EVOLVE SOFTWARE INC
Form 10-K/A
October 26, 2001

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 000-31155

EVOLVE SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	94-3219745
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1400 65TH STREET, SUITE 100, EMERYVILLE, CA	94608
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (510) 428-6000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $0.001 par value

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K. [_]

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of September 27, 2001, was approximately $8,058,342 based upon the closing sale price reported for that date on the NASDAQ National Market. Shares of common stock held by each officer and director and by each person who owns more than 5% or more of the outstanding common stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive for other purposes.

The number of shares outstanding of the registrant's common stock as of September 27, 2001, was 40,836,547.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for registrant's 2001 Annual Meeting of Stockholders to be held in November 2001 are incorporated by reference in Part III of this Annual Report on Form 10-K.

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EVOLVE SOFTWARE, INC.

FORM 10-K
FOR THE FISCAL YEAR ENDED JUNE 30, 2001
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This amended Annual Report on Form 10-K/A contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. A word such as "expects," "anticipates," "intends," "believes" or similar language identifies forward-looking statements. These forward-looking statements include, among other things, statements about our anticipated growth strategies, the trends we see in our business and the markets in which we operate, the features and functionality of our products, our expectations for our future performance and the market acceptance of our products, and the status of evolving technologies and software architectures and their growth potential. Forward-looking statements involve risks and uncertainties. Our actual results may differ materially from those contemplated by the forward-looking statements. Factors that might cause or contribute to these differences include, but are not limited to, those discussed in the section entitled "Item 1. Business, Factors That May Affect Future Results." You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly revise or update any forward-looking statements to reflect events or circumstances after the date of this report.

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PART I

ITEM 1. BUSINESS

OVERVIEW

We are a leading provider of integrated Internet-based strategic workforce optimization software for automating people-driven service organizations like professional services firms and corporate information technology ("IT") groups. Our Evolve 4 software suite integrates and streamlines the core processes that are critical to services-oriented organizations which center around managing project portfolios, project opportunities, professional resources (including contract workers) and service delivery. Our solution combines the efficiency gains of automating core business processes with the benefits of online inter-company collaboration, creating a Strategic Workforce Optimization Platform for a variety of project-driven services organizations.

We have licensed our solution to over 100 customers who have collectively purchased it to manage over 82,000 professionals. Our customers include professional services firms such as EDS and Icon Media Lab, high tech services organizations at companies such as Sun Microsystems, Novell and Autodesk and Corporate IT organizations in companies such as CSFBdirect and Fleet Financial.

INDUSTRY BACKGROUND

Organizations have invested in enterprise software applications to automate back-office business processes such as benefits management, payroll administration and general ledger accounting. However, they have found that traditional enterprise applications are difficult to adapt to their specific requirements for managing and optimizing strategic workforces, and cannot capture the unique and changing characteristics of the professionals that are an organization's core resource. Traditional applications can manage and execute simple purchase and sale transactions, but cannot support the inherently collaborative nature of project definition and delivery. Moreover, traditional applications have not been designed to address the complex and distributed processes that connect managers, employees and contractors within today's project-driven services organizations.

As a result, these basic processes generally continue to be performed manually, with spreadsheets, phones and email being the principal tools used. Some organizations have attempted to internally develop systems to manage the complexities of their operations. While providing modest efficiency gains, these nonintegrated, function-specific systems have often failed to meet the challenges of large and growing organizations with diverse, dynamic, and distributed business process needs. These systems are often cumbersome and inflexible and are only capable of managing isolated processes. The lack of effective process automation solutions often results in misallocated resources, high overhead costs, missed revenue opportunities and dissatisfaction among clients, partners and employees.

A new breed of end-to-end Internet-based business solutions has emerged, combining the efficiency gains of business process automation solutions with the capabilities of online collaborative networks. Because they integrate disparate and disconnected processes both within and between businesses, these solutions attempt to address the challenges of industries with highly customized product and service requirements, complex business processes, collaborative design, production and fulfillment workflows, and significant dependence on information exchange.

Strategic Workforce Optimization ("SWO") platforms are the next wave of critical corporate applications that focus on a key corporate asset: the workforce. While Professional Services Automation ("PSA") solutions, which Evolve pioneered, provide tools to help professional services firms better manage their resources to increase utilization, utilization is just one component of resource-value realization, i.e., the impact resources have on profitability and competitiveness. Evolve continues to provide PSA functionality to address the resource staffing and utilization challenges faced by services firms, however, Evolve delivers a broader, more comprehensive SWO platform that can be applied to a range of markets where the workforce is a key component of value creation and the work is inherently project-oriented.

Evolve currently targets three market opportunities directly: Global Services Companies, Services divisions of technology companies and Corporate IT organizations in Global 2000 companies. These three market opportunities can be further divided into vertical markets, including information technology, management consulting, advertising, media, public relations, architecture, construction, engineering, financial services, law, tax, audit, and health care.

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We believe that businesses where people are the key creators of strategic value are under increasing competitive and operational pressure due to the following trends:

- growing complexity of professional service projects;
- increasingly sophisticated, more demanding services acquirers;
- an increasingly competitive market for skilled service professionals;
- a growing need to reduce staff without affecting key business initiatives;
- increased acceptance of project outsourcing; and
- economic globalization.

We believe that project-driven services organizations are unique in a number of ways. Unlike product-oriented industries producing homogeneous products using standard components and processes, project-driven services organizations create information-based deliverables using human resources ("strategic workers") with unique knowledge, skills, abilities and availability. These project-based services organizations require extensive collaboration between services providers and clients in the definition of project needs and in the sourcing, delivery and acceptance of services and deliverables. Perhaps most importantly, project-driven services organizations are increasingly "virtual" organizations, delivering services through a complex, dynamic network of resources and providers.

We believe that the unique nature of project-driven services organizations has created an opportunity for a solution specifically designed to optimize the strategic workforce. By automating and connecting the business processes of project-driven services organizations and their customers, integrated SWO platforms can enable these organizations to better prioritize their needs, thereby ensuring that human resources are allocated to the most strategic work and the highest ROI projects.

The professional services market is especially suited for SWO solutions because consulting firms and professional services organizations within companies share many identical core business processes for managing service opportunities, resources and delivery. As Corporate IT is looking to transition to a more services-oriented model, they too need to focus on value realization to succeed. Both Corporate IT and consulting firms are challenged by the need to balance project demand against resource availability, to manage internal and external services resources, and to accurately assess the financial impact of projects. The similarity in the processes of both internal and external project-driven services providers creates a significant opportunity for an integrated SWO solution to automate the entire value chain and successfully meet the needs of all market participants.

We believe that an effective SWO platform for project-driven services organizations must provide:

- an architecture that is designed to capture the inherently virtual, collaborative, project-oriented and people-centric characteristics of the project-driven services organizations;
- a set of application modules integrating core business processes;
- an ability to rapidly deploy the solution across the enterprise;
- an integration with existing back-office information systems;
- an ability for a highly distributed and mobile workforce to access the platform locally or remotely through multiple Internet access devices;
- online inter-company collaboration capabilities that facilitate efficient interaction across the organization;
- an ability to deploy in either self-hosted or remotely hosted application service provider (ASP) models; and
- a scalable solution that can be distributed globally across the enterprise.

THE EVOLVE SOLUTION

We are a leading provider of integrated Internet-based SWO platforms for automating project-driven services organizations like professional services and corporate IT. Our solution, Evolve 4, integrates and streamlines the core processes that are critical to project-based services organizations: managing project opportunities, strategic workers and service delivery. By integrating these processes, Evolve 4 provides enhanced visibility of business performance throughout the enterprise, allowing businesses to more effectively identify and pursue revenue opportunities, prioritize their internal and external projects, increase their operational efficiency and improve the productivity of their professionals. We enable organizations to integrate the internal business processes of service providers, partners and acquirers in an efficient, collaborative environment.

We believe our Evolve 4 SWO platform provides the following benefits to project-driven services organizations seeking to optimize their strategic workforce:

Increased Operational Efficiency. Evolve 4 is designed to allow our customers to achieve significant cost savings and productivity enhancements by offering the ability to view and manage all of the core processes involved in providing services across an entire organization. Our solution is accessible to professionals and managers throughout a project-driven services organization, allowing them to communicate and collaborate throughout a project. Using our solution, services providers can rapidly match service professionals with projects to balance supply and demand for personnel resources within the extended enterprise. Services providers can also quickly identify low utilization personnel and lower priority projects to intelligently downsize the organization. Our Evolve 4 technology also automates and improves workflow processes and monitors key project parameters, allowing business managers to analyze and improve performance throughout the enterprise.

