CONCORD COMMUNICATIONS INC
Form 10-Q
November 04, 2002

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, 2002.

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

17,113,875 SHARES OF THE REGISTRANT'S COMMON STOCK, $0.01 PAR VALUE, WERE OUTSTANDING AS OF OCTOBER 30, 2002.

THIS DOCUMENT CONTAINS 40 PAGES.
THE EXHIBIT INDEX IS ON PAGE 36.

CONCORD COMMUNICATIONS, INC.

FORM 10-Q, SEPTEMBER 30, 2002

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	SEPTEMBER 30, 2002	DEC
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8,680,564	$ 9

Marketable securities	62,809,802	59
Restricted cash	938,576	
Accounts receivable, net of allowance of $1,369,295 and $1,409,835 at September 30, 2002 and December 31, 2001, respectively	18,697,277	16
Prepaid expenses and other current assets	2,650,452	3
Total current assets	93,776,671	87
Equipment and improvements, at cost:		
Equipment	22,400,710	19
Leasehold improvements	6,081,378	5
	28,482,088	25
Less-- accumulated depreciation and amortization	19,341,448	14
	9,140,640	10
Deferred tax asset	3,500,000	3
Other long-term assets	240,623	
	3,740,623	3
Total assets	$106,657,934	$102

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	$ 2,759,692	$ 3
Accrued expenses	12,852,274	13
Deferred revenue	24,644,888	22
Total current liabilities	40,256,854	38
Stockholders' Equity:		
Common stock, $0.01 par value:		
Authorized-- 50,000,000 shares		
Issued and outstanding-- 17,111,903 and 16,901,193 shares at September 30, 2002 and December 31, 2001, respectively	171,119	
Additional paid-in capital	98,063,347	96
Deferred compensation	(91,341)	
Accumulated other comprehensive income	1,488,091	1
Accumulated deficit	(33,230,136)	(34
Total stockholders' equity	66,401,080	63
Total liabilities and stockholders' equity	$106,657,934	$102

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

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

THREE MONTHS ENDED

	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001	SEP
Revenues:			
License revenues	$12,201,638	$13,207,481	$38
Service revenues	10,852,119	8,632,804	31
Total revenues	23,053,757	21,840,285	70
Cost of Revenues			
Cost of license revenues	469,322	381,332	1
Cost of service revenues	3,781,787	3,722,142	11
Total cost of revenues	4,251,109	4,103,474	12
Gross profit	18,802,648	17,736,811	57
Operating Expenses:			
Research and development	5,258,779	6,030,382	16
Sales and marketing	11,818,136	12,872,464	35
General and administrative	1,742,436	2,029,605	5
Stock-based compensation	25,289	41,360	
Total operating expenses	18,844,640	20,973,811	57
Operating loss	(41,992)	(3,237,000)	
Other Income (Expense)			
Interest income	816,929	886,694	2
Other (expense) income	(75,707)	4,171	
Total other income, net	741,222	890,865	2
Income (loss) before income taxes	699,230	(2,346,135)	1
Provision for income taxes	135,565	25,000	
Net income (loss)	$ 563,665	$(2,371,135)	$ 1
Net income (loss) per common and potential common share:			
Basic	$ 0.03	$ (0.14)	$
Diluted	$ 0.03	$ (0.14)	$
Weighted average common and potential common shares outstanding:			
Basic	17,104,224	16,699,679	17
Diluted	17,275,667	16,699,679	17

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

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

	NINE MONTHS ENDED SEPTEMBER 30, 2002	NINE MONTHS ENDED SEPTEMBER 30, 2001
Cash Flows from Operating Activities:		
Net income (loss)	$ 1,448,012	$(11,182,229)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	4,542,760	4,612,633
Stock-based compensation	84,997	281,790
Changes in current assets and liabilities:		
Accounts receivable	(2,160,146)	4,576,769
Prepaid expenses and other current assets	407,345	(660,458)
Accounts payable	(793,725)	148,315
Accrued expenses	(1,418,611)	3,010,043
Deferred revenue	2,503,810	5,041,563
Net cash provided by operating activities	4,614,442	5,828,426
Cash Flows from Investing Activities:		
Purchases of equipment and improvements	(2,888,674)	(3,563,454)
Change in other assets	6,032	(13,160)
Investments in marketable securities	(9,776,647)	(14,922,327)
Deposit of restricted cash	(938,576)	--
Proceeds from sales of marketable securities	6,887,800	9,730,811
Net cash used in investing activities	(6,710,065)	(8,768,130)
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	1,765,376	781,055
Net cash provided by financing activities	1,765,376	781,055
Net decrease in cash and cash equivalents	(330,247)	(2,158,649)
Cash and cash equivalents, beginning of period	9,010,811	10,725,265
Cash and cash equivalents, end of period	$ 8,680,564	$ 8,566,616
Supplemental Disclosure of Cash Flow Information:		
Cash paid for taxes	$ 186,405	$ 245,602
Supplemental Disclosure of Noncash Transactions:		
Reversal of deferred compensation related to forfeitures of stock options	$ (65,209)	$ (1,129,486)
Retirement of fully depreciated assets	$ --	$ 343,467
Unrealized gain on available-for-sale securities	$ 587,886	$ 2,089,097

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

CONCORD COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

FORM 10-Q, SEPTEMBER 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

The accompanying condensed consolidated financial statements have been presented by Concord Communications, Inc. (the "Company" or "Concord") unaudited (except the balance sheet information as of December 31, 2001 which has been derived from audited financial statements) 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. The 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 September 30, 2002 and December 31, 2001, and the Company's results of operations for the three and nine months ended September 30, 2002 and 2001. 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 2001 Annual Report on Form 10-K filed with the Securities and Exchange Commission in March 2002.

(b) Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

(c) Cash, Cash Equivalents and Marketable Securities

The Company follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities. The Company has classified its marketable securities as available-for-sale and recorded them at fair value, with the unrealized gains and losses reported as a separate component of stockholders' equity until realized. The Company considers highly liquid investments, purchased with an original maturity of 90 days or less, to be cash equivalents. Cash and cash equivalents were $8,680,564 and $9,010,811 at September 30, 2002 and December 31, 2001, respectively, and consisted primarily of money market funds.

(d) Restricted Cash

Restricted cash totaling $938,576 at September 30, 2002 consists of money market funds held in the Company's name and custodied with a major financial institution. Such funds are being used as collateral under a letter of credit arrangement with a Company supplier.

