CONCORD COMMUNICATIONS INC
Form 10-Q
August 07, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended June 30, 2003.

OR

o **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 0-23067

CONCORD COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2710876**
(State of incorporation)	(IRS Employer Identification Number)

600 Nickerson Road
Marlboro, Massachusetts 01752
(508) 460-4646
(Address and telephone of principal executive offices)

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

YES X NO

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

YES X NO

17,803,381 shares of the registrant s Common stock, $0.01 par value, were outstanding as of July 31, 2003.

THIS DOCUMENT CONTAINS 39 PAGES.
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FORM 10-Q, June 30, 2003

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PART I: FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CONCORD COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(In thousands, except share and per share data)

	June 30, 2003	December 31, 2002
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 12,774	$ 10,362
Marketable securities	67,588	62,469
Restricted cash	539	839
Accounts receivable, net of allowance of $1,169 and $1,480 at June 30, 2003 and December 31, 2002, respectively	18,576	17,417
Prepaid expenses and other current assets	2,141	2,882
Total current assets	101,618	93,969
Equipment and improvements, at cost:		
Equipment	24,782	22,987
Leasehold improvements	6,146	6,111
	30,928	29,098
Less accumulated depreciation and amortization	23,471	20,853
	7,457	8,245
Deferred tax assets	3,500	3,500
Other long-term assets	321	216
	3,821	3,716
Total assets	$112,896	$105,930
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,276	$ 3,584
Accrued expenses (including customer deposits of $834 and $180 at June 30, 2003 and December 31, 2002, respectively)	10,777	10,062
Deferred revenue	27,750	23,348
Total current liabilities	40,803	36,994
Commitments and Contingencies (Note 2)		
Stockholders Equity:		
Common stock, $0.01 par value:		
Authorized 50,000,000 shares		
Issued and outstanding 17,443,128 and 17,246,005 shares at June 30, 2003 and December 31, 2002, respectively	174	172

Additional paid-in capital	100,161	98,893
Deferred compensation	(26)	(60)
Accumulated other comprehensive income	2,227	2,408
Accumulated deficit	(30,443)	(32,477)
Total stockholders equity	72,093	68,936
Total liabilities and stockholders equity	$112,896	$105,930

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

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CONCORD COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands, except share and per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Revenues:				
License revenues	$ 13,154	$ 12,258	$ 26,063	$ 26,319
Service revenues	12,461	10,693	23,669	20,870
Total revenues	25,615	22,951	49,732	47,189
Cost of Revenues:				
Cost of license revenues	683	394	1,272	961
Cost of service revenues	4,045	3,721	8,087	7,540
Total cost of revenues	4,728	4,115	9,359	8,501
Gross profit	20,887	18,836	40,373	38,688
Operating Expenses:				
Research and development (excluding stock-based compensation of $14, $27, $34 and $60, respectively)	5,423	5,445	10,850	11,187
Sales and marketing	12,579	11,890	23,944	24,025
General and administrative	2,060	1,772	4,305	3,826
Stock-based compensation	14	27	34	60
Total operating expenses	20,076	19,134	39,133	39,098
Operating income (loss)	811	(298)	1,240	(410)
Other Income (Expense):				
Interest income	709	802	1,426	1,579
Other expense	(146)	(16)	(370)	(45)
Total other income, net	563	786	1,056	1,534
Income before income taxes	1,374	488	2,296	1,124
Provision for income taxes	177	93	262	240
Net income	$ 1,197	$ 395	$ 2,034	$ 884
Net income per common and potential common share:				
Basic	$ 0.07	$ 0.02	$ 0.12	$ 0.05
Diluted	$ 0.07	$ 0.02	$ 0.11	$ 0.05
Weighted average common and potential common shares outstanding:				
Basic	17,372,070	17,017,410	17,313,416	16,974,305
Diluted	18,022,181	17,861,027	17,767,593	17,969,848

