CONCORD COMMUNICATIONS INC
Form 10-Q
November 07, 2001

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON DC 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the quarterly period ended September 30, 2001.

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from ____________ to ______________.

COMMISSION FILE NUMBER 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, AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS;

YES X NO

16,727,333 SHARES OF THE REGISTRANT'S COMMON STOCK, $0.01 PAR VALUE, WERE OUTSTANDING AS OF NOVEMBER 5, 2001.

THIS DOCUMENT CONTAINS 32 PAGES.
THE EXHIBIT INDEX IS ON PAGE 26.

CONCORD COMMUNICATIONS, INC.

FORM 10-Q, SEPTEMBER 30, 2001

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PART I: FINANCIAL INFORMATION

PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONCORD COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	SEPTEMBER 30, 2001
ASSETS	
Current Assets:	
Cash, cash equivalents and marketable securities	$ 68,373,391
Accounts receivable, net of allowance of $1,458,786 and $1,525,965 in 2001 and 2000, respectively	15,423,424
Prepaid expenses and other current assets	3,069,808
Total current assets	86,866,623
Equipment and Improvements, at cost:	

Equipment	19,366,597
Leasehold improvements	6,018,960
	25,385,557
Less -- Accumulated depreciation and amortization	13,409,335
Equipment and Improvements, net	11,976,222
Deferred Tax Asset	3,500,000
Other Long-term Assets	102,849
	$ 102,445,694

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	$ 3,265,942
Accrued expenses	14,118,964
Deferred revenue	22,345,491
Total current liabilities	39,730,397
Stockholders' Equity:	
Common Stock, $0.01 par value:	
Authorized -- 50,000,000 shares	
Issued and outstanding -- 16,704,489 and 16,554,944 shares, in 2001 and 2000 respectively	167,045
Additional paid-in capital	95,129,414
Deferred compensation	(98,604)
Accumulated other comprehensive income	2,224,255
Accumulated deficit	(34,706,813)
Total stockholders' equity	62,715,297
	$ 102,445,694

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

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CONCORD COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED		
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	SE
Revenues:			
License revenues	$ 13,207,481	$ 17,514,786	$

Service revenues	8,632,804	5,873,824	
Total revenues	21,840,285	23,388,610	
Cost of Revenues	4,103,474	3,882,222	
Gross profit	17,736,811	19,506,388	
Operating Expenses:			
Research and development	6,030,382	5,116,687	
Sales and marketing	12,872,464	11,591,202	
General and administrative	2,029,605	2,172,194	
Stock-based compensation	41,360	163,061	
Acquisition-related charges	--	--	
Total operating expenses	20,973,811	19,043,144	
Operating (loss) income	(3,237,000)	463,244	(
Other income net	865,865	723,765	
(Loss) income before income taxes and extraordinary items	(2,371,135)	1,187,009	(
Provision for income taxes	--	286,853	
(Loss) income before extraordinary items	(2,371,135)	900,156	(
Extraordinary loss upon early retirement of debt, net of tax benefit of $72,000	--	--	
Net (loss) income	$ (2,371,135)	$ 900,156	$(
Net (loss) income per common and potential common share:			
Basic	$ (0.14)	$ 0.06	$
Diluted	$ (0.14)	$ 0.05	$
Weighted average common and potential commons shares outstanding:			
Basic	16,699,679	16,358,289	
Diluted	16,699,679	16,781,328	

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

CONCORD COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDE	
	SEPTEMBER 30, 2001	SE

Cash Flows from Operating Activities:		
Net (loss) income	$(11,182,229)	$
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	4,612,633	
Stock-based compensation	281,790	
Changes in current assets and liabilities:		
Accounts receivable	4,576,769	
Prepaid expenses and other assets	(673,618)	
Accounts payable	148,315	
Accrued expenses	3,010,043	
Deferred revenue	5,041,563	
Net cash provided by operating activities	5,815,266	
Cash Flows from Investing Activities:		
Purchases of equipment and improvements	(3,563,454)	
Net (investments in) proceeds from marketable securities	(5,191,516)	
Net cash used in investing activities	(8,754,970)	
Cash Flows from Financing Activities:		
Repayments of bank borrowings	--	
Proceeds from shares issued in connection with employee stock plans and warrants exercised	781,055	
Net cash provided by (used in) financing activities	781,055	
Net Decrease in Cash and Cash Equivalents	(2,158,649)	
Cash and Cash Equivalents, beginning of period	10,725,265	
Cash and Cash Equivalents, end of period	$ 8,566,616	$
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ --	$
Cash paid for taxes	$ 245,602	$
Supplemental Disclosure of Noncash Transactions:		
Reversal of deferred compensation related to forfeited stock options	$ (1,129,486)	$
Retirement of fully depreciated assets	$ 343,467	$
Conversion of redeemable convertible preferred stock to common stock	$ --	$
Unrealized gain on available-for-sale securities	$ 2,089,097	$

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

CONCORD COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FORM 10-Q, SEPTEMBER 30, 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been presented by Concord Communications, Inc. (the "Company") unaudited (except the balance sheet information as of December 31, 2000 which has been derived from audited financial statements) in accordance with accounting principles generally accepted in the United States 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 for complete financial statements. The financial statements reflect all adjustments and accruals which management considers necessary for a fair presentation of financial position as of September 30, 2001 and the results of operations for the three and nine months ended September 30, 2001 and 2000. 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 2000 Annual Report on Form 10-K filed with the Securities and Exchange Commission in March 2001.

REVENUE RECOGNITION

The Company's 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 upon execution of a contract and delivery of software, provided that the license fee is fixed and determinable, no significant production, modification or customization of the software is required and collection is considered probable by management. Revenues under multiple element arrangements, which typically include software products and maintenance sold together, are allocated to each element using the residual method in accordance with SOP 98-9. Service revenues are recognized as the services are performed. Maintenance revenues are derived from customer support agreements generally entered into in connection with initial license sales and subsequent renewals. Maintenance revenues are recognized ratably over the term of the maintenance period. Payments for maintenance fees are generally made in advance.

