# SECURITIES & EXCHANGE COMMISSION EDGAR FILING

## Support.com, Inc.

### Form: 10-Q

### Date Filed: 2002-05-15

| | |
|---|---|
| Corporate Issuer CIK: | 1104855 |
| Symbol: | SPRT |
| Fiscal Year End: | 12/31 |

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

# FORM 10-Q

(Mark One)

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

**For the Quarterly Period Ended March 31, 2002**

❑ **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. 000-30901**

# SUPPORTSOFT, INC.

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **Delaware** | **94-3282005** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

**575 Broadway**
**Redwood City, CA 94063**
(Address of Principal Executive Offices)

**Registrant's Telephone Number, Including Area Code: (650) 556-9440**

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 ❑

On May 15, 2002, 33,501,459 shares of the Registrant's Common Stock, $0.0001 par value, were outstanding.

**SUPPORTSOFT, INC.**

**FORM 10-Q**

**QUARTERLY PERIOD ENDED MARCH 31, 2002**

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## PART 1. FINANCIAL INFORMATION

### Item 1: Financial Statements

**SUPPORTSOFT, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(in thousands)**

| | March 31, 2002 | December 31, 2001 |
|---|---|---|
| | (unaudited) | |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 17,946 | $ 17,757 |
| Short term investments | 8,463 | 8,515 |
| Accounts receivable, net | 12,097 | 12,509 |
| Other current assets | 3,571 | 3,708 |
| Total current assets | 42,077 | 42,489 |
| Property and equipment, net | 2,169 | 1,932 |
| Purchased intangibles, net | 1,196 | 1,794 |
| Other assets | 158 | 148 |
| | $ 45,600 | $ 46,363 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,583 | $ 1,331 |
| Accrued compensation | 1,295 | 1,867 |
| Other accrued liabilities | 1,790 | 1,793 |
| Purchased technology obligation, current portion | 1,449 | 1,449 |
| Capital lease obligations, current portion | 611 | 569 |
| Deferred revenue | 11,976 | 12,535 |
| Total current liabilities | 18,704 | 19,544 |
| Capital lease obligations, net of current portion | 397 | 663 |
| Purchased technology obligation, net of current portion | 618 | 927 |
| Deferred revenue—long-term portion | 3,845 | 932 |
| Stockholders' equity: | | |
| Common stock | 3 | 3 |
| Additional paid-in capital | 107,839 | 108,031 |
| Notes receivable from stockholders | (1,523) | (1,523) |
| Deferred stock compensation | (108) | (997) |
| Accumulated other comprehensive income (loss) | (42) | 95 |
| Accumulated deficit | (84,133) | (81,312) |
| Stockholders' equity | 22,036 | 24,297 |
| | $ 45,600 | $ 46,363 |

See accompanying notes.

## SUPPORTSOFT, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
**(in thousands, except per share amounts; unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Revenue: | | |
| License fees | $ 6,587 | $ 6,494 |
| Services | 2,178 | 2,110 |
| Net revenue | 8,765 | 8,604 |
| Costs and expenses: | | |
| Cost of license fees | 65 | 230 |
| Cost of services | 1,372 | 1,848 |
| Amortization of purchased technology | 598 | 850 |
| Research and development | 2,275 | 3,439 |
| Sales and marketing | 5,592 | 7,400 |
| General and administrative | 1,339 | 1,505 |
| Amortization of deferred stock compensation (1) | 470 | 1,454 |
| Total costs and expenses | 11,711 | 16,726 |
| Loss from operations | (2,946) | (8,122) |
| Interest income (expense) and other, net | 125 | (62) |
| Net loss | (2,821) | (8,184) |
| Basic and diluted net loss per share | $ (0.09) | $ (0.27) |
| Shares used in computing basic and diluted net loss per share | 32,003 | 30,438 |

(1) Amortization of deferred stock compensation relates to the following:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Cost of services | $ 21 | $ 64 |
| Research and development | 93 | 288 |
| Sales and marketing | 169 | 525 |
| General and administrative | 187 | 577 |
| | $ 470 | $ 1,454 |

See accompanying notes.

**SUPPORTSOFT, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands; unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Operating Activities | | |
| Net loss | $ (2,821) | $ (8,184) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 583 | 560 |
| Amortization of deferred stock compensation | 470 | 1,454 |
| Amortization of purchased technology | 598 | 850 |
| Provision for bad debts | (364) | 460 |
| Other | (85) | (337) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 776 | (1,795) |
| Prepaid and other current assets | 137 | (377) |
| Accounts payable | 252 | 2,736 |
| Accrued compensation | (572) | (592) |
| Other accrued liabilities | (3) | (1,177) |
| Deferred revenue | 2,354 | 80 |
| Net cash used in operating activities | 1,325 | (5,985) |
| Investing Activities | | |
| Purchases of property and equipment | (820) | (820) |
| Other assets | (10) | (35) |
| Purchases of technology | (309) | — |
| Purchases of short-term investments | (3,000) | (17,309) |
| Sales and maturities of short-term investments | 3,000 | 34,464 |
| Net cash provided by (used in) investing activities | (1,139) | 16,300 |
| Financing Activities | | |
| Proceeds from issuances of common stock, net of repurchases | 227 | 1,170 |
| Repayment of shareholder notes | — | 100 |
| Principal payments under capital lease obligations | (224) | (151) |
| Net cash provided by financing activities | 3 | 1,119 |
| Net increase in cash and cash equivalents | 189 | 11,434 |
| Cash and cash equivalents at beginning of period | 17,757 | 11,756 |
| Cash and cash equivalents at end of period | $17,946 | $ 23,190 |

See accompanying notes.