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

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CONCORD COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Six Months Ended	
	June 30, 2003	**June 30, 2002**
Cash Flows from Operating Activities:		
Net income	$ 2,034	$ 884
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,618	3,001
Stock-based compensation	34	60
Changes in current assets and liabilities:		
Accounts receivable	(1,159)	469
Prepaid expenses and other current assets	741	42
Accounts payable	(1,308)	(382)
Accrued expenses	715	(1,020)
Deferred revenue	4,402	2,277
Net cash provided by operating activities	8,077	5,331
Cash Flows from Investing Activities:		
Purchases of equipment and improvements	(1,830)	(1,827)
Change in other assets	(105)	(42)
Investments in marketable securities	(15,988)	(2,592)
Proceeds from sales of marketable securities	10,688	2,290
Deposit of restricted cash		(1,014)
Release of restricted cash	300	
Net cash used in investing activities	(6,935)	(3,185)
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	1,270	1,683
Net cash provided by financing activities	1,270	1,683
Net increase in cash and cash equivalents	2,412	3,829
Cash and cash equivalents, beginning of period	10,362	9,011
Cash and cash equivalents, end of period	$ 12,774	$ 12,840
Supplemental Disclosure of Cash Flow Information:		
Cash paid for income taxes	$ 247	$ 130
Supplemental Disclosure of Noncash Financing and Investing Transactions:		
Reversal of deferred compensation related to forfeitures of stock options	$	$ (65)
Unrealized loss on available-for-sale securities	$ (181)	$ (8)

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

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CONCORD COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FORM 10-Q, June 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

The accompanying unaudited consolidated financial statements have been presented by Concord Communications, Inc. (the Company or Concord) in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with the instructions to Form 10-Q and Regulation S-X pertaining to interim financial statements. Accordingly, these interim financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements reflect all adjustments and accruals of a normal recurring nature, which management considers necessary for a fair presentation of the Company s financial position as of June 30, 2003 and December 31, 2002, and the Company s results of operations for the three and six months ended June 30, 2003 and 2002. The results for the interim periods presented are not necessarily indicative of results to be expected for any future period. The financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the Company s 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission in March 2003.

(b) Financial Instruments, Concentration of Credit Risk and Significant Customers

The Company has estimated the fair value of financial instruments using available market information and appropriate valuation methodologies. The carrying values of cash, cash equivalents, restricted cash, marketable securities, accounts receivable, accounts payable and accrued expenses approximate fair market value due to the short-term nature of these financial instruments. Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash, cash equivalents, restricted cash, marketable securities and accounts receivable. The Company has no significant off-balance-sheet or concentration of credit risk exposure such as foreign exchange contracts or option contracts. The Company maintains its cash, cash equivalents, restricted cash and marketable securities with established financial institutions. Concentration of credit risk with respect to accounts receivable is limited to certain customers to whom the Company makes substantial sales. To reduce its credit risk, the Company routinely assesses the financial strength of its customers. The Company maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area. No individual customer or reseller accounted for more than 10% of revenues for the three and six months ended June 30, 2003 or June 30, 2002. No one customer accounted for more than 10% of the Company s accounts receivable at June 30, 2003. One customer, a reseller in Europe, accounted for 11.0% of the Company s accounts receivable at December 31, 2002. As of June 30, 2003, this customer represented approximately 1.0% of accounts receivable.

(c) Derivative Financial Instruments

The Company uses forward contracts to reduce its exposure to foreign currency risk and variability in operating results due to fluctuations in exchange rates underlying the value of accounts receivable denominated in foreign currencies until such receivables are collected. A forward contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates. These foreign currency forward exchange contracts are denominated in the same currency in which the underlying foreign currency receivables are denominated and bear a contract value and maturity date that approximate the value and expected settlement date, respectively, of the underlying transactions. For contracts that are designated and effective as hedges, unrealized gains and losses on open contracts at the end of each accounting period, resulting from changes in the fair value of these contracts, are recognized in earnings in the same period as gains and losses on the underlying foreign denominated receivables are recognized and generally offset. Gains and losses on forward contracts and foreign denominated receivables are included in other income (expense), net. The Company does not

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enter into or hold derivatives for trading or speculative purposes and only enters into contracts with highly rated financial institutions.

