

EMBARCADERO TECHNOLOGIES INC
Form 10-Q
August 11, 2003
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2003.

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 000-30293

EMBARCADERO TECHNOLOGIES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

68-0310015
(I.R.S. Employer Identification No.)

425 MARKET STREET, SUITE 425
SAN FRANCISCO, CA 94105
(415) 834-3131
(Address of principal executive offices)

Indicate by check mark whether the registrant (1) 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 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 No

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

Yes No

The number of shares outstanding of the Registrant's Common Stock as of July 31, 2003 was 26,515,010.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

(unaudited)

| | <u>June 30,</u> <u>2003</u> | <u>December</u> <u>31,</u> <u>2002</u> |
|--|--------------------------------|--|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 34,895 | \$ 15,870 |
| Short-term investments | 13,360 | 27,893 |
| Trade accounts receivable, net | 7,383 | 7,539 |
| Prepaid expenses and other current assets | 1,754 | 1,532 |
| Deferred income taxes | 489 | 489 |
| | <u>57,881</u> | <u>53,323</u> |
| Property and equipment, net | 3,174 | 3,587 |
| Goodwill | 10,337 | 10,337 |
| Other intangible assets, net | 1,096 | 1,500 |
| Deferred income taxes | 2,840 | 2,840 |
| Other assets | 4,675 | 5,128 |
| | <u>80,003</u> | <u>76,715</u> |
| | <u>\$ 80,003</u> | <u>\$ 76,715</u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 276 | \$ 379 |
| Accrued liabilities | 4,215 | 3,431 |
| Deferred revenue | 12,462 | 10,705 |
| | <u>16,953</u> | <u>14,515</u> |
| | <u>16,953</u> | <u>14,515</u> |
| Stockholders Equity: | | |
| Common stock, \$0.001 par value | 27 | 27 |
| Treasury stock | (6,287) | (5,116) |
| Additional paid-in capital | 75,883 | 75,858 |
| Accumulated other comprehensive income | 102 | 184 |
| Deferred stock-based compensation | (163) | (598) |
| Accumulated deficit | (6,512) | (8,155) |

| | | |
|--|------------------|------------------|
| Total stockholders' equity | <u>63,050</u> | <u>62,200</u> |
| Total liabilities and stockholders' equity | <u>\$ 80,003</u> | <u>\$ 76,715</u> |

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.**

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-----------------|--------------------------------------|---------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues: | | | | |
| License | \$ 6,421 | \$ 6,516 | \$12,768 | \$13,612 |
| Maintenance | 6,024 | 5,403 | 11,885 | 10,809 |
| Total revenues | 12,445 | 11,919 | 24,653 | 24,421 |
| Cost of revenues: | | | | |
| License | 105 | 155 | 205 | 284 |
| Amortization of acquired technology | 556 | 405 | 1,111 | 674 |
| Maintenance | 565 | 524 | 1,153 | 1,150 |
| Total cost of revenues | 1,226 | 1,084 | 2,469 | 2,108 |
| Gross profit | 11,219 | 10,835 | 22,184 | 22,313 |
| Operating expenses: | | | | |
| Research and development | 4,016 | 3,560 | 7,806 | 7,290 |
| Purchased research and development | | 1,100 | | 1,100 |
| Sales and marketing | 4,844 | 4,619 | 9,739 | 9,494 |
| General and administrative | 1,308 | 1,408 | 2,610 | 2,749 |
| Amortization of other intangible assets | | 385 | | 770 |
| Total operating expenses | 10,168 | 11,072 | 20,155 | 21,403 |
| Income (loss) from operations | 1,051 | (237) | 2,029 | 910 |
| Other income, net | 159 | 180 | 285 | 356 |
| Income (loss) before provision for income taxes and share in loss of joint venture | 1,210 | (57) | 2,314 | 1,266 |
| Benefit from (provision for) income taxes | (463) | 58 | (671) | (312) |
| Income before share in loss of joint venture | 747 | 1 | 1,643 | 954 |
| Share in loss of joint venture, net of income taxes | | (123) | | (423) |
| Net income (loss) | \$ 747 | \$ (122) | \$ 1,643 | \$ 531 |

| | | | | |
|--|---------|-----------|---------|----------|
| Net income (loss) per share: | | | | |
| Basic | \$ 0.03 | \$ (0.00) | \$ 0.06 | \$ 0.02 |
| Diluted | \$ 0.03 | \$ (0.00) | \$ 0.06 | \$ 0.02 |
| Weighted average shares used in per share calculation: | | | | |
| Basic | 26,488 | 27,225 | 26,569 | 27,180 |
| Diluted | 28,212 | 27,225 | 28,244 | 29,383 |
| Non-cash stock-based compensation included in the above expenses: | | | | |
| Cost of revenues | \$ | \$ 1 | \$ | \$ 2 |
| Research and development | 3 | 8 | 6 | 21 |
| Sales and marketing | 77 | 208 | 182 | 458 |
| General and administrative | 97 | 338 | 247 | 755 |
| | \$ 177 | \$ 555 | \$ 435 | \$ 1,236 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

| | Six Months Ended June 30, | |
|---|--------------------------------------|----------------|
| | 2003 | 2002 |
| Cash Flows from Operating Activities: | | |
| Net income | \$ 1,643 | \$ 531 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,065 | 1,000 |
| Provision for (recovery of) doubtful accounts | (57) | 243 |
| Amortization of developed technology | 1,139 | 764 |
| Amortization of other intangible assets | | 770 |
| Amortization of deferred stock-based compensation | 435 | 1,236 |
| Share in loss of joint venture, net of income taxes | | 423 |
| Changes in assets and liabilities: | | |
| Trade accounts receivable | 191 | (633) |
| Prepaid expenses and other assets | (199) | (506) |
| Accounts payable and accrued liabilities | 641 | 391 |
| Deferred revenue | 1,706 | 1,521 |
| Net cash provided by operating activities | <u>6,564</u> | <u>5,740</u> |
| Cash Flows from Investing Activities: | | |
| Purchase of investments | (11,396) | |
| Maturities of investments | 10,200 | |
| Sales of investments | 15,617 | 1,541 |
| Purchase of property and equipment | (592) | (1,564) |
| Technology acquired and developed | (275) | (290) |
| Acquisition of businesses | | (2,000) |
| Investment in joint venture | | (500) |
| Net cash provided by (used in) investing activities | <u>13,554</u> | <u>(2,813)</u> |
| Cash Flows from Financing Activities: | | |
| Payments for repurchase of common stock | (1,171) | (102) |
| Proceeds from exercise of stock options | 25 | 504 |
| Net cash provided by (used in) financing activities | <u>(1,146)</u> | <u>402</u> |
| Effect of exchange rate changes on cash and cash equivalents | 53 | 40 |
| Net increase in cash and cash equivalents | 19,025 | 3,369 |

| | | |
|--|-----------|----------|
| Cash and cash equivalents at beginning of period | 15,870 | 23,371 |
| Cash and cash equivalents at end of period | \$ 34,895 | \$26,740 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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EMBARCADERO TECHNOLOGIES, INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)**

NOTE 1 THE COMPANY AND BASIS OF PRESENTATION

Embarcadero Technologies, Inc. (with its subsidiaries, collectively referred to as the Company) was incorporated in California on July 23, 1993 and reincorporated in Delaware on February 15, 2000. The Company provides software products that enable organizations to effectively manage their database infrastructure and manage the underlying data housed within that infrastructure. The Company is headquartered in San Francisco, California and has international operations in Toronto, Canada, Maidenhead, United Kingdom and Melbourne, Australia.

The Company has historically derived a significant percentage of its revenues from its DBArtisan product. This product is expected to continue to account for a significant portion of net revenues for the foreseeable future. As a result of this revenue concentration, the Company's business could be harmed by a decline in demand for, or in the prices of, this product resulting from any change in pricing model, a maturation in the market for this product, increased price competition or a failure by the Company to keep up with technological change.

The Company markets its software and related maintenance services directly through telesales and field sales organizations in the United States, the United Kingdom and Australia, and indirectly through independent distributors worldwide.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, which, in the opinion of the Company, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are normal recurring adjustments. These financial statements have been prepared in accordance with generally accepted accounting principles related to interim financial statements and the applicable rules of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2002 was derived from audited financial statements, but it does not include all disclosures required by generally accepted accounting principles.