SUPPORTSOFT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

## (1) Significant Accounting Policies:

### Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of SupportSoft (formerly known as Support.com, Inc.) and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The balance sheet at March 31, 2002 and the statements of operations for the three months ended March 31, 2002 and 2001 and cash flows for the three months ended March 31, 2002 and 2001 are unaudited. In the opinion of management, these financial statements reflect all adjustments (consisting of normal reoccurring adjustments) that are necessary for a fair presentation of the results for and as of the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The condensed consolidated financial statement information as of December 31, 2001 is derived from audited financial statements as of that date. These financial statements should be read with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 29, 2002. Certain prior period balances have been reclassified to conform to current period presentation.

### Financial Instruments

Estimated fair values of financial instruments are based on quoted market prices. The following is a summary of available-for-sale securities (in thousands) at March 31, 2002:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Cash | $ 2,482 | $ — | $ — | $ 2,482 |
| Money market funds | 15,464 | — | — | 15,464 |
| Federal agencies | 8,436 | 27 | — | 8,463 |
| | $ 26,382 | $ 27 | $ — | $ 26,409 |
| Classified as: | | | | |
| Cash and cash equivalents | $ 17,946 | — | — | $ 17,946 |
| Short-Term Investments | 8,436 | 27 | — | 8,463 |
| | $ 26,382 | $ 27 | $ — | $ 26,409 |

### Revenue Recognition

License revenue is comprised of fees for term and perpetual licenses of SupportSoft's software by corporate customers and resellers. Term licenses are sold with maintenance for which SupportSoft does not have vendor specific objective evidence (VSOE) to determine fair value as maintenance is not priced or offered separately in term licensing arrangements. SupportSoft therefore recognizes maintenance revenue and the term license fees over the service period of the arrangement as license revenue. If any portion of the fee for a term license with maintenance is payable in excess of 12 months from the date of the agreement, as is the case with the majority of our term license arrangements, the fee is considered to not be fixed or determinable and revenue is recognized ratably over the service period of the agreement commencing in the month in which the first payment is due. Revenue from perpetual license fees is recognized when persuasive evidence of an arrangement exists, the software product has been delivered, there are no uncertainties surrounding product acceptance, the fee is fixed or determinable and collectibility is probable.

License revenue from arrangements with resellers is recognized upon delivery limited by guaranteed minimum amounts received or due under the arrangement or sell through activity.

Services revenue is primarily comprised of revenue from professional services, such as consulting services and training and also includes maintenance under perpetual license arrangements.

**Concentration of Credit Risk and Significant Customers**

SupportSoft performs ongoing evaluations of its customers' financial condition and generally does not require collateral. SupportSoft maintains reserves for credit losses, and such losses have been within management's expectations. If the financial condition of SupportSoft's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional reserves may be required. The Company had reserves for credit losses at March 31, 2002 and December 31, 2001 of $464,000 and $828,000, respectively.

For the quarter ended March 31, 2002, one single customer accounted for 18% of total revenue, no other customer accounted for more than 10% of total revenue. For the quarter ended March 31, 2001, one single customer accounted for 12% of total revenue, no other customer accounted for more than 10% of total revenue.

**Net Loss Per Common Share**

Basic and diluted net loss per share are presented in accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("FAS 128"), for all periods presented.

Basic and diluted net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase.

Had SupportSoft been in a net income position, diluted earnings per share would have included the shares used in the computation of basic net loss per share as well as the impact of common shares outstanding subject to repurchase and outstanding options and warrants to purchase an additional 7,965,738 and 7,801,572 shares, prior to the application of the treasury stock method, for the three months ended March 31, 2002 and 2001. Such shares have been excluded because they are antidilutive for all periods presented.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share data):

| | Three months ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Net loss attributable to common shareholders | $ (2,821) | $ (8,184) |
| Basic and diluted: | | |
| Weighted-average shares of common stock outstanding | 33,450 | 33,254 |
| Less: Weighted-average shares subject to repurchase | (1,447) | (2,816) |
| Shares used in computing basic and diluted net loss per share | 32,003 | 30,438 |
| Basic and diluted net loss per share attributable to common stockholders | $ (0.09) | $ (0.27) |

**(2) Purchased Intangibles**

On September 20, 2000, SupportSoft purchased source code and other related intellectual property rights from ePeople, Inc. (formerly known as NoWonder, Inc.) for $6.8 million The purchase price was recorded as purchased intangibles and included as an other asset in the Company's consolidated balance sheet. The Company paid $3.4 million during the year ended December 31, 2000, and will pay an additional $3.4 million in equal quarterly installments through the quarter ended September 30, 2003. The purchased technology is being amortized on a straight-line basis over two years. Total amortization related to the purchased intangibles for the three months ended March 31, 2002 was $598,000 and for the three months ended March 31, 2001 was $850,000.