At June 30, 2003, the Company had one forward contract outstanding, which is presented in the table below. The notional exchange rate is quoted using market conventions where the currency is expressed in currency units per U.S. dollar.

Currency	Position	Maturity Date	Notional Amount	Notional Exchange Rate	Fair Market Value as of June 30, 2003
Euro	Sell	8/29/03	$ 108,000	1.1474	$ 123,000

(d) Stock-Based Compensation

The Company accounts for employee stock-based compensation arrangements under the provisions of Accounting Principles Board (APB) Opinion No. 25 and related interpretations. Statement of Financial Accounting Standards (SFAS) No. 123 permits the use of either a fair-value based method or the intrinsic value method under APB No. 25 to account for employee stock-based compensation arrangements. Companies that elect to use the intrinsic value method provided in APB No. 25 are required to disclose the pro forma net income (loss) and net income (loss) per share that would have resulted from the use of the fair value method. The Company has provided below the pro forma disclosures of the effect on net income (loss) and net income (loss) per share as if SFAS No. 123, as amended by SFAS No. 148, had been applied in measuring compensation expense for all periods presented.

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
	(In thousands, except per share data)			
Net income:				
As reported	$ 1,197	$ 395	$ 2,034	$ 884
Add:				
Stock-based employee compensation expense included in reported net income, net of related taxes	14	27	34	60
Less:				
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(1,541)	(2,303)	(3,202)	(4,758)
Pro forma net loss	$ (330)	$ (1,881)	$ (1,134)	$ (3,814)
Basic net income (loss) per share:				
As reported	$ 0.07	$ 0.02	$ 0.12	$ 0.05
Pro forma	$ (0.02)	$ (0.11)	$ (0.07)	$ (0.22)
Diluted net income (loss) per share:				
As reported	$ 0.07	$ 0.02	$ 0.11	$ 0.05
Pro forma	$ (0.02)	$ (0.11)	$ (0.07)	$ (0.22)

2. INDEMNIFICATIONS

As permitted under Massachusetts law, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was serving, at the Company s request in such capacity. The term of the indemnification period is for the officer or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a Director and Officer insurance policy pursuant to which the company may recover all or a portion of amounts it pays to Directors or Officers under their indemnification agreements. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal.

The Company warrants that its software products will perform in all material respects in accordance with its standard published specifications in effect at the time of delivery of the licensed products to the customer for a period of 90 days. Additionally, the Company warrants that its maintenance services will be performed consistent

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with its maintenance policy in effect at the time those services are delivered. The Company believes its maintenance policy is consistent with generally accepted industry standards. If necessary, the Company would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history, however, the Company has never incurred significant expense under product or services warranties. As a result, the Company believes the estimated liability of these warranties is minimal.

The Company enters into standard indemnification agreements in the ordinary course of its business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally its business partners or customers, in connection with any patent, copyright, trademark, trade secret or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is often capped at a dollar figure. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal.

When, as part of an acquisition, Concord acquires all of the stock or all or a portion of the assets and/or liabilities of a company, it may assume liability for certain events or occurrences that took place prior to the date of acquisition. The maximum potential amount of future payments it could be required to make for such obligations is undeterminable at this time. Concord has no liabilities recorded for these liabilities as of June 30, 2003.

3. NET INCOME PER SHARE

The Company computes earnings per share following the provisions of SFAS No. 128, *Earnings per Share*. Basic net income per share is computed using the weighted-average number of common shares outstanding for a period. Diluted net income per share is computed using the weighted-average number of common and dilutive potential common shares outstanding for the period. For the three and six months ended June 30, 2003 and 2002, dilutive potential common shares consisted of outstanding stock options. The dilutive effect of outstanding stock options is computed using the treasury stock method.