(e) 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 or determinable, no significant production, modification or customization of the software is required and collection is considered reasonably assured by management. 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 Company has 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.

Maintenance revenues, a component of service revenues, are derived from customer support agreements generally entered into in connection with initial software license sales and subsequent renewals. Maintenance and customer support fees include the right to unspecified upgrades on a when-and-if-available basis and ongoing technical support. Maintenance revenues are recognized ratably over the term of the maintenance period. Payments for maintenance fees are generally made in advance and are included in deferred revenue. As of September 30, 2002 and December 31, 2001, deferred revenue includes approximately $19.3 million and $17.1 million, respectively, of deferred maintenance revenues.

(f) 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 of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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.

(g) 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 nine months ended September 30, 2002 or September 30, 2001. No one customer or reseller accounted for more than 10% of accounts receivable as of September 30, 2002. One customer, a reseller in South America, accounted for 13.4% of accounts receivable at December 31, 2001; a total of 7.2% of the receivables from this customer was included in the Company's deferred revenue at December 31, 2001. As of September 30, 2002, this customer represented 3.0% of accounts receivable.

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

At September 30, 2002, 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 September 30, 2002
Euro	Sell	10/28/02	$486,169	0.9715	$472,314

(i) Reclassifications

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

2. BASIC AND DILUTED INCOME/LOSS PER COMMON SHARE

The Company computes earnings per share following the provisions of 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 income (loss) per share is computed using the weighted-average number of common shares outstanding for a period. Diluted net income (loss) per share is computed using the weighted-average number of common and dilutive common-equivalent shares outstanding for the period. Diluted net loss per common share is the same as basic net loss per common share for the three and nine months ended September 30, 2001, as the effects of potential common stock are antidilutive. Dilutive common-equivalent shares primarily consist of employee stock options. The dilutive effect of outstanding stock options is computed using the treasury stock method. For the three and nine months ended September 30, 2002, employee stock options to purchase 3,142,910 and 2,107,830 shares, respectively, were outstanding but not included in the diluted weighted-average share calculation as their effects would have been 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 as a result of the Company's reported loss for the periods.

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

	THREE MONTHS ENDED	
	September 30, 2002	September 30, 2001
Net income (loss) applicable to common stockholders	$ 563,665	$(2,371,135)
Weighted average common shares outstanding	17,104,224	16,699,679
Potential common shares pursuant to stock options	171,443	--
Diluted weighted average shares	17,275,667	16,699,679
Basic net income (loss) per common share	0.03	(0.14)
Diluted net income (loss) per common and potential common share	0.03	(0.14)

3. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for the three and nine months ended September 30, 2002 and 2001 is as follows:

	THREE MONTHS ENDED		NI
	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001	SEPTEMBE 2002
Net income (loss) available to common stockholders	$ 563,665	$(2,371,135)	$1,448,
Unrealized gain on marketable securities	595,749	1,434,424	587,
Comprehensive income (loss)	$1,159,414	$ (936,711)	$2,035,

4. 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		NINE MONTHS ENDED	
	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001
United States	$15,016,000	$12,951,000	$44,372,000	$39,545,000
Europe	4,634,000	6,197,000	15,533,000	15,234,000
Rest of the World	3,404,000	2,692,000	10,337,000	9,106,000
Total	$23,054,000	$21,840,000	$70,242,000	$63,885,000

No one country, except the United States, accounts 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.

The table presents the approximate revenues by reportable segment:

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001
MSP/TC	$ 9,703,000	$10,461,000	$27,494,000	$29,393,000
Enterprise	13,351,000	11,379,000	42,748,000	34,492,000
Total	$23,054,000	$21,840,000	$70,242,000	$63,885,000

5. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes 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, which required 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 adopted SFAS No. 144 beginning on January 1, 2002. The adoption did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

In November 2001, the Emerging Issues Task Force issued EITF 01-14 relating to the accounting for reimbursements received for out-of-pocket expenses. In accordance with EITF 01-14, reimbursements received for out-of-pocket expenses incurred should be characterized as revenues in the statement of operations. The Company has historically accounted for reimbursements received for out-of-pocket expenses incurred as a reduction to cost of service revenues in the statement of operations to offset the costs incurred. The Company adopted EITF 01-14 on January 1, 2002, and comparative financial statements for prior periods have been reclassified to comply with the guidance in EITF 01-14. During the three and nine months ended September 30, 2002, reimbursed out-of-pocket expenses totaled $0 and $18,051, respectively. During the three and nine months ended September 30, 2001, reimbursed out-of-pocket expenses totaled $18,822 and $45,936, respectively. There was no impact on the gross profit as a percentage of total revenues or gross margin for the three and nine month periods ended September 30, 2002 or 2001.

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

OVERVIEW

Concord develops, markets and supports the eHealth(TM) Suite of scalable information technology ("IT") infrastructure fault and performance management software solutions. Concord's eHealth(TM) Suite integrates fault and performance management of the systems, applications and networks that comprise today's IT infrastructure. Concord's solutions optimize the performance and availability of IT infrastructures on which enterprises, managed service providers and telecommunication carriers depend for their day-to-day business and operational success. 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 a high volume of data from the IT infrastructure; alert IT personnel to faults and potential outages, maximize uptime of the IT infrastructure and automatically execute corrective action to restore availability, if desired.

The information provided by Concord or statements made by our employees may contain forward-looking statements. In particular, some statements contained in this Form 10-Q for the quarterly period ended September 30, 2002 are not historical statements including, but not limited to, statements concerning the plan and objectives of management, increases in revenues (domestically and internationally), increases in absolute dollars or decreases as a percentage of revenues in sales and marketing, research and development and general and administrative expenses (domestically and internationally), Concord's ability to use deferred tax assets, Concord's success in competing in international markets, Concord's expected future profitability and Concord's expected liquidity and capital resources. This document contains forward-looking statements. Any statements contained herein that do not describe historical facts are forward-looking statements. The Company 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. The facts 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.