Real-time Communication and Collaboration Across the Virtual Organization. Our solution allows for the real-time, collaborative sale, management, and delivery of services through a dynamic and complex network of resources and providers. By connecting not only service professionals within an organization but also to external services providers, we allow our customers to employ the Internet to communicate in real-time about changes in project requirements and timing, resource characteristics, availability and actual time and expense.

Improved Retention of Service Professionals. By enabling professionals to access and revise their skill profiles, staffing preferences and assignment schedules in real time, Evolve 4 helps close the gap between professional development and project staffing needs, improving service professionals' levels of satisfaction and retention. Improving retention of service professionals reduces recruitment and training expenses, protects key knowledge assets and can have a significant impact on operating results of services providers.

Stringently Qualifying Opportunities. We believe our SWO platform enables our customers to stringently qualify their project opportunities by prioritizing projects and enhancing the visibility of demand for services within a project, thereby allowing them to match their available resources to project opportunities. Our SWO platform provides tools that significantly reduce the complexity inherent in assessing and matching resource capabilities and available revenue opportunities on a global basis and across organizational boundaries. This helps companies focus on selecting the most valuable and strategic opportunities based on a limited and/or shrinking workforce.

Enhanced Client Satisfaction. Our solution improves client satisfaction by more effectively matching client needs with the most knowledgeable and experienced available resources for their project. In addition, Evolve 4 facilitates timely completion of projects by enabling project managers to collaborate with the service provider team and the client and make better decisions more quickly. We believe that collaborative management is essential to increasing client satisfaction and generating repeat business.

THE EVOLVE STRATEGY

Our objective is to become the leading SWO platform provider for automating the strategic worker in external and internal services organizations. We intend to achieve our goal by gaining broad market acceptance for our SWO platform and by enabling our customers to collaborate online with their services partners and customers. Key elements of our strategy include:

Extend Market Position Among IT Services Organizations and Leverage Leadership into Other Markets. Historically, we have targeted our solution primarily at professional services organizations specializing in IT consulting. We chose to initially target the IT services market because of its large size and because IT services professionals face particularly complex collaboration and transactional processes in selling, managing, and delivering their services. We are now using our growing portfolio of customer references to penetrate services organizations in the technology sector and Global 2000 Corporate IT organizations. Building on our experience and understanding of professional services organizations, we have taken their best practices and incorporated them into our SWO platform, which we believe will help us expand into other professional services sectors such as management consulting and advertising.

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Capitalize on Technology Leadership and Expand Product Offerings. We have acquired substantial domain expertise in developing solutions addressing the core business process automation needs of the services organizations. We have implemented a technical architecture that meets the needs of services organizations for flexible solutions that can rapidly be configured to meet their individual requirements and can be expanded or "scaled" as their organizations grow. The Evolve 4 architecture is designed for rapid and cost-effective implementation and configuration without requiring modifications to the application's source code. We will continue to enhance our technology and expand our service offerings to meet the evolving needs of our customers and promote broad market adoption and increased usage of our SWO platform solution. We expect to devote significant resources to building, expanding and continuing to tightly integrate our SWO platform functionality, as well as enhancing integration with complementary systems.

Encourage Continued Adoption of Our SWO Platform Through Expanded Acquisition, Deployment and Pricing Options. We make our platform accessible to a broad range of businesses by providing a range of acquisition and deployment options, all based on the same technology platform and using our value-based pricing model which charges customers based on the number of resources managed with our software.

Take Advantage of Our Installed Base to Increased Sales of Complementary Services and Increase Penetration of Customer Organizations. We intend to capitalize on the success of existing deployments to encourage adoption of Evolve 4 across additional workgroups and divisions within our customers' organizations. We also will continue to encourage customers to deploy additional software modules.

PRODUCTS AND SERVICES

Our SWO solution helps external and internal services organizations improve the effectiveness of their operations and connects them to their clients, partners and suppliers. Our products capture the inherently virtual, collaborative, project-oriented and people-centric characteristics of services organizations by employing the universal accessibility of the Internet, an intuitive interface, and applications functionality encapsulating our extensive domain expertise. Our highly configurable rules engine allows the platform to be deployed by a wide variety of customers supporting different business practices with no source code changes. This enables us to address the different needs of a diverse base of customers ranging from small emerging service firms to large complex global services organizations across a variety of markets.

This graphic is entitled "Evolve Strategic Workforce Optimization."

Description of graphic: The Strategic Workforce Optimization diagram consists of six boxes aligned around an X and Y axis. An X and Y axis are drawn and three boxes are placed along each axis with a box in the center where the X/Y axis meet. A circular line is then drawn around the outside, connecting five of the boxes. Starting left along the X axis is a box called PLAN. Next moving into the center is a box called ENGAGE. On the far right of the diagram is the final box of the X axis called DELIVER. Starting at the top of the Y axis, above the box in the center, is a box called SOURCE and the last box is below the center box, which is called ENABLE.

Evolve believes that an integrated solution is required to address the following needs:

- Plan: Tackle new projects intelligently and align your operations with corporate goals
- Source: Find the skilled workers you need, just in time, while reducing hiring costs
- Engage: Deploy the right mix of people for each project and keep teams on track
- Enable: Accelerate project delivery with online knowledge management and collaboration tools
- Deliver: Stick to budgets and save

EVOLVE 4

Evolve 4, our flagship product suite, is an enterprise software application system that is deployed by project-driven services organizations on a

distributed basis across their computer networks or accessed remotely on an application service provider (ASP) basis. Evolve 4 is a proven end-to-end solution that can expand to address the needs of rapidly growing organizations. Evolve 4 automates and integrates the key processes that are critical to the operational effectiveness of project-driven services organizations. Evolve 4 also enables collaboration with outside organizations in the areas of project management, external sourcing of staff and invoicing. The Evolve 4 product suite consists of seven applications or "modules", which can be deployed individually, or can be used together to form a comprehensive SWO solution. These modules are:

Opportunity Manager: Evolve Opportunity Manager automates key front-end activities, from tracking new projects and business opportunities to budgeting, pricing, and capacity planning.

Resource Manager: Evolve Resource Manager is a full-visibility enterprise scheduling and workflow system that manages resource assignment, project staffing, and matching the right strategic worker with the right projects in minutes.

Time & Expense Manager: Evolve Time and Expense Manager enables fast, accurate time and expense entry and tracking based on project assignments and enables customer billing or chargebacks to corporate business units.

Delivery Manager: Evolve Delivery Manager features powerful online tools to enable complete control over project budgets and financial performance. Delivery Manager connects seamlessly with Evolve Time & Expense Manager so project financial data displays without manual re-entry.

Contractor Manager: Evolve Contractor Manager, automates the business process and workflow for sourcing, reviewing, negotiating, paying and procuring contingent workers such as outside consultants, freelancers and contractors.

Portfolio Manager: Evolve Portfolio Manager provides a powerful, real-time executive dashboard for tracking project risk, value, and performance which helps align projects' portfolios with corporate strategy.

Knowledge Collaboration: Evolve Knowledge Collaboration system provides convenient online workspaces and knowledge management tools to help project teams boost quality, accelerate project delivery, and fully leverage the organization's intellectual assets.

We depend on certain third-party hosting service providers to manage and host the systems underlying our application service provider (ASP) service offering and our internal information systems. These providers include Exodus Communications and COLO.COM, each of which has experienced financial difficulties and is currently in bankruptcy reorganization. To date, no disruption of our ASP service or our internal operations has occurred. However, should such disruptions occur, we may be required to expend significant effort and resources to move our systems to alternative network service providers.

CUSTOMERS

Our current customers include eBusiness consultants, the services organizations of traditional software and hardware companies and the internal IT organizations within Global 2000 companies. The following are case studies of a sample of Evolve customers who have purchased our solution:

ERICSSON

Ericsson has operations in 140 countries and can claim more customers than any other telecommunications supplier in the world. Four out of every ten mobile calls are handled by Ericsson equipment. Ericsson chose to optimize their professional teams using Evolve's workforce optimization solution. Ericsson can

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see how its services professionals are deployed in real time, gain insight into the future demand for services and integrate employees into worldwide collaborative business processes.

RYDER LOGISTICS & TRANSPORTATION SOLUTIONS WORLDWIDE

Consistently ranked as one of the most admired companies in the transportation industry, Ryder System, Inc. is a global leader in logistics and transportation management solutions. Evolve was Ryder's top choice for automating their Solution Design, Implementation and Operations unit. Evolve allows Ryder to better manage its professional resources and represents a major step towards achieving the operational efficiencies needed to run the value-generating processes at Ryder. With Evolve, executives gain real-time visibility into how each operation is performing, and get instant updates on sales, budgets, staff availability, and revenue projections. With global visibility and sophisticated performance-analysis tools from Evolve 4, Ryder can deploy people more efficiently, cut costs, and build profitable growth strategies.

