

CONCORD COMMUNICATIONS INC

Form 10-Q

August 06, 2004

**Table of Contents**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2004.**

**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**  
(State of incorporation)

**04-2710876**  
(IRS Employer Identification  
Number)

**600 Nickerson Road**  
**Marlborough, Massachusetts 01752**  
**(508) 460-4646**

(Address and telephone of principal executive offices)

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

YES  NO

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

YES  NO

18,302,196 shares of the registrant's common stock were outstanding as of July 30, 2004.

**CONCORD COMMUNICATIONS, INC.**

**FORM 10-Q, June 30, 2004**

**TABLE OF CONTENTS**

	<u>Page</u>
<b><u>PART I: FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2004 and December 31, 2003</u>	2
<u>Condensed Consolidated Statements of Operations for the Three and Six Months ended June 30, 2004 and 2003</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the Six Months ended June 30, 2004 and 2003</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5-11
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12-43
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	44
<u>Item 4. Controls and Procedures</u>	45
<b><u>PART II: OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 2. Changes in Securities, Use of Proceeds and Registrant Purchases of Equity Securities</u>	46
<u>Item 3. Defaults Upon Senior Securities</u>	46
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	46
<u>Item 5. Other Information</u>	47
<u>Item 6. Exhibits and Reports on Form 8-K</u>	47
<u>SIGNATURE</u>	48
<u>EXHIBIT INDEX</u>	49-51
<u>EX-10.40 Management Change in Control Agreement</u>	
<u>EX-31.1 Section 302 CEO Certification</u>	
<u>EX-31.2 Section 302 CFO Certification</u>	
<u>EX-32.1 Section 906 CEO Certification</u>	
<u>EX-32.2 Section 906 CFO Certification</u>	

---

**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONCORD COMMUNICATIONS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**  
**(In thousands, except share data)**

	<b>June 30, 2004</b>	<b>December 31, 2003</b>
	<u>          </u>	<u>          </u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 32,484	\$ 69,436
Marketable securities	125,955	92,455
Restricted cash	65	194
Accounts receivable, net of allowance of \$1,334 and \$1,050 at June 30, 2004 and December 31, 2003, respectively	22,114	22,194
Deferred tax assets	5,059	4,638
Prepaid expenses and other current assets	4,336	4,851
	<u>          </u>	<u>          </u>
Total current assets	190,013	193,768
Equipment and improvements, net	6,423	6,697
Goodwill	6,225	6,225
Other intangible assets, net	2,597	3,004
Deferred tax assets	5,394	4,962
Unamortized debt issuance costs and other long-term assets	3,400	3,770
	<u>          </u>	<u>          </u>
Total assets	<u>\$214,052</u>	<u>\$218,426</u>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 2,339	\$ 5,218
Accrued expenses	9,656	12,627
Deferred revenue	27,895	26,490
	<u>          </u>	<u>          </u>
Total current liabilities	39,890	44,335
Convertible senior notes	86,250	86,250
	<u>          </u>	<u>          </u>
Total liabilities	<u>126,140</u>	<u>130,585</u>

Commitments and Contingencies (Note 5)

Stockholders' Equity:

Common stock, \$0.01 par value:

Authorized - 50,000,000 shares

Issued and outstanding - 18,299,824 and 18,121,211 shares at

June 30, 2004 and December 31, 2003, respectively

Additional paid-in capital

Accumulated other comprehensive (loss) income

Accumulated deficit

183	181
113,275	111,651
(590)	816
(24,956)	(24,807)
<u>          </u>	<u>          </u>

Total stockholders' equity

87,912	87,841
<u>          </u>	<u>          </u>

Total liability and stockholders' equity

\$214,052	\$218,426
<u>          </u>	<u>          </u>

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

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
Revenues:				
License revenues	\$ 12,592	\$ 13,154	\$ 22,942	\$ 26,063
Service revenues	14,113	12,461	27,608	23,669
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	26,705	25,615	50,550	49,732
	<hr/>	<hr/>	<hr/>	<hr/>
Costs of Revenues:				
Cost of license revenues	848	683	1,670	1,272
Cost of service revenues	4,363	4,045	8,312	8,087
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost of revenues	5,211	4,728	9,982	9,359
	<hr/>	<hr/>	<hr/>	<hr/>
Gross profit	21,494	20,887	40,568	40,373
	<hr/>	<hr/>	<hr/>	<hr/>
Operating Expenses:				
Research and development	5,963	5,437	11,752	10,884
Sales and marketing	12,393	12,579	23,909	23,944
General and administrative	2,735	2,060	5,378	4,305
Acquired in-process research and development	100		100	
	<hr/>	<hr/>	<hr/>	<hr/>
Total operating expenses	21,191	20,076	41,139	39,133
	<hr/>	<hr/>	<hr/>	<hr/>
Operating income (loss)	303	811	(571)	1,240
	<hr/>	<hr/>	<hr/>	<hr/>
Other Income:				
Interest income	1,073	709	2,162	1,426
Interest expense	(819)		(1,642)	
Other expense	(20)	(146)	(189)	(370)
	<hr/>	<hr/>	<hr/>	<hr/>

Total other income, net	234	563	331	1,056
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) before income taxes	537	1,374	(240)	2,296
Provision for (benefit from) income taxes	204	177	(91)	262
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income (loss)	\$ 333	\$ 1,197	\$ (149)	\$ 2,034
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income (loss) per common and potential common share:				
Basic	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.12
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.11
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Weighted average common and potential common shares outstanding:				
Basic	18,258,159	17,372,070	18,208,832	17,313,416
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	18,563,673	18,022,181	18,208,832	17,767,593
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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

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

	<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>
Cash Flows from Operating Activities:		
Net (loss) income	\$ (149)	\$ 2,034
Adjustments to reconcile net (loss) income to net cash (used for) provided by operating activities:		
Depreciation and amortization	2,237	2,618
Stock-based compensation		34
Amortization of debt issuance costs	352	
Deferred income taxes	50	
Changes in assets and liabilities:		
Accounts receivable	80	(1,159)
Prepaid expenses and other current assets	515	741
Other assets	18	(105)
Accounts payable	(2,879)	(1,308)
Accrued expenses	(2,971)	715
Deferred revenue	1,405	4,402
	<u>          </u>	<u>          </u>
Net cash (used for) provided by operating activities	<u>(1,342)</u>	<u>7,972</u>
Cash Flows from Investing Activities:		
Purchases of equipment and improvements	(1,556)	(1,830)
Purchases of marketable securities	(60,713)	(15,988)
Proceeds from maturities and sale of marketable securities	24,904	10,688
Deposit of restricted cash	(65)	
Release of restricted cash	194	300
	<u>          </u>	<u>          </u>
Net cash used for investing activities	<u>(37,236)</u>	<u>(6,830)</u>
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	1,626	1,270
	<u>          </u>	<u>          </u>
Net cash provided by financing activities	<u>1,626</u>	<u>1,270</u>