RECLASSIFICATIONS

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. BASIC AND DILUTED INCOME/LOSS PER COMMON SHARE

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 128, Earnings Per Share. SFAS No. 128 establishes standards for computing and presenting earnings per share and applies to entities with publicly held common stock or potential common stock. Basic net (loss) income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common and dilutive common-equivalent shares outstanding during the period. Dilutive common-equivalent shares primarily consist

of employee stock options. Diluted loss per share is the same as basic loss per share for the three and nine month periods ended September 30, 2001, as the effects of potential common stock are antidilutive. For the three and nine months ended September 30, 2001, employee stock options to purchase 2,318,735 and 2,436,069 shares, respectively, were outstanding but not included in the diluted weighted-average share calculation as the effect would have been antidilutive.

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

	THREE MONTHS ENDED	
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000
Net (loss) income available to common stockholders	$ (2,371,135)	$ 900,156
Weighted average common shares outstanding	16,699,679	16,358,289
Potential common shares pursuant to stock options and warrants	--	423,039
Diluted weighted average shares	16,699,679	16,781,328
Basic net (loss) income per common share	$ (0.14)	$ 0.06
Diluted net (loss) income per common and potential common share	$ (0.14)	$ 0.05

3. COMPREHENSIVE (LOSS) INCOME

Comprehensive (loss) income for the three months and nine months ended September 30, 2001 and 2000 is as follows:

	THREE MONTHS ENDED		
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	S
Net (loss) income	$ (2,371,135)	$ 900,156	$
Unrealized gain on marketable securities	1,434,424	543,097	
Comprehensive (loss) income	$ (936,711)	$ 1,443,253	$

4. ACQUISITIONS

On February 4, 2000, the Company consummated a transaction pursuant to which it acquired FirstSense Software, Inc. ("FirstSense"). Under the terms of the agreement, the shareholders and option holders of FirstSense received an aggregate of 1,940,000 equivalent Concord shares to effect the business combination. The transaction has been accounted for as a pooling of interests. Accordingly, all prior period financial statements presented have been restated to reflect the combination of the respective companies, as required by APB Opinion No. 16, "Accounting for Business Combinations". All inter-company transactions have been eliminated as a result of the business combination. As a part of the transaction, the Company incurred direct, acquisition-related charges of approximately $4,300,000. All such costs have been charged to operations in fiscal 2000 upon consummation of the FirstSense acquisition in February 2000.

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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 131, is the Executive Management Committee.

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

	THREE MONTHS ENDED		NINE MONTHS END	
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	SEPTEMBER 30, 2001	SEP
United States	$12,951,000	$15,590,000	$39,545,000	$4
Europe	6,197,000	3,938,000	15,234,000	1
Rest of the World.....	2,692,000	3,861,000	9,106,000	
Total	$21,840,000	$23,389,000	$63,885,000	$6

For the three month period ending September 30, 2001, the United States and France each accounted for greater than 10% of total revenues. Except for the United States, no one country accounted for greater than 10% of total revenues in the three months ended September 30, 2000 or the nine months ended September 30, 2001 and 2000 respectively. Substantially all of the Company's assets are located in the United States.

The Company's reportable segments are determined by customer type: service providers/telecommunications companies (SP/T) 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 revenue. 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.

The following table presents the approximate revenue by reportable segment:

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	SEPTEMBER 30, 2001	SEPTEMBER 2000
SP/T	$10,461,000	$11,797,000	$29,362,000	$29,570,0
Enterprise.....	11,379,000	11,592,000	34,523,000	35,897,0
Total	$21,840,000	$23,389,000	$63,885,000	$65,467,0

6. RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133, as amended, addresses the accounting for derivative instruments, including certain derivative instruments embedded in other contracts. Under SFAS No. 133, entities are required to carry all derivative instruments as either assets or liabilities in the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it. Pursuant to SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133, SFAS 133 is effective for all quarters of fiscal years beginning after June 15, 2000. The adoption did not have a material effect on the Company's consolidated financial position or results of operations.

On June 30, 2001, the FASB issued SFAS No. 141, Accounting for Business Combinations, and SFAS No. 142, Accounting for Goodwill and Other Intangible Assets. SFAS 141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method. Upon adoption of SFAS No. 142, goodwill will no longer be subject to amortization over its estimated useful life. Rather, goodwill will be subject to at least an annual assessment of impairment by applying a fair-value based test. The Company does not anticipate that the adoption of these statements will have a material impact on the financial position or results of operations or cash flows.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supercedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. SFAS No. 144 further refines the requirements of SFAS No. 121 that companies (1) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable based on its undiscounted future cash flows and (2) measure an impairment loss as the difference between the carrying amount and fair value of the asset. In addition, SFAS No. 144 provides guidance on accounting and disclosure issues surrounding long-lived assets to be disposed of by sale. The Company does not anticipate that the adoption of this statement will have a material impact on its financial position or results of operations or cash flows.

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

OVERVIEW

Concord develops, markets and supports a suite of highly scalable software solutions, our eHealth(TM) Suite family of products, which maximizes the availability and performance of networks, systems, and applications that form the critical underlying IT infrastructure on which businesses depend for their operations. Concord's software solutions monitor fault conditions throughout the infrastructure in real time; test availability and responsiveness of critical services; collect, consolidate, normalize and analyze high volumes of data from the IT infrastructure; alert IT personnel to faults and potential outages and automatically execute corrective action to restore availability and maximize uptime of the IT infrastructure, if desired.

This document contains forward-looking statements. Any statements contained herein 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. The 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 elsewhere in this Form 10-K under the heading "Risk Factors".

