002, ASI had net operating loss carryforwards of approximately $19.0 million that ASI must utilize before we would receive payment for any currently generated tax benefits. Such net operating losses expire in varying amounts through 2022.

Services Agreement We purchase or sell various services from or to ASI based upon various cost methodologies as described below:

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Service	Cost methodology	Expense for the three months ended October 31, 2002	Expense for the three months ended October 31, 2001	Expense for the six months ended October 31, 2002	Expense for the six months ended October 31, 2001
General corporate services, including accounting and insurance expense	Apportioned based on formula to all ASI subsidiaries	$ 302,500	$ 316,700	$ 606,500	$ 647,700
Professional services to our customers (services are available unless ASI determines it is not economic or otherwise feasible)	Cost plus billing with the percentage of costs and expenses to be negotiated	1,200	99,500	20,200	235,500
Employee benefits services	Apportioned based on formula to all ASI subsidiaries	3,500	12,700	7,000	16,200

Facilities Agreement We lease various properties from ASI for specified square foot rates. The stated term of the agreement is for two years with automatic one year extensions; however, it may be terminated by either party after a 90-day notice. ASI allocates utility expenses based on our percentage of occupancy. Also included in these costs are utilities, telephone, and security expenses. The parties valued the services related to this agreement at $111,000 for the three months ended October 31, 2002, $122,000 for the three months ended October 31, 2001, $240,000 for the six months ended October 31, 2002, and $251,000 for the six months ended October 31, 2001.

Marketing License Agreement Effective August 1, 2002, we entered into a Marketing License Agreement (the Marketing License Agreement) with American Software, USA (USA) in which USA agreed to act as a nonexclusive marketing representative for licensing of our products. We pay ASI 30% of net license fees for its services. This agreement replaced a similar agreement executed by the parties in 1997. It has a term of one year and may be extended by the agreement of both parties. The parties valued the services related to this agreement at $23,000 for the three months ended October 31, 2002, $8,000 for the three months ended October 31, 2001, $63,000 for the six months ended October 31, 2002, and $24,000 for the six months ended October 31, 2001.

Technology License Agreement We have granted ASI a nonexclusive, nontransferable, worldwide perpetual right and license to use, execute, reproduce, display, etc. our Supply Chain Planning and Execution Solutions (which ASI had transferred to us) so that ASI may maintain and support end-users of the software products. The license is fully paid and royalty-free.

Stock Option Agreement We have granted ASI an option to purchase our common stock to enable ASI to maintain the necessary ownership percentage required to consolidate Logility in ASI s consolidated Federal income tax return. The purchase price of the option is the average of the closing price on each of the five business days immediately preceding the date of payment.

G. Lease Commitments

We occupy our principal office facilities under a facilities agreement with ASI dated August 1, 1997, that is cancelable upon 90-day notice by either party (see note F). Amounts allocated to the Company for rent expense for these facilities were $82,073 for the three months ended October 31, 2002, $84,660 for the three months ended October 31, 2001, $166,733 for the six months ended October 31, 2002, and $169,320 for the six months ended October 31, 2001. In addition, we have various other operating facilities leases. Rent expense under these leases was $34,838 for the three months ended October 31, 2002, $116,488 for the three months ended October 31, 2001, $152,172 for the six months ended October 31, 2002, and $273,426 for the six months ended October 31, 2001.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements relating to our future financial performance, business strategy, financing plans and other future events that involve uncertainties and risks. You can identify these statements by forward-looking words such as anticipate , intend , plan , continue , could , grow , may , potential , predict , strive , will , seek , estimate , believe , expect , and simila uncertainty of future events or outcomes. Any forward-looking statements we make herein are pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning future:

- results of operations;
- liquidity, cash flow and capital expenditures;
- demand for and pricing of our products and services;
- acquisition activities and the effect of completed acquisitions;
- industry conditions and market conditions; and
- general economic conditions.