Edgar Filing: CONCORD COMMUNICATIONS INC - Form 10-Q

Net (decrease) increase in cash and cash equivalents	(36,952)	2,412
Cash and cash equivalents, beginning of period	<u>69,436</u>	<u>10,362</u>
Cash and cash equivalents, end of period	<u>\$ 32,484</u>	<u>\$ 12,774</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid for income taxes	\$ 309	\$ 247
Supplemental Disclosure of Noncash Investing Transactions:		
Unrealized loss on available-for-sale securities	\$ (2,309)	\$ (181)

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

**Table of Contents**

**CONCORD COMMUNICATIONS, INC.**

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

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***(a) Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared by Concord Communications, Inc. (the Company or Concord ) in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with the instructions to Form 10-Q and Regulation S-X pertaining to interim financial statements. Accordingly, these interim financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements reflect all adjustments and accruals of a normal recurring nature, which management considers necessary for a fair presentation of the Company's financial position as of June 30, 2004 and December 31, 2003, and the Company's results of operations for the three and six months ended June 30, 2004 and 2003. 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 consolidated financial statements and the notes thereto included in the Company's 2003 Annual Report on Form 10-K filed with the Securities and Exchange Commission in March 2004.

***(b) Financial Instruments, Concentration of Credit Risk and Significant 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. One customer, located in the United States, accounted for 10.3% of revenues for the three months ended June 30, 2004. No individual customer accounted for more than 10% of revenues for the six months ended June 30, 2004. No individual customer accounted for more than 10% of revenues for the three and six months ended June 30, 2003. One customer, located in the United States, accounted for 17.2% of the Company's accounts receivable at June 30, 2004. No individual customer accounted for more than 10% of the Company's accounts receivable at December 31, 2003.

***(c) Derivative Financial Instruments***

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

At June 30, 2004, the Company had one forward contract outstanding, which is presented in the table below. The Company has determined that this forward contract qualifies for hedge accounting. The notional exchange rate is

quoted using market conventions where the currency is expressed in currency units per U.S. dollar:

<b>Currency</b>	<b>Position</b>	<b>Maturity Date</b>	<b>Notional Amount</b>	<b>Notional Exchange Rate</b>	<b>Fair Market Value as of June 30, 2004</b>
Australian Dollars	Sell	7/12/04	AUD\$302,000	0.6894	US\$ 208,000

-5-

**Table of Contents****(d) Stock-Based Compensation**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	<b>(In thousands, except per share data)</b>			
Net income (loss):				
As reported	\$ 333	\$ 1,197	\$ (149)	\$ 2,034
Add:				
Stock-based employee compensation expense included in reported net income (loss)		14		34
Less:				
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	<u>(1,787)</u>	<u>(1,541)</u>	<u>(3,798)</u>	<u>(3,202)</u>
Pro forma net loss	<u>\$ (1,454)</u>	<u>\$ (330)</u>	<u>\$ (3,947)</u>	<u>\$ (1,134)</u>
Basic net income (loss) per share:				
As reported	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.12
Pro forma	\$ (0.08)	\$ (0.02)	\$ (0.22)	\$ (0.07)
Diluted net income (loss) per share:				
As reported	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.11
Pro forma	\$ (0.08)	\$ (0.02)	\$ (0.22)	\$ (0.07)

**(e) Restricted Cash**

Restricted cash totaling \$65,000 and \$194,000 at June 30, 2004 and December 31, 2003, respectively, consists of money market funds held in the Company's name with a major financial institution. The balance as of June 30, 2004 is being used as collateral for a lease of one of the Company's facilities and will expire in May 2005. The December 31, 2003 balance was being used as collateral under a letter of credit arrangement with a Company supplier and expired in May 2004.

***(f) Reclassification***

Certain amounts in the 2003 condensed consolidated financial statements have been reclassified to conform to the 2004 presentation.

**2. ACQUISITION OF NETVIZ CORPORATION**

On July 17, 2003, the Company completed the acquisition of netViz Corporation ( netViz ). netViz s software

-6-

---

**Table of Contents**

enables users to visualize business processes and allows them to map relationships within the supporting technology infrastructure through data-driven icons. The integration of netViz's technologies with Concord's eHealthSuite will provide a new, more automated means of application service optimization. This integration will enable enterprises and service providers to employ data-driven icons to visualize and take action on the critical relationships between business processes, application services, and network and system infrastructures. Furthermore, this will allow customers to measure the performance and availability of application services, map the dependencies between business processes, and manage the complete application service. Integrating netViz technologies will further increase the eHealth® Suite's value proposition by capturing the business context of information and delivering IT knowledge.

The results of operations of the acquired business have been included in the financial statements of the Company since the date of acquisition.

The following table reflects unaudited pro forma results of operations of the Company assuming that the netViz acquisition had occurred on January 1, 2003:

	<b>Three Months Ended June 30, 2003</b>	<b>Six Months Ended June 30, 2003</b>
	(in thousands, except per share data)	
Revenues	\$ 26,570	\$ 51,568
Net income	\$ 1,112	\$ 1,864
Net income per diluted share	\$ 0.06	\$ 0.10

The unaudited pro forma results of operations are not necessarily indicative of the actual results that would have occurred had the transaction actually taken place at the beginning of these periods.

**3. GOODWILL AND OTHER INTANGIBLE ASSETS**

All of the Company's goodwill resulted from the acquisition of netViz (see Note 2). The goodwill is tested for impairment on June 30th of each year and whenever changes in circumstances indicate goodwill could be impaired. As of June 30, 2004, the Company performed its annual test for impairment on the carrying value of goodwill of its MSP/TC and Enterprise reporting units. The Company compared the fair value of each reporting unit to which goodwill has been allocated to its book value and determined that no impairment existed at that date.

Other intangible assets as of June 30, 2004 consist of the following:

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
	(in thousands)		
Completed technology (software)	\$2,130	\$ (533)	\$1,597
Reseller relationships	570	(114)	456
Maintenance relationships	340	(68)	272

Edgar Filing: CONCORD COMMUNICATIONS INC - Form 10-Q

Contractor agreements	300	(75)	225
Trade name/trademark	70	(23)	47
	<u>          </u>	<u>          </u>	<u>          </u>
Total	\$3,410	\$ (813)	\$2,597
	<u>          </u>	<u>          </u>	<u>          </u>

Aggregate amortization expense for the three and six months ended June 30, 2004 and 2003 was \$0.2 million, \$0.4 million, \$0 and \$0, respectively. For each period, approximately 66% of the aggregate expense was included in costs of revenues and the remainder was included in operating expenses.

