EPICOR SOFTWARE CORP
Form 10-Q
November 13, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003

OR

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

For the transition period from _____ to _____

Commission File No. 0-20740

EPICOR SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**33-0277592**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

195 Technology Drive

Irvine, California 92618-2402

(Address of principal executive offices, zip code)

Registrant s telephone number, including area code: (949) 585-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

As of October 30, 2003, there were 44,172,193 shares of common stock outstanding.

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PART I

FINANCIAL INFORMATION

Item 1 - Financial Statements:

EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(Unaudited)

	September 30, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 34,008	$ 31,313
Accounts receivable, net	23,025	22,471
Prepaid expenses and other current assets	3,804	3,977
Total current assets	60,837	57,761
Property and equipment, net	2,796	2,972
Software development costs, net	200	1,007
Intangible assets, net	14,604	8,477
Goodwill	10,823	
Other assets	3,285	3,051
Total assets	$ 92,545	$ 73,268
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,502	$ 3,390
Accrued expenses	22,113	24,041
Current portion of long-term debt		2,229
Current portion of accrued restructuring costs	3,124	964
Deferred revenue	37,823	35,815
Total current liabilities	67,562	66,439
Long-term portion of accrued restructuring costs	1,787	3,043

Commitments and contingencies

Stockholders equity:		
Preferred stock	10,423	4,859
Common stock	46	44
Additional paid-in capital	251,661	246,936
Less: treasury stock at cost	(235)	(87)
Less: unamortized stock compensation expense	(6,126)	(723)
Less: notes receivable from officers for issuance of restricted stock		(7,796)
Accumulated other comprehensive loss	(936)	(2,305)
Accumulated deficit	(231,637)	(237,142)
Net stockholders equity	23,196	3,786
Total liabilities and stockholders equity	$ 92,545	$ 73,268

See accompanying notes to condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Revenues:				
License fees	$ 9,352	$ 6,772	$ 26,674	$ 24,428
Consulting	10,637	9,115	27,752	28,638
Maintenance	19,797	17,492	55,358	51,624
Other	550	574	1,575	2,055
Total revenues	40,336	33,953	111,359	106,745
Cost of revenues	15,349	13,868	42,220	44,007
Amortization of intangible assets and capitalized software development costs	1,986	1,786	5,215	5,342
Total cost of revenues	17,335	15,654	47,435	49,349
Gross profit	23,001	18,299	63,924	57,396
Operating expenses:				
Sales and marketing	10,080	10,732	27,048	32,728
Software development	5,459	4,540	14,919	13,889
General and administrative	4,737	4,351	13,935	15,096
Provision for doubtful accounts	48	108	(841)	333
Stock-based compensation expense	1,125	204	2,216	638
Restructuring charges and other	(292)		937	
Total operating expenses	21,157	19,935	58,214	62,684
Income (loss) from operations	1,844	(1,636)	5,710	(5,288)
Other income, net	112	218	245	156
Income (loss) before income taxes	1,956	(1,418)	5,955	(5,132)
Provision for income taxes	118		208	
Net income (loss)	$ 1,838	$ (1,418)	$ 5,747	$ (5,132)
Value of beneficial conversion related to preferred stock			(241)	
Net income (loss) applicable to common stockholders	$ 1,838	$ (1,418)	$ 5,506	$ (5,132)

Unrealized foreign currency translation adjustments	241	(172)	1,367	411
Comprehensive income (loss)	$ 2,079	$ (1,590)	$ 6,873	$ (4,721)
Net income (loss) per share applicable to common stockholders:				
Basic	$ 0.04	$ (0.03)	$ 0.13	$ (0.12)
Diluted	$ 0.04	$ (0.03)	$ 0.11	$ (0.12)
Weighted average common shares outstanding:				
Basic	43,179	44,071	42,926	43,681
Diluted	50,748	44,071	48,936	43,681

See accompanying notes to condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2003	**2002**
Operating activities		
Net income (loss)	$ 5,747	$ (5,132)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	7,034	8,193
Stock-based compensation expense	2,216	638
Write-down of capitalized software development costs and prepaid assets		716
Provision for doubtful accounts	(841)	259
Interest accrued on notes receivable from officers	(44)	(490)
Restructuring charges and other	937	
Changes in operating assets and liabilities, net of effects of acquistion:		
Accounts receivable	4,346	12,551
Prepaid expenses and other current assets	1,117	721
Other assets	(185)	1,032
Accounts payable	666	(3,038)
Accrued expenses	(6,525)	(2,596)
Accrued restructuring costs	(98)	(2,230)
Deferred revenue	(1,489)	(4,133)
Net cash provided by operating activities	12,881	6,491
Investing activities		
Purchases of property and equipment	(1,023)	(675)
Cash paid for acquisitions, net of cash acquired	(18,736)	
Net cash used in investing activities	(19,759)	(675)
Financing activities		
Proceeds from exercise of stock options	733	6
Proceeds from employee stock purchase plan	519	565
Net proceeds from issuance of restricted stock	3	
Purchase of treasury stock	(147)	(427)
Proceeds from sale of treasury stock		316
Issuance of preferred stock, net of transaction costs	5,322	
Collection of notes receivable from officers	3,580	64
Principal payments on long-term debt	(2,229)	(2,629)
Net cash provided by (used in) financing activities	7,781	(2,105)
Effect of exchange rate changes on cash	1,792	739
Net increase in cash and cash equivalents	2,695	4,450

Cash and cash equivalents at beginning of period	31,313	24,435
Cash and cash equivalents at end of period	$ 34,008	$ 28,885
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid (received) during the year for:		
Interest	$ 70	$ 340
Net income tax payments (refunds)	$ 287	$ (1,020)
NON-CASH ITEM:		
Common stock received in payment of notes receivable from officers	$ 4,260	$

See Note 18 for details of assets acquired and liabilities assumed in purchase transactions.

See accompanying notes to condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements included herein have been prepared by Epicor Software Corporation (the Company) in conformity with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial information for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2002.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments and the write-down of prepaid software royalty during the nine months ended September 30, 2002, as discussed in Note 12) necessary for a fair presentation of the Company s financial position, results of operations and cash flows.

The results of operations for the three and nine months ended September 30, 2003, are not necessarily indicative of the results of operations that may be reported for any other interim period or for the entire year ending December 31, 2003. The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements, as permitted by SEC rules and regulations for interim reporting.

Note 2. Stock-Based Compensation

The Company has elected to account for its stock-based compensation plans using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no compensation expense has been recognized for options issued to employees and stock issued under the stock purchase plan. Had compensation costs for the Company s stock option plans and stock purchase plan been determined based upon fair value at the grant date consistent with Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, the Company s net income (loss) applicable to common stockholders and net income (loss) applicable to common stockholders per share would have been as follows (*in thousands, except per share amounts*):

	Nine Months Ended September 30,	
	2003	**2002**
Net income (loss) applicable to common stockholders as reported	$ 5,506	$ (5,132)

Stock-based employee compensation expense determined under fair value based method for all awards	(1,008)	(1,279)
Net income (loss) applicable to common stockholders pro forma	$ 4,498	$ (6,411)
Net income (loss) per share applicable to common stockholders as reported:		
Basic	$ 0.13	$ (0.12)
Diluted	$ 0.11	$ (0.12)
Net income (loss) per share applicable to common stockholders pro forma:		
Basic	$ 0.10	$ (0.15)
Diluted	$ 0.09	$ (0.15)

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The fair value of options and purchase plan shares have been estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Nine Months Ended September 30,			
	2003		2002	
	Stock Option Plans	Purchase Plan	Stock Option Plans	Purchase Plan
Expected life (years)	3.6	0.5	3.0	0.5
Risk-free interest rate	2.2%	1.0%	2.3%	1.6%
Volatility	0.8	0.8	1.0	1.0
Dividend rate	0.0%	0.0%	0.0%	0.0%

For options granted during the nine month periods ended September 30, 2003 and 2002, the weighted average fair value at date of grant was $2.00 and $1.43, per option, respectively. The weighted average fair value at date of grant for stock purchase plan shares during the nine month periods ended September 30, 2003 and 2002 was $2.90, and $0.58, per share, respectively.

Note 3. Revenue Recognition

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, principally:

- Statement of Position (SOP) No. 97-2, Software Revenue Recognition, issued by the American Institute of Certified Public Accountants (AICPA) and interpretations;
- AICPA SOP No. 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions; and
- Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, issued by the United States Securities and Exchange Commission.

The Company enters into contractual arrangements with end users of its products that may include software licenses, maintenance services, consulting services, or various combinations thereof, including the sale of such elements separately. For each arrangement, revenues are recognized when both parties have signed an agreement, the fees to be paid by the customer are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, vendor-specific objective evidence about the value of each element are met and no other significant obligations on the part of the Company remain.

For multiple-element arrangements, each element of the arrangement is analyzed and the Company allocates a portion of the total fee under the arrangement to the elements based on the fair value of the element, regardless of any separate prices stated within the contract for each element. Fair value is considered the price a customer would be required to pay if the element were to be sold separately. The Company applies the residual method as allowed under SOP 98-9 in accounting for any element of an arrangement that remains undelivered.

License Revenues: Amounts allocated to software license revenues are recognized at the time of shipment of the software when fair value for any undelivered elements is determinable and all the other revenue recognition criteria discussed above have been met.

Revenues on sales made to the Company s resellers are recognized upon shipment of the Company s software to the reseller, when the reseller has an identified end user and all other revenue recognition criteria noted above are met. Under limited arrangements with certain distributors, all the revenue recognition criteria have been met upon delivery of the product to the distributor and, accordingly, revenues are recognized at that time. The Company does not offer a right of return on its products.

Consulting Service Revenues: Consulting service revenues are comprised of consulting and implementation services and, to a limited extent, training. Consulting services are generally sold on a time-and-materials basis and can include services ranging from software installation to data conversion and building non-complex interfaces to allow the software to operate in integrated environments. Consulting engagements can last anywhere from one week to

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several months and are based strictly on the customer s requirements and complexities and are independent of the functionality of the Company s software. The Company s software, as delivered, can be used by the customer for the customer s purpose upon installation. Further, implementation and integration services provided are not essential to the functionality of the software, as delivered, and do not result in any material changes to the underlying software code. Services are generally separable from the other elements under the same arrangement since the performance of the services are not essential to the functionality of the other elements of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. For services performed on a time-and-material basis, revenue is recognized when the services are performed and billed. On occasion, the Company enters into fixed fee arrangements or arrangements in which customer payments are tied to achievement of specific milestones. In fixed fee arrangements revenue is recognized on a percentage-of-completion basis as measured by costs incurred to date as compared to total estimated costs to be incurred. In milestone achievement arrangements, the Company recognizes revenue as the respective milestones are met.

The Company has recorded unbilled consulting receivables totaling $845,000 and $723,000 at September 30, 2003 and December 31, 2002, respectively. These unbilled receivables represent consulting services performed during the last two weeks of the quarter but not billed until the 15th of the following month. The Company cuts-off consulting billing on the 15th of each month.

Maintenance Service Revenues: Maintenance service revenues consist primarily of fees for providing unspecified software upgrades on a when-and-if-available basis and technical support over a specified term, which is typically twelve months. Maintenance revenues are typically paid in advance and are recognized on a straight-line basis over the term of the contract.

Note 4. Basic and Diluted Net Income (Loss) Per Share

Net income (loss) per share is calculated in accordance with SFAS No. 128, Earnings per Share. Under the provisions of SFAS No. 128, basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period, excluding shares of unvested restricted stock. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and common equivalent shares outstanding during the period if their effect is dilutive. Common equivalent shares of 958,570 for the three month period ended September 30, 2002, and 1,433,997 for the nine month period ended September 30, 2002, respectively, have been excluded from diluted weighted average common shares as the effect would be anti-dilutive.