In the past, a small number of customers has contributed a substantial portion of our revenues in each fiscal period. For instance, for the fiscal year ended June 30, 2001, sales to one customer accounted for 14% of our total revenues, and for the fiscal year ended June 30, 2000, sales to two customers accounted for 19% and 13% of our total revenues. We expect this concentration of customer sales to continue in the future. Accordingly, the loss of a single customer or customer prospect may have a substantial impact on our operating results if we depended on the sale of our products to that customer to meet our financial performance targets during a given fiscal period. Our agreements with existing customers often do not include long-term commitments from customers to continue to purchase our products.

TECHNOLOGY

At the core of our SWO solution is a highly adaptable, expandable (scalable), multi-tier, distributed, Internet-based architecture. Our SWO platform architecture provides a common foundation on which all Evolve products and services are built, including the various components of the Evolve 4 application suite. Our architecture includes the following components:

Evolve 4 Server
Some of the key features of our Java-based Evolve 4 application server include:

- the option of running multiple application servers to provide scalability for large sophisticated organizations;
- patent-pending resource matching algorithms that reduce the time required to staff projects;
- a flexible object-based design allowing rapid incorporation of new features and functionality;
- java-based portability that provides flexibility to support multiple operating environments; and
- Presentation Interface.

We have the flexibility to provide access to a broad set of users by employing different presentation interfaces:

- Internet Browser - an ease-of-use interface that allows services organizations to manage and share information through a secure intranet or Internet connection; and
- Handheld Devices - an interface for mobile access to time and expense entry through popular personal digital assistants such as Palm devices.

Our architecture is designed to allow us to quickly develop and introduce new presentation interfaces that leverage new and emerging access technologies.

sXML
Our SWO platform employs XML (eXtensible Mark-up Language), a common information exchange standard for electronic commerce. We are in the process of developing Services XML (sXML), an advanced version of the XML standard optimized for exchanging information on service opportunities, resources and delivery.

Analytics Engine
We have the ability to report on key data through a sophisticated analytics engine. These reports are available through our browser-based reporting tools, which provides views of the entire value chain, such as opportunity and revenue pipelines, utilization and profitability analysis, and resource supply and demand planning.

Application Connectors
Our system provides connectors that support common industry standards and technologies such as JDBC (Java DataBase Connectivity), ODBC (Open DataBase Connectivity), SQL (Structured Query Language) and Java. These connectors allow for integration with:

- external databases;
- third party reporting tools that complement our built-in browser-based report center capabilities; and
- other enterprise applications such as financial, human resource and sales force automation systems.

Business Rules Repository
Our SWO platform is designed to capture and store business information, rules and standards in a single, centralized repository that can be accessed by all functional modules. This centralized information structure allows for rapid initial deployment and also facilitates adaptation to changes in the customer's organization and processes without source code modifications. We also believe this architecture will allow us to more easily extend our solution to other industries beyond information technology services.

Security Controller
Our integrated security and administration features store profiles and access rules within a centralized repository. Customers can specify individual access rules for employees based on their position within their organization, as well as for customers, partners and other external parties. Our systems support the Lightweight Directory Access Protocol (LDAP) security standard for universal sign-on and authentication functions.

Collaboration and Workflow Manager
Our platform provides sophisticated management of structured knowledge by capturing organizational processes and data in a notification-driven workflow management system. Our platform incorporates an integrated messaging system that notifies users when actions, information or approvals are required. This system helps to streamline approval processes, monitor resources and facilitate collaboration among project team participants.

RESEARCH AND DEVELOPMENT

Since our inception in 1995, we have made substantial investments in research and product development. We believe that our introduction of new and enhanced products will be a key factor for our future success. As part of our efforts to generate ideas for enhancing our existing products and for developing new ones, we maintain an ongoing dialogue with our customers who are facing new workforce optimization challenges. We have devoted and expect to continue to devote significant resources to developing new and enhanced products, including new releases of our Evolve 4 platform.

In January 2000 we opened a new engineering development center in Chennai, India. Our India development center is designed to accommodate 50 engineers.

Our research and development expenses were $19.5 million in 2001, $10.4 million in 2000 and $5.1 million in 1999, excluding stock-based compensation charges. We anticipate we will continue to commit substantial resources to research and development as we continue to respond quickly to rapid technological change, changing customer needs, frequent product introductions and evolving industry standards that may render existing products and services obsolete. We currently have a number of product development initiatives underway, but we cannot be certain that existing or new customers will embrace any enhanced or new products.

SALES AND MARKETING

We sell our solutions through our direct sales organization in both North

America and the United Kingdom. To date, international sales have accounted for less than five percent of our revenue. In the future, we intend to enhance our market presence through alliances with systems integrators and service partners.

In selling our products, we typically approach both business users and information technology professionals with an integrated team from our sales and professional services organizations. Initial sales activities typically include a demonstration of our product capabilities followed by one or more detailed technical reviews. Our sales process requires that we work closely with targeted customers to identify short-term workforce optimization needs and long-term goals. Our sales team, which includes both sales and technical professionals, then works with the customer to develop a proposal to address these needs. In many cases, we collaborate with our customers' senior management team, including the chief executive officer, chief information officer, chief operating officer and chief financial officer. The level of customer analysis and financial commitment required for many of our product implementations has caused our sales cycle to range from two to twelve months.

We use a variety of marketing programs to build market awareness of our company, our brand name and our products, as well as to attract potential customers. These programs include advertising, market research, product and strategy updates with industry analysts, public relations activities, direct mail programs, telemarketing and telesales, seminars, trade shows, speaking engagements and Web-based marketing. Our marketing organization also produces marketing materials in support of sales to prospective customers that include brochures, data sheets, white papers, presentations and demonstrations.

We also seek to establish relationships and alliances with major industry vendors that will add value to our products and enhance our market presence. The goal of our efforts is to form alliances with partners who can help introduce our solutions to their customer base, and to be able to offer to our own customers additional software applications and consulting and support services from which they are likely to benefit.

PROFESSIONAL SERVICES

We provide implementation consulting, technical support, end-user training, and change management to ensure our customers receive the guidance and support they need to implement and operate our SWO solution. Our professional services organization has developed implementation methodologies that allow our customers to rapidly configure and deploy our SWO platform to support their unique business practices.

In addition to professional services, we offer product maintenance to our customers. Maintenance services are typically subject to an annual, renewable contract and are typically priced as a percentage of product license fees. We bundle maintenance services with our application service provider (ASP) offering in a single monthly subscription fee. Customers receiving maintenance services also receive product upgrades as they are released throughout the life of the maintenance contracts.

COMPETITION

Competition could seriously harm our ability to sell additional software solutions and subscriptions on prices and terms favorable to us. The markets for our products are intensely competitive and subject to rapidly changing technology. We currently compete against providers of enterprise application software such as Peoplesoft, Siebel and SAP. Companies in each of these areas may expand their technologies or acquire companies to support greater workforce optimization functionality and capability. In addition, "in house" information technology departments of potential customers have developed or may develop systems that substitute for some of the functionality of our SWO platform.

Some of our competitors' products may be more effective than our products at performing particular functions or be more customized for particular needs. Even if these functions are more limited than those provided by our products, our competitors' software products could discourage potential customers from purchasing our products. A software product that provides some of the functions of our solutions, but also performs other tasks, may be appealing to some customers because it would reduce the number of different types of software necessary to effectively run their businesses. Further, our competitors may be able to respond more quickly than we can to changes in customer requirements.

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Some of our competitors have longer operating histories, significantly greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Our competitors have made and may also continue to make strategic acquisitions or establish cooperative relationships among themselves or with other software vendors. They may also establish or strengthen cooperative relationships with our current or future partners, thereby limiting our ability to promote our products through these partners and limiting the number of consultants available to implement our software.

We believe that the primary competitive factors in our market include:

- a critical mass of prominent customers that have successfully implemented the solutions;
- an underlying software infrastructure that fully encapsulates the virtual, collaborative, and people-centric characteristics of the services organizations;
- inter-company collaboration capabilities that facilitate efficient business processes among services organizations;
- product quality, performance, features, functionality, and usability;
- customer service and support; and
- ease of integration with customers' business processes.

We believe our current products compete favorably with respect to these factors, although our market is relatively new and evolving rapidly. We may not be able to maintain our competitiveness in the face of significant competition.