Calculations of the basic and diluted net income per common share and potential common share are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
	(in thousands except share and per share data)			
Basic:				
Net income applicable to common stockholders	$ 1,197	$ 395	$ 2,034	$ 884
Weighted average common shares outstanding	17,372,070	17,017,410	17,313,416	16,974,305
Net income per common share	$ 0.07	$ 0.02	$ 0.12	$ 0.05
Diluted:				
Net income applicable to common stockholders	$ 1,197	$ 395	$ 2,034	$ 884
Weighted average common shares outstanding	17,372,070	17,017,410	17,313,416	16,974,305
Potential common shares pursuant to stock options	650,111	843,617	454,177	995,543
Diluted weighted average shares	18,022,181	17,861,027	17,767,593	17,969,848

Diluted net income per common share	$ 0.07	$ 0.02	$ 0.11	$ 0.05

Diluted weighted average shares outstanding does not include 2,395,746, 2,455,829, 2,131,725 and 2,017,582 potential common shares for the three and six months ended June 30, 2003 and 2002, respectively, as their effect would have been antidilutive.

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4. COMPREHENSIVE INCOME

Comprehensive income is defined as the change in net assets of the Company during a period from transactions generated from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income for the three and six months ended June 30, 2003 and 2002 is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
	(in thousands)		(in thousands)	
Net income available to common stockholders	$1,197	$ 395	$2,034	$ 884
Unrealized (loss) gain on marketable securities	(68)	590	(180)	(8)
Comprehensive income	$1,129	$ 985	$1,854	$ 876

5. SEGMENT REPORTING AND INTERNATIONAL INFORMATION

The Company follows the provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. SFAS No. 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate, discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions on how to allocate resources and assess performance. The Company s chief decision-making group, as defined under SFAS No. 131, is the executive management committee which is comprised of the executive officers of the Company.

The following table presents the approximate revenues by major geographical regions:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
	(in thousands)		(in thousands)	
United States	$14,445	$14,660	$26,419	$29,356
United Kingdom	2,152	1,074	6,147	3,283
Europe (excluding United Kingdom)	5,297	4,430	9,914	7,616
Rest of the World	3,721	2,787	7,252	6,934
Total	$25,615	$22,951	$49,732	$47,189

For the three months ended June 30, 2003, no one country, except the United States, accounted for greater than 10% of total revenues. For the six months ended June 30, 2003, no one country, except the United States and the United Kingdom, accounted for greater than 10% of total revenues. For the three and six months ended June 30, 2002, no one country, except the United States, accounted for greater than 10% of total revenues. Substantially all of the Company s assets are located in the United States.

The Company s reportable segments are determined by customer type: managed service providers/ telecommunications carriers (MSP/TC) and enterprise. The accounting policies of the segments are the same as those described in Note 1. The executive management committee evaluates segment performance based on revenues. Accordingly, all expenses are considered corporate level activities and are not allocated to segments. Also, the executive management committee does not assign assets to these segments.

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The following table presents the approximate revenues by reportable segment:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
	(in thousands)		(in thousands)	
MSP/TC	$16,982	$ 7,870	$32,965	$17,791
Enterprise	8,633	15,081	16,767	29,398
Total	$25,615	$22,951	$49,732	$47,189

6. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2003, the Financial Accounting Standards Board (FASB) released Statement of Financial Accounting Standards (SFAS) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 clarifies under what circumstances a contract with an initial net investment meets the characteristics of a derivative, amends the definition of an underlying contract, and clarifies when a derivative contains a financing component in order to increase the comparability of accounting practices under SFAS No. 133. The statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 is not expected to have a material impact on the Company s consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The Statement is effective for financial instruments entered into or modified after May 31, 2003. The Company adopted this standard on June 1, 2003. Its adoption did not have any impact on the financial statements.