**(3) Recently Issued Accounting Standards**

In July 2001, the FASB issued SFAS 141, “Business Combinations.” SFAS 141 supersedes APB 16, “Business Combinations,” and SFAS 38, “Accounting for Preacquisition Contingencies of Purchased Enterprises.” SFAS 141 requires the purchase method of accounting for all business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The adoption of SFAS 141 during the quarter ended March 31, 2002 did not have a material effect on the Company’s financial condition or results of operations.

In July 2001, the FASB issued SFAS 142, “Goodwill and Other Intangible Assets.” SFAS 142 supersedes APB 17, “Intangible Assets,” and requires the discontinuance of goodwill amortization. In addition, SFAS 142 includes provisions regarding the reclassification of certain existing recognized intangibles as goodwill, reassessment of useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. SFAS 142 is required to be applied for fiscal years beginning after December 15, 2001, with certain early adoption permitted. The adoption of SFAS 142 during the quarter ended March 31, 2002 did not have a material effect on the Company’s financial condition or results of operations.

In October 2001, the FASB issued SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” which supersedes SFAS 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.” SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. However, SFAS 144 retains the fundamental provisions of SFAS 121 for: 1) recognition and measurement of the impairment of long-lived assets to be held and used: and 2) measurement of long-lived assets to be disposed of by sale. SFAS 144 is effective for fiscal years beginning after December 15, 2001. The adoption of SFAS 144 during the quarter ended March 31, 2002 did not have a material effect on the Company’s financial condition or results of operations.

**(4) Comprehensive Loss**

Statement of Financial Accounting No. 130, “Reporting Comprehensive Income” (“SFAS 130”) establishes standards for reporting and displaying comprehensive net income and its components in stockholders’ equity. However, it has no impact on our net income as presented in our financial statements. SFAS 130 requires foreign currency translation adjustments and changes in the fair value of available-for-sale securities to be included in comprehensive income.

The following are the components of comprehensive loss: (in thousands)

| | Three months ended March 31, | |
|---|---|---|
| | **2002** | **2001** |
| Net loss | $ (2,821) | $ (8,184) |
| Net unrealized gain (loss) on available-for-sale securities | (35) | 31 |
| Translation adjustment gain (loss) | (102) | (4) |
| Comprehensive loss | $ (2,958) | $ (8,157) |

The components of accumulated other comprehensive loss relate entirely to unrealized gains (losses) on available-for-sale securities and translation adjustment gains (losses) and are $(42,000) at March 31, 2002 and $54,000 at March 31, 2001.

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report on Form 10-Q contains forward-looking statements. These statements relate to our, and in some cases our customers', or alliance partners', future plans, objectives, expectations, intentions and financial performance, as well as statements as to expected net losses, expected cash flows, the adequacy of capital resources, growth in operations, the ability to compete and respond to technological change and the acceptance and performance of our products and services. In some cases, you can identify forward-looking statements because they use terms such as anticipates, believes, continue, could, estimates, expects, intends, may, plans, potential, predicts, should or will or the negative of those terms or other comparable words. These statements involve risks and uncertainties that may cause our actual results, activities or achievements to be materially different from those expressed or implied by these statements. These risks and uncertainties include those listed under Factors that May Affect Future Results and Management's Discussion and Analysis of Financial Condition and Results of Operations. These financial statements should be read in conjunction with the financial statements and related notes included in SupportSoft's Annual Report on Form 10-K for the year ended December 31, 2001, filed with the Securities and Exchange Commission on March 29, 2002.

SupportSoft expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this report to conform these statements to actual results or changes in our expectations or in events, conditions or circumstances on which any such statement is based. You should not place undue reliance on these forward-looking statements, which apply only as of the date hereof.

### Overview

SupportSoft is a leading provider of support automation software. SupportSoft sells to corporate enterprises, service providers and personal computer and device manufacturers that utilize its software platform to increase the efficiency and effectiveness of their support operations, while improving user responsiveness and satisfaction. SupportSoft sells its products primarily in the United States and, to a lesser extent in Europe, Asia, and Latin America through its direct and indirect sales force.

Substantially all of SupportSoft's revenue has come from the license of our software products and from related services. We market our products through a combination of direct sales, resellers and support outsourcers.

We license our software under term and perpetual licenses. Term license revenue is recognized ratably over the service period of the agreement. Term licenses typically have a duration of 36 months, with pre-payments generally made at the beginning of each 12 month period. We began licensing software under term arrangements in June 1999. A majority of the licenses executed to date have been term-based.

### RESULTS OF OPERATIONS

The following table sets forth the results of operations for the three months ended March 31, 2002 and 2001 expressed as a percentage of total revenue.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Revenue: | | |
| License fees | 75% | 75% |
| Services | 25 | 25 |
| Net revenue | 100 | 100 |
| Costs and expenses: | | |
| Cost of license fees | 1 | 3 |
| Cost of services | 16 | 21 |
| Amortization of purchased technology | 7 | 10 |
| Research and development | 26 | 40 |
| Sales and marketing | 64 | 86 |
| General and administrative | 15 | 17 |
| Amortization of deferred stock compensation | 5 | 17 |
| Total costs and expenses | 134 | 194 |
| Loss from operations | (34) | (94) |
| Interest income (expense) and other, net | 2 | (1) |
| Net loss | (32)% | (95)% |

### Three Months Ended March 31, 2002 and 2001

### Revenue

Total revenue increased 2% to $8.8 million in the three months ended March 31, 2002 from $8.6 million in the three months ended March 31, 2001.