RESULTS OF OPERATIONS

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

UNAUDITED	THREE MONTHS ENDED		N
	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000	SEPTEMBE 2001
Revenues:			
License revenues	60.5%	74.9%	62.
Service revenues	39.5	25.1	37.
Total revenues	100.0	100.0	100.
Cost of Revenues	18.8	16.6	21.
Gross profit	81.2	83.4	78.
Operating Expenses:			
Research and development	27.6	21.9	29.
Sales and marketing	58.9	49.6	59.
General and administrative	9.3	9.3	10.
Stock-based compensation	0.2	0.7	0.
Acquisition-related charges	0.0	0.0	0.
Total operating expenses	96.0	81.4	100.
(Loss) income from Operations	(14.8)	2.0	(21.
Other income, net	4.0	3.1	3.
(Loss) income before taxes and extraordinary items	(10.8)	5.1	(17.
Provision for income taxes	0.0	1.2	0.
(Loss) income before extraordinary items	(10.8)	3.8	(17.
Extraordinary items	0.0	0.0	0.
Net (loss) income	(10.8)%	3.8%	(17.

TOTAL REVENUES. The Company's total revenues decreased 6.6% to $21.8 million in the three months ended September 30, 2001 from $23.4 million in the three months ended September 30, 2000. Total revenue decreased 2.4% to $63.9 million in the nine months ended September 30, 2001 from $65.5 million in the nine months ended September 30, 2000.

LICENSE REVENUES. The Company's license revenues, which are derived from the licensing of software products, decreased 24.6% to $13.2 million, or 60.5% of total revenues, in the three months ended September 30, 2001, from $17.5 million, or 74.9% of total revenues in the three months ended September 30, 2000. License revenues decreased 20.3% to $39.8 million, or 62.2% of total revenues, in the nine months ended September 30, 2001, from $49.9 million, or

76.2% of total revenues in the nine months ended September 30, 2000. The decrease of license revenues is due to the general slowdown of the economy in the United States and abroad which negatively affected IT infrastructure spending. The decrease in license revenues as a percent of total revenues was, in part, due to a significant increase in service revenues.

SERVICE REVENUES. The Company's service revenues, which consist of fees earned for maintenance, training and professional services, increased 47% to $8.6 million, or 39.5% of total revenues, in the three months ended September 30, 2001 from $5.9 million, or 25.1% of total revenues, in the three months ended September 30, 2000. Service revenues increased 54.7% to $24.1 million, or 37.8% of total revenues, in the nine months ended September 30, 2001 from $15.6 million, or 23.8% of total revenues, in the nine months ended September 30, 2000. The increase in service revenues was attributed to an increase of our customer base and the resulting demand for services by these customers.

COST OF REVENUES. Cost of revenues includes expenses associated with royalty costs, production, fulfillment and product documentation, along with personnel costs associated with providing customer support in connection with maintenance, training and professional service contracts. Royalty costs are composed of third party software costs. Cost of revenues increased 5.7% to $4.1 million, or 18.8% of total revenues, in the three months ended September 30, 2001 from $3.9 million, or 16.6% of total revenues, in the three months ended September 30, 2000, resulting in gross margins of 81.2% and 83.4% in each respective period. Cost of revenues increased 50.3% to $13.5 million, or 21.1% of total revenues, in the nine months ended September 30, 2001 from $8.9 million, or 13.6% of total revenues, in the nine months ended September 30, 2000, resulting in gross margins of 78.9% and 86.4% in each respective period. The increase in cost of revenues as a percent of total revenues was primarily driven by the increased spending in customer support to be more responsive to growing customer needs. We expect to decrease our cost of revenues as a percentage of total revenues; however, this will depend on our royalty costs and our growth, among other factors.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses consist primarily of personnel costs associated with software development. Research and development expenses increased 17.9% to $6.0 million, or 27.6% of total revenues, in the three months ended September 30, 2001 from $5.1 million, or 21.9% of total revenues, in the three months ended September 30, 2000. Research and development expenses increased 28.3% to $18.7 million, or 29.3% of total revenues, in the nine months ended September 30, 2001 from $14.6 million, or 22.3% of total revenues, in the nine months ended September 30, 2000. The increase in absolute dollars in research and development expenses was primarily due to increased headcount in research and development from 129 to 145 people for the period from September 30, 2000 to September 30, 2001. We intend to decrease our research and development expenses as a percentage of total revenues; however, this depends on our growth, among other factors.

SALES AND MARKETING EXPENSES. Sales and marketing expenses consist primarily of salaries, commissions to sales personnel and agents, travel, tradeshow participation, public relations, advertising and other promotional expenses. Sales and marketing expenses increased 11.1% to $12.9 million, or 58.9% of total revenues, in the three months ended September 30, 2001 from $11.6 million, or 49.6% of total revenues, in the three months ended September 30, 2000. Sales and marketing expenses increased 21.8% to $38.2 million, or 59.8% of total revenues, in the nine months ended September 30, 2001 from $31.4 million, or 48.0% of total revenues, in the nine months ended September 30, 2000. The increase in absolute dollars was primarily the result of increased headcount to continue to build the direct sales force along with additional marketing and promotional activities to penetrate the market. Headcount in sales and marketing increased from 163 to 195 people from September 30, 2000 to September 30, 2001. We intend to decrease our sales and marketing expenses as a percentage of total revenues; however, this depends on our growth, among other factors.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of salaries for financial, administrative and management personnel and related travel expenses, as well as legal, bad debt and other accounting expenses. General and administrative expenses decreased 6.6% to $2.0 million, or 9.3% of total revenues, in the three months ended September 30, 2001 from $2.2 million, or 9.3% of total revenues, in the three months ended September 30, 2000. The decrease in absolute dollars quarter over quarter is due mainly to a reduction in discretionary expenses. General and administrative expenses increased 28.9% to $6.8 million, or 10.7% of total revenues, in the nine months ended September 30, 2001 from $5.3 million, or 8.1%

of total revenues, in the nine months ended September 30, 2000. The increase in absolute dollars year over year is associated with an increase of costs in general support areas, such as human resources, finance and legal services, which will enable the Company to scale its infrastructure in anticipation of future growth. Headcount in general and administrative functions increased from 37 to 40 people from September 30, 2000 to September 30, 2001. We intend to continue to decrease our general and administrative expenses as a percentage of total revenues; however, this depends on our growth, among other factors.

ACQUISITION-RELATED EXPENSES. Acquisition-related expenses of approximately $4.3 million were incurred in the nine months ended September 30, 2000 related to accounting, legal and investment banking fees associated with the acquisition of FirstSense Software, Inc. in February 2000.