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		NINE MONTHS END	
	SEPTEMBER 30, 2002	SEPTEMBER 30, 2001	SEPTEMBER 30, 2002	SEP
Revenues:				
License revenues	52.9%	60.5%	54.8%	
Service revenues	47.1%	39.5%	45.2%	
Total revenues	100.0%	100.0%	100.0%	1
Cost of Revenues				
Cost of license revenues	2.0%	1.7%	2.0%	
Cost of service revenues	16.4%	17.0%	16.1%	
Total cost of revenues	18.4%	18.8%	18.2%	
Gross profit	81.6%	81.2%	81.8%	
Operating Expenses:				
Research and development	22.8%	27.6%	23.4%	
Sales and marketing	51.3%	58.9%	51.0%	
General and administrative	7.6%	9.3%	7.9%	
Stock-based compensation	0.1%	0.2%	0.1%	
Total operating expenses	81.7%	96.0%	82.5%	1

Operating loss	-0.1%	-14.8%	-0.6%	-
Other income, net	3.2%	4.1%	3.2%	
Income (loss) before taxes	3.1%	-10.7%	2.6%	-
Provision for income taxes	0.6%	0.1%	0.5%	
Net income (loss)	2.5%	-10.9%	2.1%	-

REVENUES. Concord'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 or determinable, no significant production, modification or customization of the software is required and collection is considered reasonably assured 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, a component of service 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.

TOTAL REVENUES. The Company's total revenues increased 5.6% to $23.1 million in the three months ended September 30, 2002 from $21.8 million in the three months ended September 30, 2001. Total revenues increased 10.0% to $70.2 million in the nine months ended September 30, 2002 from $63.9 million in the nine months ended September 30, 2001.

LICENSE REVENUES. Concord's license revenues are derived from the licensing of software products. License revenues decreased 7.6% to $12.2 million, or 52.9% of total revenues, in the three months ended September 30, 2002 from $13.2 million, or 60.5% of total revenues, in the three months ended September 30, 2001. License revenues decreased 3.1% to $38.5 million, or 54.8% of total revenues, in the nine months ended September 30, 2002, from $39.8 million, or 62.2% of total revenues, in the nine months ended September 30, 2001. The decrease in license revenues for the three months and nine months ended September 30, 2002 was due, in large part, to decreases in, or postponements or cancellations of IT infrastructure purchases by some of our customers due to worldwide economic uncertainty. In addition to the continuing worldwide slowdown in the economy, political uncertainty resulting in financial instability in Brazil, reduced spending by some telecommunication carriers on their infrastructures and the announcement of accounting improprieties by a few major U.S. based firms have also

negatively affected IT spending by our customers and potential customers. The decrease in license revenues as a percent of total revenues was the result of a significant increase in service revenues, consisting mainly of maintenance revenues.

SERVICE REVENUES. Concord's service revenues consist of fees for maintenance, training and professional services. Service revenues increased 25.7% to $10.9 million, or 47.1% of total revenues, in the three months ended

September 30, 2002 from $8.6 million, or 39.5% of total revenues, in the three months ended September 30, 2001. Service revenues increased 31.5% to $31.7 million, or 45.2% of total revenues, in the nine months ended September 30, 2002 from $24.1 million, or 37.8% of total revenues, in the nine months ended September 30, 2001. The increase in service revenues for the three months and nine months ended September 30, 2002 was attributed to an increase in our customer base and the resulting demand for services by these customers.

INTERNATIONAL REVENUES. Concord's international revenues decreased 9.6% to $8.0 million, or 34.9% of total revenues, for the three months ended September 30, 2002 from $8.9 million, or 40.7% of total revenues, for the three months ended September 30, 2001. International revenues increased 6.3% to $25.9 million, or 36.8% of total revenues, for the nine months ended September 30, 2002 from $24.3 million, or 38.1% of total revenues, for the nine months ended September 30, 2001. International revenues are primarily driven by customers based in Europe, as well as the continued expansion of the Company's operations outside the United States.

SEGMENT REVENUES. Concord's reportable segments are determined by customer type: managed service providers/telecommunications carriers ("MSP/TC") and enterprise. Concord's MSP/TC revenues decreased 7.2% to $9.7 million, or 42.1% of total revenues, for the three months ended September 30, 2002 from $10.5 million, or 47.9% of total revenues, for the three months ended September 30, 2001. MSP/TC revenues decreased 6.5% to $27.5 million, or 39.1% of total revenues, for the nine months ended September 30, 2002 from $29.4 million, or 46.0% of total revenues, for the nine months ended September 30, 2001. The decrease in MSP/TC revenues for the three months and nine months ended September 30, 2002 was due to the general reduced spending by major telecommunications firms on IT infrastructure projects. The general slowdown of the economy in the United States and abroad, the overcapacity in the telecommunications infrastructure market and the bankruptcies of some major U.S. carriers have all contributed to the lower spending by this segment. The decrease in MSP/TC revenues as a percent of total revenues was the result of a significant increase in enterprise revenues, including both new and existing customers.

Concord's enterprise revenues increased 17.3% to $13.4 million, or 57.9% of total revenues, for the three months ended September 30, 2002 from $11.4 million, or 52.1% of total revenues, for the three months ended September 30, 2001. Enterprise revenues increased 23.9% to $42.7 million, or 60.9% of total revenues, for the nine months ended September 30, 2002 from $34.5 million, or 54.0% of total revenues, for the nine months ended September 30, 2001. The increase in enterprise revenues for the three and nine months ended September 30, 2002 was due to an increase in orders from new customers and repeat sales to existing customers.

COST OF REVENUES. Cost of revenues includes cost of license revenues and cost of service revenues. Cost of revenues increased 3.6% to $4.3 million, or 18.4% of total revenues, in the three months ended September 30, 2002 from $4.1 million, or 18.8% of total revenues, in the three months ended September 30, 2001, resulting in gross margins of 81.6% and 81.2% respectively. Cost of revenues decreased 5.3% to $12.8 million, or 18.2% of total revenues, in the nine months ended September 30, 2002, from $13.5 million, or 21.1% of total revenues, in the nine months ended September 30, 2001. We expect to maintain our cost of revenues as a percentage of total revenues; however, this will depend upon our royalty costs and our revenue growth, among other factors. Accordingly, there can be no assurance that we will be successful in maintaining our cost of revenues as a percentage of total revenues.

COST OF LICENSE REVENUES. Cost of license revenues includes expenses associated with royalty costs, production, fulfillment and product documentation. The cost of license revenues increased 23.1% to $469,000, or 2.0% of total revenues, in the three months ended September 30, 2002 from $381,000, or 1.7% of total revenues, in the three months ended September 30, 2001. Cost of license revenues decreased 13.9% to $1.4 million, or 2.0% of total revenues, in the nine months ended September 30, 2002, from $1.7 million, or 2.6% of total revenues, in the nine months ended September 30, 2001. The increase in cost of license revenues for the three months ended September 30, 2002 is due to increases in some royalty costs. The decrease in cost of license revenues for the nine

months ended September 30, 2002 as a percent of total revenues was driven by increased efficiencies and better management of expenses within the operations organization.