The financial statements and related disclosures have been prepared with the presumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the related notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, filed on March 26, 2003.

Operating results for the six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2003 or for any future period. Further, the preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the recorded amounts reported therein. A change in facts or circumstances surrounding the estimates could result in a change to the estimates and impact future operating results.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)**NOTE 2- SIGNIFICANT ACCOUNTING POLICIES***Stock-Based Compensation*

Pursuant to SFAS No. 123, Accounting for Stock-Based Compensation, the Company accounts for employee stock options under Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and follows the disclosure-only provisions of SFAS No. 123. Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant, between the estimated fair value of the Company's common stock and the exercise price of options to purchase that stock. For purposes of estimating the compensation cost of the Company's option grants in accordance with SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Had compensation cost for the Company's stock-based compensation plan been determined based on the fair value at the grant dates for the awards under a method prescribed by SFAS No. 123, the Company's net income (loss) would have been changed to the pro forma amounts indicated below (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|--|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (unaudited) | | (unaudited) | |
| Net income (loss), as reported | \$ 747 | \$ (122) | \$ 1,643 | \$ 531 |
| Add: Employee stock-based compensation expense included in reported net income (loss), net of tax | 147 | 476 | 364 | 1,058 |
| Less: Total employee stock-based compensation expense determined under fair value, net of tax | (849) | (1,827) | (1,542) | (2,803) |
| Pro forma net income (loss) | \$ 45 | \$ (1,473) | \$ 465 | \$ (1,214) |
| Basic and diluted net income (loss): | | | | |
| As reported | \$ 0.03 | \$ (0.00) | \$ 0.06 | \$ 0.02 |
| Pro forma | \$ 0.00 | \$ (0.05) | \$ 0.02 | \$ (0.04) |

The fair value of each option grant is estimated on the date of grant using the fair value method, using the following weighted average assumptions:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------|--|-------------|--------------------------------------|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| Risk-free interest rate | 2.33-6.65% | 3.56-6.65% | 2.33-6.65% | 3.56-6.65% |

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| | | | | | |
|--------------------|----|------|------|------|------|
| Expected life | | 4 | 4 | 4 | 4 |
| Expected dividends | \$ | \$ | \$ | \$ | \$ |
| Volatility | | 113% | 113% | 113% | 113% |

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Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)*Recent Accounting Pronouncements*

In November 2002, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee or an indemnification. In addition, FIN 45 requires disclosures about the guarantees or indemnifications that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees and indemnifications issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company fully adopted FIN 45 in the first quarter of 2003. The disclosure requirements are contained within Note 10, and the impact of the recognition and initial measurement of FIN 45 did not have a material effect on the Company's financial position and results of operations.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of this standard did not have a material impact on the Company's financial position and results of operations.

NOTE 3 COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) consists of unrealized gains (losses) on available-for-sale investments and foreign currency translation adjustments during the period.

The components of comprehensive income (loss) are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|----------------|--|---------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (unaudited) | | (unaudited) | |
| Net income (loss) | \$ 747 | \$ (122) | \$ 1,643 | \$ 531 |
| Unrealized loss on available-for-sale investments, net of income taxes | | | (112) | |
| Foreign currency translation adjustments, net of income taxes | 48 | 64 | 30 | 40 |
| Comprehensive income (loss) | \$ 795 | \$ (58) | \$ 1,561 | \$ 571 |

NOTE 4 EARNINGS PER SHARE

Basic net income (loss) per share excludes the effect of potentially dilutive securities and is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share reflects the potential dilution of securities by adding dilutive stock options to the weighted average number of common shares outstanding for the period.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net income (loss) per share is as follows (in thousands, except per share data):

| | Three Months | | Six Months Ended | |
|--|---------------------|-------------|-------------------------|-------------|
| | Ended | | June 30, | |
| | June 30, | | June 30, | |
| | 2003 | 2002 | 2003 | 2002 |
| | (unaudited) | | (unaudited) | |
| Calculation of basic net income (loss) per share: | | | | |
| Net income (loss) | \$ 747 | \$ (122) | \$ 1,643 | \$ 531 |
| Weighted average common shares outstanding | 26,488 | 27,225 | 26,569 | 27,180 |
| Net income (loss) per share, basic | \$ 0.03 | \$ (0.00) | \$ 0.06 | \$ 0.02 |
| Calculation of diluted net income (loss) per share: | | | | |
| Net income (loss) | 747 | (122) | 1,643 | 531 |
| Weighted average common shares outstanding | 26,488 | 27,225 | 26,569 | 27,180 |
| Dilutive securities- common stock options | 1,724 | | 1,675 | 2,203 |
| Weighted average common and common equivalent shares | 28,212 | 27,225 | 28,244 | 29,383 |
| Net income (loss) per share, diluted | \$ 0.03 | \$ (0.00) | \$ 0.06 | \$ 0.02 |
| Anti-dilutive common stock options not included in net income (loss) per share calculation | 1,605 | 1,555 | 1,581 | 914 |

NOTE 5 ACCOUNTING FOR BUSINESS COMBINATIONS, GOODWILL AND OTHER INTANGIBLE ASSETS

Between January 1, 2003 and June 30, 2003, there were no changes to the Company's goodwill balance of \$10.3 million.

Other intangible assets subject to amortization consist of technology that is being amortized over a period of four years and a covenant not to compete that was fully amortized at the end of 2002. The components of other intangible assets, excluding goodwill, are as follows (in thousands):

| As of June 30, 2003 | | | As of December 31, 2002 | | |
|------------------------------|---------------------------------|----------------------------|--------------------------------|---------------------------------|----------------------------|
| Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |

| Other intangible assets: | | | | | | |
|--------------------------|----------|----------|----------|----------|----------|----------|
| Purchased technology | \$ 3,230 | \$ 2,134 | \$ 1,096 | \$ 3,230 | \$ 1,730 | \$ 1,500 |
| Covenant not to compete | 3,080 | 3,080 | | 3,080 | 3,080 | |
| Total | \$ 6,310 | \$ 5,214 | \$ 1,096 | \$ 6,310 | \$ 4,810 | \$ 1,500 |

Expected future amortization expense for other intangible assets is as follows (in thousands):

| Fiscal Years: | |
|-------------------|-----------------|
| Remainder of 2003 | \$ 404 |
| 2004 | 692 |
| | <u>\$ 1,096</u> |

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)**NOTE 6 CAPITALIZED SOFTWARE**

The Company accounts for certain software development costs, including purchased software, in accordance with SFAS No. 86, Accounting for Costs of Computer Software to be Sold, Leased or Otherwise Marketed. In the three and six months ended June 30, 2003, the Company capitalized approximately \$170,000 and \$275,000, respectively, of software development costs pursuant to SFAS No. 86. For the comparable periods in 2002, the Company capitalized approximately \$130,000 and \$290,000, respectively, of such costs. Gross software development costs capitalized in accordance with SFAS No. 86 were \$6.2 million and \$5.9 million at June 30, 2003 and December 31, 2002, respectively, and related accumulated amortization was \$1.9 million and \$1.1 million, respectively. Amortization expense for the three and six months ended June 30, 2003 was \$366,000 and \$735,000, respectively, and was \$247,000 and \$359,000 respectively, for the comparable periods in 2002.

NOTE 7 LEASE RELATED IMPAIRMENT LOSS

During the third quarter of 2001, the Company recorded an impairment loss of \$1.5 million related to office leases in San Francisco and Boston.

A summary of the restructuring accrual is as follows (in thousands):

| | Accrual as of January 1, 2003 | Charged to Accrual | Net Cash Payments | Accrual as of June 30, 2003 |
|---|--|-----------------------------------|------------------------------|--|
| Facilities leases, net of sublease income | \$ 795 | \$ | \$ (191) | \$ 604 |

The accrual balance at June 30, 2003 was \$604,000 and the rent is payable through 2004 for the San Francisco offices leases and 2007 for the Boston office lease.