#### 4. IN-PROCESS RESEARCH AND DEVELOPMENT

On July 11, 2003, Concord entered into a license agreement with Tavve Software Company ( Tavve ) whereby Concord licensed components of Tavve s technology. Concord has licensed Tavve s root cause analysis and discovery of layer 2 and 3 network topology to build upon Concord s current position in optimizing application availability and performance across networks and systems. The transaction included two different purchases of

## **Table of Contents**

Tavve technology. The first purchase valued at \$1.2 million, included \$0.2 million of prepaid maintenance and \$1.0 million of in-process research and development. This was accounted for as in-process research and development as an integrated product had not reached technological feasibility and had no alternative future use. This purchase of in-process research and development was expensed during the three months ended September 30, 2003.

With regard to the second purchase, during the three months ended June 30, 2004, the Company paid \$0.1 million to Tavve for additional source code. This was also accounted for as in-process-research-and-development as an integrated product has not reached technological feasibility and has no alternative future use.

Technological feasibility is established when either of two sets of criteria is met:

a) the detail program design has been completed, documented, and traced to product specifications and its high-risk development issues have been resolved; or

b) a working model of the product has been finished and determined to be complete and consistent with the product design.

Upon acquiring the licensed components of Tavve's technology, Concord did not have a completed product design at the time of the purchase as it had not completed, documented, and traced the detail program design to product specifications. Concord did not have the high-risk development issues resolved.

A working model is defined as an operative version of the computer software product that is completed in the same software language as the product to be ultimately marketed, performs all the major functions planned for the product, and is ready for initial customer testing (usually identified as beta testing). Upon acquiring the licensed components of Tavve's technology, Concord did not have a working model as defined.

In addition, the purchased source code has no alternative future use, i.e., Concord will not use the source code for any other purpose than described above.

The detail program design for the integration of Tavve's technology into Concord eHealth® Suite of products has not been completed as of June 30, 2004; thus, the exact costs and efforts required for completion of this integration has not been determined. Based on management's initial estimates, an integrated product based on Tavve's technology will be introduced in the next 12 to 18 months. However, as with any major software development project, actual introduction may vary. Failure to successfully market and sell the integrated product may adversely impact the Company's business.

## **5. COMMITMENTS AND CONTINGENCIES**

### *(a) Indemnifications*

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



The Company warrants that its software products will perform in all material respects in accordance with its standard published specifications in effect at the time of delivery of the licensed products to the customer for a period of 90 days. Additionally, the Company warrants that its maintenance services will be performed consistent with its maintenance policy in effect at the time those services are delivered. The Company believes its maintenance policy is consistent with generally accepted industry standards. If necessary, the Company would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history; however, the Company has never incurred significant expense under product or services warranties. As a result, the Company believes the estimated liability of these warranties is minimal.

## **Table of Contents**

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

When, as part of an acquisition, the Company acquires all of the stock or all or a portion of the assets and/or liabilities of a company, it may assume liability for certain events or occurrences that took place prior to the date of acquisition. The maximum potential amount of future payments it could be required to make for such obligations is undeterminable at this time. The Company has no liabilities recorded for these exposures as of June 30, 2004.

The Company has entered into separate registration rights agreements with Vo Tran, a major shareholder of netViz, and with Bear, Stearns & Co. Inc. Pursuant to these agreements, the Company indemnifies and holds harmless the indemnified parties under the agreements in connection with any material misstatements or omissions by the Company in its filings with the SEC or, with respect to the agreement entered into with Vo Tran, the violation by the Company of any applicable securities law or regulation. The term of the indemnification provisions in these agreements is perpetual. The Company has never incurred costs to defend lawsuits or settle claims related to these agreements. As a result, the Company believes the estimated liability of these agreements is minimal.

### *(b) Claims*

The Company has received a letter from LMS Technology Distributions SDN BHD ( LMS ) of Malaysia that demands that the Company reimburse LMS for approximately \$4.65 million in alleged losses arising out of the Company's purported wrongful termination of a Concord Authorized Reseller Agreement (the CAR Agreement ) with LMS. The Company disputes that the CAR Agreement was wrongfully terminated or that LMS is owed any of the amounts claimed, and the Company intends to defend vigorously against the demand. It is not possible to predict or determine the outcome of these demands or to provide ranges of losses that may arise, if any.

## **6. NET INCOME (LOSS) PER SHARE**

The Company computes earnings per share following the provisions of SFAS No. 128, *Earnings per Share*. Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding for a period. Diluted net income per share is computed using the weighted-average number of common and dilutive potential common shares outstanding for the period. Diluted net (loss) per share is computed using the weighted-average number of common shares outstanding for a period.

Diluted net loss per share is the same as basic net loss per share for the six months ended June 30, 2004, as the effects of potential common shares outstanding are anti-dilutive. For the three months ended June 30, 2004 and the three and six months ended 2003, dilutive potential common shares outstanding consisted of stock options. The dilutive effect of outstanding stock options is computed using the treasury stock method. The dilutive effect of senior convertible notes is computed using the if-converted method.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
<b>(in thousands except share and per share data)</b>				
Basic:				
Net income (loss) applicable to common stockholders	\$ 333	\$ 1,197	\$ (149)	\$ 2,034
Weighted average common shares outstanding	18,258,159	17,372,070	18,208,832	17,313,416

**Table of Contents**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
(in thousands except share and per share data)				
Basic net income (loss) per common share	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.12
Diluted:				
Net income (loss) applicable to common stockholders	\$ 333	\$ 1,197	\$ (149)	\$ 2,034
Weighted average common shares outstanding	18,258,159	17,372,070	18,208,832	17,313,416
Potential common shares pursuant to stock options	305,514	650,111	—	454,177
Diluted weighted average common shares outstanding	18,563,673	18,022,181	18,208,832	17,767,593
Diluted net income (loss) per common share	\$ 0.02	\$ 0.07	\$ (0.01)	\$ 0.11

For the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, diluted weighted average shares outstanding does not include 2,972,533; 2,395,746; 1,981,292 and 2,131,725 potential common shares, respectively, as their effect would have been anti-dilutive.

For the period ended June 30, 2004, common stock reserved for issuance upon conversion of the convertible senior notes in the amount of 3,209,776 shares were not included in diluted earnings per share because the conversion criteria had not been met. When the convertible senior notes conversion criteria is met and prior to converting those notes, 3,209,776 shares will be included in the diluted weighted average common shares outstanding and equivalents for the net income per share calculation, excluding interest expense for the period.