Although we believe that the goals, plans, expectations, and prospects that our forward-looking statements reflect are reasonable in view of the information currently available to us, those statements are not guarantees of performance. There are many factors that could cause our actual results to differ materially from those anticipated by forward-looking statements made herein. These factors include, but are not limited to, continuing economic uncertainty, the timing and degree of business recovery, unpredictability and the irregular pattern of future revenues, competitive pressures, delays and other risks associated with new product development, the difficulty of predicting the effectiveness and duration of third-party marketing agreements, undetected software errors, and risks associated with market acceptance of our products and services. The terms fiscal 2003 , fiscal 2002 , and fiscal 2001 refer to our fiscal years ended April 30, 2003, 2002, and 2001, respectively.

OVERVIEW

We provide collaborative supply chain solutions to streamline and optimize the management, production and distribution of products between manufacturers, suppliers, distributors, retailers, carriers and other organizations and their respective trading partners. The supply chain refers to the complex network of relationships that organizations maintain with trading partners (customers, suppliers and carriers) to source, manufacture, and deliver products and services to the customer and includes demand chain, supply chain, logistics, warehouse management and business-to-business process management for collaborative relationships between customers, suppliers and carriers. Our solutions enable enterprises to build competitive advantages and increase profitability by significantly improving efficiencies, collaborating with suppliers and customers, more effectively responding to market demand and engaging in dynamic business relationships via the Internet.

Leveraging our supply chain management expertise, we have been an innovator in developing and deploying collaborative supply chain management solutions, with our first Internet-based collaborative planning solution implemented in 1996. We continue to invest and expand our e-Business offerings and innovative solutions, which support the Voluntary Interindustry Commerce Standards Association (VICS), collaborative planning, forecasting

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and replenishment (CPFR®) standards, as well as other emerging collaborative supply chain management standards for transportation and distribution center management. In addition to enterprise supply chain optimization and collaboration, we designed our *Logility Voyager Solutions* suite and related services to power the emerging Internet trading exchanges and private marketplaces for collaborative planning and procurement of direct materials and collaborative transportation management. We market our solution worldwide, primarily to large enterprises that require comprehensive supply chain planning, warehouse management and logistics solutions. We make sales through a dedicated sales force and through relationships with third-party vendors (including American Software) and service providers.

We previously conducted our business and operations as three separate business units of American Software: a supply chain planning software group, a warehouse management software group, and a transportation management software group. In 1997, American Software transferred to us substantially all of its Supply Chain Planning division and its *WarehousePRO* software and substantially all associated operations (including research and development), assets and liabilities. Also in 1997, American Software s wholly-owned subsidiary, Distribution Sciences, Inc., was merged into Logility, transferring its business, operations, assets and liabilities, including the *Transportation Planning* and *Transportation Management* software, to us.

We derive revenues primarily from three sources: software licenses, services, and maintenance. We base software license fees generally on the number of modules, servers, users and/or sites licensed. Services revenues consist primarily of fees from software implementation, training, consulting and customization services. Maintenance agreements typically are for a one- to three-year term and usually are entered into at the time of the initial product license.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We have based this discussion and analysis of financial condition and results of operations upon our combined financial statements, which we have prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. On an ongoing basis, we evaluate our estimates, including, but not limited to, those related to bad debts, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for judgments we make about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results could differ from these estimates under different assumptions or conditions.

The critical accounting policies listed below affect significant judgments and estimates we use in preparing the combined financial statements.

Revenue Recognition. We recognize revenue in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition* , and SOP 98-9, *Software Revenue Recognition with Respect to Certain Transactions.* We recognize license revenues in connection with license agreements for standard proprietary and tailored software upon delivery of the software, provided we deem collection to be probable, the fee is fixed or determinable, there is evidence of an arrangement, and vendor-specific evidence exists to defer any revenue related to undelivered elements of the arrangement. We generally bill maintenance fees annually in advance and recognize the resulting revenues ratably over the term of the maintenance agreement. We derive revenues from services which primarily include consulting, implementation, and training. We bill for these services under both time and materials and fixed fee arrangements and recognize fees as we perform the services. Deferred revenues represent advance payments or billings for software licenses, services, and maintenance billed in advance of the time we recognize revenues. We record revenues from sales of third-party products in accordance with Emerging Issues Task Force Issue 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent.*

Generally, our software products do not require significant modification or customization. Installation of the products is normally routine and is not essential to the functionality of the product. Our sales frequently include maintenance contracts and professional services with the sale of our software licenses. We have established vendor-specific objective evidence of fair value (VSOE) for our maintenance contracts and professional services. We determine fair value based upon the prices we charge to customers when we sell these elements separately. We defer maintenance revenues, including those we sell with the initial license, based on VSOE, which we typically derive from by the renewal rate of the annual maintenance contract, and recognize the revenues ratably over the maintenance contract period. We recognize consulting and training service revenues, including those sold with license fees, as we perform the services based on their established VSOE. We determine the amount of revenue we allocate to the licenses sold with services or maintenance using the residual method of accounting. Under the residual method, we allocate the total value of the arrangement first to the undelivered elements based on their VSOE and allocate the remainder to license fees.