NOTE 8 TREASURY STOCK

In September 2001, the Company's Board of Directors authorized an initial stock repurchase program of up to 1,000,000 shares of its common stock. In July 2002, the Board of Directors amended the stock repurchase program, allowing the Company to repurchase an additional 2,000,000 shares. Depending on market conditions and other factors, repurchases can be made from time to time in the open market and in negotiated transactions, including block transactions, and this program may be discontinued at any time. In the six months ended June 30, 2003, the Company repurchased approximately 230,000 shares at a cost of approximately \$1.2 million. For the six months ended June 30, 2002, the Company repurchased approximately 12,000 shares at a cost of approximately \$102,000.

NOTE 9 SEGMENT AND GEOGRAPHIC REPORTING

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the chief decision maker of an organization, in order to make operating and resource allocation decisions. By this definition, Embarcadero operates in one reportable operating segment, the design, development, marketing, sales and support of software for database and application development and management.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)

The Company's geographic sales data is based on customer location as defined by the following regions: North America, United Kingdom and Other. The Company's wholly owned subsidiary, Embarcadero Europe Ltd., transacts all sales in Europe, the Middle East and Africa. Various distributors handle sales in regions outside Europe, the Middle East, Africa and North America.

Revenues and long-lived assets by geographic region are as follows (in thousands):

| <u>Geographic Region</u> | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------|------------------------------------|------------------|----------------------------------|--------------------------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (unaudited) | | (unaudited) | |
| Revenues: | | | | |
| North America | \$ 9,953 | \$ 9,604 | \$ 19,653 | \$ 19,453 |
| United Kingdom | 688 | 1,064 | 1,571 | 2,082 |
| Other | 1,804 | 1,251 | 3,429 | 2,886 |
| Total | \$ 12,445 | \$ 11,919 | \$ 24,653 | \$ 24,421 |
| | | | As of June 30, 2003 | As of December 31, 2002 |
| | | | (unaudited) | |
| Long lived assets: | | | | |
| North America | | | \$ 19,071 | \$ 20,299 |
| United Kingdom | | | 211 | 253 |
| Total | | | \$ 19,282 | \$ 20,552 |

NOTE 10 COMMITMENTS AND CONTINGENCIES***Bank Credit Facility***

In June 2003, the Company renewed its \$3.0 million revolving credit facility with a bank. The credit facility bears interest at the prime rate and expires on June 30, 2004. This facility requires that the Company maintain various quarterly financial covenants including covenants related to tangible net worth, total liabilities and profitability. At June 30, 2003, the Company was in compliance with all covenants and had no amounts outstanding under this credit

facility.

Leases

The Company leases office space and equipment under noncancelable operating lease agreements that expire at various dates through 2008. The Company recognizes rent expense on a straight-line basis over the lease period and has accrued for rent expense incurred but not paid. Certain of the Company's leases have renewal options with renewal terms ranging from one to five years.

Table of Contents**EMBARCADERO TECHNOLOGIES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**
(unaudited)

Future minimum lease payments under noncancelable operating leases are as follows (in thousands):

| Year Ending December 31, | Operating Leases |
|-------------------------------------|-----------------------------|
| Remainder of 2003 | \$ 1,222 |
| 2004 | 1,789 |
| 2005 | 1,597 |
| 2006 | 1,469 |
| 2007 | 1,423 |
| Thereafter | 510 |
| Total minimum lease payments | \$ 8,010 |

Contingencies

In October 2002, The Client Server Factory Inc. filed a claim in the Superior Court for the County of San Francisco alleging causes of action for breach of fiduciary duty for misappropriation and theft of corporate opportunity, fraud, negligent misrepresentation, conspiracy and other similar claims, which are primarily related to alleged activities of Wayne Williams, currently the Company's Chief Technology Officer, and EngineeringPerformance, Inc., prior to November 2000, when the Company acquired Engineering Performance and Mr. Williams joined the Company. The complaint names as defendants, in addition to Mr. Williams, Stonegate Insurance Company LTD, a holding company owned by Mr. Williams through which he held his interest in EngineeringPerformance; EngineeringPerformance Inc. and a related company, EngineeringPerformance, LLC; and the Company and Stephen Wong, the Company's President and Chief Executive Officer. Among other things, the complaint alleges that the defendants conspired together to deprive the plaintiff of its proprietary rights to software that the Company acquired from EngineeringPerformance, Inc., which is being used in a product currently under development by the Company. The complaint seeks damages in an unspecified amount.

While we believe that the Company's defenses to the claims are meritorious and the Company intends to defend itself vigorously, no estimate can be made of the possible loss or possible range of loss associated with the resolution of this contingency and accordingly, the Company has not recorded a liability. As the litigation is at an early stage and is uncertain, the Company is unable to predict an outcome at this time and an unfavorable outcome may have a material adverse effect on its financial position, results of operations and cash flow.

The Company may, from time to time, become a party to other legal proceedings arising in the normal course of business. The Company may also be indirectly affected by administrative or court proceedings or actions in which the Company is not involved but which have general applicability to the software industry.

The Company provides general indemnification provisions in its license agreements. In these agreements, the Company states that it will defend or settle, at its own expense, any claim against the customer asserting a patent, copyright, trademark, trade secret or proprietary right violation related to any products that the Company has licensed

to the customer. The Company agrees to indemnify its customers against any loss, expense or liability, including reasonable attorney's fees, from any damages alleged against the customer in its course of using products sold by the Company. The Company has not received any claims under this indemnification and does not know of any instances in which such a claim may be brought against the Company in the future.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included in this Form 10-Q, and with our management's discussion and analysis included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, filed on March 26, 2003.

This report contains forward-looking statements within the meaning of the federal securities laws that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, intend, or the negative of these terms or other comparable terminology. Such statements are only predictions. Risks and uncertainties and the occurrence of other events could cause actual results to differ materially from these predictions. The factors discussed below under Factors That May Affect Future Results should be considered carefully in evaluating Embarcadero and its business. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, we assume no responsibility for the accuracy and completeness of these statements. We are under no duty to update any of the forward-looking statements after the date of this report or to conform these statements to actual results.

Overview

We provide software products that enable organizations to effectively manage their database infrastructure and manage the underlying data housed within that infrastructure. Our Database Administration, Enterprise Data Architecture, Enterprise Data Integration and Performance Management products offer customers comprehensive solutions for managing the database life cycle, which is the process of creating, optimizing and managing the databases that underlie critical business applications. By simplifying the management of the database life cycle, our products allow organizations to ensure the availability, performance and reliability of their critical business applications and to maximize the value they extract from their corporate data.

We were incorporated in California as Client Worx, Inc. in July 1993 and changed our name to Embarcadero Technologies, Inc. in October 1993. We reincorporated in Delaware in February 2000 and completed our initial public offering in April 2000.

Sources of Revenue and Revenue Recognition Policy

Revenues are primarily derived from software license fees and related maintenance and support contracts. Revenues from software license fees are recognized upon shipment, when terms are F.O.B. shipping point, provided that evidence of an arrangement exists, the fee is fixed or determinable and collection of the resulting receivable is probable. Maintenance and support contracts generally cover a one-year term and are paid for in advance. Revenues from maintenance and support contracts are recognized ratably over the contract term. License revenues include the nominal shipping and handling charges associated with most license orders. Actual shipping costs that we incur are included in cost of revenue.

We use a purchase order, a pre-payment via check, wire or credit card, a signed license agreement or other persuasive evidence as substantiation of an arrangement.

For arrangements with multiple obligations (e.g. undelivered maintenance and support contracts and consulting and training services bundled with licenses), we allocate revenue to the delivered elements of the arrangement using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to us. The vendor specific objective evidence of fair value for maintenance and support obligations related to licenses is based upon the prices paid for the separate renewal of these services by the customer. Vendor specific

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objective evidence of the fair value of other services, primarily consulting and training services, is based upon separate sales of those services.

Customers are generally granted payment terms of net thirty days, but some payments are collected via check, wire or credit card at the time an order is placed.

Products may be sold through resellers and distributors in the United States and certain international markets. Revenues from software license fees and maintenance contracts sold through resellers or distributors are recognized on the sell-through method. Distributors purchase products to fulfill specific customer orders and generally do not hold inventory of our products.