COST OF SERVICE REVENUES. Cost of service revenues includes the personnel costs associated with providing customer support in connection with maintenance, training and professional service contracts. Cost of service revenues increased 1.6% to $3.8 million, or 16.4% of total revenues, in the three months ended September 30, 2002 from $3.7 million, or 17.0% of total revenues, in the three months ended September 30, 2001. Cost of service revenues decreased 4.0% to $11.3 million, or 16.1% of total revenues, in the nine months ended September 30, 2002, from $11.8 million, or 18.5% of total revenues, in the nine months ended September 30, 2001. The decrease in cost of service revenues for the nine months ended September 30, 2002 was driven by increased efficiencies and better management of expenses.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses consist primarily of personnel costs associated with software development. Research and development expenses decreased 12.8% to $5.3 million, or 22.8% of total revenues, in the three months ended September 30, 2002 from $6.0 million, or 27.6% of total revenues, in the three months ended September 30, 2001. Research and development expenses decreased 12.1% to $16.4 million, or 23.4% of total revenues, in the nine months ended September 30, 2002 from $18.7 million, or 29.3% of total revenues, in the nine months ended September 30, 2001. The decrease in research and development expenses was primarily due to a decrease in headcount in research and development from 145 to 130 people for the period from September 30, 2001 to September 30, 2002 as well as a reduction of discretionary expenses for the three and nine month periods ended September 30, 2002 compared to September 30, 2001. We intend to decrease our research and development expenses as a percentage of total revenues. Our ability to decrease these expenses as a percentage of total revenues will depend upon our revenue growth, among other factors. Accordingly, there can be no assurance that we will be successful in decreasing our research and development expenses as a percentage of total revenues.

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 decreased 8.2% to $11.8 million, or 51.3% of total revenues, in the three months ended September 30, 2002 from $12.9 million, or 58.9% of total revenues, in the three months ended September 30, 2001. Sales and marketing expenses decreased 6.1% to $35.8 million, or 51.0% of total revenues, in the nine months ended September 30, 2002 from $38.2 million, or 59.8% of total revenues, in the nine months ended September 30, 2002. The decrease in sales and marketing expenses was primarily the result of a reduction in sales bonuses and commissions due to the reduction in license revenues in 2002 as well as a reduction in headcount in sales and marketing from 195 to 172 people from September 30, 2001 to September 30, 2002. We intend to decrease our sales and marketing expenses as a percentage of total revenues. Our ability to decrease these expenses as a percentage of total revenues will depend upon our revenue growth, among other factors. Accordingly, there can be no assurance that we will be successful in decreasing our expenses as a percentage of total revenues.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of salaries for financial, accounting, legal, investor relations, human resources, administrative and management personnel. General and administrative expenses decreased 14.1% to $1.7 million, or 7.6% of total revenues, in the three months ended September 30, 2002 from $2.0 million, or 9.3% of total revenues, in the three months ended September 30, 2001. General and administrative expenses decreased 18.4% to $5.6 million, or 7.9% of total revenues, in the nine months ended September 30, 2002 from $6.8 million, or 10.7% of total revenues, in the nine months ended September 30, 2001. The decrease in general and administrative expenses is due to a decrease in headcount from 40 to 31 people from September 30, 2001 to September 30, 2002, a decrease in bad debt expense for both the three and nine months ended September 30, 2002 and a reduction in discretionary expenses. We expect to decrease these expenses as a percentage of total revenues, however, this will ultimately depend upon our revenue growth, among other factors. Accordingly, there can be no assurance that we will be successful in decreasing our expenses as a percentage of total revenues.

STOCK-BASED COMPENSATION. Stock-based compensation relates to the issuance of stock options with exercise prices below the deemed fair value of the Company's common stock at the date of grant. Deferred stock-based compensation resulted solely from the issuance of stock options to employees of FirstSense Software, Inc. ("FirstSense") in connection with the Company's acquisition of FirstSense on February 4, 2000 and is amortized

through charges to operations over the vesting period of the options, which is generally four years. Stock-based compensation was approximately $25,000 and $41,000 for the three months ended September 30, 2002 and 2001, respectively, and was approximately $85,000 and $282,000 for the nine months ended September 30, 2002 and 2001, respectively. The Company recorded forfeitures of deferred stock based compensation of approximately $65,000 and $1.1 million for the nine months ended September 30, 2002 and 2001, respectively, related to forfeitures of stock options by terminated employees. There were no forfeitures of deferred stock compensation for the three months ended September 30, 2002 and 2001.

OTHER INCOME. Other income consists of interest earned on funds available for investment, net of foreign currency exchange gains and losses and miscellaneous foreign taxes. The Company had net other income of $741,000 and $891,000 for the three months ended September 30, 2002 and 2001, respectively. The Company had net other income of $2.3 million and $2.5 million for the nine month periods ended September 30, 2002 and 2001.

PROVISION FOR INCOME TAXES. The Company recorded an income tax provision of approximately $136,000 and $375,000 for the three and nine months ended September 30, 2002, respectively. The Company recorded an income tax provision of approximately $25,000 and $111,000 for the three and nine months ended September 30, 2001, respectively. The income tax provisions for the three and nine months ended September 30, 2002 and 2001 are mainly related to foreign taxes resulting from the profitability of certain of the Company's foreign operations.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2002, the Company had cash, cash equivalents and marketable securities of $71.5 million, excluding restricted cash totaling approximately $939,000. This represents an increase of $3.2 million from $68.3 million as of December 31, 2001. Concord had working capital of $53.5 million and $49.0 million as of September 30, 2002 and December 31, 2001, respectively.

The increase in working capital was primarily attributable to an increase in cash, cash equivalents and marketable securities due to income from continuing operations during 2002.

Net cash provided by operating activities was $4.6 million for the nine months ended September 30, 2002 and $5.8 million for the nine months ended September 30, 2001. Accounts receivable increased $2.2 million primarily due to slower collections particularly with international customers. Deferred revenue increased $2.5 million mainly due to an increase in new and renewed maintenance contracts.

Investing activities have consisted of the acquisition of property and equipment, most notably computer and networking equipment to support the 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 of relatively short duration that trade in highly liquid markets.

Financing activities consisted primarily of the issuance of common stock from the exercise of stock options during the nine months ended September 30, 2002 and 2001.