The following table presents the calculation of basic and diluted net income (loss) per common share (*in thousands, except per share amounts*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income (loss) applicable to common stockholders	$ 1,838	$ (1,418)	$ 5,506	$ (5,132)
Basic:				
Weighted average common shares outstanding	45,962	44,837	44,767	44,674
Weighted average common shares of unvested restricted stock	(2,783)	(766)	(1,841)	(993)
Shares used in the computation of basic net income (loss) per share	43,179	44,071	42,926	43,681

Net income (loss) per share applicable to common stockholders - basic	$ 0.04	$ (0.03)	$ 0.13	$ (0.12)
Diluted:				
Weighted average common shares outstanding	43,179	44,071	42,926	43,681
Convertible preferred stock	3,617		3,143	
Common stock equivalents	3,952		2,867	
Shares used in the computation of diluted net income (loss) per share	50,748	44,071	48,936	43,681
Net income (loss) per share applicable to common stockholders - diluted	$ 0.04	$ (0.03)	$ 0.11	$ (0.12)

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Note 5. New Accounting Pronouncements

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others. FIN No. 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while the provisions of the disclosure requirements are effective for financial statements of interim or annual reports ending after December 15, 2002. The Company adopted the disclosure provisions of FIN No. 45 during the fourth quarter of fiscal 2002 and adopted the recognition provisions of FIN No. 45 effective January 1, 2003, and such adoption did not have a material impact on its consolidated financial statements. The Company warrants its media from material defects in material and workmanship under normal use and warrants that the licensed software will perform substantially in accordance with the specification in the documentation ranging from three months to one year depending on the product. Historical costs related to these warranties have been insignificant and no related warranty accrual is deemed necessary.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods for voluntary transition to SFAS No. 123 s fair value method of accounting for stock-based employee compensation (the fair value method). SFAS No. 148 also requires disclosure of the effects of an entity s accounting policy with respect to stock-based employee compensation on reported net income (loss) and earnings (loss) per share in annual and interim financials statements. Effective January 1, 2003, the Company adopted the provisions of SFAS No. 148 and these provisions did not have a material adverse impact on its consolidated results of operations and financial position since the Company has not adopted the fair value method. However, should the Company be required to adopt or elect the fair value method in the future, such adoption could have a material impact on its consolidated results of operations or financial position.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN No. 46 apply immediately to variable interest entities created after January 31, 2003. The Company adopted FIN No. 46, effective February 1, 2003. The adoption did not have a material impact on its consolidated financial statements as the Company has no variable interest entities.

In January 2003, the Emerging Issues Task Force (EITF) issued EITF 00-21, Revenue Arrangements with Multiple Deliverables, which requires companies to allocate the consideration received on arrangements involving multiple arrangements based on their relative fair values. Further, this EITF requires that the companies consider the revenue recognition criteria separately for each of the deliverables. This EITF is applicable for revenue arrangements entered into in fiscal years beginning after June 15, 2003. Early adoption is permitted. The Company does not anticipate that the adoption of this EITF will have a material impact on the Company s consolidated financial statements.

On January 1, 2003, the Company adopted SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity to be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost as defined in EITF 94-3 was recognized at the date of an entity s commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Company will apply the provisions of SFAS No. 146 for exit or disposal activities that are initiated after December 31, 2002.

In April 2003, FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative discussed in paragraph 6(b) of Statement 133, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying to conform it to language used in FIN 45, and (4)

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amends certain other existing pronouncements, which will collectively result in more consistent reporting of contracts as either derivatives or hybrid instruments. SFAS No. 149 is effective for contracts and hedging relationships entered into or modified after June 30, 2003. The Company does not believe that the adoption of SFAS No. 149 will have a material impact on the Company s consolidated financial statements as the Company has not entered into any derivative or hedging transactions.

In May 2003, FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both debt and equity and requires an issuer to classify the following instruments as liabilities in its balance sheet:

a financial instrument issued in the form of shares that is mandatorily redeemable and embodies an unconditional obligation that requires the issuer to redeem it by transferring its assets at a specified or determinable date or upon an event that is certain to occur;

a financial instrument, other than an outstanding share, that embodies an obligation to repurchase the issuer s equity shares, or is indexed to such an obligation, and requires the issuer to settle the obligation by transferring assets; and

a financial instrument that embodies an unconditional obligation that the issuer must settle by issuing a variable number of its equity shares if the monetary value of the obligation is based solely or predominantly on (1) a fixed monetary amount, (2) variations in something other than the fair value of the issuer s equity shares, or (3) variations inversely related to changes in the fair value of the issuer s equity shares.

SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and is effective for all other financial instruments as of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle. The Company does not expect the adoption of SFAS No. 150 to have a material impact on the Company s consolidated financial statements.

Note 6. Goodwill

In acquisitions accounted for using the purchase method, goodwill is recorded for the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and identified intangible assets acquired. SFAS No. 142 requires a periodic review of goodwill and indefinite life intangibles for possible impairment. The following table represents the balance and changes in goodwill as of and for the nine months ended September 30, 2003 (*in thousands*):

Balance as December 31, 2002	$
Goodwill acquired during the nine months ended September 30, 2003:	
ROI	$ 9,536
TDC/T7	$ 1,287
Balance as of September 30, 2003	$ 10,823

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Note 7. Intangible Assets

The following summarizes the components of intangible assets *(in thousands)*:

	As of September 30, 2003			As of December 31, 2002		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Acquired technology	$ 28,338	$ 18,912	$ 9,426	$ 20,322	$ 15,598	$ 4,724
Customer base	9,190	5,926	3,264	8,730	4,977	3,753
Trademark	1,550	119	1,431			
Covenant not to compete	510	27	483			
Total	$ 39,588	$ 24,984	$ 14,604	$ 29,052	$ 20,575	$ 8,477

During the third quarter of 2003, the Company acquired ROI Systems, Inc. (ROI) and certain assets of TDC Solutions, Inc (TDC) and T7 Group, LLC (T7) (see Note 18). As a result of these transactions, the Company added the following intangible assets (*in thousands*):

	ROI	Amortizable Life	TDC/T7	Amortizable Life
Acquired technology	$ 7,320	5 years	$ 670	5 years
Customer base	460	7 years		
Trademark	1,550	5 years		
Covenant not to compete	320	3 years	190	4 years
Total	$ 9,650		$ 860	

These intangibles will be amortized on a straight-line basis over the estimated economic life of the assets.

Amortization expense of the Company s intangible assets for the three months ended September 30, 2003 and 2002 was $1,777,000 and $1,278,000, respectively, and for the nine months ended September 30, 2003 and 2002, amortization expense was $4,408,000 and $3,942,000, respectively. Estimated amortization expense for the remainder of 2003, 2004, 2005, 2006, 2007 and thereafter approximates $1,825,000, $3,621,000, $3,578,000, $2,263,000, $2,169,000, and $1,148,000, respectively.

Note 8. Deferred Revenue

The following summarizes the components of deferred revenue (*in thousands*):

	As of	
	September 30, 2003	December 31, 2002
Deferred license fees	$ 793	$ 1,115
Deferred maintenance	30,253	29,680
Deferred consulting	6,777	5,020
Total	$ 37,823	$ 35,815

Deferred software license fees have been deferred because one or more of the revenue recognition criteria have not been met. Once these criteria have been fully met, the revenue will be recognized. Deferred maintenance represents fees paid in advance for unspecified software upgrades on a when-and-if available basis and technical support over a specified time and recognized on a straight-line basis over the term of the contract. Deferred consulting services represent prepaid and unearned consulting, implementation and training services. Revenue for these services will be recognized as the services are performed.

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Note 9. Segment Information

In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company has prepared operating segment information to report components that are evaluated regularly by the Company s chief operating decision maker, or decision making groups, in deciding how to allocate resources and in assessing performance.

The Company s reportable operating segments include software licenses, consulting, maintenance and other. Other consists primarily of resale of third-party hardware and sales of business forms. Currently, the Company does not separately allocate operating expenses to these segments, nor does it allocate specific assets to these segments. Therefore, the segment information reported includes only revenues, cost of revenues and gross profit.

Operating segment data for the three and nine months ended September 30, 2003 and 2002 is as follows (*in thousands*):

	Software Licenses	Consulting	Maintenance	Other	Total
Three months ended September 30, 2003:					
Revenues	$ 9,352	$ 10,637	$ 19,797	$ 550	$ 40,336
Cost of revenues	3,847	8,584	4,551	353	17,335
Gross profit	$ 5,505	$ 2,053	$ 15,246	$ 197	$ 23,001
Three months ended September 30, 2002:					
Revenues	$ 6,772	$ 9,115	$ 17,492	$ 574	$ 33,953
Cost of revenues	3,200	7,880	4,216	358	15,654
Gross profit	$ 3,572	$ 1,235	$ 13,276	$ 216	$ 18,299
Nine months ended September 30, 2003:					
Revenues	$ 26,674	$ 27,752	$ 55,358	$ 1,575	$ 111,359
Cost of revenues	10,075	22,759	13,673	928	47,435
Gross profit	$ 16,599	$ 4,993	$ 41,685	$ 647	$ 63,924
Nine months ended September 30, 2002:					
Revenues	$ 24,428	$ 28,638	$ 51,624	$ 2,055	$ 106,745
Cost of revenues	10,068	25,513	12,561	1,207	49,349
Gross profit	$ 14,360	$ 3,125	$ 39,063	$ 848	$ 57,396

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The following schedule presents the Company s operations by geographic area for the three and nine months ended September 30, 2003 and 2002 (*in thousands*):

	United States	United Kingdom	Australia and Asia	Canada	Other	Consolidated
Three months ended September 30, 2003:						
Revenues	$ 29,509	$ 6,353	$ 1,850	$ 1,936	$ 688	$ 40,336
Operating income (loss)	(1,682)	2,033	218	1,244	31	1,844
Identifiable assets	59,965	16,937	10,425	2,580	2,638	92,545
Three months ended September 30, 2002:						
Revenues	$ 23,703	$ 6,227	$ 2,006	$ 1,385	$ 632	$ 33,953
Operating income (loss)	(3,806)	1,443	264	681	(218)	(1,636)
Identifiable assets	37,642	17,742	10,478	1,209	2,289	69,360
Nine months ended September 30, 2003:						
Revenues	$ 78,228	$ 18,499	$ 6,093	$ 6,251	$ 2,288	$ 111,359
Operating income (loss)	(5,021)	5,024	1,157	3,919	631	5,710
Identifiable assets	59,965	16,937	10,425	2,580	2,638	92,545
Nine months ended September 30, 2002:						
Revenues	$ 75,085	$ 18,480	$ 6,492	$ 4,747	$ 1,941	$ 106,745
Operating income (loss)	(11,551)	3,525	949	2,627	(838)	(5,288)
Identifiable assets	37,642	17,742	10,478	1,209	2,289	69,360

Revenues are attributed to geographic areas based on the location of the Company s subsidiary that entered into the related contract.

Note 10. Restructuring Charges and Other

The following table summarizes the activity in the Company s reserves associated with its restructurings (*in thousands*):

	Separation costs for terminated employees and contractors	Facilities closing and consolidation	Remaining accrual from prior periods 1999, 1998, 1997 and 1996	Asset impairment	Total restructuring costs
Balance at December 31, 2001	$ 1,526	$ 2,276	$ 188	$	$ 3,990
2002 restructuring charges and other	1,081	2,177		821	4,079
Reversal of prior period accrual			(188)		(188)
Write-off of fixed assets				(821)	(821)
Cash payments	(2,468)	(585)			(3,053)
Balance at December 31, 2002	$ 139	$ 3,868	$	$	$ 4,007

2003 restructuring charges and other		937			937
ROI acquisition	986	707		192	1,885
Cash payments	(612)	(1,306)			(1,918)
Balance at September 30, 2003	$ 513	$ 4,206	$	$ 192	$ 4,911
Less current portion	(513)	(2,419)		(192)	$ (3,124)
Total long-term restructuring reserve	$	$ 1,787	$	$	$ 1,787

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2003 ROI Acquisition

In connection with the Company s acquisition of ROI on July 8, 2003 (see Note 18), the Company assumed a liability of $1,885,000 for the restructuring costs associated with the ROI reduction in workforce and the closure of certain ROI offices. This liability represents $921,000 for separation costs for terminated employees, $772,000 for the closing of certain of ROI s facilities and $192,000 for asset impairment. In conjunction with the acquisition, 41 ROI employees or 26% of the ROI workforce have been terminated from all functional areas.

2003 Restructuring Charges and Other

During the second quarter of 2003, the Company recorded an additional restructuring charge of approximately $1,229,000 related to a facility that was to be consolidated as part of the Company s 2002 restructuring. The Company determined that sublease income on this facility would not be realized according to the original estimate used in the 2002 restructuring due to the unanticipated loss of its sublease income and thus recorded an additional charge based on a revised estimate of sublease income. During the third quarter of 2003, the Company finalized the sublease agreement with a new tenant in this facility, which resulted in a reduction of the original estimated loss. As a result, the Company recorded a $292,000 reduction in the restructuring charge in the third quarter of 2003.

2002 Restructuring Charges and Other

In the fourth quarter of 2002, the Company underwent a restructuring of its operations in an effort to reduce its cost structure through a reduction in workforce and the consolidation of certain of its facilities. In connection with this restructuring, the Company recorded a restructuring charge of $3,070,000 during the year ended December 31, 2002. This charge represents $1,081,000 for separation costs for terminated employees and contractors and $2,177,000 for the closing and consolidation of certain of the Company s facilities. The Company terminated 121 employees worldwide or approximately 15% of the workforce from all functional areas of the Company. All terminations have been completed.

For facility costs included in the restructuring charge, the associated subleased and unoccupied space is physically separate from the utilized space of the facility. The lease payments on the facilities to be closed or consolidated were considered net of contractual and estimated future sublease income. For leased space not currently sublet, sublease income was estimated based on prevailing market rates and conditions. Any future losses or changes in sublease income that is not realized according to the Company s original estimates, will be recognized as a restructuring charge in the period in which the Company makes the determination that such additional losses will be incurred. Although the consolidation efforts were substantially completed as of the end of 2002, lease payments on buildings being vacated or downsized will continue to be made until the respective noncancelable terms of the leases expire.