The Company also enters into arrangements with Original Equipment Manufacturers (OEM) that provide for license fees based on inclusion of the Company's products in the OEM products. These arrangements often provide for non-refundable up front minimum royalty payments. Assuming that all other revenue recognition criteria are met, such payments are recognized as revenue when due. The OEM arrangements usually include maintenance and support contracts. The Company allocates revenue to the delivered elements of the arrangements using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company.

We sell our software and related maintenance services directly through our telesales and field sales organizations in the United States, the United Kingdom and Australia, and indirectly through our distribution partners worldwide. We intend to continue to expand our international sales activities in an effort to increase revenues from foreign sales.

Our license and maintenance revenues, results of operations, cash flows from operations and financial condition could be adversely affected in future periods by a continued downturn in global economic conditions as well as increased competitive pressures.

Critical Accounting Policies

There have been no material changes to our critical accounting policies and estimates as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2002.

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The following table sets forth, for the periods indicated, the percentage relationship of certain items from the Company's condensed consolidated statements of operations to total revenues:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|-------------|--|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues: | | | | |
| License | 51.6% | 54.7% | 51.8% | 55.7% |
| Maintenance | 48.4 | 45.3 | 48.2 | 44.3 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues: | | | | |
| License | 0.8 | 1.3 | 0.8 | 1.2 |
| Amortization of acquired technology | 4.5 | 3.4 | 4.5 | 2.7 |
| Maintenance | 4.6 | 4.4 | 4.7 | 4.7 |
| Total cost of revenues | 9.9 | 9.1 | 10.0 | 8.6 |
| Gross profit | 90.1 | 90.9 | 90.0 | 91.4 |
| Operating expenses: | | | | |
| Research and development | 32.3 | 29.9 | 31.7 | 29.9 |
| Purchased research and development | | 9.2 | | 4.5 |
| Sales and marketing | 38.9 | 38.8 | 39.5 | 38.9 |
| General and administrative | 10.5 | 11.8 | 10.6 | 11.3 |
| Amortization of other intangible assets | | 3.2 | | 3.2 |
| Total operating expenses | 81.7 | 92.9 | 81.8 | 87.7 |
| Income (loss) from operations | 8.4 | (2.0) | 8.2 | 3.7 |
| Other income, net | 1.3 | 1.5 | 1.2 | 1.5 |
| Income (loss) before provision for income taxes and share in loss of joint venture | 9.7 | (0.5) | 9.4 | 5.2 |
| Benefit from (provision for) income taxes | (3.7) | 0.5 | (2.7) | (1.3) |
| Income before share in loss of joint venture | 6.0 | | 6.7 | 3.9 |
| Share in loss of joint venture, net of income taxes | | (1.0) | | (1.7) |
| Net income (loss) | 6.0% | (1.0)% | 6.7% | 2.2% |

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Three and Six Months Ended June 30, 2003 and 2002

Revenues

Total Revenues. Total revenues were \$12.4 million for the three months ended June 30, 2003, an increase of 4.4% over the \$11.9 million reported in the comparable period of 2002. For the six months ended June 30, 2003, total revenues were \$24.7 million, a 1.0% increase over the \$24.4 million reported in the comparable period of 2002.

License. License revenues were \$6.4 million for the three months ended June 30, 2003, representing a 1.5% decrease from the \$6.5 million reported in the comparable period of 2002. For the six month period, license revenues were \$12.8 million representing a 6.2% decrease from the \$13.6 million reported in the comparable period of 2002. The decrease in license revenues for both periods was due to continued unfavorable macro-economic conditions and the resulting impact on IT related spending. Customers have been faced with shrinking budgets and tighter internal spending controls, which has led to a reduction in IT spending and has impacted not only our license sales but also those of the software industry as a whole. Future license revenues cannot be predicted and will vary based on IT spending patterns, demand for DBArtisan and our other existing products, acceptance of our new products, competitive conditions and other related factors.

Maintenance. Maintenance revenues were \$6.0 million for the three months ended June 30, 2003, an 11.5% increase over the \$5.4 million reported in the comparable period of 2002. Maintenance revenue was \$11.9 million for the six months ended June 30, 2003, an increase of 10.0% over the \$10.8 million reported in the comparable period of 2002. The increase in maintenance revenues was due to the cumulative number of licenses sold and a corresponding increase in our customer base and maintenance renewals. Maintenance revenues are a factor of both new licenses sold and renewals of existing licenses. Future license sales as well as the percentage of existing license holders who opt to renew their maintenance agreements in the future will impact the growth rate of maintenance revenues.

Cost of Revenues

License. Cost of license revenues consists primarily of royalties, credit card merchant fees, product media and packaging and amortization of internally developed software development costs. Cost of license revenues was \$105,000 for the three months ended June 30, 2003, or 1.6% of license revenues, as compared to \$155,000, or 2.4% of license revenues, in the comparable period of 2002. The decrease in absolute dollars from 2002 to 2003 is primarily due to a reduction in amortization expense of approximately \$33,000 relating to internally developed software as some products were fully amortized at the beginning of 2003; also contributing to the decrease were lower credit card merchant fees and royalty fees of approximately \$7,000 and \$4,000, respectively, in the three month period. Cost of license revenues was \$205,000 for the six months ended June 30, 2003, or 1.6% of license revenues, as compared to \$284,000, or 2.1% of license revenues, in the comparable period of 2002. For the six month period, the decrease in absolute dollars from 2002 to 2003 is due to a reduction in amortization expense of approximately \$63,000 relating to internally developed software, as well as lower credit card merchant fees and royalty fees of approximately \$7,000 and \$4,000, respectively, in the three month period. Cost of license revenues as a percentage of license revenues may vary in the future depending on the mix of internally developed versus externally licensed products and the volume and mix of completed license transactions. Additionally, if products for which software development costs have been capitalized come to market, the related amortization expense over the life of the product will increase cost of license revenues in absolute dollars and may increase cost of license revenues as a percentage of license revenues.

Amortization of acquired technology. This amortization relates to technology acquired from third parties that was deemed to have reached technological feasibility at the date of acquisition and therefore capitalized. This expense was \$556,000 and \$1.1 million and for the three and six months ended June 30, 2003, respectively, and \$405,000 and

\$674,000 for the three and six months ended June 30, 2002, respectively. The increase in amortization expense from 2002 to 2003 is related to the timing of the general availability of products containing acquired technology. Amortization of acquired technology may vary in the future depending on the mix of internally developed versus acquired products and whether any potential impairment charges need to be taken to write down the related assets.

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Maintenance. Cost of maintenance revenues consists primarily of customer support personnel and related expenses, including payroll, employee benefits and allocated overhead. Cost of maintenance revenues was \$565,000 for the three months ended June 30, 2003, or 9.4% of maintenance revenues, as compared to \$524,000, or 9.7% of maintenance revenues, for the comparable period in 2002. The increase in absolute dollars is due to a slight increase in personnel related expenses. The decrease as a percentage of related revenues from 2002 to 2003 for the three month period was due to greater efficiencies of scale from the support organization, as the revenue base grew while headcount remained relatively consistent. For the six months ended June 30, 2003 and 2002, cost of maintenance revenues was \$1.2 million or 9.7% and 10.6%, respectively, of maintenance revenues. If we hire more support personnel to support our expanding product line and customer base in advance of an increase in the related revenues, our cost of maintenance revenues may increase in absolute dollars and as a percentage of maintenance revenues.

Operating Expenses***Research and Development***

Research and development expenses consist primarily of personnel and related expenses, including payroll, employee benefits and allocated overhead, non-cash stock-based compensation and payments made to outside software development contractors. Research and development expenses were \$4.0 million, or 32.3% of revenues, for the three months ended June 30, 2003 and \$3.6 million, or 29.9% of revenues, for the comparable period of 2002. Research and development expenses for the six months ended June 30, 2003 were \$7.8 million, or 31.7% of revenues, as compared to \$7.3 million, or 29.9% of revenues, for the comparable period of 2002. The increase in absolute dollars and as a percentage of revenue for both the three and six month periods of 2003 was primarily due to an increase in outside contractor expense. Research and development expenses may vary in future periods based on decisions to trim or expand our product development activities, including related headcount and use of third party contractors, depending upon market conditions and our product development cycles.