OTHER INCOME. Other income consists of interest earned on funds available for investment, net of interest expense in connection with the financing of capital equipment and interest expense paid by FirstSense on a term loan obtained by FirstSense prior to its acquisition by Concord. The Company had net other income of $866,000 for the three months ended September 30, 2001 and net other income of $724,000 for the three months ended September 30, 2000. The Company had net other income of $2.4 million for the nine months ended September 30, 2001 and net other income of $2.3 million for the nine months ended September 30, 2000.

EXTRAORDINARY ITEMS. The Company recognized an extraordinary loss of $216,000 (net of the tax benefit of $72,000) related to the early extinguishment of certain debt that the Company assumed as part of the FirstSense acquisition.

BENEFIT FROM INCOME TAXES. The Company did not record any income tax benefit in the nine months ended September 30, 2001 versus an income tax expense of $287,000 and $774,000 in the three and nine months ended September 30, 2000, respectively. The Company did not record such a benefit in 2001 based on its estimate of its year-end tax position.

LIQUIDITY AND CAPITAL RESOURCES

The Company financed its operations, prior to its initial public offering, primarily through the private sales of equity securities and a credit line for equipment purchases. On October 24, 1997, the Company completed its initial public offering yielding the Company net proceeds of approximately $34.7 million. The Company had working capital of $47.1 million at September 30, 2001.

Net cash provided by operating activities was $5.8 million and $3.2 million for the nine months ended September 30, 2001 and 2000, respectively. Cash, cash equivalents and marketable securities were $68.4 million and $63.2 million at September 30, 2001 and December 31, 2000, respectively. Accounts receivable decreased $4.6 million due to lower license revenue for the nine months ended September 30, 2001.

Investing activities have consisted of the acquisition of property and equipment, most notably computer and networking equipment to support the growing employee base and corporate infrastructure and also investments in marketable securities. The Company manages its market risk on its investment securities by selecting investment grade securities with the highest credit ratings and relatively short duration that trade in highly liquid markets.

Financing activities consisted primarily of the issuance of common stock and exercise of options during the nine months ended September 30, 2001 and 2000 and from the repayments in 2000 of borrowings on a subordinated debt financing by FirstSense.

Pursuant to the Tax Reform Act of 1986, the utilization of net operating loss carryforwards for tax purposes may be subject to an annual limitation if a cumulative change of ownership of more than 50% occurs over a three-year period. As a result of the Company's 1995 preferred stock financings, such a change in ownership has occurred. As a result of this ownership change, the use of the net operating loss (NOL) carryforwards is limited. The Company has determined that its initial public offering did not cause another ownership change. In addition, NOL carryforwards acquired as a result of the FirstSense acquisition are also restricted as a result of a prior ownership change. The Company had deferred tax assets of approximately $14.9 million composed primarily of net operating loss carryforwards and research and development credits at December 31, 2000. The Company has partially reserved for these deferred tax assets by recording a valuation allowance of $11.4 million at December 31, 2000. The net deferred tax asset is based on the Company's estimate of NOL carryforwards it expects to use in the next two years; all other tax assets have been fully reserved.

Pursuant to paragraphs 20 to 25 of SFAS No. 109, the Company considered both positive and negative evidence in assessing the need for a valuation allowance. The factors that weighed most heavily on the Company's decision to record a valuation allowance

were (i) the substantial restrictions on the use of certain of its existing NOL carryforwards and (ii) the uncertainty of future profitability.

As a result of the Company's ownership change described above, the future use of approximately $6.6 million of the Company's NOL carryforwards are limited to only $330,000 per year; the substantial majority of such NOL carryforwards will expire before they can be used. The FirstSense NOL carryforwards are limited to $4.2 million per year. Pursuant to the provisions of SFAS No. 109, the Company used all of its remaining unrestricted NOL and credit carryforwards in computing the 1998 tax provision. As a part of restating its financial statements to reflect the FirstSense acquisition, the Company determined that approximately $3.0 million of valuation allowance previously recorded by FirstSense prior to the acquisition was not necessary, given the Company's estimates of future taxable income. Accordingly, pursuant to SFAS No. 109, the Company recorded an asset and reduced its provision for income taxes in the period in which such NOL carryforwards were generated by FirstSense. The Company is also subject to rapid technological change, competition from substantially larger competitors, a limited family of products and other related risks, as more thoroughly described in the "Risk Factors" section beginning on page 14 and in the "Risk factors" section of the Company's Form 10-K, for the fiscal year ended December 31, 2000. The Company's dependence on a single product family in an emerging market makes the prediction of future results difficult, if not impossible, especially in the highly competitive software industry. As a result, the Company found the evidence described above to be the most reliable objective evidence available in determining that a valuation allowance against its tax assets would be necessary.

The Company's net operating loss deferred tax asset includes approximately $3.75 million pertaining to the benefit associated with the exercise and subsequent disqualifying disposition of incentive stock options by the Company's employees. When and if the Company realizes this asset, the resulting change in the valuation allowance will be credited directly to additional paid-in capital, pursuant to the provisions of SFAS No. 109.

RISK FACTORS

References in these risk factors to "we," "our" the "Company" and "us" refer to Concord Communications, Inc., a Massachusetts corporation. Any investment in our common stock involves a high degree of risk. If any of the following risks actually occur, our business, results of operations and financial condition would likely suffer.

This document contains forward-looking statements. Any statements contained herein 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. The 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.

OUR FUTURE OPERATING RESULTS ARE UNCERTAIN.

We changed our focus to network management software in 1991 and commercially introduced our first Network Health(R) product in 1995. We acquired Empire Technologies in October 1999 and FirstSense Software in February 2000, enabling our products to cover IT management across networks, systems and applications. Simultaneously, we have internally developed products and capabilities that brought us into the broader performance, availability and fault management market. Accordingly, we have a relatively limited operating history in these broader markets upon which you can evaluate our business and prospects can be based. We incurred significant net losses in each of the five fiscal years prior to recording a small loss in 1997, and turning profitable in 1998, 1999 and 2000. As of September 30, 2001, we had accumulated net losses of approximately $34.7 million. Our limited operating history makes the prediction of future results of operations difficult or impossible. Our prospects must be considered in light of the risks, costs and difficulties frequently encountered by emerging companies, particularly companies in the competitive software industry.