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. If the financial condition of these customers were to deteriorate, resulting in an impairment of their ability to make payments, we may require additional allowances or we may defer revenue until we determine that collectibility is probable or we decide to charge off the account. We specifically analyze accounts receivable and historical bad debts, customer creditworthiness, current economic trends and changes in customer payment terms when we evaluate the adequacy of the allowance for doubtful accounts.

Valuation of Long-Lived and Intangible Assets. In accordance with Financial Accounting Standards Board Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* (SFAS No. 144) and Statement No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* (SFAS No. 86), we review the carrying value of intangible assets and other long-lived assets (asset group), including, but not limited to, capitalized computer software development costs, on a regular basis for the existence of facts or circumstances that may suggest impairment. Factors we consider important that could trigger an impairment review include:

- significant under-performance relative to historical or projected future operating results;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period;
- significant decline in our technological value as compared to the market; and
- our market capitalization relative to net book value.

If such circumstances exist, we evaluate the carrying value of long-lived assets (asset group) to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and comparing that value to the carrying value of the assets. If the carrying value of the asset is greater than the estimated future cash flows, we write down the asset to the net realizable value for software or the estimated fair value for other long-lived and intangible assets. We determine the estimated fair value of the assets on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risks inherent in our current business model. In determining expected future cash flows, we group assets at the lowest level for which cash flows are identifiable and independent of cash flows from other asset groups. We estimate cash flows using appropriate and customary assumptions and projections.

Income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases. We measure deferred tax assets and liabilities using enacted statutory tax rates in effect in the year in which we expect

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the differences to reverse. We establish a deferred tax asset for the expected future benefit of net operating loss and credit carry-forwards. Under Statement of Financial Accounting Standards No. 109 (SFAS No. 109), *Accounting for Income Taxes,* we cannot recognize a deferred tax asset for the future benefit of our net operating losses, tax credits and temporary differences unless we can establish that it is more likely than not that we would realize the deferred tax asset. Due to our history of net losses, we have not recognized a tax asset and have recorded a full valuation allowance against our otherwise recognizable deferred tax asset, in accordance with SFAS No. 109. Future events could cause us to conclude that it is more likely than not that we will realize a portion of the deferred tax asset. If we reach such a conclusion, we would reduce the valuation allowance and recognize the deferred tax asset.

COMPARISON OF RESULTS OF OPERATIONS

The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage changes in those items for the three months ended October 31, 2002 and 2001:

	Percentage of Total Revenues		Pct. Change in Dollars
	2002	2001	2002 vs 2001
Revenues:			
License fees	24%	25%	(25)%
Services and other	26	34	(41)
Maintenance	50	41	(4)
Total revenues	100	100	(22)
Cost of revenues:			
License fees	14	13	(14)
Services and other	14	25	(57)
Maintenance	9	7	6
Total cost of revenues	37	45	(35)
Gross margin	63	55	(12)
Operating expenses:			
Research and development	24	20	(8)
Less: Capitalized development	(13)	(10)	2
Sales and marketing	34	32	(16)
General and administrative	17	12	10
Total operating expenses	62	54	(10)
Operating income (loss)	1	1	(74)
Other income, net	3	4	(32)
Income before income taxes	4	5	(41)
Income taxes			
Net income	4%	5%	(41)

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The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage increases or decreases in those items for the six months ended October 31, 2002 and 2001:

	Percentage of Total Revenues		Pct. Change in Dollars
	2002	**2001**	**2002 vs 2001**
Revenues:			
License fees	27%	28%	(29)%
Services and other	25	34	(46)
Maintenance	48	38	(5)
Total revenues	100	100	(25)
Cost of revenues:			
License fees	16	13	(8)
Services and other	17	24	(47)
Maintenance	8	6	(1)
Total cost of revenues	41	43	(29)
Gross margin	59	57	(23)
Operating expenses:			
Research and development	24	19	(5)
Less: Capitalized development	(13)	(11)	(9)
Sales and marketing	35	35	(25)
General and administrative	15	11	(2)
Total operating expenses	61	54	(16)
Operating income (loss)	(2)	3	nm
Other income, net	3	3	(33)
Income before income taxes	1	6	(87)
Income taxes			
Net income	1%	6%	(87)

nm not meaningful

COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED OCTOBER 31, 2002 AND 2001:

REVENUES:

Our total revenues decreased 22% to approximately $5.4 million from $6.9 million for the comparable quarter a year ago. This decrease was due primarily to decreases in license fees and services revenues, and to a lesser extent a decrease in maintenance revenues. International revenues represented approximately 12% of total revenues in the quarter ended October 31, 2002 compared to approximately 13% a year ago. No single customer accounted for more than 10% of our total revenues in the quarter ended October 31, 2002.

LICENSES. License fee revenues decreased 25% to approximately $1.3 million from $1.7 million for the same quarter a year ago primarily as a result of slow general economic conditions. The direct sales channel provided approximately 84% of license fee revenues for the quarter ended October 31, 2002, compared to approximately 94% in the comparable quarter a year ago. This decrease was due primarily to lower sales volume generated by the direct

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sales channel. For the quarter ended October 31, 2002, our margins after commissions on direct sales were approximately 91% and our margins after commissions on indirect sales were approximately 89%.

SERVICES AND OTHER. Services and other revenues decreased 41% to approximately $1.4 million from $2.4 million for the same quarter a year ago. This decrease was primarily a result of a decrease in software implementation services which in turn resulted from lower license fees in recent quarters.

MAINTENANCE. Maintenance revenues decreased 4% to approximately $2.7 million from $2.8 million for the same quarter a year ago. Maintenance revenues have a direct relationship to current and historic license fee revenues, since new licenses are the potential source of new maintenance customers.

GROSS MARGIN:

Total gross margin for the quarter ended October 31, 2002 was 63% of total revenues, compared to 55% a year ago. This increase was primarily due to increased gross margins on services revenues, partially offset by decreases in gross margins on license fees and maintenance revenues. License fee gross margin decreased to 39% from 47% a year ago, due to lower license fees combined with the relatively fixed level of cost of license fees. The gross margin on services revenues increased to 48% from 28% a year ago, due primarily to cost reduction efforts. Maintenance gross margins decreased slightly to 82% versus 83% for the prior year quarter.

OPERATING EXPENSES:

RESEARCH AND DEVELOPMENT. Gross product development costs include all non-capitalized and capitalized software development costs. A breakdown of the research and development costs is as follows:

	Three Months Ended (000 s omitted)		
	October 31, 2002	**Percent Change**	**October 31, 2001**
Gross product development costs	$ 1,320	(8)%	$ 1,428
Percentage of total revenues	24%		20%
Less: Capitalized development	(721)	2%	(706)
Percentage of gross prod. dev. costs	55%		49%
Product development expenses	$ 599	(17)%	$ 722
Percentage of total revenues	11%		10%

Gross product development costs decreased 8% in the quarter ended October 31, 2002 compared to a year ago, due to cost reduction efforts and the reallocation of some R&D resources to services and support activities. Capitalized development increased 2% from a year ago, and the rate of capitalized development as a percentage of gross product development costs increased to 55% versus 49% a year ago, primarily as a result of lower levels of gross development costs. Product development expenses, as a percentage of total revenues, increased to 11% from 10% a year ago, due primarily to decreased total revenues.

SALES AND MARKETING. Sales and marketing expenses decreased 16% from the same period a year ago, due primarily to cost reduction efforts. As a percentage of total revenues, sales and marketing expenses were 34% for the quarter ended October 31, 2002, compared to 32% for the quarter ended October 31, 2001.