For the year ended December 31, 2002, an additional charge of $821,000 was included in restructuring charges and other for the write-down to fair value of fixed assets related to assets to be disposed of as a result of the facility closures in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. These assets consisted primarily of leasehold improvements and computer equipment related to buildings being vacated or downsized.

Note 11. Credit Facility

On July 26, 2000, the Company entered into a $30 million senior credit facility with a financial institution comprised of a $10 million term loan and a $20 million revolving line of credit. In August 2000, the Company received the $10 million proceeds from the term loan. The term loan was due in 36 equal monthly installments, plus interest at the greater of the lender s prime rate plus 3%, or 9%. The revolving line of credit bore interest at the greater of a variable rate equal to either the prime rate or at LIBOR, at the Company s option, plus a margin ranging from 0.25% to 1.25% on prime rate loans and 2.5% to 3.75% on LIBOR loans, depending on the Company s results of operations, or 9%. Borrowings under the revolving line of credit were limited to 85% of eligible accounts receivable, as defined. To date, the Company has not borrowed any amounts against the revolving line of credit facility. The credit facility was paid off on August 1, 2003. Borrowings under the credit facility were secured by substantially all of the Company s assets. The Company was required to comply with various financial covenants. Significant financial covenants included:

Achieving a minimum of earnings before interest, taxes, depreciation and amortization (EBITDA)

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Achieving a minimum tangible net worth, and

Maintaining the principal balance of the term loan at less than 20% of collections derived from maintenance agreements during the immediately preceding twelve months.

Additional material covenants under the agreement included limitations on the Company s indebtedness, liens on Company assets, guarantees, investments and disposal of material assets by the Company.

The credit facility was paid off on August 1, 2003 and as of September 30, 2003, was terminated. The Company is in the process of finalizing a new credit facility.

Note 12. Write-Down of Prepaid Software Royalty

During the first quarter of 2002, the Company determined that the carrying value of certain prepaid software royalties exceeded their net realizable value as a result of a revised forecast of future revenues prepared during the quarter showing lower than anticipated product sales. Accordingly, a charge of approximately $600,000 was included in cost of revenues for the first quarter of 2002 to reflect the write-down of the prepaid software royalty to its estimated net realizable value.

Note 13. Issuance of Preferred Stock

On February 13, 2003, the Company completed a private placement of 300,000 shares of newly created Series D preferred stock resulting in gross proceeds to the Company of $5,730,000. The Company sold the shares, each of which is currently convertible into 10 shares of the Company s common stock, to investment funds affiliated with Trident Capital (Trident), a venture capital firm, pursuant to a Series D Preferred Stock Purchase Agreement dated as of February 11, 2003 between the Company and Trident. The price of the Series D preferred stock was determined to be $19.10, reflecting the Company s common stock closing price of $1.91 on February 10, 2003, the day preceding the purchase agreement.

The Company s outstanding Series D preferred stock is convertible into common shares of the Company on a ten-for-one basis at any time at the option of the holders. Such shares, once registered, automatically convert into common stock of the Company ten days after formal notification by the Company that the average consecutive 20-trading day closing stock price of the common stock has exceeded $5.73 per share and that the Company meets certain other conditions. The holders of Series D preferred stock are entitled to vote with holders of common stock on an as-converted basis and, pursuant to the terms of the Stock Purchase Agreement, the Company has agreed to register the sale of shares of common stock issuable upon conversion of the preferred stock. The Company is in the process of registering these shares, however, the registration on Form S-3 is not yet effective.

The holders of the Series D preferred stock are entitled to receive, when and if declared by the Board of Directors, dividends out of any assets of the Company legally available. Such dividends are required to be pari-passu with any dividend paid to the holders of the Series C preferred stock and prior to and on an equal basis to any dividend, which may be declared by the Board of Directors for holders of common stock. Dividends shall not be cumulative and no dividends have been declared or paid as of September 30, 2003. In the event of liquidation, dissolution or winding up of the Company, the holders of the Series D preferred stock shall be entitled to receive, on a pari-passu basis with any distribution to the holders of the Series C preferred stock and prior and in preference to any distribution to the common stockholders, an amount per share equal to $19.10.

During the first quarter of 2003, the Company recorded $241,000 for a fee paid to the holders of the preferred stock accounted for as a beneficial conversion option on this preferred stock. In connection with this placement, the Company incurred transaction costs of approximately $166,000, which were netted against the gross proceeds.

Note 14. Sale and Acquisition of Treasury Stock

During March 2002, the Company entered into Restricted Stock Purchase Agreements with two separate accredited non-affiliated investors, which provided for the sale at $2.00 per share of 25,000 and 133,239 shares, respectively, of the Company s common stock being held in treasury. The total net proceeds from the sale were $317,000. The shares in treasury were acquired by the Company as a result of the vesting of shares on January 26, 2002, pursuant to the stock option exchange program executed in January 2001 (see Note 17). The Company repurchased a portion of the vested shares as consideration for the Company s payment of applicable employee withholding taxes. Under

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the terms of the Restricted Stock Purchase Agreements, the shares must be held by the purchasers either until the shares are subsequently registered or the purchasers hold the shares for a minimum of one year and fulfill the other requirements of Rule 144 promulgated under the Securities Exchange Act.

Pursuant to the stock option exchange program executed in January 2001, the following treasury stock acquisitions were made during 2003:

Vesting Date	Shares acquired	Value of Shares
January 26, 2003	22,308	$ 38,000
April 26, 2003	12,225	35,000
July 26, 2003	9,486	71,000

The Company repurchased a portion of the vested shares as consideration for the Company s payment of applicable employee withholding taxes. As of September 30, 2003, these repurchased shares are held in treasury and are available for future reissuance.

Note 15. Officer Notes Receivable

In February 2003, the promissory notes from the Company s Chief Executive Officer came due and the principal and interest were repaid with a combination of a cash payment of $3,580,000 and the return of the 2,000,000 shares of common stock related to the February 1996 restricted stock agreement. The market value of the shares on the repayment date was $2.13 per share. These shares were retired and are not available for reissuance.

Note 16. Issuance of Restricted Stock

On March 18, 2003, the compensation committee of the board of directors granted to the Company s CEO the right to receive 3,000,000 shares of restricted stock for a purchase price equal to the par value of such stock. The first grant was effective immediately and consisted of 1,000,000 shares. The second grant of 2,000,000 was conditioned upon stockholder approval of an increase in the number of shares reserved under the Company s 1999 Nonstatutory Stock Option Plan. Such stockholder approval was obtained on May 20, 2003. Based on the market value of the Company s stock on the grant date for the 1,000,000 share grant and the market value of the Company s stock on the stockholder approval date for the 2,000,000 share grant, the Company recorded stock compensation expense of $1,056,000 and $1,944,000 for the three and nine months ended September 30, 2003, respectively. Future quarterly stock-based compensation expense to be charged to operations for these restricted stock grants for the remainder of 2003, 2004 and 2005 is as follows:

Quarter Ending	Compensation Expense
December 31, 2003	1,056,000
March 31, 2004	591,000
June 30, 2004	591,000
September 30, 2004	591,000

December 31, 2004	591,000
March 31, 2005	591,000
June 30, 2005	591,000
September 30, 2005	591,000
December 31, 2005	591,000
Total future stock compensation expense	$ 5,784,000

Note 17. Stock Option Exchange Program

In January 2001, the Company offered to current employees that held stock options the opportunity to exchange all of their outstanding stock options for restricted shares of the Company s common stock, at a price equal to the par value of such Common Stock. All employees who accepted the offer received one share of restricted stock for every two options exchanged. The restricted stock vests over a period of two to four years, depending upon whether the exchanged options were vested or unvested at the time of the exchange. Employees who elected to exchange their options were ineligible for stock option grants for a period of six months and one day following the exchange date of January 26, 2001. For the three months ended September 30, 2003 and 2002, the Company recorded compensation expense of $69,000 and $204,000, respectively, related to this restricted stock. For the nine months ended

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September 30, 2003 and 2002, the Company recorded compensation expense of $272,000 and $638,000, respectively. The Company will record future stock-based compensation expense of up to $342,000 over the vesting period of the restricted shares, which represents the fair market value of the remaining restricted common stock issued on the exchange date. Stock-based compensation expense to be charged to operations for the remainder of 2003, 2004 and 2005 approximates $65,000, $260,000, and $17,000 respectively, assuming all restricted stock grants vest.

The breakdown of the total stock-based compensation charge for both the stock option exchange program and the issuance of restricted shares to the Company s CEO (see Note 16) for the three and nine months ended September 30, 2003 and 2002 by the Company s operating functions is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Cost of revenues	$ 29,000	$ 45,000	$ 73,000	$ 142,000
Sales and marketing	8,000	58,000	61,000	173,000
Software development	7,000	22,000	26,000	69,000
General and administrative	1,081,000	79,000	2,056,000	254,000
Total compensation expense	$ 1,125,000	$ 204,000	$ 2,216,000	$ 638,000

Note 18. Acquisitions

ROI

On July 8, 2003, the Company acquired all of the outstanding stock of ROI Systems, Inc. (ROI), a privately held Enterprise Resource Planning (ERP) provider of manufacturing software solutions for approximately $20.8 million in an all cash transaction. At the time of the acquisition, ROI had approximately $3.6 million in cash and marketable securities, resulting in a net cash outlay of approximately $17.2 million. The Company plans to continue to develop and support ROI s existing product line and to also leverage ROI s existing market position and customer base to create new sales opportunities which complement the Company s existing market position in the discrete make-to-order manufacturing, distribution, hospitality and services-oriented industries. The Company recorded the acquisition of ROI as a purchase in the third quarter of 2003 and the results of ROI operations are included in the accompanying statement of operations from the date of acquisition.

In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. In order to allocate the purchase price in accordance with SFAS No. 141, the Company has obtained an independent appraisal of the fair value of the acquired intangible assets. The fair value of the tangible assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 20,750
Transaction costs	683

Total purchase price	$ 21,433
Fair value of tangible assets acquired:	
Cash and marketable securities	$ 3,592
Accounts receivable, net	3,194
Property and equipment, net	492
Prepaid and other assets	910
Total tangible assets acquired	8,188
Assumed liabilities	(5,941)
Acquired technology	7,320
Customer base	460
Trademark	1,550
Covenant not to compete	320
Goodwill	9,536
Net assets acquired	$ 21,433

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The pro forma statement of operations data of the Company set forth below gives effect to the acquisition by Epicor of ROI using the purchase method as if it occurred on January 1, 2002. This pro forma information is presented for illustrative purposes only and is not necessarily indicative of the combined financial position or results of operations for future periods or the financial position or result of operations that actually would have been realized had the acquisition occurred during the specified periods. (*in thousands, except per share data*)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Total revenues	$ 40,958	$ 39,048	$ 122,341	$ 121,573
Net income (loss)	(46)	(1,433)	3,346	(5,582)
Basic net income (loss)	0.00	(0.03)	0.08	(0.13)
Diluted net income (loss)	0.00	(0.03)	0.07	(0.13)

TDC/T7

On July 1, 2003, the Company acquired certain assets of TDC Solutions, Inc. (TDC), a developer of warehouse management software and T7, Inc. (T7), a software and hardware reseller for approximately $1.9 million in cash; $1.0 million was paid on July 1, 2003 and $0.9 million is to be paid on July 1, 2004. TDC and T7 are related entities as they are under common ownership. The assets acquired include intellectual property related to TDC s warehouse management software, customer contracts, customer lists and fixed assets. Prior to this acquisition, the Company distributed TDC s warehouse solutions, which integrated with the Company s e by Epicor product line, under an OEM arrangement with TDC. The Company plans to continue to develop, distribute and support the warehouse management solution as a key component of its distribution suite. The Company recorded this purchase in the third quarter of 2003 and the results of TDC and T7 operations are included in the accompanying statement of operations from the date of acquisition.

In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. The fair values of the assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 1,000
Future payment due	870
Transaction costs	52
Total purchase price	$ 1,922
Fair value of tangible assets acquired	$ 100
Assumed liabilities	(325)
Acquired technology	670
Covenant not to compete	190
Goodwill	1,287
Net assets acquired	$ 1,922

The proforma impact of this acquisition was not significant to the Company s historical results of operations.

Clarus

In December 2002, the Company completed an acquisition of certain assets of Clarus Corporation (Clarus) including customer contracts and core intellectual property products, including the Procurement, Sourcing, and Settlement solutions, for a cash purchase price of $1.0 million. The purchase price was paid by the Company out of working capital and reflects a negotiated price between the parties. The Company, which has been engaged in reselling Clarus procurement product for more than two years prior to the acquisition, will continue to provide service and support to the majority of Clarus installed base of procurement customers. The Company believes that the acquisition will enable the Company to initially focus on cross-selling opportunities and to further leverage its experience in procurement and sourcing, its integration expertise, as well as its .NET product architecture.