INTELLECTUAL PROPERTY

Our success is dependent on our ability to develop and protect our proprietary technology and intellectual property rights. We seek to protect our software, documentation and other written materials primarily through a combination of patent, trade secret, trademark and copyright laws, confidentiality procedures and contractual provisions. For example, we license rather than sell our software and require licensees to enter into license agreements that impose certain restrictions on the licensees' ability to utilize the software. In addition, we seek to avoid disclosure of our trade secrets by, among other things, requiring persons with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code.

We have been issued a patent in the United States covering the enablement of dynamically configurable software systems by our Evolve software server. We also have two patent applications pending in the United States with respect to the "Team Builder" functionality in our Resource Manager module and the time and expense functionality of our Time and Expense module. There can be no assurance that either of these two applications would survive a legal challenge to its validity or provide significant protection to us. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult. While we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem, particularly in foreign countries where the laws may not protect proprietary rights as fully as in the United States. We can offer no assurance that our means of protecting its proprietary rights will be adequate or that our competitors will not reverse engineer or independently develop similar technology.

It is also possible that third-parties will claim that we have infringed their current or future products or technologies. We expect that enterprise application software developers will increasingly be subject to infringement claims as the number of products in different industry segments overlap. Any claims, with or without merit, could be time-consuming, result in costly litigation, prevent product shipment, cause delays, or require us to enter into royalty or licensing agreements, any of which could harm our business. Patent litigation in particular has complex technical issues and inherent uncertainties. In the event an infringement claim against us was successful and we could not obtain a license on acceptable terms or license a substitute technology or redesign to avoid infringement, our business could be harmed.

We rely on software that we have licensed from third parties, including Inprise/Borland, ProSight, Actuate, Intraspect and Allaire, to perform key functions of our Evolve solution and we rely on these and other third parties to support their products for our development and customer support efforts. We embed into our software the products that we license from Inprise/Borland and Allaire. Our agreement with Allaire renews automatically each year, with either party able to terminate the agreement upon sixty days written notice. We pay Allaire a royalty every time a customer licenses our software, and the agreement specifies that the parties can reevaluate the royalty pricing every time we release a new version of our software. Our agreement with Inprise/Borland renews each year for up to five years provided that we pay the annual renewal fee. We pay Inprise/Borland a royalty every time a customer licenses our software. We

resell products that we license from Actuate, ProSight, and Intraspect These products are ancillary to our core products, and provide enhanced reporting, portfolio management and knowledge management capabilities respectively. Our agreement with Actuate runs through 2002 with the right to renew for successive one year terms by mutual consent; our agreement with Prosight has an initial 18-month term with a right to renew for another year; and our agreement with Intrapsect has an initial 14-month term and may be renewed is for additional one year terms provided that neither party is in breach of the agreement. The terms of our agreements with each of these three vendors require that we pay a royalty each time we license their software to our customers. These companies could terminate our licenses if we breach our agreements with them, or they could discontinue support of the products we license from them. This could result in delays or reductions of sales or shipments of our SWO platform until alternative software can be developed or licensed.

We indemnify some of our customers against claims that our products infringe upon the intellectual property rights of others. We could incur substantial costs in defending our company and our customers against infringement claims. In the event of a claim of infringement, we, or our customers, may be required to obtain one or more licenses from third parties. We cannot assure you that such licenses could be obtained from third parties at a reasonable cost, or at all. Defense of any lawsuit or failure to obtain any such required license could have a material adverse effect on our business.

EMPLOYEES

As of June 30, 2001, we had a total of 258 full-time employees, including 109 in research and development, 72 in sales, marketing and business development, 48 in professional services and 29 in finance and administration. None of our employees is subject to a collective bargaining agreement. We consider our employee relations to be good.

FACTORS THAT MAY AFFECT FUTURE RESULTS

OUR BUSINESS IS DIFFICULT TO EVALUATE BECAUSE OUR OPERATING HISTORY IS LIMITED.

It is difficult to evaluate our business and our prospects because our revenue and income potential are unproven. We commenced recognizing sales revenues in March of 1999. Because of our limited operating history, there may not be an adequate basis for forecasts of future operating results, and we have only limited insight into the trends that may emerge in our business and affect our financial performance.

WE HAVE INCURRED LOSSES SINCE INCEPTION, AND WE MAY NOT BE ABLE TO ACHIEVE PROFITABILITY.

We have incurred net losses and losses from operations since our inception in 1995, and we may not be able to achieve profitability in the future. As of June 30, 2001, we had an accumulated deficit of approximately $215.8 million. Since inception, we have funded our business primarily from the sale of our stock and by borrowing funds, not from cash generated by our business. Despite recent cost reductions, we expect to continue to incur significant sales and marketing, research and development, and general and administrative expenses. As is the case with many enterprise software companies, we have experienced a sequential quarterly decline in revenue for the quarter ending June 30, 2001, and may experience a further decline in the current quarter. As a result, we expect to experience continued losses and negative cash flows from operations. If we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future.

OUR FUTURE OPERATING RESULTS MAY NOT FOLLOW PAST TRENDS DUE TO MANY FACTORS, AND ANY OF THESE COULD CAUSE OUR STOCK PRICE TO FALL.

We believe that year-over-year comparisons of our operating results are not a good indication of future performance. Although our operating results have generally improved from year to year in the recent past, our future operating results may not follow past trends. It is likely that in some future years our operating results may be below the expectations of public market analysts and investors due to factors beyond our control and, as a result, the price of our common stock may fall.

Factors that may cause our future operating results to be below expectations and cause our stock price to fall include:

- the lack of demand for and acceptance of our products, product enhancements and services; for instance, as we expand our target customer focus beyond the information technology service consultancies

and into internal information technology of corporate customers as well as into overseas markets, we may encounter increased resistance to adoption of our business process automation solutions;
- unexpected changes in the development, introduction, timing and

competitive pricing of our products and services or those of our competitors;
- any inability to expand our direct sales force and indirect marketing channels both domestically and internationally;
- difficulties in recruiting and retaining key personnel;
- unforeseen reductions or reallocations of our customers' information technology infrastructure budgets; and
- any delays or unforeseen costs incurred in integrating technologies and businesses we may acquire.

We plan to aggressively and prudently manage our operating expenses with a focus on our research and development organization and our direct sales group. Our operating expenses are based on our expectations of future revenues and are relatively fixed in the short-term. If revenues fall below our expectations in any quarter, and we are not able to quickly reduce our spending in response, our operating results for that quarter would be lower than expected, and our stock price may fall.

WE MAY NEED SUBSTANTIAL ADDITIONAL CAPITAL TO FUND CONTINUED BUSINESS OPERATIONS AT THEIR CURRENT LEVELS IN FISCAL 2002 AND 2003 AND SUCH FINANCING MAY NOT BE AVAILABLE ON FAVORABLE TERMS, IF AT ALL.

We require substantial amounts of capital to fund our business operations. The rate at which our capital is utilized is affected by the level of our fixed expenses (including employee related expenses and expenses relating to real estate) and variable expenses. Substantial capital has been used to fund our operating losses. Since inception, we have experienced negative cash flow from operations and expect to experience significant negative cash flow from operations for the foreseeable future. In September 2001 we signed a definitive agreement for a private placement of our Series A Preferred Stock, which is expected to result in proceeds of at least $13 million. This financing, combined with the cost reductions we are undertaking and our existing credit facilities, are expected to be sufficient to meet our working capital requirements through the end of the fiscal year ending June 30, 2002. However, we may require additional capital prior to that time if one or more of the following occur:

- Our revenues from the sale of our products may fall below our current expectations because of the current economic slowdown or otherwise.
- Forecasted cash collections from customers may decline if some of our customers become insolvent or encounter financial difficulties.
- We may be unable to reduce our operating expenses as rapidly and as extensively as we hope. For instance, we may discover that we cannot reduce our employee headcount as rapidly as we would like in the event that we are unable to secure commitments from third parties to provide integration and support services to our customers in lieu of providing these services ourselves.
- We may be unable to comply with the financial and other covenants required under our existing credit facilities, and these credit facilities may be withdrawn as a result.
- We may encounter opportunities that we wish to pursue to acquire other businesses or technologies for cash consideration.

Accordingly, we may require or seek to raise additional capital during the 2002 fiscal year. We cannot be certain that additional financing will be available on favorable terms, if at all.

The investors participating in the private placement of our Series A Preferred Stock hold warrants to purchase additional shares of our Series A Preferred Stock and common stock which, if exercised in full, would result in additional proceeds to us of $26 million. However, these warrants are exercisable at prices in excess of the current market price of our common stock, and we cannot predict whether they will be exercised. We have not commenced any efforts to secure additional financing.