WE CANNOT ENSURE THAT OUR REVENUES WILL GROW OR THAT WE WILL BE PROFITABLE.

Although we have achieved revenue growth and profitability for the fiscal years ended 2000, 1999, and 1998, we cannot ensure that we can generate revenue growth on a quarterly or annual basis, or that we can achieve or sustain any revenue growth in the future. In 2001, our annual revenue may be lower than in 2000.

We may increase in the future, our operating expenses in order to:

- fund higher levels of research and development;
- increase our sales and marketing efforts;
- develop new distribution channels;
- broaden our customer support capabilities; and
- expand our administrative resources in anticipation of future growth.

To the extent that increases in our expenses precede or are not followed by increased revenue, our profitability will continue to suffer. Our revenue must grow substantially in order for us to become profitable on a quarterly or annual basis. In addition, in view of the rapidly evolving nature of our business and markets, our recent acquisitions and our limited operating history in our current market, we believe that one should not rely on period-to-period comparisons of our financial results as an indication of our future performance. In light of our strong performance in 1998, we used all of our remaining unrestricted tax net operating loss and credit carryforwards in 1998. Accordingly, we recorded a tax benefit of $986,000 during 1998, a tax provision of $4.3 million during 1999 and a tax provision of $375,000 during 2000. The continuing restrictions on our future use of our net operating loss carryforwards will severely limit the benefit, if any, we will attribute to this asset.

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE.

We are likely to experience significant fluctuations in our quarterly operating results caused by many factors, including, but not limited to:

- changes in the demand for our products by customers or group of customers;
- the timing, composition and size of orders from our customers, including the tendency for significant bookings to occur in the last month of each fiscal quarter;
- our customers' spending patterns and budgetary resources for fault and performance management software solutions;
- the success of our new customer generation activities;
- introductions or enhancements of products, or delays in the introductions or enhancements of products, by us or our competitors;
- changes in our pricing policies or those of our competitors;
- changes in the distribution channels through which products are sold;
- our success in anticipating and effectively adapting to developing markets and rapidly changing technologies;
- changes in networking or communications technologies;

- our success in attracting, retaining and motivating qualified personnel;

- changes in the mix of products sold by us and our competitors;

- the publication of opinions about us and our products, or our competitors and their products, by industry analysts or others;

- changes in general economic conditions; and

- geopolitical conditions in the world.

Though our services revenue has been increasing as a percentage of total revenues, we do not have a significant ongoing revenue stream that may mitigate quarterly fluctuations in operating results as do other software companies with a longer history of operations. Increases in our revenues will also depend on our successful implementation of our distribution strategy as we attempt to expand our channels of distribution. Due to the buying patterns of certain of our customers and also to our own sales incentive programs focused on annual sales goals, revenues in our fourth quarter could be higher than revenues in our first quarter of the following year. There also may be other factors, such as seasonality and the timing of receipt and delivery of orders within a fiscal quarter, that significantly affect our quarterly results, which are difficult to predict given our limited operating history.

Our quarterly sales and operating results depend generally on:

- the volume and timing of orders within the quarter;

- the tendency of sales to occur late in fiscal quarters; and

- our fulfillment of orders received within the quarter.

In addition, our expense levels are based in part on our expectations of future orders and sales, which are extremely difficult to predict. A substantial portion of our operating expenses are related to personnel, facilities and sales and marketing programs. Accordingly, we may not be able to adjust our fixed expenses quickly enough to address any significant shortfall in demand for our products in relation to our expectations.

Due to all of the foregoing factors, we believe that our quarterly operating results are likely to vary significantly in the future. Therefore, in some future quarter our results of operations may fall below the expectations of securities analysts and investors. In such event, the trading price of our common stock would likely suffer.

THE MARKET FOR INTEGRATED FAULT AND PERFORMANCE MANAGEMENT SOFTWARE IS EMERGING.

The market for our integrated end-to-end solution is in an early stage of development. Although the rapid expansion and increasing complexity of computer networks, systems and applications in recent years has increased the demand for fault and performance management software products, the awareness of and the need for an integrated fault and performance solution is a recent development. Because the market for this solution is only beginning to develop, it is difficult to assess:

- the size of this market;

- the appropriate features and prices for products to address this market;

- the optimal distribution strategy; and

- the competitive environment that will develop.

The development of this market and our growth will depend significantly upon the desire and success of telecommunication carriers, managed services providers and enterprises to integrate fault and performance management for their applications, systems and networks. Moreover, it will depend on the willingness of telecommunications carriers, ISPs, systems integrators and outsourcers to integrate fault and performance management software into their product and service offerings. The market for integrated fault and performance management software may not grow or we may fail to assess and address the needs of this market.

OUR SUCCESS IS DEPENDENT UPON SALES TO TELECOMMUNICATIONS CARRIERS, SERVICE PROVIDERS AND ENTERPRISE CUSTOMERS.

We derive and likely will continue to derive a significant portion of our revenues from the sales of our products to telecommunications carriers, service providers and enterprise customers. These markets worldwide have suffered from a turbulent economy during 2000 and 2001, turbulence that has been exacerbated by the tragic events of September 11, 2001 and their aftermath. Concord has been negatively affected by the downturn in capital spending within this market. The volume of sales of our products and services to telecommunications carriers, service providers and enterprise customers may increase slower than we expect or may decrease.

MARKET ACCEPTANCE OF OUR eHEALTH(TM) PRODUCT FAMILY IS CRITICAL TO OUR SUCCESS.

We currently derive substantial product revenues from our eHealth(TM) product family, and we expect that revenues from these products will continue to account for almost all of our product revenues in the foreseeable future. Broad market acceptance of these products is critical to our future success. We cannot ensure that market acceptance of our eHealth(TM) Suite of products will increase or even remain at current levels. Factors that may affect the market acceptance of our integrated solution include:

- the availability and price of competing solutions, products and technologies; and

- the success of our sales efforts and those of our marketing partners.