International revenue represented 12% of total revenue for the three months ended March 31, 2002 compared with 20% for the three months ended March 31, 2001.

One customer accounted for 18% of our total revenue for the three months ended March 31, 2002. No other single customer accounted for 10% or more of our total revenue in this period.

*License revenue*

License revenue increased to $6.6 million in the three months ended March 31, 2002 from $6.5 million in the three months ended March 31, 2001. The increase in license revenue was due primarily to greater demand for and market acceptance of our software products. For the quarters ended March 31, 2002 and 2001, revenue from perpetual licenses as a percentage of license fees was 38% and 29%, and as a percentage of total revenue was 29% and 22%, respectively.

*Services revenue*

Service revenue increased to $2.2 million in the three months ended March 31, 2002 from $2.1 million in the three months ended March 31, 2001. This increase was due primarily to increased maintenance revenue associated with the growth in our customer base from prior year and the overall number of maintenance contracts. For the three months ended March 31, 2002 and 2001, services revenue from implementation, consulting and training services remained consistent.

### Cost of Revenue

*Cost of license fees*

Cost of license revenue consists primarily of costs related to license fees paid to third parties under technology license arrangements. Cost of license revenue decreased to $65,000 in the three months ended March 31, 2002 from $230,000 in the three months ended March 31, 2001. The decrease was primarily due to a decrease in fees paid for third party technology that is sold with our products.

*Cost of services revenue*

Cost of services consists primarily of salaries, travel costs net of reimbursements, related overhead expenses and payments made to third parties for consulting services. Cost of services revenue decreased to $1.4 million in the three months ended March 31, 2002 from $1.8 million in the three months ended March 31, 2001. This decrease was primarily due to a reduction in salary and travel expenses.

***Amortization of Purchased Intangibles***

Amortization of purchased intangibles was $598,000 for the three months ended March 31, 2002 compared to $850,000 for three months ended March 31, 2001. The amortization of purchased technology relates to the acquisition of source code and related intellectual property rights from ePeople, Inc in September 2000. This decrease is attributable to lower than expected payments made to ePeople pursuant to the acquisition agreement. We expect to amortize approximately $598,000 per quarter for the next two quarters related to this technology acquisition.

***Research and Development Expense***

Research and development expense consists primarily of payroll and consulting expenses and related costs for research and development personnel. Research and development expense decreased to $2.3 million in the three months ended March 31, 2002 from $3.4 million in the three months ended March 31, 2001. The decrease was due primarily to a reduction in salary and third party consulting expenses.

***Sales and Marketing Expense***

Sales and marketing expense consists primarily of payroll expense, including salaries and commissions and promotional expenses, including public relations, advertising and trade shows. Sales and marketing expense decreased to $5.6 million in the three months ended March 31, 2002 from $7.4 million in the three months ended March 31, 2001. The decrease was due to a number of factors including a reduction in salary, travel and consulting expenses and a reduction in promotional expenses, including public relations and trade shows.

***General and Administrative Expense***

General and administrative expense consists primarily of payroll expense and related costs of administrative personnel and professional fees for legal, accounting and other professional services. General and administrative expense decreased to $1.3 million in the three months ended March 31, 2002 from $1.5 million in the three months ended March 31, 2001. The decrease was due primarily to a reduction in salary expense and legal services.

***Amortization of Deferred Stock Compensation***

We amortized deferred compensation expense of approximately $470,000 during the three months ended March 31, 2002 as compared to $1.5 million during the same period in 2001. This compensation expense relates to options awarded to individuals in all operating expense categories. Total remaining deferred compensation at March 31, 2002 of approximately $108,000 is being amortized over the remaining vesting periods of the options using a graded vesting method and will be fully amortized during the remainder of 2002.

***Interest Income (Expense) and Other, Net***

Interest income and other, net was $125,000 for the three months ended March 31, 2002, as compared to interest expense and other, net of $62,000 in the same period in 2001. The increase in interest income and other, net was primarily due to a write-down in the first quarter of 2001 of $700,000 associated with our investment in commercial paper of a utility company which went bankrupt. Had the Company not taken this write down in the first quarter of 2001, interest income and other, net would have decreased by $513,000 due to lower cash and investment balances and lower interest rates. The investment write-down was fully recovered by the company during the three month period ended June 30, 2002. For the first quarter of 2002, interest income and other, net consists primarily of interest earned on cash, cash equivalents and short-term investments.

## LIQUIDITY AND CAPITAL RESOURCES

Since our incorporation in December 1997, we have financed our operations primarily through the private placement of our preferred and common stock, and to a lesser extent through bank borrowings and capital equipment lease financing. In July 2000, we completed our initial public offering from which we received net proceeds of approximately $61.8 million.

### *Operating Activities*

Net cash provided by operating activities was $1.3 million in the three months ended March 31, 2002, an increase of $7.3 million over the $6.0 million used in operating activities during the three month period ended March 31, 2001. Amounts included in net loss, which do not require the use of cash, including amortization of deferred stock compensation, amortization of purchased intangibles, depreciation of fixed assets and the provision of bad debt, amounted to $1.2 million for the three months ended March 31, 2002 compared to $3.0 million for the three months ended March 31, 2001. Net cash provided by operating activities in the three month period was primarily the result of an increase of $2.4 million in deferred revenue and a decrease in accounts receivable of $776,000, offset by a net loss of $2.8 million and a combined increase in accrued compensation and other accrued liabilities of $575,000.