As of September 30, 2002, the Company has future payments under facility and certain equipment lease agreements expiring through June 2007 of $3.7 million, $6.6 million and $3.3 million in one year, one to three years, and thereafter, respectively.

The Company has deferred tax assets of approximately $21.9 million, the largest component of which represents net operating loss ("NOL") carryforwards and research and development credits. The Company has significantly reserved for these deferred tax assets by recording a valuation allowance of $18.4 million. The resulting net deferred tax asset is based on the Company's estimate of NOL carryforwards it expects to use in the future; 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 at September 30, 2002 and December 31, 2001. 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 and credit carryforwards and (ii) the uncertainty of future profitability. In addition, the Company is 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 of the Company's Form 10-K for the year ended December 31, 2001 and in the "Factors that Could Affect Future Results" section of this Form 10-Q. 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.

Pursuant to the Tax Reform Act of 1986, the utilization of NOL 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. At December 31, 2001, the utilization of approximately $2,309,000 of the Company's NOL carryforwards are restricted to $330,000 per year as a result of an ownership change that occurred in 1995. In addition, the utilization of approximately $15,663,000 of NOL carryforwards that were acquired as a result of the FirstSense acquisition is also restricted as a result of a prior ownership change of FirstSense. Utilization of the FirstSense NOL carryforwards is limited to $4.3 million per year.

As of December 31, 2001, the Company's NOL deferred tax asset includes approximately $2.3 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.

As of September 30, 2002, Concord's principal sources of liquidity included cash, cash equivalents and marketable securities. The Company believes that its current cash, cash equivalents and marketable securities and cash provided by future operations will be sufficient to meet the working capital and anticipated capital expenditure requirements for at least the next 12 months. Although operating activities may provide cash in certain periods, to the extent Concord experiences growth in the future, its operating and investing activities may require additional cash. Consequently, any such future growth may require Concord to obtain additional equity or debt financing.

CRITICAL ACCOUNTING POLICIES

In December 2001, the SEC requested that all registrants list their three to five most "critical accounting policies" in the Management Discussion and Analysis section of their Annual Report on Form 10-K. The SEC indicated that a "critical accounting policy" is one which is both important to the portrayal of the company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We believe that the following three accounting policies fit this definition: Revenue Recognition, Accounts Receivable and Accounting for Income Taxes.

(a) Revenue Recognition Policy

We recognize revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed or determinable and collection of the resulting receivable is reasonably assured. Delivery generally occurs when product is delivered to a common carrier and the delivery terms are FOB Concord. All revenues generated from our worldwide operations are approved at our corporate headquarters, located in the United States.

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 usually 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 usually recognize revenue upon receipt of cash.

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 through our resellers are usually evidenced by a master agreement governing the relationship together with purchase orders on a transaction-by-transaction basis.

For arrangements with multiple obligations (for example, undelivered maintenance and support), 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 values 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 values of services, such as training or consulting, by referencing the prices at which we have separately sold comparable services to our customers.

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.

(b) Accounts Receivable Policy

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 a percentage of our accounts receivable, our historical experience and any specific customer collection issues that we have identified. While management believes 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 Policy

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, 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 of $18.4 million as of September 30, 2002, 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 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 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.

Our net deferred tax assets as of September 30, 2002 were $3.5 million, net of a valuation allowance of $18.4 million.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. There are also areas in which the exercise of management's judgment in selecting an available alternative would not produce a materially different result. See our audited consolidated financial statements and notes thereto which begin on page F-1 of the Annual Report on Form 10-K for the year ended December, 31, 2001 and which contain accounting policies and other disclosures required by generally accepted accounting principles.

FACTORS THAT COULD AFFECT FUTURE RESULTS

References in these risk factors to "we," "our," the "Company," "Concord," 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 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; increases in absolute dollars or decreases as a percentage of revenues in sales and marketing, research and development, customer support and service, and general and administrative expenses; 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.

OUR FUTURE OPERATING RESULTS ARE UNCERTAIN.

Prior to 2001, we marketed and sold our products primarily in the performance management market. In 2001, our product functionality was expanded to include both fault and performance management features to penetrate the fault management market. While sales of our fault products were approximately 15% of our license revenues for the quarter ended September 30, 2002, we still have a limited operating history in this expanded market upon which we can evaluate our business. As currently developed, our product is an integrated fault and performance management tool that manages applications, systems and networks. The integrated fault and performance market is highly competitive and rapidly evolving. Additionally, many of our competitors in this new market have a longer operating history and greater resources. Our limited operating history and an economic climate which continues to look uncertain as of October 2002, 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 operating in the highly competitive software industry.

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

As a company, we have expended considerable resources to develop innovative products that have enabled us to penetrate new markets both in the United States and internationally. As a result of these efforts, we achieved revenue growth and profitability for the fiscal years ended 2000, 1999, and 1998. However, as the worldwide economy continued to weaken in 2001, our revenues did not grow at expected levels. We operated at a net loss during the first three quarters of 2001 and 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. While quarterly revenues are up modestly in the last two quarters of 2002, our annual revenues in 2002 may be lower than our annual revenues in 2001.

In an effort to return to profitability, we reduced our operating expenses for 2001 and have further limited our operating expenses in 2002. However, competition in the marketplace may require us to increase our operating expenses in the future 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;
- expand our administrative resources in anticipation of future growth; and
- respond to unforeseeable economic or business circumstances.

To the extent that increases in our expenses precede or are not followed by increased revenues, our profitability will be at risk. In addition, in view of the rapidly evolving nature of our business and markets, the uncertain economic and geopolitical landscape, 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.

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 groups of customers;
- the timing, composition, and size of orders from our customers, including the tendency for significant bookings to occur in the final two weeks of each fiscal quarter;
- our customers' spending patterns and budgetary resources for fault

and performance management;

- geopolitical conditions in the world, with specific reference to the current situation in the Middle East, Indonesia and Brazil;

- 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 our products are sold;

- our success in anticipating and effectively adapting to developing markets and rapidly changing technologies;

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

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

- changes in general economic conditions.

Though our service revenues have 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.

A significant portion of our product sales occur in the final two weeks of each fiscal quarter. Any delay in the shipment of products near the end of the quarter may result in decreased revenues for the quarter. Additionally, intense competition and budgetary constraints placed upon our customers typically increase during the final two weeks of a fiscal quarter and may adversely affect our revenues for that quarter. Weak economic conditions tend to exacerbate these factors.

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 is related to personnel, facilities and equipment, 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 will likely suffer.