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In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. The fair values of the assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 1,000
Transaction costs	296
Total purchase price	$ 1,296
Fair value of tangible assets acquired	$ 903
Assumed liabilities	(542)
Acquired technology	935
Net assets acquired	$ 1,296

The proforma impact of this acquisition was not significant to the Company s historical results of operations.

Note 19. Contingencies

Litigation

The Company is subject to legal proceedings and claims in the normal course of business. The Company is currently defending these proceedings and claims, and it is the opinion of management that it will be able to resolve these matters in a manner that will not have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Guarantees

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. These contracts primarily relate to: (i) divestiture and acquisition agreements, under which the Company may provide customary indemnifications to either (a) purchasers of the Company s businesses or assets; or (b) entities from whom the Company is acquiring assets or businesses: (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company s use of the applicable premises: (iii) certain agreements with the Company s officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their relationship with the Company; and (iv) Company license and consulting agreements with its customers, under which the Company may be required to indemnify such customers for Intellectual Property infringement claims, and other claims arising from the Company s provision of services to such customers.

The terms of such obligations vary. A maximum obligation arising out of these types of agreements is not explicitly stated and therefore, the overall maximum amount of these obligations cannot be reasonably estimated. Specifically with respect to past divestiture agreements, the Company has been subject to capped indemnification provisions for claims by the acquirer of a nature specified in such agreements. These indemnity caps have ranged from $1.0 million to $3.5 million, but all such capped indemnity provisions have expired. Historically, the Company has not been obligated to make significant payments for these obligations. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2003 is not considered significant to the Company s financial position, results of operations or cash flows.

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

Overview

The Company designs, develops, markets and supports computer software applications, which assist mid-sized companies in the planning, management and operation of their businesses. The Company is focused on the mid-market, which includes companies with annual revenues between $10 million and $500 million. The Company s software products and related consulting and support services are designed to help these companies automate key aspects of their business operations, processes, and procedures from customer relations, ordering, purchasing and planning, to production, distribution, accounting and financial reporting. By automating these processes, companies may gain faster access to more accurate information, which can improve operating efficiency, reduce cost and allow companies to be more responsive to their customers, ultimately leading to increased revenues. The Company also offers support, consulting and education services in support of its customers use of its software products. The Company s products and services are sold worldwide by its direct sales force and an authorized network of Value Added Resellers (VARs), distributors and authorized consultants.

Critical Accounting Policies

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. As such, management is required to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant accounting policies which are most critical to aid in fully understanding and evaluating reported financial results include the following:

Revenue Recognition

The Company enters into contractual arrangements with end users that may include licensing of the Company s software products, product support and maintenance services, consulting services, resale of third-party hardware, or various combinations thereof, including the sale of such products or services separately. The Company s accounting policies regarding the recognition of revenue for these contractual arrangements is fully described in Notes to Unaudited Condensed Consolidated Financial Statements.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

- The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
- Availability of products to be delivered
- Time period over which services are to be performed
- Creditworthiness of the customer
- The complexity of customizations to the Company s software required by service contracts
- The sales channel through which the sale is made (direct, VAR, distributor, etc.)

Discounts given for each element of a contract

Any commitments made as to installation or implementation go live dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse affect on the Company s future revenues and operating results.

Allowance for Doubtful Accounts

The Company sells its products directly to end users generally requiring a significant up-front payment and remaining terms appropriate for the creditworthiness of the customer. The Company also sells its products to VARs and other software distributors generally under terms appropriate for the creditworthiness of the VAR or distributor. The Company believes no significant concentrations of credit risk existed at September 30, 2003. Receivables from customers are generally unsecured. The Company continuously monitors its customer account balances and actively

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pursues collections on past due balances. The Company maintains an allowance for doubtful accounts comprised of two components, one of which is based on historical collections performance and a second component based on specific collection issues. If actual bad debts differ from the reserves calculated based on historical trends and known customer issues, the Company records an adjustment to bad debt expense in the period in which the difference occurs. Such adjustment could result in additional expense or, as occurred in the first quarter of 2003, a reduction of expense.

The Company s accounts receivable go through a collection process that is based on the age of the invoice and requires attempted contacts with the customer at specified intervals and the assistance from other personnel within the Company who have a relationship with the customer. If after a specified number of days, the Company has been unsuccessful in its collection efforts, the Company may turn the account over to a collection agency. The Company writes-off accounts to its allowance when the Company has determined that collection is not likely. The factors considered in reaching this determination are (i) the apparent financial condition of the customer, (ii) the success that the Company has had in contacting and negotiating with the customer and (iii) the number of days the account has been with a collection agency.

Capitalized Software Development Costs

Software development costs incurred subsequent to the determination of technological feasibility and marketability of a software product are capitalized. Amortization of capitalized software development costs commences when the products are available for general release. Amortization is determined on a product by product basis using the greater of a ratio of current product revenues to projected current and future product revenues or an amount calculated using the straight-line method over the estimated economic life of the product, generally three to five years. In addition to in-house software development costs, the Company purchases certain software from third-party software providers and capitalizes such costs in software development costs. The Company continually evaluates the recoverability of its capitalized software development costs and considers any events or changes in circumstances that would indicate that the carrying amount of an asset may not be recoverable. Any material changes in circumstances, such as a large decrease in revenues or the discontinuation of a particular product line could require future write-downs in the Company s capitalized software development costs and could have a material adverse impact on the Company s operating results for the periods in which such write-downs occur.

Intangible Assets

The Company s intangible assets were recorded as a result of acquisitions completed in December 1998, December 2002 and July 2003 and represent acquired technology, customer base, trademarks and covenants not to compete. These intangibles are amortized on a straight-line basis over the estimated economic life of the asset. The Company continually evaluates the recoverability of the intangible assets and considers any events or changes in circumstances that would indicate that the carrying amount of an asset may not be recoverable. Any material changes in circumstances, such as large decreases in revenue or the discontinuation of a particular product line could require future write-downs in the Company s intangibles assets and could have a material adverse impact on the Company s operating results for the periods in which such write-downs occur.

Goodwill

In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. SFAS No. 142 requires goodwill and other intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment annually and written down when impaired. During the fourth quarter of each year, or earlier if indicators of potential impairment exist, goodwill will be tested

for impairment by determining if the carrying value of each reporting unit exceeds its estimated fair value. Future impairment reviews may require write-downs in the Company s goodwill and could have a material adverse impact on the Company s operating results for the periods in which such write-downs occur.

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Restructuring Charges and Other

The following table summarizes the activity in the Company s reserves associated with its restructurings (*in thousands*):

	Separation costs for terminated employees and contractors	Facilities closing and consolidation	Remaining accrual from prior periods 1999, 1998, 1997 and 1996	Asset impairment	Total restructuring costs
Balance at December 31, 2001	$ 1,526	$ 2,276	$ 188	$	$ 3,990
2002 restructuring charges and other	1,081	2,177		821	4,079
Reversal of prior period accrual			(188)		(188)
Write-off of fixed assets				(821)	(821)
Cash payments	(2,468)	(585)			(3,053)
Balance at December 31, 2002	$ 139	$ 3,868	$	$	$ 4,007
2003 restructuring charges and other		937			937
ROI acquisition	986	707		192	1,885
Cash payments	(612)	(1,306)			(1,918)
Balance at September 30, 2003	$ 513	$ 4,206	$	$ 192	$ 4,911
Less current portion	(513)	(2,419)		(192)	$ (3,124)
Total long-term restructuring reserve	$	$ 1,787	$	$	$ 1,787

2003 ROI Acquisition

In connection with the Company s acquisition of ROI on July 8, 2003 (see Note 18), the Company assumed a liability of $1,885,000 for the restructuring costs associated with the ROI reduction in workforce and the closure of certain ROI offices. This liability represents $921,000 for separation costs for terminated employees, $772,000 for the closing of certain of ROI s facilities and $192,000 for asset impairment. In conjunction with the acquisition, 41 ROI employees or 26% of the ROI workforce have been terminated from all functional areas.

2003 Restructuring Charges and Other

During the second quarter of 2003, the Company recorded an additional restructuring charge of approximately $1,229,000 related to a facility that was to be consolidated as part of the Company s 2002 restructuring. The Company determined that sublease income on this facility would not be realized according to the original estimate used in the 2002 restructuring due to the unanticipated loss of its sublease income and thus recorded an additional charge based on a revised estimate of sublease income. During the third quarter of 2003, the Company finalized the sublease agreement with a new tenant in this facility, which resulted in a reduction of the original estimated loss. As a result, the Company recorded a $292,000 reduction in restructuring charge in the third quarter of 2003.

2002 Restructuring Charges and Other

In the fourth quarter of 2002, the Company underwent a restructuring of its operations in an effort to further reduce its cost structure through a reduction in workforce and the consolidation of certain of its facilities. In connection with this restructuring, the Company recorded a restructuring charge of $3,070,000 during the year ended December 31, 2002. This charge represents $1,081,000 for separation costs for terminated employees and contractors and $2,177,000 for the closing and consolidation of certain of the Company s facilities. The Company terminated 121 employees worldwide or approximately 15% of the workforce from all functional areas of the Company. All of these terminations have been completed.

For facility costs included in the restructuring charge, the associated subleased and unoccupied space is physically separate from the utilized space of the facility. The lease payments on the facilities to be closed or consolidated were considered net of contractual and estimated future sublease income. For leased space not currently sublet, sublease income was estimated based on prevailing market rates and conditions. Any future losses or changes in sublease income that is not realized according to the Company s original estimates, will be recognized as a restructuring charge in the period in which the Company makes the determination that such additional losses will be

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incurred. Although the consolidation efforts were substantially completed as of the end of 2002, lease payments on buildings being vacated or downsized will continue to be made until the respective noncancelable terms of the leases expire.

For the year ended December 31, 2002, an additional charge of $821,000 was included in restructuring charges and other for the write-down to fair value of fixed assets related to assets to be disposed of as a result of the facility closures in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. These assets consisted primarily of leasehold improvements and computer equipment related to buildings being vacated or downsized.

Acquisitions

ROI

On July 8, 2003, the Company acquired all of the outstanding stock of ROI Systems, Inc. (ROI), a privately held ERP provider of manufacturing software solutions for approximately $20.8 million in an all cash transaction. At the time of the acquisition, ROI had approximately $3.6 million in cash and marketable securities, resulting in a net cash outlay of approximately $17.2 million. The Company plans to continue to develop and support ROI s existing product line and to also leverage ROI s existing market position and customer base to create new sales opportunities which complement the Company s existing market position in the discrete make-to-order manufacturing, distribution, hospitality and services-oriented industries. The Company recorded the acquisition of ROI as a purchase in the third quarter of 2003 and the results of ROI operations are included in the accompanying statement of operations from the date of acquisition.

In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. In order to allocate the purchase price in accordance with SFAS No. 141, the Company has obtained an independent appraisal of the fair value of the acquired intangible assets. The fair value of the tangible assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 20,750
Transaction costs	683
Total purchase price	$ 21,433
Fair value of tangible assets acquired:	
Cash and marketable securities	$ 3,592
Accounts receivable, net	3,194
Property and equipment, net	492
Prepaid and other assets	910
Total tangible assets acquired	8,188
Assumed liabilities	(5,941)
Acquired technology	7,320
Customer base	460
Trademark	1,550
Covenant not to compete	320
Goodwill	9,536

Net assets acquired	$ 21,433

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The pro forma statement of operations data of the Company set forth below gives effect to the acquisition by Epicor of ROI using the purchase method as if it occurred on January 1, 2002. This pro forma information is presented for illustrative purposes only and is not necessarily indicative of the combined financial position or results of operations for future periods or the financial position or result of operations that actually would have been realized had the acquisition occurred during the specified periods. (*in thousands, except per share data*)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Total revenues	$ 40,958	$ 39,048	$ 122,341	$ 121,573
Net income (loss)	(46)	(1,433)	3,346	(5,582)
Basic net income (loss)	0.00	(0.03)	0.08	(0.13)
Diluted net income (loss)	0.00	(0.03)	0.07	(0.13)

TDC/T7

On July 1, 2003, the Company acquired certain assets of TDC Solutions, Inc. (TDC), a developer of warehouse management software and T7, Inc. (T7), a software and hardware reseller for approximately $1.9 million in cash; $1.0 million was paid on July 1, 2003 and $0.9 million is to be paid on July 1, 2004. TDC and T7 are related entities as they are under common ownership. The assets acquired include intellectual property related to TDC s warehouse management software, customer contracts, customer lists and fixed assets. Prior to this acquisition, the Company distributed TDC s warehouse solutions, which integrated with the Company s e by Epicor product line, under an OEM arrangement with TDC. The Company plans to continue to develop, distribute and support the warehouse management solution as a key component of its distribution suite. The Company recorded this purchase in the third quarter of 2003 and the results of TDC and T7 operations are included in the accompanying statement of operations from the date of acquisition.