Moreover, if demand for integrated fault and performance management software products increases, we anticipate that our competitors will introduce additional competitive products and new competitors could enter our market and offer alternative products. Product and integrated solution introductions by our competitors may also reduce future market acceptance of our products.

OUR INDUSTRY IS SUBJECT TO RAPID TECHNOLOGICAL CHANGE. OUR SUCCESS DEPENDS UPON MAINTENANCE OF STANDARD PROTOCOLS.

The software industry is characterized by:

- rapid technological change;

- frequent introductions of new products;

- changes in customer demands; and

- evolving industry standards.

The introduction of products embodying new technologies and the emergence of new industry standards can render existing products and integrated solutions obsolete and unmarketable. Our eHealth(TM)-Network product's analysis and reporting, as well as the quality of its reports, depends upon its utilization of the industry-standard Simple Network Management Protocol (SNMP) and the data resident in conventional Management Information Bases (MIBs). Any change in these industry standards, the development of vendor-specific proprietary MIB technology, or the emergence of new network technologies could affect the compatibility of our eHealth(TM)-Network products with these devices, which in turn could affect its analysis and generation of comprehensive reports or the quality of the reports. Similarly, Live Health(TM) - Fault Manager product receives only SNMP traps from failing devices, systems and applications. Any change in these industry standards could hinder the effectiveness of this product. Furthermore, although our eHealth(TM) Suite of products currently run on industry-standard UNIX operating systems and Windows NT, any significant change in industry-standard operating systems could affect the demand for, or the pricing of, our products and solutions.

WE MUST INTRODUCE PRODUCT ENHANCEMENTS AND NEW PRODUCTS ON A TIMELY BASIS.

Because of rapid technological change in the software industry and potential changes in the IT infrastructure fault and performance management software market and industry standards, the life cycle of versions of our eHealth(TM) products is difficult to estimate. We cannot ensure that:

- we will successfully develop and market enhancements to our eHealth(TM) products or successfully develop new products that respond to technological changes, evolving industry standards or customer requirements;

- we will not experience difficulties that could delay or prevent the successful development, introduction and sale of such enhancements or new products; or

- that such enhancements or new products will adequately address the requirements of the marketplace and achieve any significant degree of market acceptance.

OUR ACQUISITIONS MAY NEGATIVELY IMPACT OUR RESULTS OF OPERATIONS.

In October 1999, we acquired Empire Technologies, Inc. Empire is a provider of solutions for proactive self-management of UNIX, Linux and Windows NT systems, as well as mission-critical applications. In February 2000, we acquired FirstSense Software, Inc. FirstSense is a provider of application response management solutions. Because these acquisitions have been recorded as "pooling-of-interests" for accounting and financial reporting purposes, we recorded the expenses of these acquisitions, which are substantial, in the period in which each acquisition occurred.

THE MARKET FOR OUR PRODUCTS IS INTENSELY COMPETITIVE.

The market for our products is new, intensely competitive, rapidly evolving and subject to technological change. Our current and future competitors include:

- fault management vendors;

- element management software vendors;

- systems management software vendors;

- other performance analysis and reporting vendors;

- companies offering network performance reporting services;

- large network management platform vendors which may bundle their products with other hardware and software in a manner that may discourage users from purchasing our products; and

- developers of network element management solutions.

We expect competition to persist, increase and intensify in the future with possible price competition developing in our markets. Many of our current and potential competitors have longer operating histories and significantly greater financial, technical and marketing resources and name recognition than us. We do not believe our market will support a large number of competitors and their products. In the past, a number of software markets have become dominated by one or a small number of suppliers, and a small

number of suppliers or even a single supplier may dominate our market. If we do not provide products that achieve success in our market in the short term, we could suffer an insurmountable loss in market share and brand name acceptance. We cannot ensure that we will compete effectively with current and future competitors.

OUR FAILURE TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS MAY HARM OUR COMPETITIVE POSITION IN THE NETWORK MANAGEMENT SOFTWARE MARKET.

Our success depends significantly upon our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, non-disclosure agreements and other contractual provisions to establish, maintain and protect our proprietary rights. These means afford only limited protection. We have ten issued U.S. patents, seven pending U.S. patent applications, and various foreign counterparts. We cannot ensure that patents will issue from our pending applications or from any future applications or that, if issued, any claims allowed will be sufficiently broad to protect our technology. In addition, we cannot ensure that any patents that have been or may be issued will not be challenged, invalidated or circumvented, or that any rights granted thereunder would protect our proprietary rights. Failure of any patents to protect our technology may make it easier for our competitors to offer equivalent or superior technology. We have registered or applied for registration for certain trademarks, and will continue to evaluate the registration of additional trademarks as appropriate. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or services or to obtain and use information that we regard as proprietary. Third parties may also independently develop similar technology without breach of our proprietary rights. In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the United States. In addition, many of our products are licensed under shrinkwrap license agreements that are not signed by licensees. The law governing the enforceability of shrinkwrap license agreement is not settled in most jurisdictions. There can be no guarantee that we would achieve success in enforcing one or more shrinkwrap license agreements if we sought to do so in a court of law.

WE LICENSE CERTAIN TECHNOLOGIES FROM THIRD PARTIES.

We license from third parties, generally on a non-exclusive basis, certain technologies used in our products. The termination of any such licenses, or the failure of the third-party licensors to adequately maintain or update their products, could result in delay in our shipment of certain of our products while we seek to implement technology offered by alternative sources, and any required replacement licenses could prove costly. While it may be necessary or desirable in the future to obtain other licenses relating to one or more of our products or relating to current or future technologies, we cannot ensure that we will be successful in doing so on commercially reasonable terms or at all.

INTELLECTUAL PROPERTY INFRINGEMENT CLAIMS WOULD HARM OUR BUSINESS.