### *Investing Activities*

Net cash used in investing activities was $1.1 million in the three months ended March 31, 2002, a decrease of $17.4 million over the $16.3 million provided by investing activities in the comparable period ended March 31, 2001. Net cash used in investing activities for the three months ended March 31, 2002, was primarily due to the purchase of $820,000 in property and equipment and the purchase of $3.0 million in short-term investments offset by the sale and maturity of $3.0 million in short-term investments.

### *Financing Activities*

Net cash provided by financing activities was $3,000 for the three months ended March 31, 2002 and $1.1 million for the three months ended March 31, 2001. For the period ended March 31, 2002, cash provided by financing activities was attributable primarily to net proceeds from the purchase of common stock under the Employee Stock Purchase Plan offset by the repayment of principal payments under capital lease obligations.

### *Commitments*

As of March 31, 2002, our principal commitments consisted of obligations outstanding under capital and operating leases. We anticipate requiring minimal additional space in the next 12 months. The following summarizes our contractual obligations as of December 31, 2001 and the effect these contractual obligations are expected to have on our liquidity and cash flows in future periods (in thousands).

| | Payments Due By Period | | | |
|---|---|---|---|---|
| | Total | 1 Year or Less | 1–3 Years | After 3 Years |
| Purchased technology | $ 2,376 | $ 1,449 | $ 927 | $ — |
| Capital lease obligations | 1,232 | 569 | 663 | — |
| Operating leases | 1,663 | 611 | 668 | 384 |
| Total | $ 5,271 | $ 2,629 | $ 2,258 | $ 384 |

Subsequent to December 31, 2001, we signed a new lease for our corporate headquarters in Redwood City, California. In conjunction with the new lease, we have future lease commitments of $720,000 in 2002 and $300,000 in 2003.

### *Working Capital and Capital Expenditure Requirements*

We believe that our existing cash balances will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. We evaluate potential acquisitions of other businesses, products and technologies and may in the future require additional equity or debt financings to accomplish any potential acquisitions.

If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional equity or debt securities. The sale of additional equity or debt securities could result in more dilution to our stockholders. Financing arrangements may not be available to us, or may not be available in amounts or on terms acceptable to us.

## Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Our significant accounting policies are described in Note 1 to the consolidated financial statements. The items in our financial statements requiring significant estimates and judgments include revenue recognition and allowance for bad debt.

### *Revenue Recognition*

We license our software under term and perpetual licenses. License revenue is generally recognized when a customer agreement has been signed, the software product has been delivered, there are no uncertainties surrounding product acceptance, the fees are fixed or determinable, and collection is considered probable. If any of these criteria are not met, revenue recognition is deferred until all of the criteria are met. We sell our term licenses with maintenance for which we do not have vendor specific objective evidence to determine fair value. As a result, license revenue for term licenses is recognized ratably over the service period of the agreement, and license revenue includes maintenance for term licenses. We do not allocate maintenance revenue from term licenses to services revenue as we do not believe there is an allocation methodology that provides a meaningful and supportable allocation between license and maintenance revenues. SupportSoft considers all arrangements with payment terms extending beyond 12 months and other arrangements with payment terms longer than normal not to be fixed or determinable. If the fee is determined not to be fixed or determinable, revenue is recognized as payments become due from the customer. License revenue from arrangements with resellers is recognized ratably over the term of the arrangement commencing when payments are received or become due limited by guaranteed minimum amounts received or due under the arrangement or sell through activity.

Term licenses typically have a duration of 36 months, with pre-payments generally billed to the customer at the beginning of each 12 month period. If we receive an order from a customer for a 36-month term license in December of a year, we would recognize only one month of license fees for that year even if that customer prepaid 12 months of the 36-month term. Pursuant to this agreement, the Company would record one year of contract fees in accounts receivable upon signing a new term license agreement, while recognizing only one month of revenue. As a result, our accounts receivable balance could represent a significant portion of our total revenue and increase our days sales outstanding (DSO) calculation. We began licensing software under term arrangements in June 1999. A majority of the licenses executed to date have been term-based.

Term and perpetual licensing arrangements may include service elements. Services revenue is primarily comprised of revenue from professional services, such as consulting services, training, maintenance and support. Arrangements that include software services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When software services are considered essential, revenue under the arrangement is recognized using contract accounting. When software services are not considered essential, the revenue related to the software services is recognized as the services are performed.

*Allowance for Bad Debt*

SupportSoft maintains reserves for estimated credit losses resulting from the inability of its customers to make required payments. A considerable amount of judgment is required when we assess the realization of receivables, including assessing the probability of collection and the current credit-worthiness of each customer. If the financial condition of SupportSoft's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional reserves may be required.