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

The market for our integrated fault and performance solution is still in an early stage of development. Although the rapid expansion and increasing complexity of computer applications, systems, and networks in recent years has increased the demand for both fault and performance management software products, the awareness of, and the demand for, an integrated fault and performance solution is a recent development. The market for this solution is only beginning to develop, and therefore 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 telecommunication carriers, managed service providers, 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.

THE MARKET FOR OUR PRODUCTS IS INTENSELY COMPETITIVE.

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

- report toolset vendors;
- fault management software vendors;
- application performance software vendors;
- enterprise management software, framework and platform providers;
- large, well established management framework companies that have developed network or application management platforms;
- developers of network element management solutions;
- probe vendors;
- telecommunications vendors;

- system agent vendors; and

- vendors who provide as a service some of the functionality of our products.

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. 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.

THE MARKET FOR INTEGRATED PERFORMANCE AND FAULT MANAGEMENT OF SOFTWARE APPLICATIONS, SYSTEMS AND NETWORKS IS BECOMING INCREASINGLY TARGETED BY LARGER COMPANIES WITH SUBSTANTIALLY GREATER RESOURCES.

Our revenues are generated from sales of products that manage integrated fault and performance aspects of software applications, systems and networks. This market is very competitive and we are in direct competition with larger companies with substantially greater resources. These larger companies are able to devote considerable resources to the development of competitive products and the creation and maintenance of direct and indirect sales channels. The continued presence of these larger companies in this market may impact our ability to retain or increase our market share.

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 integrated solutions, products and technologies;

- the demand for integrated, as opposed to stand-alone, solutions; 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 resulting in decreased market acceptance of our products.

WE MAY NEED FUTURE CAPITAL FUNDING.

We plan to continue to expend substantial funds on the continued development, marketing, and sale of the eHealth(TM) product family. While we have approximately $72 million in short term investments (cash, cash equivalents and marketable securities) as of September 30, 2002, we cannot ensure that our existing capital resources 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.

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 changes in 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

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

THE NEED FOR OUR PRODUCTS MAY DECREASE IF MANUFACTURERS INCORPORATE OUR PRODUCT FEATURES INTO THEIR PRODUCT OFFERINGS.

Our products manage the performance of computer applications, systems, and networks. Presently, manufacturers of both hardware and software have not implemented these management functions into their products in any significant manner. These products typically include, but are not limited to, operating systems, workstations, network devices, and software. If manufacturers begin to incorporate these management functions into their products it may decrease the value of our products and have a substantial impact on our business.

CONTINUING PUBLIC COMPANY ACCOUNTING IMPROPRIETIES MAY ADVERSELY IMPACT OUR REVENUES.

The public's perception of accounting improprieties by public companies has undermined confidence in the public markets, adding to economic uncertainty. This economic uncertainty can affect customer demand for our products and services, thus affecting our revenue. For example, the announcement by a large American telecommunications firm near the end of our second fiscal quarter that it had improperly accounted for some expenses created uncertainties for some of our customers last quarter. Specifically, banks holding debt for this telecommunications company reduced expenditures to mitigate the exposure created by the telecommunications company's actions. Our revenues suffered in the final weeks of the quarter ended June 30, 2002 as many of our customers considerably decreased, postponed or potentially canceled IT infrastructure purchases due to this uncertainty. It is likely that similar announcements by other companies would impact the Company's future sales.

CURRENT GEOPOLITICAL INSTABILITY AND THE CONTINUING THREAT OF DOMESTIC AND INTERNATIONAL TERRORIST ATTACKS MAY ADVERSELY IMPACT OUR REVENUES.

International tensions, exacerbated by the possibility of war in the Middle East and recent events in Indonesia, contribute to an uncertain political and economic climate, both in the United States and globally, which may affect our ability to generate revenue on a predictable basis. In addition, recent terrorist attacks internationally have contributed to continued international tensions and uncertainty, while ongoing terrorist threats in the United States have continued to fuel economic uncertainty in the wake of the tragic events of September 11, 2001. As we sell products both in the United States and internationally, the threat of future terrorist attacks may adversely affect our business.

OUR SUCCESS IS DEPENDENT UPON SALES TO TELECOMMUNICATION 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 telecommunication carriers, service providers, and enterprise customers. These markets worldwide have suffered from a turbulent economy during 2000, 2001 and the first nine months of 2002, turbulence that has been exacerbated by the tragic events of September 11, 2001 and their aftermath, as well as heightened geopolitical tensions as we enter the fourth quarter of 2002. We have been negatively affected by the general weakness in capital spending within these markets. The volume of sales of our products and services to telecommunication carriers, service providers, and enterprise customers may increase slower than we expect or may decrease.

OUR COMMON STOCK PRICE COULD EXPERIENCE SIGNIFICANT VOLATILITY.

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;
- announcements relating to financial improprieties by public companies; 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 leading to an increased risk of securities class action litigation. Such litigation could result in substantial costs and a diversion of our attention and resources.

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, our 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 runs 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 and those of our competitors.

WE HAVE CHANGED THE DATABASE WHICH IS SHIPPED WITH OUR PRODUCTS.

We have started shipping Oracle(R) software as the database on which the eHealth(TM) Suite of products runs, which will eventually replace the Ingres(R) database on which our eHealth(TM) Suite of products currently operates. While we believe the switch to Oracle will make our products even more robust and we are comfortable with the choice of Oracle as a database vendor, there is no guarantee that our customers will readily accept this change. There also is no guarantee that Oracle will be able to continue to deliver to us an acceptable database solution, nor that the product Oracle delivers will continue to interface effectively in conjunction with our eHealth(TM) Suite of products.

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;

- value added resellers;

- system integrators;

- telecommunication carriers;

- original equipment manufacturers; 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. Specifically, beginning in the second half of 2002, we are focusing on identifying and developing our key distribution partners worldwide. We intend to decrease the total number of distributors selling our products, but increase the quality and focus of our most valuable distributors. Our success will depend in large part on our development of these more focused distribution relationships and on the performance and success of these third parties, particularly telecommunication carriers and other network service providers. We sell our products in the United States through both direct sales to customers and indirect sales to customers through our channel partners. Internationally, we sell our products almost exclusively through indirect sales via our channel partners. Our international channel partners are located in Europe, the Middle East, Africa, Asia, and North and South America and are subject to local laws, regulations, and customs that may make it difficult to accurately assess the potential revenues that can be generated from a certain market. Our success depends upon our ability to attract and retain valuable channel partners and to accurately assess the size and vitality of the markets in which our products are sold. While we have implemented policies and procedures to achieve this, we cannot predict the extent to which we are able to attract and retain financially stable, motivated channel partners. Additionally, our channel partners may not be successful in marketing and selling our products. We may:

- fail to attract important and effective channel partners;
- fail to penetrate our targeted market segments through the use of 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, their financial insolvency or otherwise.