7. SUBSEQUENT EVENTS

On July 11, 2003, Concord entered into a license agreement with Tavve Software Company (Tavve) whereby Concord licensed components of Tavve s technology. Concord has licensed Tavve s root cause analysis and discovery of layer 2 and 3 network topology to build upon Concord s current position in optimizing application availability and performance across networks and systems. The value of the transaction estimated at $1.2 million will be accounted for as in-process-research-and-development as the integrated product has not reached technological feasibility and has no alternative future use.

On July 17, 2003, the Company acquired privately-held netViz Corporation. netViz s software enables users to visualize business processes and allows them to map relationships within the supporting technology infrastructure through data-driven icons. The acquisition was valued at $10 million and paid in a combination of $5 million cash and $5 million in shares of the Company s common stock. The acquisition will be completed in the third quarter of 2003 and will be accounted for under the purchase method of accounting.

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CONCORD COMMUNICATIONS, INC.
FORM 10-Q, June 30, 2003

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

OVERVIEW

Concord develops, markets and supports an application availability and performance software solution, over networks and systems, its *e*Health® Suite family of products. Concord s solutions ensure the high availability of the information technology (IT) infrastructure by providing an end-to-end view across the components of this infrastructure: the network, the systems and the applications.

This document contains forward-looking statements. Any statements contained in this document that do not describe historical facts are forward-looking statements. Concord makes such forward-looking statements under the provisions of the safe harbor section of the Private Securities Litigation Reform Act of 1995. In particular, statements contained in Management s Discussion and Analysis of Financial Condition and Results of Operations, which are not historical facts (including, but not limited to, statements concerning: the plans and objectives of management; decreases as a percentage of revenues in, research and development, and general and administrative expenses; customization of products and services for international markets; changes in contribution of reportable segments to total revenues; changes in gross profit; expectations regarding increased competition and Concord s ability to compete successfully; sustenance of revenue growth both domestically and internationally; the size, scope and description of Concord s target customer market; future product development, including but not limited to anticipated expense levels to fund product development, acquisitions and the integration of acquired companies; and our expected liquidity and capital resources) constitute forward-looking statements. Forward-looking statements contained herein are based on current expectations, but are subject to a number of risks and uncertainties. Concord s actual future results may differ significantly from those stated in any forward-looking statements. Factors that may cause such differences include, but are not limited to, the factors discussed below.

The forward-looking statements contained herein are based on current expectations but are subject to a number of risks and uncertainties. The factors that could cause actual results to differ materially from current expectations include the following: risks of intellectual property rights and litigation, risks in technology development and commercialization, risks in product development and market acceptance of and demand for the Company s products, risks of downturns in economic conditions generally, and in the software, networking and telecommunications industries specifically, risks associated with competition and competitive pricing pressures, risks associated with international sales, risks associated with a limited family of products and other risks detailed in this Form 10-Q under the heading Factors that Could Affect Future Results and elsewhere in the Company s filings with the Securities and Exchange Commission.

SUBSEQUENT EVENTS

On July 11, 2003, Concord entered into a license agreement with Tavve Software Company (Tavve) whereby Concord licensed components of Tavve s technology. Concord has licensed Tavve s root cause analysis and discovery of layer 2 and 3 network topology to build upon Concord s current position in optimizing application availability and performance across networks and systems. The value of the transaction estimated at $1.2 million will be accounted for as in-process-research-and-development as the integrated product has not reached technological feasibility and has no alternative future use.

On July 17, 2003, the Company acquired privately-held netViz Corporation. netViz s software enables users to visualize business processes and allows them to map relationships within the supporting technology infrastructure through data-driven icons. The acquisition was valued at $10 million and paid in a combination of $5 million cash and $5 million in shares of the Company s common stock. This will be accounted for under the purchase method of accounting.

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CRITICAL ACCOUNTING POLICIES, SIGNIFICANT ESTIMATES AND JUDGMENTS

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States (US GAAP). The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. US GAAP requires us to make estimates and judgments in several areas. See our note to condensed consolidated financial statements (unaudited) attached hereto and our audited consolidated financial statements and notes thereto which contain accounting policies and other disclosures required by generally accepted accounting principles included in the Company s 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission in March 2003.