**7. COMPREHENSIVE (LOSS) INCOME**

Comprehensive (loss) income is defined as the change in net assets of the Company during a period from transactions generated from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Comprehensive (loss) income for the three and six months ended June 30, 2004 and 2003 is as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	<b>(in thousands)</b>			
Net income (loss)	\$ 333	\$1,197	\$ (149)	\$2,034
Unrealized loss on marketable securities, net of tax	(1,949)	(68)	(1,406)	(180)
Comprehensive (loss) income	<u>\$ (1,616)</u>	<u>\$ 1,129</u>	<u>\$ (1,555)</u>	<u>\$ 1,854</u>

## 8. 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:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	<b>(in thousands)</b>			
United States	\$18,319	\$14,445	\$32,661	\$26,419
United Kingdom	1,914	2,152	3,563	6,147

**Table of Contents**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	<b>(in thousands)</b>			
Europe (excluding the U.K.)	3,768	5,297	8,311	9,914
Rest of the World	2,704	3,721	6,015	7,252
<b>Total</b>	<b>\$26,705</b>	<b>\$25,615</b>	<b>\$50,550</b>	<b>\$49,732</b>

For the three and six months ended June 30, 2004, no one country, except the United States, accounted for greater than 10% of total revenues. For the three months ended June 30, 2003, no one country, except the United States, accounted for greater than 10% of total revenues. For the six months ended June 30, 2003, no one country, except the United States and the United Kingdom, accounted for greater than 10% of total revenues. 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 for the Company on a consolidated basis. 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 following table presents the approximate revenues by reportable segment:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
	<b>(in thousands)</b>			
MSP/TC	\$13,492	\$12,323	\$22,005	\$28,308
Enterprise	13,213	13,292	28,545	21,424
<b>Total</b>	<b>\$26,705</b>	<b>\$25,615</b>	<b>\$50,550</b>	<b>\$49,732</b>

The Company currently does not provide revenues by product or product family, as it is impractical due to the nature of its single suite of products. Some components of the suite could be included in more than one product family. In addition, categorization and classification of the Company's components into product families is changing in nature; changes in packaging, licensing and product categorization occur on a frequent basis.

## 9. RECENT ACCOUNTING PRONOUNCEMENTS

The Emerging Issues Task Force (EITF) has recently added to its agenda Issue 04-8, *Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share*. The Company's convertible senior notes fall under the proposed scope of this EITF Issue. The issue under consideration concerns whether the dilutive effect of contingently convertible debt with a market price trigger should be included in diluted earnings per share. The EITF discussion to date has not been sufficiently definitive to allow the Company to assess its possible impact. The Company continues to monitor developments with regards to this agenda item.

**Table of Contents**

**CONCORD COMMUNICATIONS, INC.  
FORM 10-Q, June 30, 2004**

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

**OVERVIEW**

We are a software company that provides a solution to enterprise customers, managed service providers and telecommunication carriers. We serve the Business Service Management (BSM) market with our solution, the eHealth® Suite of products, which maps Information Technology (IT) services to business needs, measures the actual end user experience and manages application, system and network infrastructure.

We sell our products worldwide through a direct sales force, channel partners and other resellers. We have sales offices in 18 countries, including the United States and we have customers in 63 countries.

Our products are generally sold on a perpetual license basis. On an initial purchase, customers will usually buy our eHealth® Console and a certain number of software elements, which is dependent on the number of components of the IT services to be managed. As a customer's IT services management requirements expands, they will order additional modules and elements. We believe that our significant installed base provides an opportunity to sell additional software elements and other products to our existing customer accounts. Most of our customers purchase maintenance upon the initial licensing of our software. In addition, the majority of these customers renew their maintenance agreements annually. For an annual maintenance fee, a customer receives telephone, email and web-based support, as well as updated product releases. In addition to on-going technical support, we also offer professional and education services to our customers.

Our total revenues are generated from license revenue and service revenue. License revenues are usually generated by the purchase of a license to our product. Concord's service revenues consist of fees for maintenance, training and professional services. For the three month and six month periods ending June 30, 2004, our total revenues increased year over year while our profitability decreased over the same periods. For the three month period ending June 30, 2004, total revenues were \$26.7 million, up 4.3% from \$25.6 million for the three month period ending June 30, 2003. For the six-month period ending June 30, 2004, total revenues were \$50.6 million, up 1.6% from \$49.7 million for the six month period ending June 30, 2003. Our diluted earnings per share decreased to \$0.02 per share for the three-month period ending June 30, 2004 compared to \$0.07 per share for the corresponding prior year period. Our diluted earnings per share decreased to (\$0.01) per share for the six-month period ending June 30, 2004 compared to \$0.11 per share for the corresponding prior year period. We used \$1.3 million in operating cash during the six-month period ending June 30, 2004 and finished the quarter with \$158.4 million of cash, cash equivalents and marketable securities.

**Critical Accounting Policies, Significant Estimates and Judgments**

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ( US GAAP ). The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances.



However, future events are subject to change and the best estimates and judgments routinely require adjustment. US GAAP requires us to make estimates and judgments in several areas. If actual results differ significantly from management's estimates and projections, there could be a material effect on our financial statements. See our audited consolidated financial statements and notes thereto of our Annual Report on Form 10-K and which contain accounting policies and other disclosures required by US GAAP.

## **Table of Contents**

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

### ***(a) Revenue Recognition***

Our revenues consist of software license revenues and service revenues. Software license revenues are recognized in accordance with the American Institute of Certified Public Accountants' Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with respect to Certain Transactions*. Software license revenues are recognized when persuasive evidence of an arrangement exists and delivery of the software has occurred, provided that the license fee is fixed or determinable, collection is considered reasonably assured and no customer acceptance clauses exist. If an arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of a receipt of a written customer acceptance or expiration of the acceptance period. If an arrangement includes a right of return for the possibility that the software does not meet published specifications during the warranty period, which is typically 90 days, revenue is recognized upon shipment if all other criteria are met as the company's product is mature and we have not experienced returns of our products. If the fee is determined not to be fixed or determinable, revenue is recognized when the fees become due. If collection is not considered reasonably assured, revenue is recognized upon the receipt of cash. Revenues under multiple-element arrangements, which typically include software products, services, maintenance and sometimes undelivered specified software upgrades sold together, are allocated to each element using the residual method in accordance with SOP 98-9. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized when these elements are delivered; the remainder of the arrangement consideration is allocated to the software. We have established sufficient vendor specific objective evidence for professional services, training, maintenance, customer support services and specified software upgrades 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, maintenance, customer support services and specified software upgrades.