Purchased Research and Development.

Purchased research and development consists of technology purchased from third parties. From time to time, we purchase technology to supplement our research and development efforts and to leverage the resources available to us. Such purchases are for the rights, titles, and interest in the technology. If we determine that the purchased software has not reached technological feasibility, we expense the cost of the technology in the year of the purchase.

For both the three and six months ended June 30, 2002, we spent \$1.1 million to purchase technology that had not reached technological feasibility. The technology was subsequently integrated into our products in 2002, and there are no related contractual obligations for future purchases of technology. No comparable expense was incurred in 2003. We may choose to purchase additional technology in the future based on our development needs and our decisions to build technology internally rather than purchase technology from third parties. Our past purchases and integration of research and development did not create a material strain on our financial or personnel resources. However, if we choose to purchase additional research and development in the future, such purchases may have a material effect on our financial and/or personnel resources.

Sales and Marketing

Sales and marketing expenses consist primarily of personnel and related expenses, commissions earned by sales personnel, non-cash stock-based compensation, trade shows, travel and other marketing communication costs, such as advertising and other marketing programs. Sales and marketing expenses were \$4.8 million for the three months ended June 30, 2003, or 38.9% of revenues, as compared to \$4.6 million, or 38.8% of revenues, for the comparable

period of 2002. For the six months ended June 30, 2003, sales and marketing expenses were \$9.7 million, or 39.5% of revenues, as compared to \$9.5 million, or 38.9% of revenues, for the comparable period in 2002. The slight increase in expenses for both the three and six month periods of 2003 was due to an increase in sales headcount related expenses. We expect to release new products in 2003. When and if these products are released, we may

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increase our marketing efforts to promote the new products and hire new sales personnel to expand our sales capacity, which would lead to an increase in sales and marketing expense in future periods.

General and Administrative

General and administrative expenses consist primarily of personnel and related expenses, general operating expenses and non-cash stock-based compensation. General and administrative expenses were \$1.3 million, or 10.5% of revenues, for the three months ended June 30, 2003 and were \$1.4 million, or 11.8% of revenues, for the comparable period in 2002. For the six months ended June 30, 2003, general and administrative expenses were \$2.6 million, or 10.6% of revenues, as compared to \$2.7 million, or 11.3% of revenues, for the comparable period of 2002. Given that general and administrative expenses were relatively consistent from year to year for both the three and six month periods on an absolute dollar basis, the decrease as a percentage of revenues was primarily due to the increase in revenues from 2002 to 2003. General and administrative expenses may increase in absolute dollars if we choose to expand our administrative staff and facilities to support future growth in our operations.

Amortization of Other Intangible Assets. This amortization expense relates to a covenant not to compete purchased as a part of an acquisition in 2000. This intangible asset was fully amortized as of January 1, 2003. The related amortization expense was \$385,000 and \$770,000 for the three and six months ended June 30, 2002, respectively.

Benefit from (Provision for) Income Taxes. Benefit from (provision for) income taxes was (\$463,000) and (\$671,000) for the three and six months ended June 30, 2003, respectively, and \$58,000 and (\$312,000) for the same periods in 2002, respectively. The annual effective tax rate is approximately 29% for 2003 and 19% for 2002. The increase in the effective rate results primarily from the reduction in 2003 disqualifying dispositions derived from the exercise of the Company's outstanding stock options. The exercise of stock options typically creates disqualifying dispositions which benefits the overall corporate tax rate. Significant management judgment is required in determining our provision for income taxes and our deferred tax assets and liabilities. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust the effective rate for the current year.

Share in Loss of Joint Venture. In September 2001, we formed a joint venture with Aztec Software, Inc., a California corporation and wholly owned subsidiary of Aztec Software and Technology Services Limited, an Indian company publicly traded on the Bombay stock exchange. In accordance with the terms of the agreement, Embarcadero and Aztec Software, Inc. each contributed \$1.0 million to the venture. We account for this venture under the equity method of accounting. For our fifty percent share in the loss of the venture in the three and six ended June 30, 2002, we recorded \$123,000, net of a tax benefit of \$37,000, and \$423,000, net of a tax benefit of \$154,000, as a loss from joint venture in our consolidated statement of operations. As of December 31, 2002, our investment in this entity was zero and we had no remaining commitments to the entity. We do not expect to realize any future income from our investment in this entity.

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RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 requires that a liability be recorded in the guarantor s balance sheet upon issuance of a guarantee or an indemnification. In addition, FIN 45 requires disclosures about the guarantees or indemnifications that an entity has issued, including a reconciliation of changes in the entity s product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees and indemnifications issued or modified after December 31, 2002, irrespective of the guarantor s fiscal year-end. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. We fully adopted FIN 45 in the first quarter of 2003. The disclosure requirements are contained within Note 10 of the notes to our condensed consolidated financial statements, and the impact of the recognition and initial measurement of FIN 45 did not have a material effect on our financial position and results of operations.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of this standard did not have a material impact on our financial position and results of operations.

LIQUIDITY AND CAPITAL RESOURCES

We have funded our business to date from cash generated by our operations and financings. In April 2000, we completed our initial public offering of common stock, generating net proceeds to us of approximately \$43.0 million. As of June 30, 2003, we had cash, cash equivalents and short-term investments of \$48.3 million.

Net cash provided by operating activities was \$6.6 million and \$5.7 million for the six months ended June 30, 2003 and 2002, respectively. The \$900,000 increase from 2002 to 2003 was primarily due to a \$1.1 million increase in net income.

In the six months ended June 30, 2003 and 2002, our net income was reduced by a number of non-cash expense items. The items include depreciation and amortization of property and equipment and intangible assets as well as amortization of deferred stock-based compensation. To the extent that these non-cash items increase or decrease and positively or negatively impact our future operating results, there will be no corresponding impact on our cash flows.

Our primary source of operating cash flow is the collection of accounts receivable from our customers and the timing of payments to our vendors and service providers. We measure the effectiveness of our collections efforts by an analysis of average accounts receivable days outstanding (days outstanding). Collections of accounts receivable and related days outstanding will fluctuate in future periods due to the timing and amount of our future revenues, payment terms extended to our customers and the effectiveness of our collection efforts.

Our operating cash flows may be impacted in the future by the timing of payments to our vendors for accounts payable. We typically pay our vendors and service providers in accordance with their invoice terms and conditions. The timing of cash payments in future periods will be impacted by the nature of accounts payable arrangements and management s assessment of our cash inflows.

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Net cash provided by (used in) investing activities was \$13.6 million and (\$2.8) million for the six months ended June 30, 2003 and 2002, respectively. In both periods, cash was used to purchase property and equipment and to acquire and develop technology. In the six months ended June 30, 2003, \$11.4 million was used to purchase investments and \$25.8 million was provided by sales and maturities of investments. In the six months ended June

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30, 2002, a \$2.0 million previously deferred payment was made in connection with an acquisition completed in 2000, \$1.5 million was provided by sales and maturities of investments and \$500,000 was invested in a joint venture. We do not have any additional deferred payments related to our past acquisitions. We may continue to invest in short-term investments, and we may acquire additional technology in the future.

For the six months ended June 30, 2003, net cash used in financing activities of \$1.1 million was for the repurchase of common stock, slightly offset by \$25,000 provided by the exercise of common stock options. For the six months ended June 30, 2002, net cash provided by financing activities of \$402,000 came from the exercise of stock options under the Company's stock option plan, partially offset by \$102,000 used to repurchase shares of the Company's common stock. Under our stock purchase plan discussed below, we may use cash to buy back shares of our common stock in the future.

In September 2001, our Board of Directors authorized a stock repurchase program of up to 1,000,000 shares of our common stock. In July 2002, our board of directors amended the stock repurchase program, allowing the Company to repurchase an additional 2,000,000 shares. In the six months ended June 30, 2003, we repurchased approximately 231,000 shares at a cost of approximately \$1.2 million. Since inception of the repurchase program, we have repurchased approximately 1.2 million shares.