Further, the additional shares of our capital stock we may issue in any such financings may result in additional dilution, which may be substantial. If we need additional funds and cannot raise them on acceptable terms, we may not be able to continue our operations at the current level or at all.

WE MAY LOSE EXISTING CUSTOMERS, OR BE UNABLE TO ATTRACT NEW CUSTOMERS, IF WE DO NOT DEVELOP NEW PRODUCTS OR ENHANCE OUR EXISTING PRODUCTS.

If we are not able to maintain and improve our product-line and develop new products, we may lose existing customers or be unable to attract new customers. We may not be successful in developing and marketing product enhancements or new products on a timely or cost-effective basis. These products, if developed, may not achieve market acceptance.

A limited number of our customers expect us to develop product enhancements that may address their specific needs. For instance, we have shared with some of our customers our internal product roadmap that includes descriptions of new functional enhancements such as improved time and expense management for future releases of our software. If we fail to deliver these enhancements on a timely basis, we risk damaging our relationship with these customers. We have experienced delays in the past in releasing new products and product enhancements and may experience similar delays in the future. These delays or problems in the installation or implementation of our new releases may cause some of these customers to forego additional purchases of our products or to purchase those of our competitors.

WE MUST DIVERSIFY OUR CUSTOMER BASE IN ORDER TO ENHANCE OUR REVENUE AND MEET OUR GROWTH TARGETS.

We have historically derived a substantial percentage of our revenues from sales of our products and services to firms that provide technology-oriented consulting, design and integration services, including a number of firms specializing in Website design and e-commerce application development. Growth among these "e-business" consultancies has recently slowed dramatically, and many such firms have ceased operations or have encountered substantial difficulties in raising capital to fund their operations. In anticipation of these developments, we commenced a program to aggressively diversify our client base, targeting both established consulting services companies and in-house service departments of large corporations. While we have recorded a number of significant customer wins in these areas, we may in the future encounter significant challenges in further expanding our customer base. More established corporations are often more reluctant to implement innovative enterprise technologies such as ours, in part because they often have made substantial investments in legacy applications and information systems. We may also encounter extended sales cycles with such prospective customers, and slower rates of adoption of our solutions within their organizations. As we reduce our sales force headcount in order to reduce expenses, our sales capacity is diminished which may impact our ability to diversify our customer base. All of these factors may adversely affect our ability to sustain our revenue growth and attain profitable operations.

FINANCIAL DIFFICULTIES OF SOME OF OUR CUSTOMERS MAY ADVERSELY AFFECT OUR OPERATING RESULTS.

As discussed above, a substantial portion of our early customers were e-business consultancies focusing on Web development and e-commerce integration. As public valuations for many such businesses have declined substantially in recent months, some of our customers may encounter difficulties in securing additional financing to meet their obligations, or may seek to limit expenditures to conserve their cash resources. As a result, we may encounter difficulties in securing payment of certain customer obligations when due, and may be compelled to increase our bad debt reserves. Any difficulties encountered in collections from customers would also adversely affect our cash flow, and would adversely impact our operating results.

WE REDUCED OUR WORKFORCE DURING THE SECOND HALF OF THE YEAR, AND, IF WE FAIL TO MANAGE THIS REDUCTION IN WORKFORCE, OUR ABILITY TO GENERATE NEW REVENUE, ACHIEVE PROFITABILITY AND SATISFY OUR CUSTOMERS COULD BE HARMED.

We reduced our workforce during the second half of this year after growing significantly the first half of this year and in previous years. Any failure to manage this reduction in workforce could impede our ability to increase revenues and achieve profitability. We reduced our number of employees from 326 at June 30, 2000, to 258 as of June 30, 2001, and further reduced our headcount by 49 persons in August 2001.

As we reduce our sales force headcount in order to reduce expenses, our sales capacity is reduced which may impact our revenue growth. As we reduce our service employee headcount, including our consulting services, training and technical support personnel, we may not be able to provide the same level of customer responsiveness or expertise, and customer satisfaction may be impacted as a result.

In order to manage our reduced workforce, we must:

- hire, train and integrate new personnel in response to attrition;
- continue to augment our management information systems;

- manage our sales and services operations, which are in several locations; and
- expand and improve our systems and facilities.

IF THE MARKET FOR PROCESS AUTOMATION SOLUTIONS FOR PROFESSIONAL SERVICES ORGANIZATIONS AND OTHER STRATEGIC WORKFORCES DOES NOT CONTINUE TO GROW, THE GROWTH OF OUR BUSINESS WILL NOT BE SUSTAINABLE.

The future growth and success of our business is contingent on growing acceptance of, and demand for, business process automation solutions for professional services organizations and other strategic workforces. Substantially all of our historical revenues have been attributable to the sale of automation solutions for professional services organizations. This is a relatively new enterprise application solution category, and it is uncertain whether major services organizations and service departments of major corporations will choose to adopt process automation systems. While we have devoted significant resources to promoting market awareness of our products and the problems our products address, we do not know whether these efforts will be sufficient to support significant growth in the market for process automation products. Accordingly, the market for our products may not continue to grow or, even if the market does grow in the immediate term, that growth may not be sustainable.

REDUCTIONS IN CAPITAL SPENDING BY CORPORATIONS COULD REDUCE DEMAND FOR OUR PRODUCTS.

Historically, corporations and other organizations have tended to reduce or defer major capital expenditures in response to slower economic growth or recession. Market analysts have observed a significant reduction in the growth of corporate spending on information technology projects in response to the current economic slowdown. To the extent that current economic uncertainty persists, some of the prospective customers in our current sales pipeline could choose to postpone or reduce orders for our products, or may delay implementing our solutions within their organizations. In addition, existing customers seeking to reduce capital expenditures may cancel or postpone plans to expand use of our products in additional operating divisions, or may defer plans to purchase additional modules of our solutions. Any of the foregoing would have an adverse impact on our revenues and our operating results, particularly if the current period of volatility in the stock market and the general economy is prolonged.

ANY INABILITY TO ATTRACT AND RETAIN SENIOR EXECUTIVE OFFICERS AND ADDITIONAL PERSONNEL COULD AFFECT OUR ABILITY TO SUCCESSFULLY GROW OUR BUSINESS.

We recently initiated an executive search for a new Chief Executive Officer. Our future performance will depend in significant measure on our ability to recruit a highly qualified individual to serve in such a position and the ability of the new CEO to work effectively with other members of our executive staff and key employees, customers and partners. In addition, if we are unable to hire and retain a sufficient number of qualified personnel, particularly in sales, marketing, research and development, services and support, our ability to grow our business could be affected. The loss of the services of our key engineering, sales, services or marketing personnel would harm our operations. For instance, loss of sales and customer service representatives could harm our relationship with the customers they serve, loss of engineers and development personnel could impede the development of product releases and enhancements and decrease our competitiveness, and departure of senior management personnel could result in a loss of confidence in our company by customers, suppliers and partners. None of our key personnel is bound by an employment agreement, and we do not maintain key person insurance on any of our employees. Because we, like many other technology companies, rely on stock options as a component of our employee compensation, if the market price of our common stock decreases or increases substantially, some current or potential employees may perceive our equity incentives as less attractive. In that case, our ability to attract and retain employees may be adversely affected.

IF WE FAIL TO EXPAND OUR RELATIONSHIPS WITH THIRD-PARTY RESELLERS AND INTEGRATORS, OUR ABILITY TO GROW REVENUES COULD BE HARMED.

In order to grow our business, we must establish, maintain and strengthen relationships with third-parties, such as information technology ("IT") consultants and systems integrators as implementation partners, and hardware and software vendors as marketing partners. If these parties do not provide sufficient, high-quality service or integrate and support our software correctly, our revenues may be harmed. In addition, these parties may offer products of other companies, including products that compete with our products. Our contracts with third-parties may not require these third-parties to devote resources to promoting, selling and supporting our solutions. Therefore, we may have little control over these third-parties. We cannot assure you that we can generate and maintain relationships that offset the significant time and effort that are necessary to develop these relationships, or that, even if we are able to develop such relationships, these third-parties will perform adequately.

WE MAY NOT BE ABLE TO REDUCE OUR OPERATING EXPENDITURES AS AGGRESSIVELY AS PLANNED AND WE MAY NEED TO IMPLEMENT ADDITIONAL RESTRUCTURING ACTIVITIES.

In response to the current uncertain economic environment and volatility in the public equity markets, we recently implemented significant measures designed to reduce our operating expenses and enhance our ability to attain operating profitability. For example, from July 1, 2000, through June 30, 2001, we reduced our employee headcount by 133 persons, with reductions in virtually all areas of operations. We further reduced our headcount by 49 persons in August 2001. We expect that our workforce reductions and other expense containment measures will allow us to continue operations into the foreseeable future.