In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. The fair values of the assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 1,000
Future payment due	870
Transaction costs	52
Total purchase price	$ 1,922
Fair value of tangible assets acquired	$ 100
Assumed liabilities	(325)
Acquired technology	670
Covenant not to compete	190
Goodwill	1,287
Net assets acquired	$ 1,922

The proforma impact of this acquisition was not significant to the Company s historical results of operations.

Clarus

In December 2002, the Company completed an acquisition of certain assets of Clarus Corporation (Clarus) including customer contracts and core intellectual property products, including the Procurement, Sourcing, and Settlement solutions, for a cash purchase price of $1.0 million. The purchase price was paid by the Company out of working capital and reflects a negotiated price between the parties. The Company, which has been engaged in reselling Clarus procurement product for more than two years prior to the acquisition, will continue to provide service and support to the majority of Clarus installed base of procurement customers. The Company believes that the acquisition will enable the Company to initially focus on cross-selling opportunities and to further leverage its experience in procurement and sourcing, its integration expertise, as well as its .NET product architecture.

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In accordance with SFAS No. 141, Business Combinations, the acquisition has been accounted for under the purchase method of accounting. The fair values of the assets acquired and liabilities assumed represent management s estimate of current fair values. The following table summarizes the components of the purchase price (*in thousands*):

Cash	$ 1,000
Transaction costs	296
Total purchase price	$ 1,296
Fair value of tangible assets acquired	$ 903
Assumed liabilities	(542)
Acquired technology	935
Net assets acquired	$ 1,296

The proforma impact of this acquisition was not significant to the Company s historical results of operations.

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Results of Operations

The following table summarizes certain aspects of the Company s results of operations for the three and nine months ended September 30, 2003 compared to the three and nine months ended September 30, 2002 (*in millions, except percentages*):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Change $	Change %	2003	2002	Change $	Change %
Revenues:								
License fees	$ 9.4	$ 6.8	$ 2.6	38.1%	$ 26.7	$ 24.4	$ 2.3	9.2%
Consulting	10.6	9.1	1.5	16.7%	27.8	28.6	(0.8)	(3.1)%
Maintenance	19.8	17.5	2.3	13.2%	55.3	51.6	3.7	7.2%
Other	0.5	0.6	(0.1)	(4.2)%	1.6	2.1	(0.5)	(23.4)%
Total revenues	$ 40.3	$ 34.0	$ 6.3	18.8%	$ 111.4	$ 106.7	$ 4.7	4.3%
As a percentage of total revenues:								
License fees	23.2%	20.0%			24.0%	22.9%		
Consulting	26.4%	26.8%			24.9%	26.8%		
Maintenance	49.1%	51.5%			49.7%	48.4%		
Other	1.3%	1.7%			1.4%	1.9%		
Total revenues	100.0%	100.0%			100.0%	100.0%		
Amortization of intangible assets and capitalized software development costs	$ 2.0	$ 1.8	$ 0.2	11.2%	$ 5.2	$ 5.3	$ (0.1)	(2.4)%
As a percentage of total revenues	4.9%	5.3%			4.7%	5.0%		
Gross profit	$ 23.0	$ 18.3	$ 4.7	25.7%	$ 63.9	$ 57.4	$ 6.5	11.4%
As a percentage of total revenues	57.0%	53.9%			57.4%	53.8%		
Sales and marketing expense	$ 10.1	$ 10.7	$ (0.6)	(6.1)%	$ 27.0	$ 32.7	$ (5.7)	(17.4)%
As a percentage of total revenues	25.0%	31.6%			24.3%	30.7%		
Software development expense	$ 5.5	$ 4.5	$ 1.0	20.2%	$ 14.9	$ 13.9	$ 1.0	7.4%
As a percentage of total revenues	13.5%	13.4%			13.4%	13.0%		
General and administrative expense, including provision for doubtful accounts	$ 4.8	$ 4.5	$ 0.3	7.3%	$ 13.1	$ 15.4	$ (2.3)	(15.1)%
As a percentage of total revenues	11.9%	13.1%			11.8%	14.5%		
Stock-based compensation expense	$ 1.1	$ 0.2	$ 0.9	451.5%	$ 2.2	$ 0.6	$ 1.6	247.3%
As a percentage of total revenues	2.8%	0.6%			2.0%	0.6%		

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Revenues

License fee revenues increased in both absolute dollars and as a percentage of total revenues for the three and nine months ended September 30, 2003, as compared to the same periods in 2002. This increase is primarily the result of an approximate 15% increase in sales volume and an increase in average selling price which are attributable to the Company s strong execution across all product groups and regions of the Company s business plus the contribution from the ROI acquisition, which contributed approximately 11% of the software license revenue growth quarter-over-quarter and approximately 3% of the year-over-year growth. The Company expects total revenues for the fourth quarter of 2003 to increase due to the fact that the fourth quarter is seasonally strongest for the Company compared to the third quarter being seasonally weakest.

Consulting revenues increased in absolute dollars for the three months ended September 30, 2003, as compared to the same period in 2002. This increase is primarily due to the acquistions of ROI and TDC/T7, which added $1.8 million and $0.3 million, respectively, in consulting revenues for the three months ended September 30, 2003, as compared to the same period in 2002. For the nine months ended September 30, 2003, consulting revenues decreased in both absolute dollars and as a percentage of revenue compared to the same period in 2002. This decrease is mainly due to fewer implementation engagements as a result of lower software sales in the past few quarters, which is offset by the revenue contributions from ROI and TDC/T7.

Maintenance revenues increased in absolute dollars for the three and nine months ended September 30, 2003, as compared to the same periods in 2002. This increase is due to the ROI acquisition, which resulted in additional maintenance revenues of $2.3 million and to the continued high renewal rates experienced by the Company s customer base, especially in Europe.

Other revenues consist primarily of resale of third-party hardware and sales of business forms. The decrease in other revenues in absolute dollars for the three and nine months ended September 30, 2003, as compared with the same periods in 2002, is due to a decrease in third-party hardware sales due to increased competition in the Company s hardware sales business.

International revenues were $10.8 million and $10.3 million, respectively, for the three months ended September 30, 2003 and 2002, representing 26.8% and 30.2%, respectively, of total revenues. International revenues were $33.1 million and $31.7 million, respectively, for the nine months ended September 30, 2003 and 2002 representing 29.8% and 29.7%, respectively, of total revenues. International license revenues increased $0.3 million and $0.2 million for the three and nine months ended September 30, 2003, respectively, compared to the same periods in 2002, consistent with the Company s strong execution across all product groups and regions of the Company s business. International maintenance revenues for the third quarter of 2003 remained flat compared to the same period in 2002. However, international maintenance revenue for the nine months ended September 30,2003, as compared to the same period in 2002, increased approximately $1.5 million, primarily due to the continued high renewal rates in Europe and Canada. International consulting revenues increased $0.2 million for the three months ended September 30, 2003 compared to the same period in 2002 and decreased $0.1 million for the nine months ended September 30, 2003 compared to the same period in 2002. The quarter-over-quarter increase is primarily due to the increase in consulting revenues from Canada, which is the result of increased license fee revenues over the last four quarters. The year-over-year decrease is primarily due to the previous quarters decreases in license revenues that resulted in fewer current implementation engagements. With sales offices located in the Europe, Australia, Asia and South America, the Company expects international revenues to remain a significant portion of total revenues.

The Company s total revenue per employee increased from $144,000 to $172,000, respectively, for the three months ended September 30, 2003, as compared to the same period of 2002. For the nine months ended September 30, 2003, as compared to the same period of 2002, total revenue per employee increased from $149,000 to $174,000, respectively. These increases are primarily due to higher 2003 sales levels and headcount reductions associated with the 2002 restructuring.

Amortization of Intangible Assets and Capitalized Software Development Costs

Amortization of intangible assets consists of amortization of capitalized acquired technology, customer base and trademarks that were recorded as a result of the DataWorks Corporation (DataWorks) acquisition in December 1998, the Clarus asset purchase in December 2002, the ROI acquisition in July 2003 and the TDC/T7 asset purchase in July 2003. The Company s intangible assets are amortized on a straight-line basis over the estimated economic life of the assets. For the three months ended September 30, 2003 and 2002, the Company recorded amortization

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expense related to intangible assets of $1.8 million and $1.3 million, respectively. For the nine months ended September 30, 2003 and 2002, the Company recorded amortization expense related to intangible assets of $4.4 million and $3.8 million, respectively. Amortization of acquired technology and trademarks will be complete in 2008, and amortization of the customer base will be complete in 2010.

Amortization of capitalized software development costs is determined on a product by product basis using the greater of a ratio of current product revenues to projected current and future product revenues or an amount calculated using the straight-line method over the estimated economic life of the product, generally three to five years. For the three months ended September 30, 2003 and 2002, the Company recorded amortization expense related to capitalized software development costs of $0.2 million and $0.5 million, respectively. For the nine months ended September 30, 2003 and 2002, the Company recorded amortization expense related to capitalized software development costs of $0.8 million and $1.5 million, respectively. The Company did not capitalize any software development costs for the three or nine months ended September 30, 2003, as no costs were eligible for capitalization. Amortization of software development costs that were capitalized prior to 2002 will be complete in 2003.

Gross Profit

Cost of revenues consists of royalties paid for third-party software incorporated into the Company s products; costs associated with product packaging, documentation and software duplication; costs of consulting, custom programming, education and support; amortization of capitalized software development costs; amortization of acquired intangible assets; and the write-down of prepaid software royalties. A charge of approximately $0.6 million is included in cost of revenues for the first quarter of 2002 to write-down certain of the Company s prepaid software royalties to net realizable value due to lower than anticipated product sales.

The increase in gross profit in both absolute dollars and as a percentage of revenues for the three and nine months ended September 30, 2003, as compared to the same periods in 2002, is primarily due to improved margins in both North America and Europe from consulting services and software licenses. For both periods, consulting margins improved as a result of the 2002 restructuring which decreased the underlying service costs of the consulting services in these locales and increased utilization rates. For the nine months ended September 30, 2003, margins from software licenses increased due to the decrease in the amortization of certain capitalized software developments costs due to the completion of amortization during the second quarter of 2003. For the three months ended September 30, 2003, although amortization increased due to the ROI and TDC/T7 acquisitions, software margins increased as compared to the same period in 2002 due to the increase in software license revenues quarter over quarter.

Sales and Marketing Expense

Sales and marketing expenses consist primarily of salaries, commissions, travel, advertising and promotional expenses. The decrease in both absolute dollars and as a percentage of total revenues for the three and nine months ended September 30, 2003, as compared to the same periods of 2002, is due to decreases in the Company s advertising and related costs during 2003 of $1.0 million and $2.8 million, respectively. The remaining decrease is primarily due to a decrease in the cost of salaries, benefits and other headcount-related expenses in North America and Europe as a result of the 2002 restructuring, offset by increased expenses of $0.9 million due to the ROI acquisition in the third quarter of 2003 and increased commission expense of $0.9 million and $0.7 million for the three and nine months ended September 30, 2003, respectively. Commission expense increased in the third quarter as net license revenue increased and many sales people reached or exceeded their annual targets. The Company expects sales and marketing expenses to remain at or near the third quarter levels for the fourth quarter of 2003.

Software Development Expense

Software development costs consist primarily of compensation of development personnel, related overhead incurred to develop the Company s products as well as fees paid to outside consultants. The majority of these expenses are incurred in North America and Mexico, where the Company operates a development center. Software development costs are accounted for in accordance with SFAS No. 86 Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, under which the Company is required to capitalize software development costs between the time technological feasibility is established and the product is ready for general release. Costs that do not qualify for capitalization are charged to research and development expense when incurred. During the three and nine months ended September 30, 2003 and 2002, no software development costs were capitalized because the

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time period between technological feasibility and general release for all software product releases during the three and nine month periods ended September 30, 2003 and 2002, was insignificant. Capitalized software development costs include both internally generated development costs for development of the Company s future product releases and third party development costs related to the localization and translation of certain of the Company s products for foreign markets.

Software development expenses increased in both absolute dollars and as a percentage of revenues for the three and nine months ended September 30, 2003, as compared to the same periods in 2002. This increase is primarily due to $0.3 million of additional headcount related expenses as part of the Clarus acquisition in December 2002, $0.7 million as part of the ROI acquisition in July 2003 and $0.1 million as part of the TDC/T7 acquisition in July 2003, partially offset by reduced software development costs in connection with the 2002 restructuring. The Company expects software development expenses to remain at or near third quarter levels for the fourth quarter of 2003.