WE MAY FAIL TO MANAGE SUCCESSFULLY THE GROWTH OR CONTRACTION OF OUR BUSINESS.

We have experienced reductions in our sales and operations personnel; our products have become increasingly complex; and our product distribution channels are being developed and expanded. The rapid evolution of our markets and the increasing complexity of our products 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 that may impact our ability to grow our business.

OUR SUCCESS DEPENDS ON OUR RETENTION OF KEY PERSONNEL.

Our performance depends substantially on the performance of our key technical, senior management and sales and marketing personnel. 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. Despite current weak economic conditions, we experience intense competition for such personnel and are constantly exploring new avenues for attracting and retaining key personnel. However, 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 CONTINUE 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 channel partner arrangements. As mentioned above, we have concentrated recently on developing more focused relationships with fewer key distributors. 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;
- political and economic instability which continues to increase in light of uncertainty in the Middle East; and
- exposure to foreign currency fluctuations.

Our successful expansion into certain countries will require additional modification of our products, particularly national language support. Presently, the majority of our current export sales are denominated in United States dollars. To the extent that international sales 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 have introduced pricing in Euros in 2002. While we do maintain a foreign currency hedging program on accounts receivable, 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. Additionally, as we increase our international sales, seasonal fluctuations in revenue generation 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 FAILURE TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS MAY HARM OUR COMPETITIVE POSITION.

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 nine issued and eleven pending U.S. patents, and various foreign counterparts as of September 30, 2002. 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 by those patents 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 sought also to protect our intellectual property through the use of copyright, trademark, and trade secret laws. 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 end user license agreements (also known as "shrinkwrap" licenses) that are not signed by licensees. The law governing the enforceability of shrinkwrap license agreements 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 upon the intellectual property rights of others, claims of infringement are becoming increasingly common as the software industry develops legal protections for 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 THE LOSS OF 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 identify and predict current and future application, system, and network 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. As a matter of practice, our license agreements limit our liability in regards to product liability claims, and in many agreements, our maximum liability for product liability claims is limited to the equivalent of the cost of the products licensed under that agreement. However, any litigation or similar procedure related to a product liability claim may require considerable resources to be expended that could adversely affect our business and financial condition and decrease future revenues.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

(a) Foreign Currency Exchange Rate Risk

We have international offices in Canada, England, France, Germany, Spain, Sweden, Japan, Hong Kong, Singapore, South Africa, Australia, Mexico, Brazil and the Netherlands. Approximately 36.8% of our revenues for the nine months ended September 30, 2002 and 37.8% and 32.2% of our revenues for fiscal 2001 and 2000, respectively, were from our operations outside the United States. At September 30, 2002 and December 31, 2001, the amount of total assets located at our international subsidiaries was immaterial. These subsidiaries transact business in predominantly local currency. Therefore, we are exposed to foreign currency exchange risks and fluctuations in foreign currencies, along with economic and political instability in the foreign countries in which we operate, all of which could adversely impact our results of operations and financial condition.

We use forward contracts to reduce our exposure to foreign currency risk due to fluctuations in exchange rates underlying the value of accounts receivable denominated in foreign currencies held until such receivables are collected. A forward contract obligates us to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates. These forward contracts, to qualify as hedges of existing assets, 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.

We do not enter into or hold derivatives for trading or speculative purposes, and we only enter into contracts with highly-rated financial institutions. At September 30, 2002, we 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	S
Euro	Sell	10/28/02	$486,169	0.9715	

We plan to continue to utilize forward contracts and other instruments in the future to reduce our exposure to exchange rate fluctuations from accounts receivable denominated in foreign currencies, and we may not be able to do this successfully. Accordingly, we may experience economic loss and a negative impact on earnings and equity as a result of foreign currency exchange rate fluctuations. Also, as we continue to expand our operations outside of the United States, our exposure to fluctuations in currency exchange rates could increase.

(b) Market and Interest Rate Risk

Most of 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.

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. Due to the short-term nature of our investments, we believe we have minimal market 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.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Exchange Act Rule 15d-14(c). Based upon that evaluation, the Company's President and Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in enabling the Company to identify, process, and report information required to be included in the Company's periodic SEC filings within the required time period.

(b) Changes in Internal Controls.

There were no significant changes in the Company's internal controls or to our knowledge, in other factors that could significantly affect our disclosure controls and procedures subsequent to the Evaluation Date.

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 or 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 and has issued 1,799,000 of such shares. The Company issued the shares in a private placement transaction pursuant to Section 4(2) under the Securities Act of 1933, as amended. The merger was accounted for as a pooling of interests. The Company 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 over allotment 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

Not Applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The exhibits listed in the accompanying Exhibit Index on page 36 and 37 are filed or incorporated by reference as part of this Report.

(b) Reports on Form 8-K

A report on Form 8-K was filed with the Commission on September 9, 2002 to report that the Company's Vice President of Business Development resigned effective as of September 30, 2002.

CONCORD COMMUNICATIONS, INC.
FORM 10-Q, SEPTEMBER 30, 2002

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

November 4, 2002

Name: Melissa H. Cruz
Title: Executive Vice President, Business Services and Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Concord Communications, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John A. Blaeser, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John A. Blaeser

John A. Blaeser
President and Chief Executive Officer
November 4, 2002

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CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Concord Communications, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Melissa H. Cruz, Executive Vice President, Business Services and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Melissa H. Cruz

Melissa H. Cruz
Executive Vice President, Business Services and
Chief Financial Officer
November 4, 2002

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STATEMENT OF PRINCIPAL EXECUTIVE OFFICER

I, John A. Blaeser, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Concord Communications, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Concord Communications, Inc. as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for Concord Communications, Inc. and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to Concord Communications, Inc., including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of Concord Communications, Inc.'s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to Concord Communications, Inc.'s auditors and the audit committee of Concord Communications, Inc.'s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect Concord Communications, Inc.'s ability to record, process, summarize and report financial data and have identified for Concord Communications, Inc.'s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in Concord Communications, Inc.'s internal controls; and