In order to achieve operating profitability, we will need to achieve significant additional cost savings in future quarters, without adversely affecting our revenue growth. Numerous factors could impede our ability to further reduce our operating expenses. For instance, we currently expect to achieve significant expense reductions by limiting the headcount of our services organization; however, we may not be able to achieve the desired savings if we cannot engage and qualify third-party integration and support partners as rapidly as we hope. In addition, if our revenue growth fails to meet our current expectations, we would be forced to seek expense reductions in excess of our current plans, which may not be achievable. Any of these developments could impede our ability to achieve profitable operations in accordance with current expectations.

THE LENGTHY AND UNPREDICTABLE SALES CYCLES FOR OUR PRODUCTS AND RESISTANCE TO ADOPTION OF OUR SOFTWARE COULD CAUSE OUR OPERATING RESULTS TO FALL BELOW EXPECTATIONS.

Our operating results for future periods could be adversely affected because of unpredictable increases in our sales cycles. Our products and services have lengthy and unpredictable sales cycles varying from as little as three months to as much as nine months, which could cause our operating results to be below the expectations of analysts and investors. Since we are unable to control many of the factors that will influence our customers' buying decisions, it is difficult for us to forecast the timing and recognition of revenues from sales of our solutions.

Customers in our target market often take an extended time evaluating our products before purchasing them. Our products may have an even longer sales cycle in international markets. During the evaluation period, a variety of factors, including the introduction of new products or aggressive discounting by competitors and changes in our customers' budgets and purchasing priorities, may lead customers to not purchase or to scale down orders for our products.

As we target industry sectors and types of organizations beyond our core market of IT services consultancies, we may encounter increased resistance to use of business process automation solutions, which may further increase the length of our sales cycles, increase our marketing costs and reduce our revenues. Because we are pioneering a new solution category, we often must educate our prospective customers on the use and benefit of our solutions, which may cause additional delays during the evaluation process. These companies may be reluctant to abandon investments they have made in other systems in favor of our solution. In addition, IT departments of potential customers may resist purchasing our solutions for a variety of other reasons, particularly the potential displacement of their historical role in creating and running software, and concerns that packaged software products are not sufficiently customizable for their enterprises.

OUR SERVICES REVENUES HAVE A SUBSTANTIALLY LOWER MARGIN THAN OUR SOFTWARE LICENSE REVENUES, AND AN INCREASE IN SERVICES REVENUES RELATIVE TO LICENSE REVENUES COULD HARM OUR GROSS MARGINS.

A significant shift in our revenue mix away from license revenues to service revenues would adversely affect our gross margins. Revenues derived from the services we provide have substantially lower gross margins than revenues we derive from licensing our software. The relative contribution of services we provide to our overall revenues is subject to significant variation based on the structure and pricing of arrangements we enter into with customers in the future, and the extent to which our partners provide implementation, integration, training and maintenance services required by our customers. An increase in the percentage of total revenues generated by the services we provide could adversely affect our overall gross margins.

DIFFICULTIES WITH THIRD-PARTY SERVICES AND TECHNOLOGIES, AS WELL AS POWER INTERRUPTIONS, COULD DISRUPT OUR BUSINESS, AND MANY OF OUR COMMUNICATION AND HOSTING SYSTEMS DO NOT HAVE BACKUP SYSTEMS.

Many of our communications and hosting systems do not have backup systems capable of mitigating the effect of service disruptions. Our success in attracting and retaining customers for our Evolve application service provider

("ASP") offering and convincing them to increase their reliance on this solution depends on our ability to offer customers reliable, secure and continuous service. This requires that we provide continuous and error-free access to our systems and network infrastructure. We rely on third-parties to provide key components of our networks and systems. For instance, we rely on third-party Internet service providers to host applications for customers who purchase our solutions on an ASP basis. We also rely on third-party communications services providers for the high-speed connections that link our Web servers and office systems to the Internet. Any Internet or communications systems failure or interruption could result in disruption of our service or loss or compromise of customer orders and data. These failures, especially if they are prolonged or repeated, would make our services less attractive to customers and tarnish our reputation.

In addition, California has recently been experiencing electric power supply shortages that has resulted in intermittent loss of power in the form of rolling blackouts. While neither we nor our third-party Internet service providers or communications services providers have experienced any power failures to date that have prevented us from continuing our operations, the recurrence of blackouts may affect our ability to operate our business.

Finally, our third-party Internet and communications services providers have been and may continue to experience serious financial difficulties, which could result in the disruption of our ASP offering to our customers as well as potentially affecting our ability to operate our business. The financial difficulties of these third-party providers, especially if they go unresolved, would make our ASP offering less attractive to prospective and current customers and could tarnish our reputation.

OUR MARKETS ARE HIGHLY COMPETITIVE, AND COMPETITION COULD HARM OUR ABILITY TO SELL PRODUCTS AND SERVICES AND REDUCE OUR MARKET SHARE.

Competition could seriously harm our ability to sell additional software solutions and subscriptions on prices and terms favorable to us. The markets for our products are intensely competitive and subject to rapidly changing technology. We currently compete against providers of automation solutions for professional services organizations, such as Peoplesoft, Siebel and SAP. In addition, we may, in the future, face competition from providers of enterprise application software or electronic marketplaces. Companies in each of these areas may expand their technologies or acquire companies to support greater professional services automation functionality and capabilities. In addition, "in-house" information technology departments of potential customers have developed or may develop systems that substitute for some of the functionality of our product line.

Some of our competitors' products may be more effective than our products at performing particular functions or be more customized for particular customer needs. Even if these functions are more limited than those provided by our products, our competitors' software products could discourage potential customers from purchasing our products. A software product that provides some of the functions of our software solutions, but also performs other tasks may be appealing to these vendors' customers because it would reduce the number of different types of software necessary to effectively run their businesses. Further, many of our competitors may be able to respond more quickly than we can to changes in customer requirements.

Some of our competitors have longer operating histories, significantly greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Our competitors have made and may also continue to make strategic acquisitions or establish cooperative relationships among themselves or with other software vendors. They may also establish or strengthen cooperative relationships with our current or future partners, limiting our ability to promote our products through these partners and limiting the number of consultants available to implement our software.

OUR REVENUES DEPEND ON ORDERS FROM OUR TOP CUSTOMERS, AND IF WE FAIL TO SECURE ONE OR MORE ORDERS, OUR REVENUES WILL BE REDUCED.

Historically, we have received a significant portion of our revenues in each fiscal period from a small number of customers. Accordingly, the loss of a single customer or customer prospect may have a substantial impact on our operating results if we depended on the sale of our products to that customer to meet our financial performance targets during a given fiscal period. Our agreements with existing customers often do not include long-term commitments from customers to continue to purchase our products. Moreover, a substantial percentage of new customer contracts are typically signed in the last few weeks of each fiscal quarter, and prospects we are pursuing have often made a decision not to purchase our products in the final stages of the sales cycle. Accordingly, our ability to meet our financial targets during each fiscal period

is subject to substantial variation and uncertainty, and the loss of one or more customers or customer prospects can cause our operating results to fall below the expectations of investors and analysts and adversely affect our stock price.

IF OUR PRODUCTS DO NOT STAY COMPATIBLE WITH WIDELY USED SOFTWARE PROGRAMS, OUR REVENUES MAY BE ADVERSELY AFFECTED.

Our software products must work with widely used software programs. If these software programs and operating environments do not remain widely used, or we do not update our software to be compatible with newer versions of these programs and systems, we may lose customers.

Our software operates only on a computer server running both the Microsoft Windows NT or Sun Solaris operating system and database software from Microsoft or Oracle. In order to increase the flexibility of our solution and expand our client base, we must be able to successfully adapt it to work with other applications and operating systems. For example, we are in the early stages of customer deployment on the Sun Solaris operating system. Because this development effort is not complete, we cannot be certain that we will avoid significant technical difficulties that could delay or prevent completion of the development effort.

Our software connects to and uses data from a variety of our customers' existing software systems, including systems from Oracle and SAP. If we fail to enhance our software to connect to and use data from new systems of these products, we may lose potential customers.

THE COST AND DIFFICULTIES OF IMPLEMENTING OUR PRODUCTS COULD SIGNIFICANTLY HARM OUR REPUTATION WITH CUSTOMERS AND HARM OUR FUTURE SALES.