General and Administrative Expense, including Provision for Doubtful Accounts

General and administrative expenses consist primarily of costs associated with the Company s executive, financial, human resources and information services functions. For the three months ended September 30, 2003, general and administrative expenses increased primarily due to the acquisition of ROI, which added approximately $0.2 million in additional expenses, as compared to the same period in the prior year. The decrease for the nine months ended September 30, 2003, as compared to the same period in 2002, is due to a $1.1 million decrease in the provision for doubtful accounts with the remaining decrease due to the worldwide decrease in the costs of salaries, benefits and other headcount related expenses as a result of the 2002 restructuring. During the first quarter of 2003, the Company recognized a $1.1 million benefit to its provision for doubtful accounts due to (i) improved collection performance in 2003 resulting from the collection of several large accounts which had to be reserved for in 2002 because at the time collection of such accounts was not probable and (ii) an overall improvement in the aging of the Company s receivables as evidenced by a decrease in the percentage of accounts over 90 days from December 31, 2002 to March 31, 2003. The improved collection performance is the result of an enhanced collection process, which allows for earlier identification of collection issues and disputes and assignment of resolution to specific personnel both inside and outside the collections organization.

The Company expects general and administrative expenses to remain at or near current levels for the fourth quarter of 2003.

Stock-Based Compensation Expense

Stock-based compensation expense is related to restricted stock issued by the Company. Such expense for the three and nine months ended September 30, 2002 was related to restricted stock issued in connection with the Company s stock option exchange program that was carried out in 2001. Stock-based compensation expense for the three and nine months ended September 30, 2003 was related to both restricted stock issued as part of the exchange program and the 3,000,000 shares of restricted stock issued to the Company s Chief Executive Officer (CEO) in March 2003 and May 2003 (see Note 16 of Notes to Unaudited Condensed Consolidated Financial Statements). For the three and nine month periods ended September 30, 2003 stock-based compensation expense related to the restricted shares issued to the Company s CEO was $1,056,000 and $1,944,000, respectively. The increase in the stock-based compensation expense for the three and nine months ended September 30, 2003, as compared to the same periods in 2002, was due to the additional grants of restricted stock to the Company s CEO.

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Future quarterly stock-based compensation expense to be charged to operations for the remainder of 2003, 2004 and 2005 for the issuance of the 3,000,000 shares of restricted stock to the Company s CEO and the 2001 stock option exchange program is as follows:

Quarter Ending	CEO Restricted Stock	Stock Option Exchange Program	Total Future Compensation Expense
December 31, 2003	1,056,000	65,000	1,121,000
March 31, 2004	591,000	65,000	656,000
June 30, 2004	591,000	65,000	656,000
September 30, 2004	591,000	65,000	656,000
December 31, 2004	591,000	65,000	656,000
March 31, 2005	591,000	17,000	608,000
June 30, 2005	591,000		591,000
September 30, 2005	591,000		591,000
December 31, 2005	591,000		591,000
Total future stock compensation expense	$ 5,784,000	$ 342,000	$ 6,126,000

Provision for Income Taxes

The Company recorded a provision for income taxes during the third quarter of 2003 in the amount of $118,000 and no provision in 2002. The provision for the third quarter 2003 results from an alternative minimum tax liability after utilization of an alternative minimum tax loss carryforward. The effective tax rate for the nine months ended September 30, 2003, was 3.6%, while the effective rate for the nine months ended September 30, 2002 was zero. The effective rate is lower than the statutory US federal income tax rate of 35% primarily due to the benefits from the utilization of net operating loss carryforwards. The Company has provided a valuation allowance on 100% of its deferred tax assets. Any realization of the Company s net deferred tax asset will reduce the Company s effective rate in future periods; with the exception of the realization of deferred tax assets that are related to net operating losses that were generated by tax deductions resulting from the exercise of non-qualified stock options, for which there will be an increase directly to stockholder s equity.

Liquidity and Capital Resources

The following table summarizes the Company s cash and cash equivalents, working capital deficit and cash flows as of and for the nine months ended September 30, 2003 (*in millions*):

Cash and cash equivalents	$ 34.0
Working capital deficit	(6.7)
Net cash provided by operating activities	12.9
Net cash used in investing activities	(19.8)
Net cash provided by financing activities	7.8

As of September 30, 2003, the Company s principal sources of liquidity included cash and cash equivalents of $34.0 million. The Company s operating activities provided $12.9 million in cash during the nine months ended September 30, 2003. At September 30, 2003, the Company had $4.9 million in cash obligations for severance costs, lease terminations and other costs related to the Company s restructurings and $0.9 million in cash obligations for lease terminations and other costs related to the 1998 DataWorks merger which is included in accrued expenses in the accompanying unaudited condensed consolidated financial statements. The Company believes these obligations will be funded from existing cash reserves and operations.

The Company s principal investing activities for the nine month period ended September 30, 2003 included capital expenditures of $1.0 million and the acquisitions of ROI and TDC/T7 for $18.7 million. For the remainder of 2003, the Company anticipates capital spending on property and equipment will increase and these expenditures will be funded from existing cash reserves and operations.

Financing activities for the nine months ended September 30, 2003 included payments of $2.2 million made against the Company s debt obligations. Cash provided by financing activities included net proceeds from the issuance of new Series D preferred stock of $5.3 million, the collection of a note receivable from an officer in the amount of

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$3.6 million, proceeds from stock under the employee stock purchase program in the amount of $0.5 million and proceeds from the exercise of employee stock options in the amount of $0.7 million.

On July 26, 2000, the Company entered into a $30 million senior credit facility with a financial institution comprised of a $10 million term loan and a $20 million revolving line of credit. In August 2000, the Company received the $10 million proceeds from the term loan. The term loan was due in 36 equal monthly installments, plus interest at the greater of the lender s prime rate plus 3%, or 9%. The revolving line of credit bore interest at the greater of a variable rate equal to either the prime rate or at LIBOR, at the Company s option, plus a margin ranging from 0.25% to 1.25% on prime rate loans and 2.5% to 3.75% on LIBOR loans, depending on the Company s results of operations, or 9%. Borrowings under the revolving line of credit were limited to 85% of eligible accounts receivable, as defined. To date, the Company has not borrowed any amounts against the revolving line of credit facility. Borrowings under the credit facility were secured by substantially all of the Company s assets. The Company was required to comply with various financial covenants. Significant financial covenants included:

- Achieving a minimum of earnings before interest, taxes, depreciation and amortization (EBITDA)
- Achieving a minimum tangible net worth, as defined in the credit facility, and
- Maintaining the principal balance of the term loan at less than 20% of collections derived from maintenance agreements during the immediately preceding twelve months.

Additional material covenants under the agreement include limitations on the Company s indebtedness, liens on Company assets, guarantees, investments and disposal of material assets by the Company.

The current credit facility was paid off on August 1, 2003 and as of September 30, 2003, was terminated. The Company is in the process of finalizing a new credit facility.

The Company has taken steps to reduce its operating expenses as part of its October 2002 restructurings, which included a reduction in workforce and facilities consolidation and closure. In each quarter of 2002, the Company generated positive cash flow from operations primarily due to the savings from the 2001 and 2002 restructurings, the ongoing improvements in its accounts receivable collection efforts and a $1.2 million federal income tax refund received during 2002. The improved collection performance is due to an enhanced collection process, which allows for earlier identification of collection issues and disputes and assignment of resolution to specific personnel both inside and outside the collections organization. Furthermore, the Company generated positive cash flow in all three quarters of 2003. The Company expects to generate positive cash flow from operations in the fourth quarter of 2003 due to the considerable expense reduction activities the Company undertook in 2002 and better collection performance as previously discussed, both of which have contributed to eight consecutive quarters of positive operating cash flows.

As of September 30, 2003, the Company had cash and cash equivalents of $34.0 million. In July 2003, the Company utilized approximately $18.2 million of cash for the previously discussed acquisition of ROI and acquisition of certain assets of TDC and T7. The Company is dependent upon its ability to generate cash flows from license fees and other operating revenues, providing services to its customers and through collection of its accounts receivable to maintain current liquidity levels. If the Company is not successful in achieving targeted revenues and expenses or positive cash flows from operations, the Company may be required to take further cost-cutting measures and restructuring actions or seek alternative sources of funding.

The Company reported net income applicable to common stockholders for the three and nine months ended September 30, 2003 of $1.8 million and $5.5 million, respectively. While management s goal is to maintain profitability, there can be no assurance that the Company s future revenues nor its restructuring and other cost control actions will enable it to maintain operating profitability. Considering current cash reserves,

and other existing sources of liquidity, management believes that the Company will have sufficient sources of financing to continue its operations throughout at least the next twelve months. However, there can be no assurance that the Company will not seek to raise additional capital through the incurrence of debt or issuance of equity securities in the future.

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New Accounting Pronouncements

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others. FIN No. 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; while the provisions of the disclosure requirements are effective for financial statements of interim or annual reports ending after December 15, 2002. The Company adopted the disclosure provisions of FIN No. 45 during the fourth quarter of fiscal 2002 and adopted the recognition provisions of FIN No. 45 effective January 1, 2003, and such adoption did not have a material impact on its consolidated financial statements. The Company warrants its media from material defects in material and workmanship under normal use and warrants that the licensed software will perform substantially in accordance with the specification in the documentation ranging from three months to one year, depending on the product. Historical costs related to these warranties have been insignificant and no related warranty accrual is deemed necessary.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods for voluntary transition to SFAS No. 123 s fair value method of accounting for stock-based employee compensation (the fair value method). SFAS No. 148 also requires disclosure of the effects of an entity s accounting policy with respect to stock-based employee compensation on reported net income (loss) and earnings (loss) per share in annual and interim financials statements Effective January 1, 2003, the Company evaluated the provisions of SFAS No. 148 and these provisions did not have a material adverse impact on its consolidated results of operations and financial position since the Company has not adopted the fair value method. However, should the Company be required to adopt or elect the fair value method in the future, such adoption could have a material impact on our consolidated results of operations or financial position.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN No. 46 apply immediately to variable interest entities created after January 31, 2003. The Company adopted FIN No. 46 effective February 1, 2003. The adoption did not have a material impact on its consolidated financial statements as the Company has no variable interest entities.

In January 2003, the Emerging Issues Task Force (EITF) issued EITF 00-21, Revenue Arrangements with Multiple Deliverables, which requires companies to allocate the consideration received on arrangements involving multiple arrangements based on their relative fair values. Further, this EITF requires that the companies consider the revenue recognition criteria separately for each of the deliverables. This EITF is applicable for revenue arrangements entered into in fiscal years beginning after June 15, 2003. Early adoption is permitted. The Company does not anticipate that the adoption of this EITF will have a material impact on the Company s consolidated financial statements.

On January 1, 2003, the Company adopted SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity to be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost as defined in EITF 94-3 was recognized at the date of an entity s commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Company will apply the provisions of SFAS No. 146 for exit or disposal activities that are initiated after December 31, 2002.

In April 2003, FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative discussed in paragraph 6(b) of Statement 133, (2) clarifies when a derivative contains a

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financing component, (3) amends the definition of an underlying to conform it to language used in FIN 45, and (4) amends certain other existing pronouncements, which will collectively result in more consistent reporting of contracts as either derivatives or hybrid instruments. SFAS No. 149 is effective for contracts and hedging relationships entered into or modified after June 30, 2003. The Company does not believe that the adoption of SFAS No. 149 will have a material impact on the Company s consolidated financial statements as the Company has not entered into any derivative or hedging transactions.

In May 2003, FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both debt and equity and requires an issuer to classify the following instruments as liabilities in its balance sheet:

- a financial instrument issued in the form of shares that is mandatorily redeemable and embodies an unconditional obligation that requires the issuer to redeem it by transferring its assets at a specified or determinable date or upon an event that is certain to occur;
- a financial instrument, other than an outstanding share, that embodies an obligation to repurchase the issuer s equity shares, or is indexed to such an obligation, and requires the issuer to settle the obligation by transferring assets; and
- a financial instrument that embodies an unconditional obligation that the issuer must settle by issuing a variable number of its equity shares if the monetary value of the obligation is based solely or predominantly on (1) a fixed monetary amount, (2) variations in something other than the fair value of the issuer s equity shares, or (3) variations inversely related to changes in the fair value of the issuer s equity shares.

SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and is effective for all other financial instruments as of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle. The Company does not expect the adoption of SFAS No. 150 to have a material impact on the Company s consolidated financial statements.

Certain Factors that May Affect Future Results

Forward Looking Statements Safe Harbor.