GENERAL AND ADMINISTRATIVE. General and administrative expenses increased 10% to approximately $910,000 from $825,000 a year ago, mainly as a result of the timing of some professional services fees. For the three months ended October 31, 2002, the average number of total employees was approximately 125, compared to approximately 159 for the three months ended October 31, 2001. For the three months ended October 31, 2002, we

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incurred a provision for doubtful accounts of $45,000, compared to $5,000 taken in the prior year period.

OTHER INCOME:

Other income is comprised of earnings from the investment of our cash reserves. Our investments are short-term in nature, and all investments mature within one year. Investments consist of money market funds, U.S. Government Securities, A1/P1 rated commercial paper, and minimum A- rated corporate bonds. For the three months ended October 31, 2002, these investments generated an annualized yield of approximately 2.5%.

INCOME TAXES:

We are included in the consolidated federal income tax return filed by American Software, Inc. However, we provide for income taxes as if we were filing a separate income tax return. For the quarter ended October 31, 2002, we did not record any income taxes as a result of cumulative net operating losses in prior years.

SIX MONTHS ENDED OCTOBER 31, 2002 AND 2001:

REVENUES:

Our total revenues decreased 25% to approximately $11.2 million from $15.0 million for the comparable period a year ago. This decrease was due primarily to decreases in services revenues and license fees, and to a lesser extent a decrease in maintenance revenues. International revenues represented approximately 11% of total revenues in the six months ended October 31, 2002, compared to 14% for the same period a year ago. No single customer accounted for more than 10% of our total revenues in the six months ended October 31, 2002.

LICENSES. License fee revenues decreased 29% to approximately $3.0 million from $4.3 million for the same period a year ago, due to slow general economic conditions. The direct sales channel provided approximately 87% of license fee revenues for the six months ended October 31, 2002, compared to approximately 95% in the comparable period a year ago. This decrease is due primarily to lower sales volume generated by the direct sales channel. For the six months ended October 31, 2002, our margins after commissions on direct sales were approximately 91% and our margins after commissions on indirect sales were approximately 78%.

SERVICES AND OTHER. Services and other revenues decreased 46% to approximately $2.8 million from $5.1 million for the same period a year ago as a result of a decrease in software implementation services which in turn resulted from lower license fees in recent quarters.

MAINTENANCE. Maintenance revenues decreased 5% to approximately $5.4 million from $5.7 million for the same period a year ago. Maintenance revenues have a direct relationship to current and historic license fee revenues, since new licenses are the potential source of new maintenance customers.

GROSS MARGIN:

Total gross margin in the six months ended October 31, 2002 increased to 59% of total revenues, compared to 57% a year ago. The gross margin on license fee revenues decreased to 42% from 55% a year ago, primarily due to lower license fees combined with the relatively fixed level of cost of license fees. Services gross margin increased to 31% from 29% a year ago, primarily due to cost reduction efforts. Maintenance gross margins decreased slightly to 82% from 83% in the prior year period.

OPERATING EXPENSES:

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RESEARCH AND DEVELOPMENT. Gross product development costs include all non-capitalized and capitalized software development costs. A breakdown of the research and development costs is as follows:

	Six Months Ended (000 s omitted)		
	October 31, 2002	Percent Change	October 31, 2001
Gross product development costs	$ 2,735	(5)%	$ 2,885
Percentage of total revenues	24%		19%
Less: Capitalized development	(1,489)	(9)%	(1,635)
Percentage of gross prod. dev. costs	54%		57%
Product development expenses	$ 1,246	0%	$ 1,250
Percentage of total revenues	11%		8%

Gross product development costs decreased 5% in the six months ended October 31, 2002 compared to a year ago, due to cost reduction efforts and the reallocation of some R&D resources to services and support activities. Capitalized development decreased 9% from a year ago, and the rate of capitalized development as a percentage of gross product development costs decreased to 54% versus 57% a year ago, primarily as a result of the completion of several capitalized projects during the last two quarters. Product development expenses, as a percentage of total revenues, increased to 11% from 8% a year ago, due primarily to decreased total revenues.

SALES AND MARKETING. Sales and marketing expenses decreased 25% from the same period a year ago, due primarily to cost reduction efforts. As a percentage of total revenues, sales and marketing expenses were 35% for the six months ended October 31, 2002, unchanged from the prior year period.