Although we do not believe that we are infringing the intellectual property rights of others, claims of infringement are becoming increasingly common as the software industry develops and legal protections, including patents, are applied to software products. Litigation may be necessary to protect our proprietary technology, and third parties may assert infringement claims against us with respect to their proprietary rights. Any claims or litigation can be time-consuming and expensive regardless of their merit. Infringement claims against us can cause product release delays, require us to redesign our products or require us to enter into royalty or license agreements, which agreements may not be available on terms acceptable to us or at all.

PRODUCT DEFECTS COULD RESULT IN LOSS OR DELAY IN MARKET ACCEPTANCE OF OUR PRODUCTS.

As a result of their complexity, software products may contain undetected errors or failures when first introduced or as new versions are released. We cannot ensure that, despite testing by us and testing and use by current and potential customers, errors will not be found in new products we ship or, if discovered, that we will successfully correct such errors in a timely manner or at all. The occurrence of errors and failures in our products could result in loss of or delay in market acceptance of our products, and alleviating such errors and failures could require significant expenditure of capital and other resources by us.

WE MAY NOT HAVE SUFFICIENT PROTECTION AGAINST PRODUCT LIABILITY CLAIMS.

Because our products are used by our customers to predict future network, system and application problems and to avoid failures of the network to support critical business functions, design defects, software errors, misuse of our products, incorrect data from network elements or other potential problems within or out of our control may arise from the use of our products and could result in financial or other damages to our customers. While we do not maintain product liability insurance, our license agreements with our customers typically contain provisions designed to limit our exposure to potential claims as well as any liabilities arising from such

claims. We provide warranties for our products for a period of time (currently three months) after purchase. Our license agreements do not permit product returns by the customer, and product returns for fiscal 2000, 1999 and 1998 represented less than 1.0% of total revenues during each of such periods. We cannot ensure that product returns will not increase as a percentage of total revenues in future periods.

WE RELY ON STRATEGIC PARTNERS AND OTHER EVOLVING DISTRIBUTION CHANNELS.

Our distribution strategy is to develop multiple distribution channels, including sales through:

- strategic marketing partners, such as Cisco Systems;
- value added resellers, such as Empowered Networks;
- telecommunications carriers, such as MCI WorldCom;
- OEMs, such as Micromuse; and
- independent software vendors and international distributors.

We have developed a number of these relationships and intend to continue to develop new "channel partner" relationships. Our success will depend in large part on our development of these additional distribution relationships and on the performance and success of these third parties, particularly telecommunications carriers and other network service providers. We have recently established many of our channel partner relationships. Accordingly, we cannot predict the extent to which our channel partners will be successful in marketing our products. We generally expect that our agreements with our channel partners may be terminated by either party without cause. None of our channel partners are required to purchase minimum quantities of our products and none of these agreements contain exclusive distribution arrangements. We may:

- fail to attract important and effective channel partners;
- fail to penetrate the market segments of our channel partners; or
- lose any of our channel partners, as a result of competitive products offered by other companies, products developed internally by these channel partners or otherwise.

WE MAY FAIL TO MANAGE SUCCESSFULLY OUR GROWTH.

We have experienced significant growth in our sales and operations and in the complexity of our products and product distribution channels. We have increased and are continuing to increase the size of our sales force and coverage territories. Furthermore, we have established and are continuing to establish additional distribution channels through third party relationships. Our growth, coupled with the rapid evolution of our markets, has placed, and is likely to continue to place, significant strains on our administrative, operational and financial resources and increase demands on our internal systems, procedures and controls.

OUR SUCCESS DEPENDS ON OUR RETENTION OF KEY PERSONNEL.

Our performance depends substantially on the performance of our key technical and senior management personnel, none of whom is bound by an employment agreement. We may lose the services of any of such persons. We do not maintain key person life insurance policies on any of our employees. Our success depends on our continuing ability to identify, hire, train, motivate and retain highly qualified management, technical, and sales and marketing personnel, including recently hired officers and other employees. We experience intense competition for such personnel. We cannot ensure that we will successfully attract, assimilate or retain highly qualified technical, managerial or sales and marketing personnel in the future.

OUR FAILURE TO EXPAND INTO INTERNATIONAL MARKETS COULD HARM OUR BUSINESS.

We intend to continue to expand our operations outside of the United States and enter additional international markets, primarily through the establishment of additional reseller arrangements. We expect to commit additional time and development resources to customizing our products and services for selected international markets and to developing international sales and support channels. We cannot ensure that such efforts will be successful.

We face certain difficulties and risks inherent in doing business internationally, including, but not limited to:

- costs of customizing products and services for international markets;
- dependence on independent resellers;
- multiple and conflicting regulations;
- exchange controls;
- longer payment cycles;
- unexpected changes in regulatory requirements;
- import and export restrictions and tariffs;
- difficulties in staffing and managing international operations;
- greater difficulty or delay in accounts receivable collection;
- potentially adverse tax consequences;
- the burden of complying with a variety of laws outside the United States;
- the impact of possible recessionary environments in economies outside the United States; and
- political and economic instability.

Our successful expansion into certain countries will require additional modification of our products, particularly national language support. Our current export sales are denominated in United States dollars and we currently expect to largely continue this practice as we expand internationally. To the extent that international sales do continue to be denominated in U.S. dollars, an increase in the value of the United States dollar relative to other currencies could make our products and services more expensive and, therefore, potentially less competitive in international markets. In certain European Union countries, however, we expect to introduce pricing in Euros in the near future. To the extent that future international sales are denominated in foreign currency, our operating results will be subject to risks associated with foreign currency fluctuation. We would consider entering into forward exchange contracts or otherwise engaging in hedging activities. To date, as all export sales are denominated in U.S. dollars, we have not entered into any such contracts or engaged in any such activities. As we increase our international sales, seasonal fluctuations resulting from lower sales that typically occur during the summer months in Europe and other parts of the world may affect our total revenues.

OUR COMMON STOCK PRICE COULD EXPERIENCE SIGNIFICANT VOLATILITY.

We completed an initial public offering of our common stock during October 1997. The market price of our common stock may be highly volatile and could be subject to wide fluctuations in response to:

- variations in results of operations;
- announcements of technological innovations or new products by us or our competitors;
- changes in financial estimates by securities analysts; or
- other events or factors.