6. Concord Communications, Inc.'s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ John A. Blaeser

John A. Blaeser
President and Chief Executive Officer
November 4, 2002

STATEMENT OF PRINCIPAL FINANCIAL OFFICER

I, Melissa H. Cruz, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Concord Communications, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Concord Communications, Inc. as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for Concord Communications, Inc. and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to Concord Communications, Inc., including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of Concord Communications, Inc.'s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to Concord Communications, Inc.'s auditors and the audit committee of Concord Communications, Inc.'s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect Concord Communications, Inc.'s ability to record, process, summarize and report financial data and have identified for Concord Communications, Inc.'s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in Concord Communications, Inc.'s internal controls; and

6. Concord Communications, Inc.'s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Melissa H. Cruz

Melissa H. Cruz
Executive Vice President,
Business Services and Chief
Financial Officer
November 4, 2002

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CONCORD COMMUNICATIONS, INC.
FORM 10-Q, SEPTEMBER 30, 2002
EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION	SEC DOCUMENT REFE
3.01	Restated Articles of Organization of the Company	Exhibit No. 3.01 the period ended
3.02	Restated By-laws of the Company	Exhibit No. 3.02 the period ended
10.01	Working Capital Loan Agreement between the Company and Silicon Valley Bank dated April 3, 1997	Exhibit No. 10.01 Statement on Form 333-33227)
10.02	Revolving Promissory Note made by the Company in favor of Silicon Valley Bank	Exhibit No. 10.02 Statement on Form 333-33227)
10.03	Equipment Line of Credit Letter Agreement between the Company and Fleet Bank dated as of June 9, 1997	Exhibit No. 10.03 Statement on Form 333-33227)
10.04	1995 Stock Plan of the Company	Exhibit No. 10.04 Statement on Form 333-33227)
10.05	1997 Stock Plan of the Company	Exhibit No. 10.01 the period ended
10.06	1997 Stock Plan of the Company, as amended on March 12, 1998, March 1, 1999, May 15, 1999 and March 8, 2000	Exhibit No. 10.06 the period ended
10.07	1997 Employee Stock Purchase Plan of the Company	Exhibit No. 10.06 Statement on Form 333-33227)
10.08	1997 Non-Employee Director Stock Option Plan as amended on March 12, 1998, March 8, 2000, April 25, 2001 and February 6, 2002	Exhibit No. 10.08 filed on August 1
10.09	The Profit Sharing/401(K) Plan of the Company	Exhibit No. 10.08 Statement on Form 333-33227)
10.10	Lease Agreement between the Company and John Hancock Mutual Life Insurance Company dated March 17, 1994, as amended on March 25, 1997	Exhibit No. 10.09 Statement on Form 333-33227)

10.11	First Amendment to Lease Agreement between the Company and John Hancock Mutual Life Insurance Company dated March 25, 1997	Exhibit No. 10.10 Statement on Form 333-33227)
10.12	Form of Indemnification Agreement for directors and officers of the Company	Exhibit No. 10.11 Statement on Form 333-33227)
10.13	Restated Common Stock Registration Rights Agreement between the Company and certain investors dated August 7, 1986	Exhibit No. 10.12 Statement on Form 333-33227)
10.14	Amended and Restated Registration Rights Agreement between the Company and certain investors dated December 28, 1995	Exhibit No. 10.13 Statement on Form 333-33227)
10.15	Management Change in Control Agreement between the Company and John A. Blaeser dated as of August 7, 1997	Exhibit No. 10.14 Statement on Form 333-33227)
10.16	Management Change in Control Agreement between the Company and Kevin J. Conklin dated as of July 23, 1997	Exhibit No. 10.15 Statement on Form 333-33227)
10.17	Management Change in Control Agreement between the Company and Ferdinand Engel dated as of July 23, 1997	Exhibit No. 10.16 Statement on Form 333-33227)
10.18	Management Change in Control Agreement between the Company and Gary E. Haroian dated as of July 23, 1997	Exhibit No. 10.17 Statement on Form 333-33227)
10.19	Management Change in Control Agreement between the Company and Melissa H. Cruz dated as of June 12, 2000	Exhibit No. 10.18 filed on August 1
10.20	Management Change in Control Agreement between the Company and Daniel D. Phillips, Jr. dated as of July 23, 1997	Exhibit No. 10.18 Statement on Form 333-33227)
10.21	Stock Option Agreement dated January 1, 1996 between the Company and John A. Blaeser	Exhibit No. 10.19 Statement on Form 333-33227)
10.22	Stock Option Agreement dated January 1, 1996 between the Company and John A. Blaeser	Exhibit No. 10.20 Statement on Form 333-33227)
10.23	Letter Agreement between the Company and Silicon Valley Bank dated March 25, 1996 together with the Loan Modification Agreement dated November 14, 1996	Exhibit No. 10.21 Statement on Form 333-33227)
10.24	Form of Shrink-Wrap License	Exhibit No. 10.22 Statement on Form 333-33227)
10.25	Agreement and Plan of Reorganization dated as of October 19, 1999 by and among Concord Communications, Inc., E Acquisition Corp., Empire Technologies, Inc. and the stockholders of Empire Technologies, Inc.	Exhibit No. 2.1 o on November 12, 1
10.26	Agreement and Plan of Reorganization dated as of January	Exhibit No. 2.1 o

	20, 2000 by and among Concord Communications, Inc., F Acquisition Corp., and FirstSense Software, Inc.	on February 10, 2
10.27	Registration Rights Agreement dated as of February 4, 2000 by and among Concord Communications, Inc. and Timothy Barrows, as Securityholder Agent	Exhibit No. 99.1 on February 10, 2
10.28	2000 Non-Executive Employee Equity Incentive Plan	Exhibit 10.28 on period ended Dece

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION	SEC DOCUMENT REFE
10.29	Management Change in Control Agreement between the Company and Ellen Kokos dated as of February 2, 2001	Exhibit No. 10.29 filed on May 9, 2
10.30	Management Change in Control Agreement between the Company and John F. Hamilton dated as of April 16, 2001	Exhibit No. 10.30 filed July 31, 20
10.31	2001 Non-Executive Employee Stock Purchase Plan	Exhibit No. 10.31 filed on November
10.32	Management Agreement between the Company and John Hamilton dated May 6, 2002	Exhibit No. 10.32 filed on August 1
*10.33	Management Agreement between the Company and Kevin Conklin dated September 9, 2002	Exhibit No. 10.33 on Form 10-Q

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* filed herewith