**Factors that May Affect Future Results**

**We have a history of losses and if we do not become profitable, we may not be able to continue to operate.**

We incurred net losses of approximately $84.1 million for the period from December 3, 1997 through March 31, 2002. If we do not become profitable within the timeframe we predicted or expected by securities analysts or investors, the market price of our stock will likely decline. If we continue to incur net losses, we may not be able to increase our number of employees or our investment in capital equipment, sales, marketing and research and development programs. We do not know when or if we will become profitable. If we do achieve profitability, we may not sustain or increase profitability in the future and therefore may not be able to continue to operate. However, we believe that our existing cash balances will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

**Our quarterly results are difficult to predict and may fluctuate. If we do not meet quarterly financial expectations, our stock price would likely decline.**

Because of our limited operating history, our quarterly revenue and operating results are difficult to predict and may fluctuate from quarter to quarter. Our operating results in some quarters may fall below our predictions or the expectations of securities analysts or investors, which would likely cause the market price of our common stock to decline.

Several factors are likely to cause fluctuations in our operating results, including:

- demand for our support automation software;
- the price and mix of products and services we or our competitors offer;
- our ability to retain customers; and
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, infrastructure and marketing activities.

**Our quarterly results depend on the size of a small number of orders, so the delay or loss of any single large order during a quarterly period, and especially an order for a perpetual license rather than a term license, could harm that quarter's results and cause our stock price to decline.**

Our operating results could suffer if any large orders are delayed or cancelled in any future period. Each quarter, we derive a significant portion of our license revenue from a small number of relatively large orders for the licensing of our support automation software. We license our support automation software under perpetual and term licenses. Perpetual licenses typically result in our recognition of a larger amount of revenue in the quarter in which the license is granted as compared with term licenses. Revenue from a perpetual license is generally recognized upon delivery of a product. Revenue from a term license is recognized on a monthly basis over the agreement term, which is typically three years. We expect that we will continue to depend upon a small number of large orders for a significant portion of our license revenue.

**Because a small number of customers have historically accounted for and may in future periods account for substantial portions of our revenue, our revenue could decline because of delays of customer orders or the failure of existing customers to renew licenses.**

For the three months ended March 31, 2002, one customer accounted for 18% of our total revenue. Because we have a small number of customers and a few customers are likely to continue to account for a significant portion of our revenue, our revenue could decline because of the loss or delay of a single customer order or the failure of an existing customer to renew its term license. We may not obtain additional customers. The failure to obtain additional customers, the loss or delay of customer orders and the failure of existing customers to renew licenses will harm our operating results.

**Our sales cycle can be lengthy and if revenue forecasted for a particular quarter is not realized in that quarter, significant expenses incurred may not be offset by corresponding sales.**

Our sales cycle for our support automation software can range from one week to nine months or more and may vary substantially from customer to customer. While our customers are evaluating our products and services, we may incur substantial sales and marketing expenses and spend significant management effort. Any delay in completing sales in a particular quarter could cause our operating results to be below expectations.

**We must achieve broad adoption and acceptance of our support automation products and services or we will not increase our market share or grow our business.**

We must achieve broad market acceptance and adoption of our products and services or our business and operating results will suffer. Specifically, we must encourage our customers to transition from using traditional support methods. To accomplish this, we must:

- continually improve the performance, features and reliability of our products and services to address changing industry standards and customer needs; and
- develop integration with other support-related technologies.

**Our product innovations may not achieve the market penetration or price stability necessary for profitability.**

If we fail to develop, in a timely manner, new or enhanced versions of our support automation software or to provide new products and services that achieve rapid and broad market acceptance or price stability, we may not become profitable. We may fail to identify new product and service opportunities successfully. Our existing products will become obsolete if we fail to introduce new products or product enhancements that meet new customer demands, support new standards or integrate with new or upgraded versions of packaged applications. We may have little or no control over the factors that might influence market acceptance of our products and services. These factors include:

- the willingness of enterprises to transition to automated support and
- acceptance of competitors' automated support solutions.

**Our software may not operate with the hardware and software platforms that are used by our customers now or in the future, and as a result our business and operating results may suffer.**

We currently serve a customer base with a wide variety of constantly changing hardware, packaged software applications and networking platforms. If there is widespread adoption of other operating system environments, and if we fail to release versions of our support automation software that are compatible with these other operating systems, our business and operating results will suffer. Our future success also depends on:

- our ability to integrate our product with multiple platforms and to modify our product as new versions of packaged applications are introduced;
- the number of different operating systems and databases that our product can work with; and
- our management of software being developed by third parties for our customers or for use with our products.

**We rely on third-party technologies and our inability to use or integrate third-party technologies could delay product or service development.**

We intend to continue to license technologies from third parties, including applications used in our research and development activities and technologies, which are integrated into our products and services. Our inability to obtain or integrate any of these licenses could delay product and service development until equivalent technology can be identified, licensed and integrated. These technologies may not continue to be available to us on commercially reasonable terms or at all. We may fail to successfully integrate any licensed technology into our products or services. This would harm our business and operating results. Third-party licenses also expose us to increased risks that include:

- risks of product malfunction after new technology is integrated;
- the diversion of resources from the development of our own proprietary technology; and
- our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

**We may engage in future acquisitions or investments that could dilute our existing stockholders, or cause us to incur significant expenses.**

We may acquire or invest in complementary businesses, technologies or products. If we are unable to use or integrate any newly acquired entities or technologies effectively or profitably, our operating results could suffer. Acquisitions by us could also result in large and immediate write-offs, incurrence of debt and contingent liabilities or amortization of expenses related to goodwill and other intangibles, which could harm our operating results. Additional funds to finance any acquisitions may not be available on terms that are favorable to us, or at all, and, in the case of equity financings, may dilute our stockholders.