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

We license our software to end-users, resellers and OEM's. Revenue recognition is centralized at our corporate headquarters, located in the United States. Our arrangements with customers do not generally include provisions involving acceptance of our products by our customers. However, if a customer arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period. With respect to revenues from our channel partners and other resellers, we recognize revenue upon delivery of our software to the channel partner or reseller. We do not offer any right of return, price protection or similar rights to our channel partners and other resellers.

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

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

At the time of the transaction, we assess whether the fee associated with our revenue transaction is fixed or determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed or determinable

## **Table of Contents**

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, depending upon the region, we account for the fee as not being fixed or determinable. In these cases, we recognize revenue when the fees become due.

We assess collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue upon receipt of cash. Concord's channel partners and other resellers are responsible to the Company upon delivery.

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

The majority of our sales transactions are completed using standard terms and conditions; however, there are agreements that contain non-standard terms and conditions. As a result, significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple obligations arrangement should be treated as separate units of accounting for revenue recognition purposes, and if so, how the price should be allocated among the deliverable elements and when to recognize the revenue for each element. Changes in the allocation of the sales price between deliverable elements might impact the timing of revenue recognition, but would not change the total revenue recognized for the transaction.

### ***(b) Accounts Receivable***

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

### ***(c) Accounting for Income Taxes***

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

additional paid-in capital for the benefit of deductions for stock option exercises.

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. The Company has reserved for a portion of its deferred tax assets by recording a valuation allowance. The resulting net deferred tax asset is based on the Company's estimate of future taxable income it expects to generate; all other tax assets have been reserved. The remaining valuation allowance of \$1.8 million is based on our estimates of taxable income by

**Table of Contents**

jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. This amount relates to stock option deductions and will be credited to additional paid-in capital when released. If we are sufficiently profitable in 2004, the reserve will be released in 2004. 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.

***(d) Accounting for Acquisitions and Acquired In-process Research and Development***

We have completed our acquisition of netViz ( netViz ), which was accounted for under the purchase method of accounting, which has resulted in recording significant goodwill and other intangible asset balances. The purchase price has been allocated to the assets acquired and liabilities assumed at their estimated fair values on the date of acquisition, as determined by management and, with respect to the identifiable intangible assets, an appraisal. Our accounting for the netViz acquisition involves significant judgments and estimates regarding primarily, but not limited to: the fair value of acquired intangible assets, which are based on projections of future revenues and cash flows, assumptions regarding discount factors, royalty rates, tax rates, amortization methodologies and related useful lives, as well as the fair value of other acquired assets and assumed liabilities, including potential contingencies and deferred income taxes. The completed technology (software), reseller relationships, maintenance relationships and trade name/trademarks will be amortized at the greater of (a) the ratio that current revenues bear to the total of current and anticipated future revenues or (b) the straight-line method over their respective remaining useful lives. The contractor agreements will be amortized using the straight-line method over their useful lives. The values of the completed technology, reseller relationships, maintenance relationships, contractor agreements and trade name/trademarks were determined using the income approach. The income approach requires a projection of revenues and expenses specifically attributed to the intangible assets. The discounted cash flow ( DCF ) method is then applied to the potential income streams after making necessary adjustments with respect to such factors as the wasting nature of the identifiable intangible assets and the allowance of a fair return on the net tangible assets and other intangible assets employed. There are several variations on the income approach, including the relief-from-royalty method, the avoided cost method and the lost profits method.

The relief-from-royalty method was used to value the trade name/trademarks. The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the trade name/trademarks are as follows: royalty rate 1%, discount rate 21%, tax rate 40% and estimated average economic life of 3 years.

The avoided cost method was used to value the reseller relationships and contractor agreements. The avoided cost method considers the concept of avoided cost as an indicator of value. The avoided cost method is appropriate for estimating the fair value of an asset where reliable data for sales of comparable property are not available and where the property does not directly produce an income stream. The key assumptions used in valuing the reseller relationships are as follows: tax rate 40% and estimated average economic life of 5 years. The key assumptions used in valuing the contractor agreements are as follows: tax rate 40% and estimated average economic life of 4 years.

The completed technology (software) was valued using the income approach without variation. The key assumptions used in valuing the completed technology are as follows: discount rate 21%, tax rate 40% and estimated life of 4 years. The key assumptions used in valuing the maintenance relationship are as follows: discount rate 21%, tax rate 40% and estimated average economic life of 5 years.

Deferred income taxes and any valuation allowances are based in part on future estimated profitability of the Company. As a direct result of the netViz acquisition, the Company has estimated that future profitability will increase and therefore released \$0.75 million of the valuation allowance.

We have also completed our accounting of the license agreement with Tavve whereby Concord licensed components of Tavve's technology. Our accounting for the Tavve license as in-process research & development involved significant judgments and estimates regarding primarily, but not limited to: assessing if the acquired

**Table of Contents**

technology has reached technological feasibility and if the acquired technology has no alternative future use.

Technological feasibility is established when either of two sets of criteria is met:

a) the detail program design has been completed, documented, and traced to product specifications and its high-risk development issues have been resolved; or

b) a working model of the product has been finished and determined to be complete and consistent with the product design.

Upon acquiring the licensed components of Tavve's technology, Concord did not have a completed product design at the time of the purchase as it had not completed, documented, and traced the detail program design to product specifications. Concord also did not have the high-risk development issues resolved.

A working model is defined as an operative version of the computer software product that is completed in the same software language as the product to be ultimately marketed, performs all the major functions planned for the product, and is ready for initial customer testing (usually identified as beta testing). Upon acquiring the licensed components of Tavve's technology, Concord did not have a working model as defined.

In addition, the purchased source code has no alternative future use, i.e., Concord will not use the source code for any other purpose than described above.

The detail program design for the integration of Tavve's technology into Concord eHealth® Suite of products has not been completed; thus, the exact costs and efforts required for completion of this integration has not been determined. Based on management's initial estimates, an integrated product based on Tavve's technology will be introduced in the next 12 to 18 months. However, as with any major software development project, actual introduction may vary. Failure to successfully market and sell our integrated product may adversely impact our business.

***(e) Valuation of Long-Lived Tangible and Intangible Assets and Goodwill***

We have significant long-lived tangible and intangible assets and goodwill, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The long-lived tangible assets are fixed assets, which are depreciated over their estimated useful lives. The long-lived intangible assets are completed technology (software), reseller relationships, maintenance relationships, contractor agreements, and trade name / trademarks which are amortized over their estimated useful lives following the greater of the pattern in which the expected benefits will be consumed or otherwise used up or on a straight-line basis. Goodwill is not amortized.