GENERAL AND ADMINISTRATIVE. General and administrative expenses decreased 2% to approximately $1.7 million from a year ago, mainly as a result of a decrease in the number of employees. For the six months ended October 31, 2002, the average number of employees was approximately 137, compared to approximately 163 for the same period in the prior year. For the six months ended October 31, 2002, we incurred a provision for doubtful accounts of $90,000, compared to $35,000 for the prior year period.

OTHER INCOME:

Other income is comprised of earnings from the investment of our cash reserves. Our investments are short-term in nature, and all investments mature within one year. Investments consist of money market funds, U.S. Government Securities, A1/P1 rated commercial paper, and minimum A- rated corporate bonds. For the six months ended October 31, 2002, these investments generated an annualized yield of approximately 2.6%.

INCOME TAXES:

We are included in the consolidated federal income tax return filed by ASI. However, we provide for income taxes as if we were filing a separate income tax return. For the six months ended October 31, 2002, we did not record any income taxes as a result of cumulative net operating losses in prior years.

LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

The following table shows information about our cash flows during the six months ended October 31, 2002 and October 31, 2001. This table and the discussion that follows should be read in conjunction with our Condensed Combined statements of cash flows contained in Item 1. Financial Statements in Part I of this report.

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	Six Months Ended October 31 (000 s omitted)	
	2002	2001
Net cash provided by operating activities	$ 2,532	$ 2,288
Net cash provided by investing activities	2,250	6,389
Net cash used in financing activities	(74)	(33)
Net increase in cash and cash equivalents	$ 4,708	$ 8,644

We fund our operations and capital expenditures primarily with cash generated from operating activities. The changes in net cash provided by operating activities generally reflect the changes in net income and non-cash operating items plus the effect of changes in operating assets and liabilities, such as trade accounts receivable, trade accounts payable, accrued expenses and deferred revenue.

Our operating activities provided cash of approximately $2.5 million in the six months ended October 31, 2002, and approximately $2.3 million in the same period last year. For the six months ended October 31, 2002, cash provided by operations was composed primarily of the decrease in accounts in receivable ($2.0 million), and depreciation and amortization ($1.9 million). These were partially offset by the decrease in accounts payable and other accrued liabilities ($1.1 million) and the decrease in deferred revenues ($722,000). For the same period last year, cash provided by operations was composed primarily of depreciation and amortization ($2.3 million), net income ($953,000), and the decrease in accounts receivable ($480,000). These were partially offset by the decrease in deferred revenues ($894,000) and the decrease in accounts payable and other accrued liabilities ($709,000).

Cash provided by investing activities was approximately $2.3 million for the six months ended October 31, 2002. This was composed of the proceeds of maturities of investments of $53.5 million, partially offset by purchases of investments ($49.7 million), and additions to capitalized software development costs ($1.5 million). For the same period last year, cash provided by investing activities was approximately $6.4 million, composed primarily of the proceeds of maturities of investments of $20.5 million, partially offset by purchases of investments ($12.4 million), and additions to capitalized software development costs ($1.6 million).

Cash used in financing activities was $74,000 for the six months ended October 31, 2002, composed primarily of $79,000 in repurchases of our common stock, partially offset by $5,000 in cash proceeds from the exercise of stock options. For the same period last year, cash used in financing activities of $33,000 was composed of $52,000 used for repurchases of our common stock, partially offset by $19,000 in cash proceeds from the exercise of stock options.

Days Sales Outstanding (DSO) in accounts receivable were 70 days as of October 31, 2002, compared to 80 days as of October 31, 2001. This decrease was due primarily to lower levels of billed accounts receivable in the three months ended October 31, 2002.

Our current ratio on October 31, 2002 was 4.4 to 1 and we have no debt. Our principal sources of liquidity are our cash and investments, which totaled approximately $24.0 million at October 31, 2002. We believe that our sources of liquidity and capital resources will be sufficient to satisfy our presently anticipated requirements during at least the next twelve months for working capital, capital expenditures and other corporate needs. However, due to the uncertainty in the current economic environment, at some future date we may need to seek additional sources of capital to meet our requirements. If such need arises, we may be required to raise additional funds through equity or debt financing. We do not currently have a bank line of credit. No assurance can be given that bank lines of credit or other financing will be available on terms acceptable to us. If available, such financing may result in dilution to our shareholders or higher interest expense.