We believe that the policies, significant estimates and judgments discussed below are the most critical to our financial statements and the understanding of our financial condition and results of operations because their application places the most significant demands on management s judgment.

(a) Revenue Recognition

Our revenues consist of software license revenues and service revenues. Software license revenues are recognized in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2*, Software Revenue Recognition*, as modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with respect to Certain Transactions*. Under SOP 97-2, software license revenues are recognized when persuasive evidence of an arrangement exists and delivery of the software has occurred, provided that the license fee is fixed or determinable, collection is considered reasonably assured and no customer acceptance clauses exist. If an arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of a receipt of a written customer acceptance or expiration of the acceptance period. If the fee is determined not to be fixed or determinable, revenue is recognized when the fee becomes due. If collection is not considered reasonably assured, revenue is recognized upon the receipt of cash. Revenues under multiple-element arrangements, which typically include software products, services and maintenance sold together, are allocated to each element using the residual method in accordance with SOP 98-9. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized when these elements are delivered; the remainder of the arrangement consideration is allocated to the software. We have established sufficient vendor specific objective evidence for professional services, training and maintenance and customer support services based on the price charged when these elements are sold separately. Accordingly, software license revenues are recognized under the residual method in arrangements in which software is licensed with professional services, training, and maintenance and customer support services.

Service revenues include professional services, training and maintenance and customer support fees. Professional services are not essential to the functionality of the other elements in an arrangement and are accounted for separately. Service revenues are recognized as the services are performed, provided evidence of an arrangement exists, fees are fixed or determinable, and collection is considered reasonably assured.

We license our software to end-users, resellers and OEM s. All revenues generated from our worldwide operations are approved at our corporate headquarters, located in the United States. Our arrangements do not generally include clauses involving acceptance of our products by our customers. However, if an arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period.

For all sales, in the absence of a signed license agreement, we use either a purchase order or purchase order equivalent as evidence of an arrangement. If a signed license agreement is obtained, we use either the license agreement or the license agreement and a purchase order as evidence of an arrangement. Sales to resellers are usually evidenced by a master agreement governing the relationship together with purchase orders on a transaction-

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by-transaction basis. Sales to OEM s are usually evidenced by a master agreement governing the relationship together with a shipping report on a transaction-by-transaction basis.

Delivery generally occurs when product is delivered to a common carrier and the delivery terms are FOB Concord. In the case of arrangements with resellers or OEMs, revenue is recognized upon delivery to the reseller or OEM. Most of these arrangements involve a sell-through by the reseller or OEM to an end user. For a reseller, evidence usually comes in the form of a purchase order identifying the end-user while for an OEM, evidence of sell-through usually comes in the form of a shipping report, which usually identifies the ship to location.

At the time of the transaction, we assess whether the fee associated with our revenue transaction is fixed or determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of a fee is due after our normal payment terms, which are usually 30 to 60 days from invoice date, we account for the fee as not being fixed or determinable. In these cases, we recognize revenue when the fee is due.

We assess collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue upon receipt of cash.

For arrangements with multiple obligations (for example, undelivered maintenance and support or undelivered specified software upgrades), we allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. This means that we defer revenue from the fee arrangement equivalent to the fair value of the undelivered elements. We determine fair values for ongoing maintenance and support obligations using our internal pricing policies for maintenance and by referencing the prices at which we have sold separate maintenance contract renewals to our customers. We determine fair value of services, such as training or consulting, by referencing the prices at which we have separately sold comparable services to our customers. For specified undelivered software upgrades, we recognize revenue upon shipment of these upgrades.

(b) Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer s current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based on our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and appropriate reserves have been established, we cannot guarantee that we will continue to experience the same credit loss rates that we have experienced in the past.