**We may lose the services of our key personnel, which in turn would harm the market's perception of our business and our ability to achieve our business goals.**

Our success will depend on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel. The loss of the services of any of our senior management or other key personnel, including our chief executive officer, Radha R. Basu, our chief financial officer, Brian Beattie, our chief technical officer, Scott W. Dale, and our chief software officer, Cadir B. Lee, could harm the market's perception of our business and our ability to achieve our business goals.

**Our failure to establish and expand strategic alliances would harm our ability to achieve market acceptance of our support automation software.**

If we fail to maintain, establish or successfully implement strategic alliances, our ability to achieve market acceptance of our automation software will suffer and our business and operating results will be harmed. Specifically, we must establish and extend existing distribution alliances with specialized technology and services firms such as support outsourcers. We must also establish and extend existing solutions alliances with leading providers of complementary support technologies, including call center or help desk management companies, knowledge management companies and systems management firms.

**Our products depend on and work with products containing complex software and if our products fail to perform properly due to errors or similar problems in the software, we may need to spend resources to correct the errors or compensate for losses from these errors and our reputation could be harmed.**

Our products depend on complex software, both internally developed and licensed from third parties. Also, our customers may use our products with other companies' products which also contain complex software. Complex software often contains errors. These errors could result in:

- delays in product shipments;
- unexpected expenses and diversion of resources to identify the source of errors or to correct errors;
- damage to our reputation;
- lost sales;
- product liability claims; and
- product returns.

**Our system security is important to our customers and we may need to spend significant resources to protect against or correct problems caused by security breaches.**

A fundamental requirement for online communications, transactions and support is the secure transmission of confidential information. Third parties may attempt to breach our security or that of our customers. We may be liable to our customers for any breach in security and any breach could harm our business and reputation. Also, computers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We may be required to expend significant capital and other resources to further protect against security breaches or to correct problems caused by any breach.

**We may face claims of invasion of privacy or inappropriate disclosure, use or loss of our customers' information and any liability imposed could harm our reputation and cause us to lose customers.**

Our software contains features which may allow us or our customers to control, monitor or collect information from computers running the software without notice to the computing users. Therefore we may face claims about invasion of privacy or inappropriate disclosure, use or loss of this information. Any imposition of liability could harm our operating results.

**We have limited experience in international operations and if our revenue from international operations does not exceed the expense of establishing and maintaining our international operations, our business could suffer.**

We intend to expand further into international markets. We have limited experience in international operations and may not be able to compete effectively in international markets. If we do not generate enough revenue from international operations to offset the expense of these operations, our business could suffer. Risks we face in conducting business internationally include:

- difficulties and costs of staffing and managing international operations;
- differing technology standards;
- longer sales cycles and collection periods;
- changes in currency exchange rates and controls;
- dependence on local vendors; and

- the effects of the terrorist attacks in the United States and the effects of the war on terrorism and any related conflicts or similar events worldwide.

**Any system failure that causes an interruption in our customers' ability to use our products or services or a decrease in their performance could harm our relationships with our customers and result in reduced revenue.**

Our software may depend on the uninterrupted operation of our internal and outsourced communications and computer systems. These systems are vulnerable to damage or interruption from computer viruses, human error, natural disasters and intentional acts of vandalism and similar events. We have no formal disaster recovery plan and business interruption insurance may not be enough to compensate us for losses that occur. These problems could interrupt our customers' ability to use our support automation products or services which could harm our reputation and cause us to lose customers and revenue.

**We may not obtain sufficient patent protection, and this could harm our competitive position and increase our expenses which would harm our business.**

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology. It is possible that:

- our pending patent applications may not be issued;

- competitors may independently develop similar technologies or design around any of our patents;

- patents issued to us may not be broad enough to protect our proprietary rights; and

- our issued patents could be successfully challenged.

**We rely upon trademarks, copyrights and trade secrets to protect our proprietary rights and if these rights are not sufficiently protected, it could harm our ability to compete and to generate revenue.**

We also rely on a combination of laws, such as copyright, trademark and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. Our ability to compete and grow our business could suffer if these rights are not adequately protected. Our proprietary rights may not be adequately protected because:

- laws and contractual restrictions may not prevent misappropriation of our technologies or deter others from developing similar technologies; and

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the extent of this unauthorized use.

Also, the laws of other countries in which we market our products may offer little or no protection of our proprietary technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for them, which would harm our competitive position and market share.

**We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.**

Other parties may assert intellectual property infringement claims against us and our products may infringe the intellectual property rights of third parties. Intellectual property litigation is expensive and time-consuming and could divert management's attention from our business. If there is a successful claim of infringement, we may be required to develop non-infringing technology or enter into royalty or license agreements which may not be available on acceptable terms, if at all. Our failure to develop non-infringing technologies or license the proprietary rights on a timely basis would harm our business. Our products may infringe issued patents that may relate to our products.

Also, patent applications may have been filed by third parties which relate to our software products. The adoption of the new trademark and corporate name SupportSoft increases the risk that a prior user could view the mark or name to be confusingly similar to the prior user's mark or name. Although the we have conducted limited trademark and trade name searches, and do not believe the SupportSoft trademark and corporate name will infringe any known party's trademark rights, it is possible that a third party will claim our use of SupportSoft infringes its trademark.