If our customers encounter unforeseen difficulties or delays in deploying our products and integrating them with their other systems, they may reverse their decision to use our solutions, which would reduce our future revenues, could impact the collection of outstanding receivables, and potentially damage our reputation. Factors that could delay or complicate the process of deploying our solutions include:

- customers may need to modify significant elements of their existing IT systems in order to effectively integrate them with our solutions;
- customers may need to establish and implement internal business processes within their organizations before they can make effective use of our software;
- customers may need to purchase and deploy significant additional hardware and software resources and may need to make significant investments in consulting and training services; and
- customers may rely on third-party systems integrators to perform all or a portion of the deployment and integration work, which reduces the control we have over the implementation process and the quality of customer service provided to the customer.

OUR SALES ARE CONCENTRATED IN THE IT SERVICES CONSULTING INDUSTRY, AND, IF OUR CUSTOMERS IN THIS INDUSTRY DECREASE THEIR INFRASTRUCTURE SPENDING OR WE FAIL TO PENETRATE OTHER INDUSTRIES, OUR REVENUES MAY DECLINE.

Sales to customers in the IT services consulting industry accounted for 65% and 40% of our revenues in fiscal 2000 and 2001, respectively. Given the high degree of competition and the rapidly changing environment in this industry, there is no assurance that we will be able to continue sales in this industry at current levels. Many of our customers and potential customers in the IT services consultancy industry have witnessed drastic declines in their stock prices, which could limit our current customers from purchasing additional licenses of our software, and could prevent potential customers from making the kinds of infrastructure investments that would allow them to purchase our software in the first place. In addition, we intend to market our products to professional services departments of large organizations in other industries. Customers in these new industries are likely to have different requirements and may require us to change our product design or features, sales methods, support capabilities or pricing policies. If we fail to successfully address the needs of these customers, we may experience decreased sales in future periods.

IF OUR PRODUCTS CONTAIN SIGNIFICANT DEFECTS OR OUR SERVICES ARE NOT PERCEIVED AS HIGH QUALITY, WE COULD LOSE POTENTIAL CUSTOMERS OR BE SUBJECT TO DAMAGES.

Our products are complex and may contain currently unknown errors, defects, integration problems or other types of failures, particularly since new versions are frequently released. In the past we have discovered software errors in some of our products after introduction. We may not be able to detect and correct errors before releasing our products commercially. If our commercial products contain errors, we may:

- need to expend significant resources to locate and correct the errors;
- be required to delay introduction of new products or commercial shipment of products; or
- experience reduced sales and harm to our reputation from dissatisfied customers.

Our customers also may encounter system configuration problems that require us to spend additional consulting or support resources to resolve these problems.

Some of our customers have indicated to us that they want a completely integrated solution, including a single user interface and single database platform. While our product roadmap calls for such an integrated solution, any delays in delivering such a solution to our customers may cause them to downgrade their opinion of our software or to abandon our software.

Because our customers use our software products for critical operational and decision-making processes, product defects may also give rise to product liability claims. Although our license agreements with customers typically contain provisions designed to limit our exposure, some courts may not enforce all or part of these limitations. Although we have not experienced any product liability claims to date, we may encounter these claims in the future. Product liability claims, whether or not they have merit, could:

- divert the attention of our management and key personnel from our business;
- be expensive to defend; and
- result in large damage awards.

We do not have product liability insurance, and even if we obtain product liability insurance, it may not be adequate to cover all of the expenses resulting from such a claim.

OUR BUSINESS MAY SUFFER IF WE ARE NOT ABLE TO PROTECT OUR INTELLECTUAL PROPERTY.

Our success is dependent on our ability to develop and protect our proprietary technology and intellectual property rights. We seek to protect our software, documentation and other written materials primarily through a combination of patent, trade secret, trademark and copyright laws, confidentiality procedures and contractual provisions. While we have attempted to safeguard and maintain our proprietary rights, we do not know whether we have been or will be completely successful in doing so. Further, our competitors may independently develop or patent technologies that are substantially equivalent or superior to ours.

We have been issued a patent in the United States covering the enablement of dynamically configurable software systems by our Evolve software server. We also have two patent applications pending in the United States with respect to the "Team Builder" functionality in our Resource Manager module and the time and expense functionality of our Time and Expense module. There can be no assurance that either of these two applications would survive a legal challenge to its validity or provide significant protection to us. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult. While we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem, particularly in foreign countries where the laws may not protect proprietary rights as fully as in the United States. We can offer no assurance that our means of protecting its proprietary rights will be adequate or that our competitors will not reverse engineer or independently develop similar technology.

IF OTHERS CLAIM THAT WE ARE INFRINGING THEIR INTELLECTUAL PROPERTY, WE COULD INCUR SIGNIFICANT EXPENSES OR BE PREVENTED FROM SELLING OUR PRODUCTS.

We cannot provide assurance that others will not claim that we are infringing their intellectual property rights or that we do not in fact infringe those intellectual property rights. We have not conducted a search for existing intellectual property registrations, and we may be unaware of intellectual property rights of others that may cover some of our technology.

Any litigation regarding intellectual property rights could be costly and time-consuming and divert the attention of our management and key personnel from our business operations. The complexity of the technology involved and the uncertainty of intellectual property litigation increases these risks. Claims of intellectual property infringement might also require us to enter into costly royalty or license agreements.

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We may not be able to obtain royalty or license agreements on terms acceptable to us, or at all. We also may be subject to significant damages or an injunction against use of our products. A successful claim of patent or other intellectual property infringement against us would have an immediate material adverse effect on our business and financial condition.

WE CONTINUE TO OPERATE INTERNATIONALLY, BUT WE MAY ENCOUNTER A NUMBER OF PROBLEMS IN DOING SO WHICH COULD LIMIT OUR FUTURE GROWTH.

We may not be able to successfully market, sell, deliver and support our products and services internationally. Any failure to build and manage effective international operations could limit the future growth of our business. Expansion into international markets will require significant management attention and financial resources to open additional international offices and hire international sales and support personnel. Localizing our products is difficult and may take longer than we anticipate because of difficulties in translation and delays we may experience in recruiting and training international staff. We currently have no experience in developing local versions of our products, and limited experience in marketing, selling and supporting our products and services overseas. Doing business internationally involves greater expense and many additional risks, particularly:

- differences and unexpected changes in regulatory requirements, taxes, trade laws, tariffs, intellectual property rights and labor regulations;
- changes in a specific country's or region's political or economic conditions;
- greater difficulty in establishing, staffing and managing foreign operations; and
- fluctuating exchange rates.

SECURITY CONCERNS, PARTICULARLY RELATED TO THE USE OF OUR SOFTWARE ON THE INTERNET, MAY LIMIT THE EFFECTIVENESS OF AND REDUCE THE DEMAND FOR OUR PRODUCTS.

Despite our efforts to protect the confidential and proprietary information of our customers stored on our Evolve ASP solution via virtual private networks and other security devices, there is a risk that this information will be disclosed to unintended third-party recipients. To the extent our ability to implement secure private networks, on our Evolve ASP service, is impaired by technical problems, or by improper or incomplete procedural diligence by either ourselves or our customers, sensitive information could be exposed to inappropriate third-parties such as competitors of our customers, which may in turn expose us to liability and detrimentally impact our customers' confidence in our ASP service.

RESISTANCE TO ONLINE USE OF PERSONAL INFORMATION REGARDING EMPLOYEES AND CONSULTANTS MAY HINDER THE EFFECTIVENESS OF AND REDUCE DEMAND FOR OUR PRODUCTS AND SERVICES.

Companies store information on our ASP offering and on online networks created by our customers, which may include personal information of their employees, including employee backgrounds, skills, and other details. These employees may object to online compilation, transmission and storage of such information, or, despite our efforts to keep such personal information secure, this information may be delivered unintentionally to inappropriate third-parties such as recruiters. Enterprise applications like Evolve have always run on secure company intranets. The information contained in Evolve databases will be exposed to the unpredictable security of the Internet, which may create unforeseen liabilities for us. Evolve is currently targeted primarily to the North American market, but to the extent that European companies and customers will have access to it (given the global nature of the Internet), and to the extent that our services are utilized by Europeans, legal action grounded in European privacy laws could prevent our ASP service from succeeding in the European market.

POTENTIAL IMPOSITION OF GOVERNMENTAL REGULATION OR TAXATION ON ELECTRONIC COMMERCE COULD LIMIT OUR GROWTH.