(c) Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. To do this, we estimate our actual current tax liabilities, while also assessing temporary differences resulting from differing treatment of items, such as deferred revenue and expense accruals, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. To the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have recorded a valuation allowance as of June 30, 2003, due to uncertainties related to our ability to utilize some of our deferred tax assets, primarily consisting of the utilization of certain net operating loss carryforwards from prior years. We are unsure whether we will have sufficient future taxable income to allow us to use these net operating losses and tax credit carryforwords before they expire. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event

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that actual results differ from these estimates or we adjust these estimates in future periods, we may need to establish an additional valuation allowance. Establishing new or additional valuation allowances could materially adversely impact our financial position and results of operations.

Pro Forma Financial Results

We prepare and release quarterly unaudited financial statements prepared in accordance with generally accepted accounting principles (GAAP). We also disclose and discuss certain pro forma financial information, used to evaluate our performance, in related earnings releases and investor conference calls. We believe that current shareholders and potential investors in our company use multiples of pro-forma earnings per share (EPS) in making investment decisions about our company. We use pro-forma EPS to evaluate the results of our ongoing operations. Pro-forma EPS is calculated by dividing pro-forma net income by the diluted number of shares. Pro-forma net income excludes certain non-cash and special charges, consisting primarily of non-cash compensation charges and transaction costs associated with acquisitions. This proforma calculation also substitutes current period GAAP tax provisions with a pro forma tax rate. We have significant deferred tax assets and have not recorded a significant federal tax provision. The tax provision relates mostly to state and foreign taxes. This measure, and other pro-forma information, should not be considered an alternative to measurements required by accounting principles generally accepted in the United States of America (U.S. GAAP) such as net income and net cash provided by operations and should not be considered a measurement of our liquidity. In addition, our non-GAAP measures may not be comparable to similar measures reported by other companies.

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RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain financial data as percentages of the Company s total revenues:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Revenues:				
License revenues	51.4%	53.4%	52.4%	55.8%
Service revenues	48.6	46.6	47.6	44.2
Total revenues	100.0	100.0	100.0	100.0
Cost of Revenues:				
Cost of license revenues	2.7	1.7	2.6	2.0
Cost of service revenues	15.8	16.2	16.3	16.0
Total cost of revenues	18.5	17.9	18.8	18.0
Gross profit	81.5	82.1	81.2	82.0
Operating Expenses:				
Research and development (excluding stock-based compensation)	21.2	23.7	21.8	23.7
Sales and marketing	49.1	51.8	48.1	50.9
General and administrative	8.0	7.7	8.7	8.1
Stock-based compensation	0.1	0.1	0.1	0.1
Total operating expenses	78.4	83.4	78.7	82.9
Operating income (loss)	3.2	(1.3)	2.5	(0.9)
Other Income (Expense):				
Interest income	2.8	3.5	2.9	3.3
Other expense	(0.6)	(0.1)	(0.7)	(0.1)
Total other income, net	2.2	3.4	2.1	3.3
Income before income taxes	5.4	2.1	4.6	2.4
Provision for income taxes	0.7	0.4	0.5	0.5
Net income	4.7%	1.7%	4.1%	1.9%

Total Revenues

Concord s total revenues are generated from license revenue and service revenue. License revenues are derived from the licensing of software products. Service revenues consist of fees for maintenance, training and professional services

	Three Months Ended	Six Months Ended

(Dollars in thousands)	June 30, 2003	Percent Change	June 30, 2002	June 30, 2003	Percent Change	June 30, 2002
License revenues	$13,154	7.3%	$12,258	$26,063	-1.0%	$26,319
Service revenues	12,461	16.5%	10,693	23,669	13.4%	20,870
Total revenues	$25,615	11.6%	$22,951	$49,732	5.4%	$47,189
Percent of Total Revenues						
License revenues	51.4%		53.4%	52.4%		55.8%
Service revenues	48.6%		46.6%	47.6%		44.2%

The increase in total revenues for the three and six months ended June 30, 2003 as compared to the three and six months ended June 30, 2002 was mostly due to an increase of service revenues. The increase in service revenues for the three and six months ended June 30, 2003 as compared to the three and six months ended June 30, 2002 was

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