In June 2003, we renewed our \$3.0 million revolving credit facility with a bank. The credit facility bears interest at the prime rate and expires on June 30, 2004. This facility requires that we maintain various quarterly financial covenants, including covenants related to tangible net worth, total liabilities and profitability. At June 30, 2003, we were in compliance with all covenants and had no amounts outstanding under this credit facility. We have no current plans to borrow any amounts under this credit facility.

We had net deferred tax assets totaling \$2.8 million at June 30, 2003. We believe that these assets will be realizable in the future.

At June 30, 2003, our only contractual obligations consisted of facility lease commitments and operating leases for office equipment. Future minimum lease payments are as follows (in thousands):

| Year Ending December 31, | Operating Leases |
|---|-----------------------------|
| Remainder of 2003 | \$ 1,222 |
| 2004 | 1,789 |
| 2005 | 1,597 |
| 2006 | 1,469 |
| 2007 | 1,423 |
| Thereafter | 510 |
| Total minimum lease payments | \$ 8,010 |

We believe that our existing cash, cash equivalents, short-term investments and cash generated from operations will be sufficient to finance our operations through at least the next 12 to 18 months. If we fail to generate cash flow from operations in the future due to an unexpected decline in revenues or due to a sustained increase in cash

expenditures in excess of revenues generated, our cash balances may not be sufficient to fund continuing operations without obtaining additional financing. If additional financing is needed, there can be no assurance that such financing will be available to us on commercially reasonable terms, or at all.

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Factors That May Affect Future Results

In addition to other information in this report, the following factors should be considered carefully in evaluating the Company. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that we are unaware of or currently deem immaterial may also become important factors that may harm our business.

Our quarterly operating results may fluctuate in future periods, and, as a result, our stock price may fluctuate or decline.

Our operating results have fluctuated from quarter to quarter during the past three fiscal years. We believe that quarter-to-quarter comparisons of our historical results of operations are not indicative of our future performance. Our revenues and operating results may continue to vary significantly from quarter to quarter due to a number of factors, including the factors discussed below under the captions:

Our operating results would be harmed if information technology spending does not recover;

If we are not able to enhance our existing products to adapt to rapid technological change, or we introduce new products that do not achieve market acceptance, our revenues and earnings may suffer and we may experience loss of market share;

Large sales of our products and maintenance involve a lengthy sales cycle, which could cause delays in recognizing revenue or the failure to obtain revenue;

Our high fixed operating expenses might adversely affect our profitability if future revenue expectations are not met;

We may have future non-recurring charges in the event of goodwill impairment;

We may be required to change our revenue recognition policies based on changing implementation guidelines and interpretations, which could cause our revenues and operating results to fluctuate unexpectedly;

If our products do not perform as expected, we may lose customers, our costs will increase and revenues may be delayed or lost; and

Acquisitions of companies or technologies may result in disruptions to our business.

Seasonal variations in orders for our products also contribute to fluctuations in our quarterly operating results. These fluctuations are likely to cause corresponding volatility in our stock price, particularly if our operating results vary from analysts' expectations.

If sales of DBArtisan fall, our revenues and income may decline.

A significant portion of our revenues currently comes from sales of our DBArtisan product. For the six months ended June 30, 2003 and the years ended December 31, 2002 and 2001, DBArtisan accounted for approximately 38.3%, 42.0% and 38.7%, respectively, of our domestic license revenues. We expect that sales of DBArtisan will continue to represent a substantial portion of our license revenues for the foreseeable future. In addition, many of our

customers initiate a relationship with us by purchasing DBArtisan. If demand for DBArtisan declines due to competition, technological change or other factors, our revenues and income may decline significantly.

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If we do not add new customers and generate new business from our existing customers, we will not be able to sustain or increase our revenues.

Our license arrangements generally do not provide for substantial ongoing license or maintenance payments. Therefore, our future revenue growth depends on our success in attracting new customers and expanding our relationships with existing customers. Our ability to attract new customers and expand our relationships with existing customers will depend on a variety of factors, including the performance, quality, breadth and depth of our current and future products and maintenance. Our failure to add new customers or to expand our relationships with existing customers would reduce our future license and maintenance revenues. In addition, if our existing customers do not renew their support contracts, our future maintenance revenues will be adversely affected.

Our operating results would be harmed if information technology spending does not recover.

The markets into which we sell our products are cyclical and are subject to general economic conditions. The information technology industry continues to be depressed due to general economic conditions. We believe that the current economic situation has had an impact on capital spending for database technology and related products. We are uncertain as to how much longer the current situation in the database market will continue. The continuation of or any further slowdowns in the database market or in general economic conditions would likely result in a reduction in demand for our products and would harm our business.

We invest heavily in research and development with no guarantee of return from the investments that we make.

We have invested significant resources in the development of new products. If our new products are not accepted in the marketplace, we may not achieve future revenue growth and may have limited return on the investments that we have made. In addition, we plan to continue to invest in research and development and could fail to achieve the expected returns from these future investments.

If we are not able to enhance our existing products to adapt to rapid technological change, or we introduce new products that do not achieve market acceptance, our revenues and earnings may suffer and we may experience loss of market share.

The market for our products is characterized by rapid technological change, frequent product introductions and enhancements, uncertain product life cycles and changes in customer demands and industry standards. Our success depends on our ability to continue to:

- enhance our current products;
- introduce new products that keep pace with technological developments;
- satisfy increasingly complicated customer requirements;
- integrate our products with multiple database platforms; and
- modify our products as database platforms change.

However, due to the nature of computing environments, new products and product enhancements could require longer development and testing periods than we currently anticipate. The continuing economic downturn has also

made it more difficult for new products to gain acceptance in the market. Moreover, if we develop new products that do not achieve market acceptance, we may not be able to recoup development and marketing expenses, which could harm our operating results.

The introduction of new technologies and the emergence of new industry standards may render our existing products obsolete and unmarketable. Delays in the general availability of new releases or problems in the installation or implementation of new releases could harm our business and operating results. We may not be successful in developing and marketing, on a timely and cost-effective basis, new products or new product enhancements that

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respond to technological change, evolving industry standards or customer requirements. Our failure to do so would render our products obsolete and could harm our ability to compete. In addition, our products and product enhancements may not achieve market acceptance.

Large sales of our products and maintenance involve a lengthy sales cycle, which could cause delays in recognizing revenue or the failure to obtain revenue.

Since 2001, large sales of our products and maintenance to individual customers have increased. This is due to our sales efforts to sell larger deals of our traditional software, as well as the introduction of new products that have significantly higher starting prices and longer evaluation periods than our traditional products. These large sales typically involve sales cycles between 6 and 12 months, which is considerably longer than our sales cycle prior to 2001. This lengthy sales cycle is due to the need to educate and convince prospective customers of the value of our products and to gain approval from more constituencies within a prospective customer, including key management personnel. The timing of our revenues has become more difficult to forecast because of this lengthy sales cycle for large sales. We may expend substantial time and resources to negotiate transactions with prospective customers but then be delayed in concluding, or be unable to conclude, sales of our products and maintenance. Any delay in, or failure to complete, sales in a particular period would reduce our revenues in that period as well as in subsequent periods over which revenues for the sale may be recognized. If we were to experience a delay on one or more large orders, it could harm our ability to meet our forecasts for a given period. If our sales cycle unexpectedly lengthens in general or for one or more large sales, it could negatively affect the timing of our revenues and may cause our revenues and operating results to vary significantly from period to period.

Our high fixed operating expenses might adversely affect our profitability if future revenue expectations are not met.

The majority of our operating expenses consist of personnel and related expenses and facility related costs. These costs are relatively fixed in the short term, and our operating decisions such as when to hire additional personnel and when to expand our facilities and infrastructure are based in large part on expectations about expected future revenues. If we hire personnel and enter into facilities contracts based on our expectations about future revenues, and then we fail to meet these revenue expectations, we would likely have lower than expected earnings per share, which would negatively affect our stock price.

We may have future non-recurring charges in the event of goodwill impairment.

We adopted SFAS No. 142 on January 1, 2002 and, as a result, we have ceased amortization of goodwill. Going forward, we will be required to test our goodwill for impairment on an annual basis or in the event of a significant change in our business. We performed impairment tests in January and September 2002 and determined that, at those times, there had been no impairment to goodwill. At June 30, 2003, our goodwill balance totaled \$10.3 million. In the future, if we determine that this goodwill has been impaired, we will be required to take a non-recurring charge to write down this asset, which would adversely affect our earnings and book value.