The adoption of new laws or the adaptation of existing laws to the Internet may decrease the growth in the use of the Internet, which could in turn decrease the demand for our solutions, increase our cost of doing business or otherwise have a material adverse impact on our business. Few laws or regulations currently directly apply to access commerce on the Internet. Federal, state, local and foreign governments are considering a number of legislative and regulatory proposals relating to Internet commerce. As a result, a number of laws or regulations may be adopted regarding Internet user privacy, taxation, pricing, quality of products and services and intellectual property ownership. How existing laws will be applied to the Internet in areas such as property ownership, copyright, trademark, trade secret and defamation is uncertain. The recent growth of Internet commerce has been attributed by some to the lack of sales and value-added taxes on interstate sales of goods and services over the Internet. Numerous state and local authorities have expressed a desire to impose such taxes on sales to businesses in their jurisdictions. The Internet

Tax Freedom Act of 1998 prevents imposition of such taxes through October 2001. If the federal moratorium on state and local taxes on Internet sales is not renewed, or if it is terminated before its expiration, sales of goods and services over the Internet could be subject to multiple overlapping tax schemes, which could substantially hinder the growth of Internet-based commerce.

RISKS RELATED TO OUR STOCK

OUR OFFICERS, DIRECTORS AND AFFILIATED ENTITIES HAVE SIGNIFICANT CONTROL OVER US AND MAY APPROVE OR REJECT MATTERS CONTRARY TO YOUR VOTE OR INTERESTS.

Our executive officers and directors together with their affiliates beneficially own, or have rights to acquire, an aggregate of approximately 57.5% of our outstanding common stock. These stockholders, if acting together, will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or similar transactions, even if other stockholders disagree. In particular, Warburg Pincus Private Equity VIII, L.P. ("Warburg") owns or has the right to acquire securities with voting power equivalent to 55.0% of our outstanding capital stock. Furthermore, certain actions that we may wish to undertake require the consent of holders of a majority of our outstanding shares of Series A Preferred Stock, voting as a separate class. These actions include authorization and sale of certain senior securities, certain transactions involving a change of control of Evolve, the incurrence of significant indebtedness and the payment of dividends. With respect to these and other matters, the interests of the holders of our Series A Preferred Stock will not necessarily be identical to those of holders of our common stock. For instance, in the event of certain change of control transactions, the holders of Series A Preferred Stock are entitled to payment of a liquidation preference prior to payment of any consideration to the holders of our common stock. This may cause the holders of Series A Preferred Stock generally, and Warburg in particular, to favor or oppose a merger or sale of the Company or its assets in circumstances where many holders of common stock have a contrary desire. In such an instance, the Company may not be able to pursue the transaction in question even if it is supported by many or most holders of our common stock.

THE SALE OF A SUBSTANTIAL NUMBER OF SHARES OF COMMON STOCK COULD CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO DECLINE.

Sales of a substantial number of shares of our common stock in the public market, or the appearance that such shares are available for sale, could adversely affect the market price for our common stock. The market price of our stock could also decline if one or more of our significant stockholders decided for any reason to sell substantial amounts of our stock in the public market. As of August 31, 2001, we had 40,166,616 shares of common stock outstanding. Of these shares, 35,325,418 were freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 or S-8/S-3 prospectus delivery requirements, and, in some cases, only to either manner of sale, volume, or notice requirements of Rule 144 under the Securities Act of 1933, as amended. An additional 3,287,944 shares will become eligible for sale, subject only to the manner of sale requirements of Rule 144, as our right to repurchase these shares lapses over time with the continued employment by Evolve of these stockholders. The remaining 1,553,254 shares that were outstanding as of August 31, 2001, will be freely tradable, subject only to Form S-3 delivery requirements, upon the effectiveness of the Form S-3 that was filed in September 2001 and that is expected to be amended in October 2001 (as will a further 663,495 shares which were issued on September 19, 2001, and which are subject to increase or decrease based on Evolve's stock price as of the date the Form S-3 becomes effective).

As of August 31, 2001, we also had 5,092,616 shares subject to outstanding options under our stock option plans (plus 224,167 options and warrants issued outside of any plan), and 2,533,725 shares are available for future issuance under these plans. We have registered the shares of common stock subject to outstanding options and reserved for issuance under our stock option plans and

1,885,340 remaining shares of common stock are reserved for issuance under our 2000 Employee Stock Purchase Plan. Accordingly, shares underlying vested options will be eligible for resale in the public market as soon as they are purchased.

NASDAQ LISTING MAY BE AT RISK.

We failed to maintain the minimum closing bid price of $1.00 over 30 consecutive trading days as required by the Nasdaq National Market. Nasdaq has suspended this minimum bid price requirement through January 2, 2002. If the minimum bid price requirement is reinstated after that date and if we are unable to demonstrate compliance with any Nasdaq requirement, the Nasdaq staff may take further action with respect to a potential delisting of our stock. We may appeal any such decision by the Nasdaq staff to the Nasdaq Listing Qualifications Panel.

ITEM 2. PROPERTIES

Our facilities consist of approximately 72,000 square feet of office space in Emeryville, California, leased to us until 2007. We estimate that approximately 37,000 square feet of this space is in excess of our needs and are currently seeking tenants for a sublease. Our excess facilities are covered in more detail in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." We also maintain sales organizations in various locations around the United States and the United Kingdom and a research facility in India, none of which is significant individually or in the aggregate.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company may become involved in litigation relating to claims arising from the ordinary course of business. In February 2001 one of the Company's early customers, a technology consulting firm, filed an action in the United States District Court for the District of Massachusetts alleging claims that certain software and services purchased from the Company did not satisfy certain contractual obligations. The lawsuit further alleges that the Company engaged in unfair or deceptive practices in violation of Massachusetts state law and is seeking treble damages based on this claim. The claimant's prayer for relief includes award damages in excess of $75,000, interest, costs and attorneys fees. As the claim is in the early stage of litigation, it is not possible to estimate the outcome of this contingency.

We believe that there are no other claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal year 2001.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is listed on the Nasdaq National Market under the symbol "EVLV." The price range per share reflected in the table below represents the highest and lowest sale prices for our stock as reported by the Nasdaq National Market during each quarter the stock has been publicly traded since August 10, 2000, the date of our initial public offering:

	High	Low
Quarter ended September 30, 2000	$ 28.75	$ 9.00
Quarter ended December 31, 2000	$ 24.63	$ 4.38
Quarter ended March 31, 2001	$ 9.23	$ 2.00
Quarter ended June 30, 2001	$ 2.84	$ 0.51

The number of holders of record of the shares of our common stock was 784 as of August 31, 2001. There are approximately 3,100 additional beneficial owners of our common stock.

We have not paid any cash dividends on our capital stock. We currently intend to retain any earnings to fund the development and growth of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future as our bank credit agreements prohibit payment of cash dividends. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources."

RECENT SALES OF UNREGISTERED SECURITIES

On June 29, 2001, we issued and sold 1,553,254 shares of common stock to Vivant! Corporation pursuant to an Asset Acquisition Agreement dated May 22, 2001, as partial consideration for the assets acquired.

USE OF PROCEEDS OF REGISTERED SECURITIES

There has been no change to the disclosure contained in our report on Form 10-Q for the quarter ended March 31, 2001, regarding the use of proceeds generated by our initial public offering.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" presented in Item 7 and more detailed financial statements presented in Item 14(1) of this Form 10-K. The consolidated financial data for periods prior to the financial statements presented in Item 8 of this Form 10-K are derived from audited consolidated financial statements not included herein. Historical results are not necessarily indicative of results that may be expected for any future period.

SUMMARY CONSOLIDATED FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	YEAR ENDED JUNE 30,			
	2001	2000	1999	19

Revenues:				
Solutions	$ 25,398	$ 7,157	$ 150	$
Subscriptions	9,549	3,386	367	
Total revenues	$ 34,947	$ 10,543	$ 517	$
Gross profit (loss)	17,576	3,373	(124)	
Operating loss	(107,926)	(61,063)	(11,126)	(9
Net loss attributable to common stockholders	(111,367)	(69,374)	(11,471)	(10
Basic and diluted net loss per common share	$ (3.63)	$ (22.83)	$ (7.21)	$ (
Shares used in computing basic and diluted net loss per common share (1)	30,643	3,039	1,591	1

	JUNE 30,			
	2001	2000	1999	19
CONSOLIDATED BALANCE SHEET DATA:				
Cash, cash equivalents and short-term investments	$ 22,754	$ 18,660	$ 2,840	$ 2
Working capital	7,126	4,598	1,000	1
Restricted cash	-	2,000	-	
Total assets	47,621	63,979	4,087	3
Long-term debt and capital lease obligations	2,769	4,810	3,899	14
Redeemable convertible preferred stock	-	79,514	31,579	11
Total stockholders' (deficit) equity	$ 15,343	$(40,632)	$(34,734)	$(23