Certain statements in this Annual Report on Form 10-Q are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, that involve risks and uncertainties. Any statements contained herein (including without limitation statements to the effect that the Company or Management estimates, expects, anticipates, plans, believes, projects, continues, may, or will or statements concerning potential or opportunity or variations there comparable terminology or the negative thereof) that are not statements of historical fact should be construed as forward-looking statements. These statements include the Company s expectation that (i) the Company will continue to develop and support ROI s existing product line and to also leverage ROI s existing market position and customer base to create new sales opportunities which complement the Company s existing market position in the discrete make-to-order manufacturing, distribution, hospitality and services-oriented industries, (ii) the Company will continue to develop, distribute and support TDC s warehouse management solution as a key component of its distribution suite, (iii) the Company will continue to provide service and support to the majority of Clarus installed customers, (iv) the Clarus acquisition will enable the Company to focus on cross-selling and leverage its experience to deliver an expanded product offering, (v) the Company s total revenues for the fourth quarter of 2003 will increase due to the fact that the fourth quarter is seasonally strongest for the Company compared to the third quarter being seasonally weakest, (vi) international revenues will continue to represent a significant portion of total revenues, (vii) sales and marketing, software development and general and administrative expenses will remain at or near current levels in the fourth quarter of 2003, (viii) remaining DataWorks merger obligations will be funded from existing cash reserves and operations, (ix) the Company s capital spending on property and equipment will increase for the remainder of 2003 and these expenditures will be funded from existing cash reserves and operations, (x) the Company will maintain positive cash flow from operations in the fourth quarter of 2003, (xii) the Company will have sufficient sources of financing to continue its operations throughout at least the next twelve months, (xiii) the adoption of EITF 00-21, SFAS No.

149 and SFAS No. 150 will not have a material impact on the Company s consolidated financial statements, and (xiv) current legal proceedings will not have material adverse effect on the Company. Actual results could differ materially and adversely from those anticipated

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in such forward looking statements as a result of certain factors, including the factors listed at pages 34 to 40. Because these factors may affect the Company s operating results, past performance should not be considered an indicator of future performance and investors should not use historical results to anticipate results or trends in future periods. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission including its annual report on Form 10-K for the year ended December 31, 2002 at pages 14 to 21.

Our quarterly operating results are difficult to predict and subject to substantial fluctuation.

The Company s quarterly operating results have fluctuated significantly in the past. From the first quarter of 2001 through the third quarter of 2003, quarterly operating results have ranged from an operating loss of $22.1 million to operating income of $1.8 million. The Company s operating results may continue to fluctuate in the future as a result of many specific factors that include:

- The demand for the Company s products, including reduced demand related to changes in marketing focus for certain products, software market conditions or general economic conditions as they pertain to IT spending
- Fluctuations in the length of the Company s sales cycles which may vary depending on the complexity of our products as well as the complexity of the customer s specific software and service needs
- Changes in accounting standards, including software revenue recognition standards
- The size and timing of orders for the Company s software products and services, which, because many orders are completed in the final days of each quarter, may be delayed to future quarters
- The number, timing and significance of new software product announcements, both by the Company and its competitors
- Customers unexpected postponement or termination of expected system upgrades or replacement due to a variety of factors including economic conditions, changes in IT strategies or management changes
- Fluctuations in maintenance renewal rates by existing customers

In addition, the Company has historically realized a significant portion of its software license revenues in the final month of any quarter, with a concentration of such revenues recorded in the final ten business days of that month. Due to the above factors, among others, the Company s revenues are difficult to forecast. The Company, however, bases its expense levels, including operating expenses and hiring plans, in significant part, on its expectations of future revenue. As a result, the Company expects its expense levels to be relatively fixed in the short term. The Company s failure to meet revenue expectations could adversely affect operating results. Further, an unanticipated decline in revenue for a particular quarter may disproportionately affect the Company s operating results in that quarter because the majority of the Company s expenses are fixed in the short term. As a result, the Company believes that period-to-period comparisons of the Company s results of operations are not and will not necessarily be meaningful, and you should not rely upon them as an indication of future performance. Due to the foregoing factors, it is likely that, as in past quarters, in some future quarter the Company s operating results will be below the expectations of public market analysts and investors. As in those past quarters, such an event would likely have an adverse effect upon the price of the Company s Common Stock.

If we fail to rapidly develop and introduce new products and services based upon emerging technologies and platforms, or if the technologies we choose do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.

The Company s software products are built and depend upon several underlying and evolving relational database management system platforms such as Microsoft SQL Server, Progress and IBM. To date, the standards and technologies that the Company has chosen to develop its products upon have proven to be popular and have gained broad industry acceptance. However, the market for the Company s software products is subject to ongoing rapid technological developments, quickly evolving industry standards and rapid changes in customer requirements, and there may be

existing or future technologies and platforms that achieve industry standard status, which are not compatible with our products. Additionally, because the Company s products rely significantly upon popular existing user interfaces to third party business applications, the Company must forecast which user interfaces will be popular in the future. For example, the Company believes the Internet is transforming the way businesses operate and the software requirements of customers. Specifically, the Company believes that customers desire business software applications that enable a customer to engage in commerce or service over the Internet. Recently, the Company has announced its determination to pursue development of several of its primary product lines upon the

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new Microsoft .NET technology. If the Company cannot develop such .NET compatible products in time to effectively bring them to market, or if .NET does not become a widely accepted industry standard, the ability of the Company s products to interface to popular third party applications will be negatively impacted and the Company s competitive position and revenues could be adversely affected.

New software technologies could cause us to alter our business model resulting in adverse affects on our operating results.

Development of new technologies may also cause the Company to change how it licenses or prices its products, which may adversely impact the Company s revenues and operating results. Emerging licensing models include hosting as well as subscription-based licensing, in which the licensee essentially rents software for a defined period of time, as opposed to the current perpetual license model. The Company s future business, operating results and financial condition will depend on its ability to effectively train its sales force to sell an integrated comprehensive set of business software products and recognize and implement emerging industry standards and models, including new pricing and licensing models.

If the Company fails to respond to emerging industry standards, including licensing models, and end-user requirements, the Company s competitive position and revenues could be adversely affected.

Our increasingly complex software products may contain errors or defects which could result in the rejection of our products and damage to our reputation as well as cause lost revenue, delays in collecting accounts receivable, diverted development resources and increased service costs and warranty claims.

The Company s software products are made up of increasingly complex computer programs. Software products as complex as the products offered by the Company often contain undetected errors or failures (commonly referred to as bugs) when first introduced to the market or as new updates or upgrades of such products are released to the market. Despite testing by the Company, and by current and potential customers, prior to general release to the market, the Company s products may still contain material errors after their initial commercial shipment. Such material errors may result in loss of or delay in market acceptance of the Company s products, damage to the Company s reputation, and increased service and warranty costs. Ultimately, such errors could lead to a decline in the Company s revenues. The Company has from time to time been notified by some of its customers of errors in its various software products. Although it has not occurred to date, the possibility of the Company being unable to correct such errors in a timely manner could have a material adverse effect on the Company s results of operations and its cash flows. In addition, if material technical problems with the current release of the various database and technology platforms on which the Company s products operate, including Progress, IBM or Microsoft .NET, occur, such difficulties could also negatively impact sales of these products, which could in turn have a material adverse effect on the Company s results of operations.

A variety of specific business interruptions could adversely affect our business.

A number of particular types of business interruptions could greatly interfere with our ability to conduct business. For example, a substantial portion of our facilities, including our corporate headquarters and other critical business operations, are located near major earthquake faults. We do not carry earthquake insurance and do not fund for earthquake-related losses. In addition, our computer systems are susceptible to damage from fire, floods, earthquakes, power loss, telecommunications failures, and similar events. The Company also currently contracts with Worldcom/MCI for the majority of its telecommunications services. The recent events surrounding Worldcom, including financial fraud allegations and its bankruptcy filing could possibly result in a disruption of Epicor s telecommunication capabilities and thus, disrupt Epicor s business operations. The Company continues to consider and implement its options and develop contingency plans to avoid and/or minimize potential disruptions to its telecommunication services.

We may pursue strategic acquisitions, investments, and relationships and may not be able to successfully manage our operations if we fail to successfully integrate such acquired businesses and technologies.

As part of its business strategy, the Company may continue to expand its product offerings to include application software products and services that are complementary to its existing software applications, particularly in the areas of electronic commerce or commerce over the Internet, or may gain access to established customer bases into which the Company can sell its current products. This strategy has historically and may in the future involve acquisitions, investments in other businesses that offer complementary products, joint development agreements or technology

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licensing agreements. The specific risks we commonly encounter in these types of transactions include the following:

- Difficulty in effectively integrating any acquired technologies or software products into our current products and technologies
- Difficulty in predicting and responding to issues related to product transition such as development, distribution and customer support
- The possible adverse impact of such acquisitions on existing relationships with third party partners and suppliers of technologies and services
- The possibility that customers of the acquired company might not accept new ownership and may transition to different technologies or attempt to renegotiate contract terms or relationships, including maintenance or support agreements
- The possibility that the due diligence process in any such acquisition may not completely identify material issues associated with product quality, product architecture, product development, intellectual property issues, key personnel issues or legal and financial contingencies

A failure to successfully integrate acquired businesses or technology for any of these reasons could have a material adverse effect on the Company s results of operations.

Future acquisitions of technologies or companies, which are paid for partially, or entirely through the issuance of stock or stock rights could prove dilutive to existing shareholders.

Consistent with past experience, the Company expects that the consideration it might pay for any future acquisitions of companies or technologies could include stock, rights to purchase stock, cash or some combination of the foregoing. If the Company issues stock or rights to purchase stock in connection with future acquisitions, earnings (loss) per share and then-existing holders of the Company s Common Stock may experience dilution.

We rely, in part, on distributors and VARs to sell our products. Disruptions to these channels would adversely affect our ability to generate revenues from the sale of our products.

The Company distributes products through a direct sales force as well as through a distribution channel, which includes distributors, VARs and authorized consultants, consisting primarily of professional firms. During 2002, 18% of the Company s software license revenues were generated by VARs and distributors. If the Company s VARs or authorized consultants cease distributing or recommending the Company s products or emphasize competing products, the Company s results of operations could be materially and adversely affected. Historically, the Company has sold its financial and customer relationship management (CRM) products through direct sales as well as through the distribution channel. However, the Company is currently creating a distribution channel for certain of its manufacturing product lines not previously sold through VARs. It is not yet certain that these products can be successfully sold through such a channel and the long term impact of this increase in the distribution channel to the Company s performance is as of yet undetermined as is the Company s ability to generate additional license and services revenue from such a channel. The success of the Company s distributors depends in part upon their ability to attract and maintain qualified sales and consulting personnel. Additionally, the Company s distributors may generally terminate their agreements with the Company upon 90 days notice. If our distributors are unable to maintain such qualified personnel or if several of the Company s distributors terminate their agreements and the Company is unable to replace them in a timely fashion, such factors could negatively impact the Company s results of operations. Finally, there can be no assurance that having both a direct sales force and a distribution channel for the Company s products will not lead to conflicts between those two sales forces which could adversely impact the Company s ability to close sales transactions or could have a negative impact upon average selling prices, any of which may negatively impact the company s operating revenues and results of operations.

A significant portion of our future revenue is dependent upon our existing installed base of customers continuing to license additional products as well as purchasing consulting services and renewing their annual maintenance and support contracts.

Historically, approximately 50% to 60% of the Company s license revenues, 90% of the Company s maintenance revenues and a substantial portion of the Company s consulting revenues are generated from the Company s installed base of customers. Maintenance and support agreements with these customers are traditionally renewed on an annual basis at the customer s discretion, and there is normally no requirement that a customer so renew or that a

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customer pay new license fees or service fees to the Company following the initial purchase. As a result, if our existing customers fail to renew their maintenance and support agreements or fail to purchase new product enhancements or additional services from the Company at historical levels, the Company s revenues and results of operations could be materially impacted.

Our software products incorporate and rely upon third party software products for certain key functionality and our revenues, as well as our ability to develop and introduce new products, could be adversely affected by our inability to control or replace these third party products and operations.

The Company s products incorporate and rely upon software products developed by several other third party entities such as Microsoft, IBM and Progress. Specifically, the Company s software products are built and depend upon several underlying and evolving relational database management system platforms including Microsoft SQL Server, Progress OpenEdge and IBM U2. In the event that these third party products were to become unavailable to the Company or to our customers, either directly from the third party manufacturers or through other resellers of such products, the Company could not readily replace these products with substitute products. As a result, the Company cannot provide assurance that these third parties will:

- Remain in business
- Continue to support the Company s product lines
- Maintain viable product lines
- Make their product lines available to the Company on commercially acceptable terms
- Not make their products available to the Company s competitors on more favorable terms

In the long term (i.e. a year or more), an interruption of supply from these vendors could potentially be overcome through migration to another third party supplier or development within the Company. However, any interruption in the short term could have a significant detrimental effect on the Company s ability to continue to market and sell those of its products relying on these specific third party products and could have a material adverse effect on the Company s business, results of operation, cash flows and financial condition.

The market for Web-based development tools, application products and consulting and education services is emerging, which could negatively affect our client/server-based products.

The Company s development tools, application products and consulting and education services generally help organizations build, customize or deploy solutions that operate in a client/server-computing environment. There can be no assurance that the market for client/server computing will continue to grow, or will not decrease, or that the Company will be able to respond effectively to the evolving requirements of these markets. The Company believes that the environment for application software is continuing to change from client/server to a Web-based environment to facilitate commerce on the Internet. If the Company fails to respond effectively to evolving requirements of this market, the Company s business, financial condition, results of operations and cash flows will be materially and adversely affected.