In addition, the financial markets have experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many high technology companies and that often have been unrelated to the operating performance of such companies or have resulted from the failure of the operating results of such companies to meet market expectations in a particular quarter. Broad market fluctuations or any failure of our operating results in a particular quarter to meet market expectations may adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such a company. Such litigation could result in substantial costs and a diversion of our attention and resources.

WE MAY NEED FUTURE CAPITAL FUNDING.

We plan to continue to expend substantial funds on the continued development, sales and marketing of the eHealth(TM) product family. We cannot ensure that our existing capital resources, the proceeds from our initial public offering during October 1997 and any funds that may be generated from future operations together will be sufficient to finance our future operations or that other sources of funding will be available on terms acceptable to us, if at all. In addition, future sales of substantial amounts of our securities in the public market could adversely affect prevailing market prices and could impair our future ability to raise capital through the sale of our securities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

DERIVATIVE FINANCIAL INSTRUMENTS, OTHER FINANCIAL INSTRUMENTS AND DERIVATIVE COMMODITY INSTRUMENTS. The Company does not invest in derivative financial instruments, other financial instruments or derivative commodity instruments for which fair value disclosure would be required under SFAS No. 107. All of the Company's investments are in investment grade securities with high credit ratings of relatively short duration that trade in highly liquid markets and are carried at fair value on the Company's books. Accordingly, the Company has no quantitative information concerning the market risk of participating in such investments.

PRIMARY MARKET RISK EXPOSURES. The Company's primary market risk exposure is in the area of interest rate risk. The Company's investment portfolio of cash equivalents and marketable securities is subject to interest rate fluctuations, but the Company believes this risk is immaterial due to the short-term nature of these investments. Substantially all of the Company's business outside the United States is conducted in U.S. dollar-denominated transactions, whereas the Company's operating expenses in its international branches are denominated in local currency. The Company has no foreign exchange contracts, option contracts or other foreign hedging arrangements. The Company believes that the operating expenses of its foreign operations are immaterial, and therefore any associated market risk is unlikely to have a material adverse effect on the Company's business, results of operations or financial condition.

The Company's current export sales are denominated in United States dollars. To the extent that international sales continue to be denominated in United States dollars, an increase in the value of the United States dollar relative to other currencies could make the Company's products and services more expensive and, therefore, potentially less competitive in international markets.

CONCORD COMMUNICATIONS, INC.
FORM 10-Q, SEPTEMBER 30, 2001
PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any litigation that it believes could have a material adverse effect on the business, results of operations and financial condition of the Company.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) Issuance of Securities

On February 4, 2000, the Company completed a merger with FirstSense Software, Inc. The Company has reserved for issuance in connection with the merger, 1,940,000 shares of Concord Common Stock. The Company issued the shares in a private placement transaction pursuant to Section 4(2) under the Securities Act of 1933. The merger was accounted for as a pooling of interests. The Company has filed a Form S-3 Registration Statement to cover the resale of the securities issued in the merger.

(b) Use of Proceeds

On October 16, 1997, the Company commenced an initial public offering ("IPO") of 2,900,000 shares of common stock, par value $.01 per share (the "Common Stock"), of the Company pursuant to the Company's final prospectus dated October 15, 1997 (the "Prospectus"). The Prospectus was contained in the Company's Registration Statement on Form S-1, which was declared effective by the Securities and Exchange Commission (SEC File No. 333-33227) on October 15, 1997. Of the 2,900,000 shares of Common Stock offered, 2,300,000 shares were offered and sold by the Company and 600,000 shares were offered and sold by certain shareholders of the Company. As part of the IPO, the Company granted the several underwriters an overallotment option to purchase up to an additional 435,000 shares of Common Stock (the "Underwriters' Option"). The IPO closed on October 21, 1997 upon the sale of 2,900,000 shares of Common Stock to the underwriters. On October 24, 1997, the Representatives, on behalf of the several underwriters, exercised the Underwriters' Option, purchasing 435,000 additional shares of Common Stock from the Company. The aggregate offering price of the shares of Common stock in the IPO to the public was $40,600,000 (exclusive of the Underwriters' Option), with proceeds to the Company and selling shareholders, after deduction of the underwriting discount, of $29,946,000 (before deducting offering expenses payable by the Company) and $7,812,000 respectively. The aggregate offering price of the Underwriters' Option exercised was $6,090,000, with proceeds to the Company, after deduction of the underwriting discount, of $5,663,700 (before deducting offering expenses payable by the Company). The aggregate amount of expenses incurred by the Company in connection with the issuance and distribution of the shares of Common Stock offered and sold in the IPO were approximately $3.6 million, including $2.7 million in underwriting discounts and commissions and $950,000 in other offering expenses. The net proceeds to the Company from the IPO, after deducting underwriting discounts and commissions and other offering expenses were approximately $34.7 million. To date, the Company has not utilized any of the net proceeds from the IPO. The Company has invested all such net proceeds primarily in US treasury obligations and other interest bearing investment grade securities.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

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

Not Applicable

ITEM 5. OTHER INFORMATION

On October 29, 2001, the Board of Directors of the Company adopted the 2001 Non-Executive Employee Stock Purchase Plan (the "Plan"). The stockholders of the Company will consider approval of the Plan at the Company's next annual meeting.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The exhibit listed in the accompanying Exhibit Index on page 26 is filed or incorporated by reference as part of this Report.

CONCORD COMMUNICATIONS, INC.
FORM 10-Q, SEPTEMBER 30, 2001

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Concord Communications, Inc.

/s/ Melissa H. Cruz

Date: November 7, 2001

Name: Melissa H. Cruz
Title: Executive Vice President of Business Services and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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CONCORD COMMUNICATIONS, INC.
FORM 10-Q, SEPTEMBER 30, 2001

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION	SEC DOCUMENT REFERENCE
*10.31	2001 Non-Executive Employee Stock Purchase Plan	Exhibit No. 10.31 to Curre

* filed herewith

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