We may be required to change our revenue recognition policies based on changing implementation guidelines and interpretations, which may cause our revenues and operating results to fluctuate unexpectedly.

In recent years, software revenue recognition rules have been under heavy review and interpretation by various accounting authoritative and regulatory bodies, including the American Institute for Certified Public Accountants and the Financial Accounting Standards Board. These reviews and interpretations have resulted in significant changes in the practices and standards for recognizing revenues in software companies. There could be further changes in these

standards. We may have to change our methods of revenue recognition to comply with new standards, and any such change could cause deferment of revenues recognized in current periods to subsequent periods or accelerated recognition of deferred revenue to current periods, either of which could cause shortfalls in meeting securities analysts and investors' expectations in any period. Any such shortfalls could have an adverse impact on our stock price.

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The expansion of our international operations exposes us to risks.

We expect to continue to expand our international sales and research and development operations. As a result, we could face a number of risks from our expanding international operations, including:

- staffing and managing foreign operations;
- increased financial accounting and reporting complexities;
- potentially adverse tax consequences;
- the loss of revenues and net income resulting from currency fluctuations;
- compliance with a wide variety of complex foreign laws and treaties;
- the impact of war or terrorist activities;
- reduced protection for intellectual property rights in some countries;
- licenses, tariffs and other trade barriers;
- longer sales and payment cycles; and
- costs and difficulties of customizing products for foreign countries.

Further expansion of our international operations may require significant management attention and financial resources and may place burdens on our management, administrative, operational and financial infrastructure. Our possible investments in establishing facilities in other countries may not produce desired levels of revenues or profitability.

If our products do not perform as expected, we may lose customers, our costs will increase and revenues may be delayed or lost.

Computer software such as ours often contains undetected errors and may contain design flaws. Errors may be found in current versions, new versions or enhancements of our products after we make commercial shipments. If our software contains undetected errors, performs unreliably, or if we otherwise fail to meet our customers' expectations, we may suffer:

- loss of revenues, market share or customers;
- negative publicity and harm to our reputation;
- diversion of research and development and management resources;
- increased maintenance and warranty costs;
- legal actions by customers against us; and

increased insurance costs.

We may lose market share and be required to reduce prices as a result of competition from our existing competitors and other independent software vendors and developers of software.

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The market for our products is highly competitive, dynamic and subject to rapidly changing technology. Pricing pressure in the market has increased as competitors have lowered prices and engaged in more aggressive discounting. If such pricing pressure continues, it could have an adverse effect on our margins.

We compete primarily against other providers of application design, database management and data movement software solutions, which include Computer Associates, Quest Software, BMC Software, IBM/Rational Software, Borland Software Corporation, Informatica Corporation, Ascential Software and other independent software vendors. Our products also compete with products offered by database software manufacturers, including Oracle, Microsoft, Sybase and IBM. Some of these competing products are provided at no charge to their customers. We expect that companies such as Oracle, Microsoft, Sybase and IBM will continue to develop and incorporate into their products applications which compete with our products and may take advantage of their substantial technical, financial, marketing and distribution resources in those efforts. We may not be able to compete effectively with those products or efforts, which could significantly harm our business and operating results.

Over the past year, there has been consolidation in our industry, such as IBM's acquisition of Rational Software and Borland Software Corporation's acquisition of Togethersoft. Such acquisitions may have the effect of improving the competitive positions of the acquired companies and weakening our competitive situation. To effectively compete as the industry consolidates, we may need to seek alliances with other companies in order to gain better acceptance of our products. We may not be able to enter into such alliances on terms favorable to us or at all.

In addition, if the market for application design and database management products grows, some of our competitors may increase their focus on offering software directly competitive with ours, whether by internal development, external development or acquisition. Our competitors may also attempt to keep us from integrating our software with theirs, making it more difficult for our customers to adopt our software. If such increased competition were to result in resistance to integration of our software with the software of these competitors, our business would be harmed.

Further, if a single database platform were to gain a considerably larger share of the database market than other database platforms, we would lose our multi-platform competitive advantage and our sales would suffer. Many of our competitors have longer operating histories, substantially greater financial, technical, marketing and other resources, and greater name recognition than we do. They also may be able to respond more quickly than we can to changes in technology or customer requirements. Competition could seriously impede our ability to sell additional products on acceptable terms. Our competitors may:

develop and market new technologies that render our products obsolete, unmarketable or otherwise less competitive;

make strategic acquisitions or establish cooperative relationships among themselves or with other companies, thereby enhancing the functionality of their products; or

establish or strengthen cooperative relationships with channel or strategic partners which limit our ability to sell or to co-market products through these channels.

Competitive pressures could reduce our market share, reduce customer orders, reduce gross margins or require us to reduce our prices, any of which would harm our operating results.

Acquisitions of companies or technologies may result in disruptions to our business.

We may make strategic acquisitions of companies, products or technologies as necessary in order to implement our business strategy. If we make acquisitions and are unable to successfully integrate them with our existing operations, we may not receive the intended benefits of such acquisitions and the revenues and operating results of the combined company may decline. Any acquisition may temporarily disrupt our operations and divert management's attention from day-to-day operations. In addition, acquisitions may subject us to unanticipated liabilities or risks, including litigation and the costs and uncertainties related to legal proceedings. For example, we are currently a defendant in litigation related to our acquisition of EngineeringPerformance, Inc, in November 2002.

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As the litigation is at an early stage and is uncertain, we are unable to predict an outcome at this time and an unfavorable outcome may have a material adverse effect on our financial position, results of operations and cash flow.

While we have financed our acquisitions to date primarily with working capital, we may incur debt or issue equity securities to finance future acquisitions. The issuance of equity securities for any acquisition could be substantially dilutive to our stockholders. In addition, our profitability may suffer due to acquisition-related expenses.

International political instability may increase our cost of doing business and disrupt our business.

Increased international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures, sustained military action in Afghanistan and Iraq, strained international relations with North Korea and other conflicts in the Middle East and Asia, may halt or hinder our ability to do business, may increase our costs and may adversely affect our stock price. This increased instability may, for example, negatively impact the reliability and cost of transportation, negatively affect the desire of our employees and customers to travel, adversely affect our ability to obtain adequate insurance at reasonable rates or require us to take extra security precautions for our domestic and international operations. In addition, this international political instability has had and may continue to have negative effects on financial markets, including significant price and volume fluctuations in securities markets. If this international political instability continues or escalates, our business and results of operations could be harmed and the market price of our common stock could decline.

Our proprietary rights may be inadequately protected and infringement claims or independent development of competing technologies could harm our competitive position.

We rely on copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to establish and protect our proprietary rights. We also enter into confidentiality agreements with employees and consultants and attempt to restrict access to proprietary information on a need-to-know basis. Despite such precautions, unauthorized third parties may be able to copy aspects of our products or obtain and use information that we consider as proprietary.

We license our software products primarily under shrink-wrap licenses included as part of product packaging. Shrink-wrap licenses are not negotiated with or signed by individual licensees and purport to take effect upon the opening of the product package or downloading of the product from the Internet. These measures afford only limited protection. Policing unauthorized use of our products is difficult and we are unable to determine the extent to which piracy of our software exists. In addition, the laws of some foreign countries do not protect our proprietary rights as well as United States laws.

We may have to enter into litigation to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others with respect to our rights. Litigation is generally very expensive and can divert the attention of management from daily operations. Accordingly, any intellectual property litigation could disrupt our operations and harm our operating results.

We are not aware of any case in which we are infringing the proprietary rights of others. However, third parties may bring infringement claims against us. Any such claim is likely to be time consuming and costly to defend, could cause product delays and could force us to enter into unfavorable royalty or license agreements with third parties. A successful infringement claim against us could require us to enter into a license or royalty agreement with the claimant or develop alternative technology. However, we may not be able to negotiate favorable license or royalty agreements, if any, in connection with such claims and we may fail to develop alternative technology on a timely basis. Accordingly, a successful product infringement claim against us could harm our business and operating results.