The market for our software products and services is highly competitive. If we are unable to compete effectively with existing or new competitors our business could be negatively impacted.

The business information systems industry in general and the manufacturing, CRM and financial computer software industry specifically, in which the Company competes are very competitive and subject to rapid technological change, evolving standards, frequent product enhancements and introductions and changing customer requirements. Many of the Company s current and potential competitors have (1) longer operating histories, (2) significantly greater financial, technical and marketing resources, (3) greater name recognition, (4) larger technical staffs, and (5) a larger installed customer base than the Company. A number of companies offer products that are similar to the Company s products and that target the same markets. In addition, any of these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements (such as commerce on the Internet and Web-based application software), and to devote greater resources to the development, promotion and sale of their products than the Company. Furthermore, because there are relatively low barriers to entry in the software industry, the Company expects additional competition from other established and emerging companies. Such competitors may develop products and services that compete with those offered by the Company or may acquire companies, businesses and product lines that compete with the Company. It also is possible that competitors may create alliances and rapidly acquire significant market share, including in new and emerging markets.

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Accordingly, there can be no assurance that the Company s current or potential competitors will not develop or acquire products or services comparable or superior to those that the Company develops, combine or merge to form significant competitors, or adapt more quickly than will the Company to new technologies, evolving industry trends and changing customer requirements. Competition could cause price reductions, reduced margins or loss of market share for the Company s products and services, any of which could materially and adversely affect the Company s business, operating results and financial condition. There can be no assurance that the Company will be able to compete successfully against current and future competitors or that the competitive pressures that the Company may face will not materially adversely affect its business, operating results, cash flows and financial condition.

We may not be able to maintain and expand our product offerings or business if we are not able to retain, hire and integrate sufficiently qualified personnel.

The Company s success depends in large part on the continued service of key management personnel that are not subject to an employment agreement. In addition, the competition to attract, retain and motivate qualified technical, sales and software development personnel is intense. The Company has at times, including during the rise of the dot coms in the mid to late 1990 s, experienced significant attrition and difficulty in recruiting qualified personnel, particularly in software development and customer support. Additionally, the sudden unexpected loss of such technical personnel such as developers can have a negative impact on the Company s ability to develop and introduce new products in a timely and effective manner. There is no assurance that the Company can retain its key personnel or attract other qualified key personnel in the future. The failure to attract or retain such persons could have a material adverse effect on the Company s business, operating results, cash flows and financial condition.

Our future results could be harmed by economic, political, geographic, regulatory and other specific risks associated with our international operations.

The Company believes that any future growth of the Company will be dependent, in part, upon the Company s ability to maintain and increase revenues in its existing and emerging international markets, including Asia and Latin America. During 2002, 30% of total revenues were generated by the Company s international operations. There can be no assurance that the Company will maintain or expand its international sales. If the revenues that the Company generates from foreign activities are inadequate to offset the expense of maintaining foreign offices and activities, the Company s business, financial condition and results of operations could be materially and adversely affected. The increasingly international reach of the Company s businesses could also subject the Company and its results of operations to unexpected, uncontrollable and rapidly changing economic and political conditions. Specifically, our international sales and operations are subject to inherent risks, including:

- Differing intellectual property and labor laws
- Lack of experience in a particular geographic market
- Different and changing regulatory requirements in various countries and regions
- Tariffs and other barriers, including import and export requirements and taxes on subsidiary operations
- Fluctuating exchange rates and currency controls
- Difficulties in staffing and managing foreign sales and support operations
- Longer accounts receivable payment cycles
- Potentially adverse tax consequences, including repatriation of earnings
- Development and support of localized and translated products
- Lack of acceptance of localized products or the Company in foreign countries
- Shortage of skilled personnel required for local operations
- Perceived health (e.g. SARS) or terrorist risks which impact a geographic region and business operations therein

Any one of these factors or a combination of them could materially and adversely affect the Company s future international sales and, consequently, the Company s business, operating results, cash flows and financial condition. A portion of the Company s revenues from sales to foreign entities, including foreign governments, has been in the form of foreign currencies. The Company does not have any hedging or similar foreign currency contracts. Fluctuations in the value of foreign currencies could adversely impact the profitability of the Company s foreign operations.

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If third parties infringe our intellectual property, we may expend significant resources enforcing our rights or suffer competitive injury.

The Company considers its proprietary software and the related intellectual property rights in such products to be among its most valuable assets. The Company relies on a combination of copyright, trademark and trade secret laws (domestically and internationally), employee and third-party nondisclosure agreements and other industry standard methods for protecting ownership of its proprietary software. However, the Company cannot assure you that in spite of these precautions, an unauthorized third party will not copy or reverse-engineer certain portions of the Company s products or obtain and use information that the Company regards as proprietary. From time to time, the Company does take legal action against third parties whom the Company believes are infringing upon the Company s intellectual property rights. However, there is no assurance that the mechanisms that the Company uses to protect its intellectual property will be adequate or that the Company s competitors will not independently develop products that are substantially equivalent or superior to the Company s products.

Moreover, the Company expects that as the number of software products in the United States and worldwide increases and the functionality of these products further overlaps, the number of these types of claims will increase. Any such claim, with or without merit, could result in costly litigation and require the Company to enter into royalty or licensing arrangements. The terms of such royalty or license arrangements, if required, may not be favorable to the Company. In addition, in certain cases, the Company provides the source code for some of its application software under licenses to its customers and distributors to enable them to customize the software to meet their particular requirements or translate or localize the products for resale in foreign countries, as the case may be. Although the source code licenses contain confidentiality and nondisclosure provisions, the Company cannot be certain that such customers or distributors will take adequate precautions to protect the Company s source code or other confidential information. Moreover, regardless of contractual arrangements, the laws of some countries in which the Company does business or distributes its products do not offer the same level of protection to intellectual property as do the laws of the United States.

Our operating cash flows are subject to fluctuation, primarily related to our ability to timely collect accounts receivable and to achieve anticipated revenues and expenses. Negative fluctuations in operating cash flows may require us to seek additional cash sources to fund our working capital requirements.

From January 1, 2001 through September 30, 2003, the Company s quarterly operating cash flows have ranged from negative $7.6 million to positive $7.4 million. The Company s cash and cash equivalents have increased from $26.8 million at December 31, 2000 to $34.0 million at September 30, 2003. The Company has however, experienced decreasing revenues and, prior to the first quarter of 2003, continued operating losses. As a result, in the fourth quarter of 2002, the Company underwent a restructuring of its operations in an effort to reduce its cost structure through a reduction in workforce of approximately 15% and the consolidation of facilities. If the Company is not successful in achieving its anticipated revenues and expenses or maintaining a positive cash flow, the Company may be required to take further actions to reduce its operating expenses, such as additional reductions in work force, and/or seek additional sources of funding. Since December 31, 1999, the Company has also experienced fluctuations in the proportion of accounts receivable over 90 days old. These fluctuations have been due to various issues, including product and service quality, deteriorating financial condition of customers during the recent recession, and lack of effectiveness of the Company s collection processes. If the Company cannot successfully collect a significant portion of its net accounts receivable, the Company may be required to seek alternative financing sources. The Company recently terminated its bank line of credit and paid off this credit facility on August 1, 2003. The Company is in the process of finalizing a new credit facility. No assurance can be made that the Company will be successful in finalizing such credit facility.

The market for our stock is volatile and fluctuations in operating results, changes in the Company s guidance on revenues and earnings estimates and other factors could negatively impact our stock s price.

During the three year period ended December 31, 2002, the price of the Company s common stock has ranged from a low of $0.65 to a high of $10.25. During the nine months ended September 30, 2003, the stock price ranged from a low of $1.23 to a high of $9.80. As of October 30, 2003, the Company had 44,172,193 shares of common stock outstanding as well as 61,735 and 300,000 shares of Series C and D Preferred Stock outstanding, respectively. The market prices for securities of technology companies, including the Company s, have historically been quite volatile. Quarter to quarter variations in operating results, changes in the Company s guidance on revenues and earnings estimates, announcements of technological innovations or new products by the Company or its competitors, announcements of major contract awards, announcements of industry acquisitions by us or our competitors, changes

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in accounting standards or regulatory requirements as promulgated by the FASB, SEC, NASDAQ or other regulatory entities, changes in management, and other events or factors may have a significant impact on the market price of the Company s Common Stock. In addition, the securities of many technology companies have experienced extreme price and volume fluctuations, which have often been related more to changes in recommendation or financial estimates by securities analysts than to the companies actual operating performance. Any of these conditions may adversely affect the market price of the Company s Common Stock.

If proposed regulations pertaining to accounting treatment for employee stock options are enacted, the Company s business practices may be materially altered.

The Company has historically compensated and incentivized its employees, including many of its key personnel and new hires, though the issuance of options to acquire Company common stock. The Company currently accounts for the issuance of stock options to employees according to APB Opinion No. 25, Accounting for Stock Issued to Employees. If proposals currently under consideration by accounting standards organizations and governmental authorities which would require immediate expense recognition for stock options were adopted, the Company might change its current practices with respect to the granting of employee stock options to reduce the number of stock options granted to employees. Such a change could impact the Company s ability to retain existing employees or to attract qualified new candidates. As a result the Company might have to increase cash compensation to these individuals. Such changes could have a negative impact upon the Company s earnings.

Because of these and other factors affecting the Company s operating results, past financial performance should not be considered an indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. The Company s exposure to market risk for changes in interest rates relates primarily to the Company s cash and cash equivalents. At September 30, 2003, the Company had $34.0 million in cash and cash equivalents. Based on the investment interest rate, a hypothetical 1% decrease in interest rates would decrease interest income by approximately $85,000 on an annual basis, and likewise decrease the Company s earnings and cash flows. The Company does not use derivative financial instruments in its investment portfolio. The Company places its investments with high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. The Company is averse to principal loss and ensures the safety and preservation of its invested funds by limiting default risk, market risk, and reinvestment risk. The Company mitigates default risk by investing in only the safest and highest credit quality securities and by constantly positioning its portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor.

The Company s interest expense associated with its term loan and revolving credit facility will vary with market rates. Although the Company has provided quantitative disclosure regarding interest rate risk associated with its term loan and revolving credit facility, such disclosure is no longer meaningful as the loan was paid off on August 1, 2003. The Company cannot predict market fluctuations in interest rates and their impact on its variable rate debt, nor can there be any assurance that fixed rate long-term debt will be available to the Company at favorable rates, if at all. Consequently, future results may differ materially from the estimated adverse changes discussed above.

Foreign Currency Risk. The Company transacts business in various foreign currencies, primarily in certain European countries, Canada and Australia. The Company does not have any hedging or similar foreign currency contracts. International revenues represented 29.8% of the Company s total revenues for the nine months ended September 30, 2003 and 28.2% of revenues were denominated in foreign currencies. Significant currency fluctuations may adversely impact foreign revenues. For the three and nine months ended September 30, 2003, the

Company realized transaction losses of $17,000 and $242,000, respectively, primarily due to intercompany receivables and payables between subsidiaries. The most significant of this exposure involves intercompany balances between Ireland and the United Kingdom. Given a hypothetical decrease of 10% in the Euro against the Great Britain pound, the realized transaction loss would increase by approximately $700,000 at September 30, 2003 and likewise decrease the Company s earnings and cash flows for the respective periods. Given a hypothetical increase of 10% in the Euro against the Great Britain pound, the realized transaction loss would decrease by approximately $700,000 at September 30, 2003, and likewise increase the Company s earnings and cash flows.

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Item 4 - Controls and Procedures

(a) Evaluation of disclosure controls and procedures:

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

(b) Changes in internal controls over financial reporting:

There was no significant change in the Company s internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1 - Legal Proceedings

The Company is subject to legal proceedings and claims in the normal course of business. The Company is currently defending these proceedings and claims, and it is the opinion of management that it will be able to resolve these matters in a manner that will not have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows. However, the results of legal proceedings cannot be predicted with certainty. Should the Company fail to prevail in any of these legal matters or should several of these legal matters be resolved against the Company in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

Item 6 - Exhibits and Reports on Form 8-K

(a) Index to Exhibits.

Exhibit Number	Exhibit Description

31.1	Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Epicor Software Corporation Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

The Company filed a Current Report on Form 8-K dated July 8, 2003, as amended, to report under Item 2 an acquisition of all of the outstanding stock of ROI Systems, Inc. and to file under Item 7, certain required financial information in connection with its acquisition of ROI Systems, Inc.

The Company filed a Current Report on Form 8-K dated July 23, 2003 to report under Items 7 and 12, the Company s July 23, 2003 press release announcing the Company s second quarter 2003 earnings.

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SIGNATURE

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.

EPICOR SOFTWARE CORPORATION

(Registrant)

Date: November 13, 2003

/s/ *MICHAEL A. PIRAINO*

Michael A. Piraino

Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)