On December 15, 1997, our Board of Directors approved a resolution authorizing the repurchase of up to 350,000

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shares of our common stock through open market purchases at prevailing market prices. We completed this repurchase plan in November 1998. In November 1998 our Board adopted an additional stock repurchase authorizing resolution for up to 800,000 shares. The timing of any future repurchases would depend on market conditions, the market price of our common stock and management s assessment of our liquidity and cash flow needs. Under both resolutions, through December 12, 2002, we had purchased a cumulative total of 699,665 shares at a total cost of approximately $4.6 million.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 141, *Business Combinations,* which addressed financial accounting and reporting for business combinations. Statement 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. We adopted the provisions of Statement 141 effective May 1, 2002. The adoption had no material impact on our financial condition, results of operations or cash flows.

In June 2001, the FASB issued Statement No. 142, *Goodwill and Other Intangible Assets,* which addressed financial accounting and reporting for acquired goodwill and other intangible assets. Upon adoption of Statement No. 142, we were required to discontinue the amortization of our goodwill and other intangible assets with indefinite lives. Additionally, we will be required to test our goodwill and other intangible assets for impairment during the first year of adoption and then at least annually, or when it is deemed appropriate, thereafter. Because goodwill and certain intangible assets will not be amortized over a specific period but rather will be reviewed for impairment annually, there could be more volatility in reported earnings (loss) than under previous accounting standards due to impairment losses occurring irregularly and in varying amounts. We were required to adopt Statement 142 in the quarter ended July 31, 2002. The adoption had no material impact on our financial condition, results of operations or cash flows.

In August 2001, the FASB issued Statement No. 143 (SFAS No. 143), *Accounting for Asset Retirement Obligations.* SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 applies to all entities. SFAS No. 143 applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or the normal operation of a long-lived asset, except for certain obligation of leases. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. We do not anticipate the adoption of SFAS No. 143 to have a material effect on our financial condition or results of operations.

In August 2001, the FASB issued Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement 144), which supersedes both FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (Statement 121) and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (Opinion 30), for the disposal of a segment of a business (as previously defined in that Opinion). Statement 144 retains the fundamental provisions in Statement 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with Statement 121. For example, Statement 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. Statement 144 retains the basic provisions of Opinion 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike Statement 121, an impairment assessment under Statement 144 will never result in a write-down of goodwill. Rather, we evaluate goodwill for impairment under Statement No. 142, *Goodwill and Other Intangible Assets.*

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We adopted Statement 144 effective May 1, 2002. The adoption of Statement 144 did not have a material impact on our financial statements because the impairment assessment under Statement 144 is largely unchanged from Statement 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections* (SFAS 145). SFAS 145 rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt* , and an amendment of that Statement, FASB Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements* . It also rescinds FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers* . SFAS 145 amends FASB Statement No. 13, *Accounting for Leases* , to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. It also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings or describe their applicability under changed conditions. SFAS 145 had no impact on our financial statements.

In June 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.* Under the new rules, a liability for a cost associated with an exit or disposal activity must only be recognized when the liability is incurred. Under the previous guidance of EITF No. 94-3, a liability for exit costs was recognized at the date of an entity s commitment to an exit plan. Statement No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. We do not anticipate that the adoption of Statement No. 146 will have a material impact on our financial condition, results of operations or cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency. For the three months ended October 31, 2002, we generated 12% of our revenues outside the United States. International sales usually are made by our foreign operations or value added resellers, and are denominated typically in U.S. Dollars, British Pounds Sterling, or Euros. However, the expense incurred by foreign subsidiaries is denominated in the local currencies. The effect of foreign exchange rate fluctuations on us during the quarter ended October 31, 2002 was not material. We have not engaged in any hedging activities.

Interest rates. We manage our interest rate risk by maintaining an investment portfolio of held-to-maturity instruments with high credit quality and relatively short average maturities. These instruments include, but are not limited to, money-market instruments, bank time deposits, and taxable and tax-advantaged variable rate and fixed rate obligations of corporations, municipalities, and national, state, and local government agencies, in accordance with our investment policy. These instruments are denominated in U.S. Dollars. The fair market value of securities held at October 31, 2002 was approximately $23.0 million.