At each quarter-end, the carrying value of the completed technology (software) is compared to its net realizable value (NRV). NRV is the estimated future gross revenues from products that incorporate the software reduced by the estimated future costs of disposal. If NRV is less than the carrying value, the excess is written-off and the then current NRV becomes the new carrying value of the software. We assess the potential impairment of other identifiable intangible assets and fixed assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important, which could trigger an impairment of such assets, include the following:

Significant underperformance relative to historical or projected future operating results;

Significant changes in the manner of or use of the acquired assets or the strategy for our overall business;



Significant negative industry or economic trends;

Significant decline in our stock price for a sustained period; and

A decline in our market capitalization below net book value.

-16-

---

**Table of Contents**

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would impact future results of operations and financial position in the reporting period identified.

Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, or SFAS 142 requires goodwill to be tested for impairment using a two-step process. The first step compares the fair value of the reporting unit with the unit's carrying value, including goodwill. When the carrying value of the reporting unit is greater than fair value, the unit's goodwill may be impaired, and the second step must be completed to measure the amount of the goodwill impairment charge, if any. In the second step, the implied fair value of the reporting unit's goodwill is compared with the carrying amount of the unit's goodwill. If the carrying amount is greater than the implied fair value, the carrying value of the goodwill must be written down to its implied fair value. We operate in one reporting unit and, therefore, will conduct future goodwill impairment test on an enterprise-wide level. Goodwill is required to be tested for impairment at least annually, or more frequently when events and circumstances occur indicating that the recorded goodwill might be impaired. We plan to perform the annual assessment at June 30 of each fiscal year. Factors we consider important, which could trigger an impairment of goodwill, include the following:

Significant underperformance relative to historical or projected future operating results;

Significant negative industry or economic trends;

Significant decline in our stock price for a sustained period; and

A decline in our market capitalization below net book value.

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would impact future results of operations and financial position in the reporting period identified.

Significant judgments and estimates are involved in determining the useful lives of our intangible assets, determining what reporting units exist and assessing when events or circumstances would require an interim impairment analysis of goodwill or other long-lived assets to be performed. Changes in events or circumstances, including but not limited to technological advances or competition which could result in shorter useful lives, additional reporting units which may require alternative methods of estimating fair value, or economic or market conditions which may affect previous assumptions and estimates, could have a significant impact on our results of operations or financial position through accelerated amortization expense or impairment charges.

**Table of Contents****RESULTS OF OPERATIONS**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2004</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>June 30, 2003</b>
Revenues:				
License revenues	47.2%	51.4%	45.4%	52.4%
Service revenues	52.8	48.6	54.6	47.6
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	100.0	100.0	100.0	100.0
	<hr/>	<hr/>	<hr/>	<hr/>
Cost of Revenues:				
Cost of license revenues	3.2	2.7	3.3	2.5
Cost of service revenues	16.3	15.8	16.4	16.3
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost of revenues	19.5	18.5	19.7	18.8
	<hr/>	<hr/>	<hr/>	<hr/>
Gross profit	80.5	81.5	80.3	81.2
	<hr/>	<hr/>	<hr/>	<hr/>
Operating Expenses:				
Research and development	22.3	21.2	23.3	21.9
Sales and marketing	46.5	49.1	47.3	48.1
General and administrative	10.2	8.0	10.6	8.7
Acquired in-process research & development	0.4		0.2	
	<hr/>	<hr/>	<hr/>	<hr/>
Total operating expenses	79.4	78.3	81.4	78.7
	<hr/>	<hr/>	<hr/>	<hr/>
Operating income (loss)	1.1	3.2	(1.1)	2.5
	<hr/>	<hr/>	<hr/>	<hr/>
Other Income:				
Interest income	4.1	2.8	4.3	2.9
Interest expense	(3.1)		(3.3)	
Other expense	(0.1)	(0.6)	(0.4)	(0.8)
	<hr/>	<hr/>	<hr/>	<hr/>

Total other income, net	0.9	2.2	0.6	2.1
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) before income taxes	2.0	5.4	(0.5)	4.6
Provision for (benefit from) income taxes	0.8	0.7	(0.2)	0.5
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income (loss)	1.2%	4.7%	(0.3%)	4.1%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**Total Revenues**

Concord's total revenues are generated from license revenue and service revenue.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
License Revenues	\$12,592	(4.3%)	\$13,154	\$22,942	(12.0%)	\$26,063
Service Revenues	14,113	13.3%	12,461	27,608	16.6%	23,669
	<u>          </u>		<u>          </u>	<u>          </u>		<u>          </u>
Total Revenues	\$26,705	4.3%	\$25,615	\$50,550	1.6%	\$49,732
	<u>          </u>		<u>          </u>	<u>          </u>		<u>          </u>

**Percent of Total Revenues**

License Revenues	47.2%	51.4%	45.4%	52.4%
Service Revenues	52.8%	48.6%	54.6%	47.6%

**License Revenues**

Concord's license revenues are derived from the licensing of software products.

**Table of Contents**

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
License Revenues	\$ 12,592	(4.3%)	\$ 13,154	\$ 22,942	(12.0%)	\$ 26,063
<i>Percent of Total Revenues</i>						
License Revenues	47.2%		51.4%	45.4%		52.4%

**Second Quarter 2004 Compared to Second Quarter 2003:**

The decrease in license revenues in both absolute dollars and percentage of revenues was driven by lower demand for our products, especially in Europe. This decrease was partially offset by \$0.7 million of license revenues generated by netViz, which was acquired in July 2003.

**First Six Months 2004 Compared to First Six Months 2003:**

The decrease in license revenues in both absolute dollars and percentage of revenues was due to lower international license sales and sales execution issues. In the first six months of 2003, we completed a certain number of transactions over \$100K with European-based managed service providers; sales to this segment in Europe were lower in the first six months of 2004 than in the same period in 2003 as demand for our products was not as robust as during the former period. In the first six months of 2004, we had sales related execution issues, as some of our sales teams did not meet their sales targets; this affected our ability to close license revenue transactions. The Company has replaced its sales personnel in many of the non-performing areas. The decrease of license revenues in the first six months of 2004 was partially offset by \$1.3 million of license revenues generated by netViz.

The continuing decrease of license revenues as a percent of total revenues in the three and six months ended June 30, 2004 as compared to the three and six months ended June, 2003 was the result of a significant increase in service revenues combined with a decrease of the license revenues.

License revenues are partially dependent on our ability to sell to new customer accounts. License revenues can also be dependent on the number of transactions over \$100,000 that we are able to close during the period.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
New Customer Accounts	12	(68.4%)	38	34	(58.0%)	81
Transactions greater than \$100K	32	(11.1%)	36	67	(6.9%)	72
<i>Percent of Total Revenues</i>						
New Customer Accounts	18.1%		19%	15.1%		21%

***Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:***

The decrease in the number of sales to new customer accounts in the three and six months ended June 30, 2004 as compared to the corresponding prior year periods was due, in part, to sales and marketing execution issues, as our sales teams have focused their efforts on our large install base. Certain internal initiatives, such as the hiring of our dedicated product line sales force as well as the continued review of our marketing programs and sales approach, should help improve our effectiveness in increasing the number of new customer accounts acquired during the remainder of the year.