**We must compete successfully in the support automation market or we will lose market share and our business will fail.**

The market for our products is intensely competitive, rapidly changing and significantly affected by new product introductions and other market activities of industry participants. Competitive pressures could reduce our market share or require us to reduce the price of products and services and therefore our gross margin, which could harm our business and operating results. Our integrated software solution competes against various vendors' software products designed to accomplish specific elements of a complete support automation solution. For example,in the market for automated delivery of support solutions, we compete with Motive Communications, Inc.

We may encounter competition from companies such as:

- customer communications software companies;
- question and answer companies;
- customer relationship management solution providers;
- consolidated service desk solution vendors;
- Internet infrastructure companies; and
- operating systems providers.

Our potential competitors may have longer operating histories, significantly greater financial, technical, and other resources or greater name recognition than we do. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements. If we fail to compete effectively, we may lose or be unable to expand our market share and our business and operating results would suffer.

**Because our support automation software is designed to support businesses operating over the Internet, our success depends on the continued growth and levels of performance of Internet usage.**

Because a majority of our products are designed to support businesses operating over the Internet, the success of our business will depend on the continued improvement of the Internet as a convenient means of consumer interaction and commerce, as well as an efficient medium for the delivery and distribution of information by enterprises to their employees and extended enterprise. Because global commerce on the Internet and the online exchange of information is evolving, we cannot predict whether the Internet will continue to be a viable commercial marketplace.

**We may experience a decrease in market demand due to the slowing economy in the United States which has been further stymied by the recent outbreak of terrorism, war and social and political instability.**

Economic growth has slowed significantly, and some analysts believe the United States economy will experience a recession. In addition, the recent terrorists attacks in the United States may further add to the decline in the United States economy. The war on terrorism, along with the effects of the terrorist attack and other similar events, could have contributed to the further slowdown of the already slumping market demand for goods and services, including support automation software. If the economy continues to decline as a result of the recent economic, political and social turmoil, or if there are further terrorist attacks in the United States or elsewhere, we may experience decreases in the demand for our products and services, which may harm our operating results.

**Governmental regulation and legal changes could impair the growth of the Internet and decrease demand for our products or increase our cost of doing business.**

The laws and regulations that govern our business change rapidly. Any change in laws and regulations could impair the growth of the Internet and could reduce demand for our products, subject us to liability or increase our cost of doing business. The United States government and the governments of states and foreign countries have attempted to regulate activities on the Internet and the distribution of software. Also, in 1998, Congress passed the Internet Freedom Act, which imposes a three-year moratorium on state and local taxes on Internet-based transactions. Failure to renew this moratorium would allow states to impose taxes on e-commerce. This might harm our business directly and indirectly by harming the businesses of our customers, potential customers and the parties to our business alliances. The applicability to the Internet of existing laws governing issues is uncertain and may take years to resolve. Evolving areas of law that are relevant to our business include privacy laws, intellectual property laws, proposed encryption laws, content regulation and sales and use tax laws and regulations.

**We may experience power blackouts and higher electricity prices if there is a recurrence of California's recent energy crisis, which could disrupt our operations and increase our expenses.**

California recently experienced an energy crisis. If this were to occur again, it could disrupt our operations and increase our expenses. We rely on the major Northern California public utility, Pacific Gas & Electric Company, or PG&E, to supply electric power to our headquarters in Northern California. Due to problems associated with the de-regulation of the power industry in California and shortages in wholesale electricity supplies, customers of PG&E have been faced with increased electricity prices, power shortages and, in some cases, rolling blackouts. If blackouts interrupt our power supply, we may be temporarily unable to continue to operate our central computer, hardware and support systems. Any interruption in our ability to continue our operations could delay our ability to develop or provide our products and support services, which could damage our reputation and result in lost revenue, either of which could substantially harm our business and results of operations.

## ITEM 3: QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

### Qualitative and Quantitative Disclosures about Market Risk

We develop products in the United States and market and sell in North America, South American, Asia and Europe. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Because of the nature of our short-term investments, we have concluded that there is no material market risk exposure.

Our investment policy requires us to invest funds in excess of operating requirements in:

- obligations of the U.S. government and its agencies;

- investment grade state and local government obligations;

- and money market funds, deposits or notes issued or guaranteed by U.S. and non-U.S. commercial banks, meeting credit rating and net worth requirements with maturities of less than two years.

At March 31, 2002, our cash and cash equivalents consisted primarily of money market funds held by large institutions in the U.S. and our short-term investments consisted of government debt securities maturing in less than eighteen months.

## PART II: OTHER INFORMATION

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K:

During the quarter ended March 31, 2002, the Registrant filed the following reports on Form 8-K:

| Date Filed | Date of Report | Item Number | Financial Statements Required |
|---|---|---|---|
| March 22, 2002 | March 22, 2002 | 5. Other events | None |

## 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.

May 15, 2002

SUPPORTSOFT, INC.

By: /s/ BRIAN BEATTIE

Brian Beattie
Senior Vice President of Finance and Administration and
Chief Financial Officer
(Principal Financial Officer and Chief Accounting Officer