We also hold cash balances in accounts with commercial banks in the United States and foreign countries. These cash balances represent operating balances only and are invested in short-term time deposits of the local bank. Such operating cash balances held at banks outside the United States are minor and denominated in the local currency.

Many of our investments carry a degree of interest rate risk. When interest rates fall, our income from investments in variable-rate securities declines. When interest rates rise, the fair market value of our investments in fixed-rate securities declines. Should our liquidity needs force us to sell fixed-rate securities prior to maturity, we may experience a loss of principal. We attempt to limit our exposure to the risks associated with interest rate fluctuations by holding fixed-rate securities to maturity and by limiting our investments to those with relatively short maturities. Accordingly, we believe that fluctuations in interest rates will not have a material affect on our financial condition or results of operations.

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Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The Company s Chief Executive Officer and Chief Financial Officer have, within 90 days of the filing date of this report, evaluated the Company s internal controls and procedures designed to ensure that information required to be disclosed in reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within specified time periods. After such review, the Company s Chief Executive Officer and Chief Financial Officer have concluded that said information was accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls. There were no significant changes in the Company s internal controls or in other factors that could significantly affect these controls subsequent to the evaluation referred to in paragraph (a) above.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently involved in legal proceedings requiring disclosure under this item.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.

(a) The Company held its 2002 Annual Meeting of Shareholders on August 20, 2002.

(b) The shareholders elected the following director at the meeting: James C. Edenfield

The terms of the following directors continued after the meeting:

Parker H. Petit, Frederick E. Cooper, J. Michael Edenfield and John A. White

(c) At the Company s 2002 Annual Meeting of Shareholders, the only Shareholder vote taken was with respect to the election of a single director. One current director was nominated for re-election to a three-year term, and was re-elected. There were no other nominees for director. The specific results of that shareholder vote was as follows:

James C. Edenfield: Votes For: 12,108,750; Withholding Authority to Vote For: 8,163

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Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 10.1 Marketing License Agreement between American Software USA, Inc., and Logility, Inc. dated as of August 1, 2002.

(b) No report on Form 8-K was filed during the quarter ended October 31, 2002.

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Signatures, and Certifications of the Chief Executive Officer and the Chief Financial Officer of the Company.

The following pages include the Signatures page for this Form 10-Q, and two separate Certifications of the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of the Company.

The first form of Certification is required by Rule 13a-14 under the Securities Exchange Act of 1934 (the Exchange Act) in accord with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certification). The Section 302 Certification includes references to an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures and its internal controls and procedures for financial reporting . Item 4 of Part I of this Quarterly Report presents the conclusions of the CEO and the CFO about the effectiveness of such controls based on and as of the date of such evaluation (relating to Item 4 of the Section 302 Certification).

The second form of Certification is required by section 1350 of chapter 63 of title 18 of the United States Code.

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.

LOGILITY, INC.

Date: December 12, 2002	By:	/s/ J. MICHAEL EDENFIELD
		J. Michael Edenfield President and Chief Executive Officer
Date: December 12, 2002	By:	/s/ VINCENT C. KLINGES
		Vincent C. Klinges Chief Financial Officer
Date: December 12, 2002	By:	/s/ DEIRDRE J. LAVENDER
		Deirdre J. Lavender Controller and Principal Accounting Officer

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CERTIFICATION

I, J. Michael Edenfield, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Logility, Inc.;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: December 12, 2002

By: /s/ J. Michael Edenfield

J. Michael Edenfield
Chief Executive Officer

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CERTIFICATION (continued)

I, Vincent C. Klinges, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Logility, Inc.;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date:	December 12, 2002	By:	/s/ VINCENT C. KLINGES
			Vincent C. Klinges Chief Financial Officer

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CERTIFICATION (continued)

Each of the undersigned hereby certifies, for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, in his capacity as an officer of Logility, Inc., that, to his knowledge, the Quarterly Report of American Software, Inc. on Form 10-Q for the period ended October 31, 2002 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operation of Logility, Inc.

Date: December 12, 2002 By: /s/ J. MICHAEL EDENFIELD

J. Michael Edenfield
Chief Executive Officer

Date: December 12, 2002 By: /s/ VINCENT C. KLINGES

Vincent C. Klinges
Chief Financial Officer

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