The number of transactions greater than \$100,000 recorded in the three and six months ended June 30, 2004 is comparable to the number of transactions recorded in the three and six months ended June 30, 2003. We believe that

**Table of Contents**

the solution selling training offered to our new sales employees combined with on-going business oriented sales training, will improve our ability to increase the number of transactions greater than \$100,000. However, there can be no assurance that we will be successful in meeting this estimate

There were no material price increases for products during the first half of 2004 and inflation did not have a significant impact on our revenues or income during the first half of 2004.

**Service Revenues**

Concord's service revenues consist of fees for maintenance, training and professional services.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Service Revenues	\$14,113	13.3%	\$12,461	\$27,608	16.6%	\$23,669
<i>Percent of Total Revenues</i>						
Service Revenues	52.8%		48.6%	54.6%		47.6%

**Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:**

The increase in service revenues in both absolute dollars and percentage of revenues in the three and six month ended June 30, 2004 as compared to the corresponding prior year periods was due to a significant increase in maintenance revenues, which are generated from new and renewed maintenance contracts, and the maintenance generated by netViz. Maintenance generated by netViz contributed approximately \$0.5 million and \$0.9 million, respectively, in service revenue in the three and six months ended June 30, 2004 and increased service revenues from new and renewed maintenance contracts primarily comprised the balance of the increase in service revenues for such periods.

Maintenance revenues represent fees earned by granting our customers rights to technical support, software product upgrades and maintenance patches during the support period, which is usually one year. The majority of our license customers purchase maintenance upon the initial licensing of our software. In addition, the majority of these customers renew their maintenance agreements annually. An increase in the number of the Company's customers and the resulting demand for these services further helped drive the increase in service revenues in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003.

**Direct and Indirect Revenues**

Concord markets its products in the United States primarily through a direct sales force. Internationally, Concord markets primarily through indirect channels, which include channel partners and other resellers.

**Three Months Ended**

**Six Months Ended**

Edgar Filing: CONCORD COMMUNICATIONS INC - Form 10-Q

<b>(in thousands)</b>	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>June 30, 2003</b>
Direct	\$17,652	(1.1%)	\$17,851	\$31,270	1.2%	\$30,914
Indirect	9,053	16.6%	7,764	19,280	2.5%	18,818
<b>Total Revenue</b>	<b>\$26,705</b>	<b>4.3%</b>	<b>\$25,615</b>	<b>\$50,550</b>	<b>1.6%</b>	<b>\$49,732</b>
 <i><b>Percent of Total Revenues</b></i>						
Direct	66.1%		69.7%	61.9%		62.2%
Indirect	33.9%		30.3%	38.1%		37.8%

-20-



**Table of Contents****Second Quarter 2004 Compared to Second Quarter 2003:**

Direct sales are consistent with prior year. The increase in indirect sales in both absolute dollars and percentage of revenue was primarily driven by increased indirect sales in the United States.

**First Six Months 2004 Compared to First Six Months 2003:**

Direct and indirect sales are consistent with prior year.

**International Revenues**

Concord has fourteen international subsidiaries and three international branch offices. Concord has customers in 63 countries.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
United Kingdom	\$1,914	(11.1%)	\$ 2,152	\$ 3,563	(42.0%)	\$ 6,147
Europe (excluding the U.K.)	3,768	(28.9%)	5,297	8,311	(16.2%)	9,914
Rest of the World	2,704	(27.3%)	3,721	6,015	(17.1%)	7,252
Total	<u>\$8,386</u>	(24.9%)	<u>\$11,170</u>	<u>\$17,889</u>	(23.3%)	<u>\$23,313</u>

**Percent of Total  
Revenues**

United Kingdom	7.2%	8.4%	7.0%	12.4%
Europe (excluding the U.K.)	14.1%	20.7%	16.4%	19.9%
Rest of the World	10.1%	14.5%	11.9%	14.6%

**Second Quarter 2004 Compared to Second Quarter 2003:**

The decrease in international revenues in both absolute dollars and percentage of revenues was due to sales execution issues, as some of our international sales teams did not meet their sales targets. We believe that the solution selling training offered to our new sales employees combined with on-going business oriented sales training, will improve our ability to meet our international sales targets.

**First Six Months 2004 Compared to First Six Months 2003:**

The decrease in international revenues in both absolute dollars and percentage of revenues was due to a decrease in demand by UK-based service providers. Sales execution by some of our international sales teams also explains this

decrease.

Although international revenues decreased year over year, we expect revenue from international customers will be 40% to 50% of total revenues as we expect to commit additional time and development resources to customizing our products and services for selected international markets. We believe that continued growth and profitability will require further expansion of our sales, marketing and customer service functions in international markets. However, there can be no assurance that we will be successful in meeting this estimate.

---

**Table of Contents****Segment Revenues**

Concord's reportable segments are determined by customer type: managed service providers/telecommunications carriers (MSP/TC) and enterprise.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
MSP/TC	\$13,492	9.5%	\$12,323	\$22,005	(22.3%)	\$28,308
Enterprise	13,213	(0.6%)	13,292	28,545	33.2%	21,424
Total Revenues	\$26,705	4.3%	\$25,615	\$50,550	1.6%	\$49,732

**Percent of Total Revenues**

MSP/TC	50.5%	48.1%	43.5%	56.9%
Enterprise	49.5%	51.9%	56.5%	43.1%

**Second Quarter 2004 Compared to Second Quarter 2003:**

The increase in MSP/TC revenues in both absolute dollars and percentage of revenues was driven by several large telecommunication carrier orders. Most of our license revenues greater than \$100,000 in the three months ended June 30, 2004 was with MSP/TC customers. The number of license revenue transactions greater than \$100,000 can be concentrated in a specific segment in a given quarter due to unpredictable buying patterns. This variability can lead to the quarterly fluctuation in the relative percentage of revenues represented by Enterprise and MSP/TC customers.

**First Six Months 2004 Compared to First Six Months 2003:**

The increase in Enterprise revenues was driven by repeat sales to existing customers; this concentration of transactions greater than \$100,000 with Enterprise customers explains, in part, the decrease of MSP/TC revenue. In the first quarter of 2003, we completed a certain number of transactions over \$100K with UK-based managed service providers; this explains the high percentage of MSP/TC in the six months ended June 30, 2003.

Although MSP/TC revenues decreased in the prior quarter, we expect that MSP/TC revenue will be 40% to 50% of total revenues; however, there can be no assurance that we will be successful in meeting this estimate.