If we are not able to attract and retain qualified personnel, our business will not be able to grow.

Our success depends on the continued service of our executive officers and other key administrative, sales and marketing, research and development and support personnel. None of our executive officers or key employees is

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bound by an employment agreement for any specific term and we do not maintain any key person life insurance policies. If we lose the services of one or more of our executive officers or key employees, or if one or more of them decide to join a competitor or otherwise compete directly or indirectly with us, our business could be seriously harmed.

Our business will not be able to grow if we cannot attract, retain and motivate qualified personnel. Despite the economic downturn, competition for qualified employees remains intense and we may not be able to attract, assimilate or retain highly qualified personnel in the future. There has in the past been and there may in the future be a shortage of personnel that possess the technical background necessary to sell, support and develop our products effectively. Some of our current employees and those that we seek to hire may be subject to non-competition or non-solicitation covenants that could further limit our ability to attract or retain qualified personnel.

We are susceptible to business interruptions that could harm our business.

Our operations are vulnerable to damage or interruption from computer viruses, human error, natural disasters, telecommunications failures, intentional acts of vandalism and similar events. In particular, our corporate headquarters are located in San Francisco, which is known for seismic activity. Although we have a disaster recovery plan for critical data and business applications, this does not provide assurance that we would not suffer a business interruption. A significant business interruption would result in losses or damages incurred by us and would harm our business. Our business interruption insurance may not be adequate to compensate us for losses that might occur.

Certain persons have substantial control over us, which could impede stockholder approval of certain transactions.

Our executive officers and directors, in the aggregate, beneficially held 23.2% of our outstanding common stock as of June 30, 2003. In addition, despite their recent sales of our common stock, some of our founders who are no longer associated with us continue to hold a significant amount of our common stock. These groups of stockholders can significantly influence all matters requiring approval by our stockholders, including the approval of equity compensation plans, the election of directors and the approval of mergers or other business combination transactions.

We expect the price of our common stock to remain volatile, making it difficult for our stockholders to predict the return on their investment.

Since our initial public offering, the market price of our common stock has fluctuated significantly in response to a number of factors, some of which are beyond our control, including:

changes in market valuation of software and Internet companies;

quarterly variations in our operating results;

global and domestic economic and political conditions;

changes in financial estimates by securities analysts;

announcements that we or our competitors make related to significant contracts, acquisitions, capital commitments, strategic partnerships or product introductions or enhancements;

additions or departures of key personnel;

stock market price and volume fluctuations, which are particularly volatile among securities of software and Internet companies; and

sales of significant amounts of our common stock or other securities in the open market.

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Some of our founders who are no longer associated with the Company continue to hold significant amounts of our common stock. Sales of our common stock by these founders cannot be controlled by us and may add to the volatility of our stock price. Further, the market for technology and Internet-related companies has experienced extreme volatility that often has been unrelated to the operating performance of particular companies. These fluctuations may adversely affect the trading price of our common stock, regardless of our actual operating performance.

Provisions of our charter and bylaws and Delaware law could deter takeover attempts that might be beneficial to our stockholders.

Provisions of our amended and restated certificate of incorporation and bylaws as well as Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. We are subject to the provisions of Delaware law, which restrict business combinations with interested stockholders, which may have the effect of inhibiting a non-negotiated merger or other business combinations.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market risk for changes in interest rates primarily relates to our investment portfolio, which at June 30, 2003 included fixed-income securities with a fair value of approximately \$40.0 million. The values of these securities are likely to decline if interest rates increase. However, due to the short maturities of our investments, an immediate 10 percent change in interest rates is not expected to have a material effect on our near-term financial condition or results of operations.

Foreign Exchange Risk

Our operations are conducted primarily in the United States and are denominated in United States dollars. A small and potentially growing portion of our sales originate through our European subsidiary and are denominated in Pounds Sterling. From time to time, we enter into forward exchange contracts to hedge against fluctuations in the Pound Sterling relative to the United States dollar. Gains and losses on these contracts are generally recognized in the consolidated statement of operations at the time that the related transactions being hedged are recognized. Because the effect of movements in currency exchange rates on forward exchange contracts generally offset the related effect on the underlying items being hedged, use of these instruments is not expected to subject us to risks that would otherwise result from changes in currency exchange rates. We do not use derivative financial instruments for trading or speculative purposes. We did not use derivative financial instruments in the three or six months ended June 30, 2003 and 2002.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, we have evaluated our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are adequate and effective. There have not been any significant changes in our internal control over financial reporting or in other factors that could significantly affect this control subsequent to the date of management's evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. Our goal is to ensure that our senior management has timely access to all material financial and non-financial information concerning our business. While we believe the present design of our disclosure controls and procedures is effective to achieve our goal, future events affecting our business may cause us to significantly modify our disclosure controls and procedures.

Table of Contents**PART II****OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Information with respect to this item is incorporated by reference to Note 10 of the Notes to the Condensed Consolidated Financial Statements included herein on page 12 of this Quarterly Report on Form 10-Q.

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

On June 4, 2003, the Company held its annual meeting of stockholders. The following items were submitted to a vote of the stockholders:

- (a) To elect one three-year term Class III member serving on the Board of Directors.

| <u>Election of Director</u> | <u>Votes For</u> | <u>Votes Withheld</u> |
|---------------------------------|------------------|---------------------------|
| Stephen R. Wong | 24,873,028 | 811,024 |

As a result, Mr. Wong was elected as Director of the Company. The following incumbent members continue to serve on the Board of Directors: Timothy C.K. Chou, Frank M. Polestra, Michael J. Roberts and Samuel T. Spadafora.

- (b) To approve amendments to the Company's 2000 Nonemployee Directors Stock Option Plan.

| | <u>Votes</u> |
|-----------------|--------------|
| For | 21,235,765 |
| Against | 2,210,311 |
| Abstain | 9,085 |
| Broker Non-Vote | 2,228,891 |

The amendments to the plan were approved.

- (c) To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent accountants for the year ending December 31, 2003.

| | <u>Votes</u> |
|---------|--------------|
| For | 25,670,858 |
| Against | 11,644 |
| Abstain | 1,550 |

The appointment was ratified.

ITEM 5. OTHER INFORMATION.

In June 2003, our Board of Directors amended the Company's 1993 Stock Option Plan to extend its term, to give the Company the ability to issue restricted stock and to increase the number of shares authorized for issuance by 1,000,000 shares on each of July 1, 2004, 2005 and 2006, unless the plan is earlier terminated or superseded by another plan. The amended plan will become effective on November 1, 2003. As of June 30, 2003, there were 4,344,081 options issued and outstanding and 1,200,492 options still available for issuance under the plan.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

The following documents are filed as Exhibits to this Report:

- 10.1 Amended and Restated Embarcadero Technologies, Inc. 1993 Stock Option Plan
- 10.2 Amended and Restated 2000 Nonemployee Directors Stock Option Plan of Embarcadero Technologies, Inc.

The following documents are furnished as Exhibits to this Report:

- 31.1 Certification of Stephen Wong pursuant to Rule 13a-14(a) of the Securities and Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Raj Sabhlok pursuant to Rule 13a-14(a) of the Securities and Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Stephen Wong pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Raj Sabhlok pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K:

On April 3, 2003, we furnished the SEC with a Current Report on Form 8-K to report the issuance of a press release regarding preliminary results for the first quarter of 2003. In accordance with SEC Release No. 33-8216, such information, which was intended to be furnished under Item 12 of Form 8-K, Results of Operations and Financial Condition, was instead furnished under Item 9, Regulation FD Disclosure.

On April 22, 2003, we furnished the SEC with a Current Report on Form 8-K to report the issuance of a press release regarding final results for the first quarter of 2003. In accordance with SEC Release No. 33-8216, such information, which was intended to be furnished under Item 12 of Form 8-K, Results of Operations and Financial Condition, was instead furnished under Item 9, Regulation FD Disclosure.

On May 28, 2003, we filed with the SEC a Current Report on Form 8-K to report, under Item 5 thereof, Other Events and Required FD Disclosure, that there was a typographical error in the 2003 Equity Incentive Plan attached as Appendix B to the Company's Definitive Proxy Statement for its Annual Meeting of Stockholders held on June 4, 2003.