**Revenues Recognized in Connection With Third Party Software**

Concord bundles third party software in some of its products when it determines that bundling such software is cost-effective or increases the effectiveness of Concord's products. In some instances, the Company has determined that it can be cost prohibitive to develop such software applications, especially if such applications are already available in the marketplace. In addition, bundling third party software allows Concord, in certain instances, to

accelerate the delivery of increased functionality within a short timeframe.

Revenues generated by Concord products that included third party software were:

<b>(in thousands)</b>	<b>Three Months Ended</b>			<b>Six Months Ended</b>		
	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>June 30, 2003</b>	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>June 30, 2003</b>
Revenues	\$2,612	8.3%	\$2,411	\$5,371	11.3%	\$4,827
<i>Percent of Total Revenues</i>						
Revenues	9.8%		9.4%	10.6%		9.7%

*Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months of 2003:*

**Table of Contents**

The increase of revenues from third party software in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 in both absolute dollars and percentage of revenues was mostly driven by increased demand for Oracle database software that is integrated into our product offering. Demand for the Oracle database product is also driven by the transition of our large install base from the Ingres database to the Oracle database. In 2002, we integrated the Oracle database software into our product offering; this enabled us to replace the Ingres database we used previously with the Oracle product and to offer one single database solution to our customers.

**Cost of Revenues**

Cost of revenues includes cost of license revenues and cost of service revenues.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Cost of License Revenues	\$ 848	24.2%	\$ 683	\$ 1,670	31.3%	\$ 1,272
Cost of Service Revenues	4,363	7.9%	4,045	8,312	2.8%	8,087
Total Cost of Revenues	\$5,211	10.2%	\$4,728	\$9,982	6.7%	\$9,359

**Percent of Total Revenues**

Cost of License Revenues	3.2%	2.7%	3.3%	2.5%
Cost of Service Revenues	16.3%	15.8%	16.4%	16.3%

**Cost of License Revenues**

Cost of license revenues includes expenses associated with royalty fees, production, fulfillment of orders, product documentation and amortization expense associated with the completed technology intangible asset. Royalty costs are composed of third party software costs.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Cost of License Revenue	\$848	24.2%	\$ 683	\$ 1,670	31.3%	\$ 1,272
<b>Percent of Total Revenues</b>						
Cost of License Revenues	3.2%		2.7%	3.3%		2.5%

**Second Quarter 2004 Compared to Second Quarter 2003**

The increase of cost of license revenues in both absolute dollars and percentage of revenues was driven by higher royalty costs, which are fees paid to third party software companies, and amortization expense relating to the acquisition of netViz which was completed in July 2003. The amortization expense relates to the completed technology intangible asset, which has an estimated useful life of 4 years. Royalty costs and amortization expense contributed approximately 18% and 72%, respectively, to the increase in the cost of license revenues.

***First Six Months 2004 Compared to First Six Months 2003:***

-22-

---

**Table of Contents**

The increase of cost of license revenues in both absolute dollars and percentage of revenues was driven by higher royalty costs and amortization expense relating to the acquisition of netViz. Royalty costs and amortization expense contributed approximately 36% and 64%, respectively, to the increase in the cost of license revenues.

**Expenses Recognized in Connection With Third Party Software**

Royalty costs are comprised of third party software costs. The Company bundles third party software in some of its products when it determines that bundling such software is cost-effective or increases the effectiveness of Concord's products. Costs associated with revenues generated by Concord products that included third party software were:

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Expenses	\$420	7.7%	\$390	\$869	19.9%	\$725
<i>Percent of Total Revenues</i>						
Expenses	1.6%		1.5%	1.7%		1.5%

**Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:**

The increase of costs in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 associated with third party software in both absolute dollars and percentage of revenues was mostly driven by the cost of distribution of the Oracle database and the related maintenance costs. Third party maintenance charges are usually based on the number of sold units. As the Company's installed base has grown, the number of its products under maintenance, which includes third party software, has also increased.

**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.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Cost of Service Revenues	\$4,363	7.9%	\$4,045	\$8,312	2.8%	\$8,087
<i>Percent of Total Revenues</i>						
Cost of Service Revenues	16.3%		15.8%	16.4%		16.3%

***Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:***

The increase of cost of service revenues in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 in both absolute dollars and percentage of revenues was driven by supporting a growing base of service customers which resulted in an increase in personnel and related costs in servicing those customers.

**Gross Profit**

Total gross profit includes gross profit from license revenues and gross profit from service revenues.



**Table of Contents**

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Gross Profit	\$21,494	2.9%	\$20,887	\$40,568	0.5%	\$40,373
<i>Percent of Total Revenues</i>						
Gross Profit	80.5%		81.5%	80.3%		81.2%

**Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:**

The increase of gross profit in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 in absolute dollars is driven by growth in total revenues in each respective period. The decrease of gross profit, as a percentage of total revenues, in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 is driven by the amortization expense associated with the completed technology intangible asset. We expect to increase our gross profit in absolute dollars; however, this will depend upon our revenue growth, among other factors. Accordingly, there can be no assurance that we will be successful in increasing our gross profit on an absolute basis of total revenues.

**Research and Development Expenses**

Research and development expenses consist primarily of personnel costs associated with software development.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Research and Development	\$5,963	9.7%	\$5,437	\$11,752	8.0%	\$10,884
<i>Percent of Total Revenues</i>						
Research and Development	22.3%		21.2%	23.3%		21.9%

**Second Quarter 2004 Compared to Second Quarter 2003:**

The increase in research and development expenses in both absolute dollars and percentage of revenues was driven by higher salary expenses and the acquisition of netViz. This acquisition resulted in higher headcount, additional rent and amortization expense of intangible assets; each factor contributed approximately 31%, 12% and 3%, respectively, to the variance. Excluding the netViz acquisition, research and development expenses increased due to higher salaries following the annual merit increases; this contributed to 31% of the variance.

**First Six Months 2004 Compared to First Six Months 2003:**

The increase in research and development expenses in both absolute dollars and percentage of revenues was related to the increased salary expenses and the acquisition of netViz. The netViz acquisition resulted in higher headcount, additional rent and amortization expense of intangible assets. Each factor contributed approximately 35%, 15% and 6%, respectively, to the variance. Research and development costs, excluding netViz, increased mainly due to higher salaries following annual merit increases; this contributed to 44% of the variance.

We intend to decrease, over time, 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.

**Table of Contents**

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Sales and Marketing	\$12,393	(1.5%)	\$12,579	\$23,909	(0.1%)	\$23,944
<i>Percent of Total Revenues</i>						
Sales and Marketing	46.5%		49.1%	47.3%		48.1%

**Second Quarter 2004 Compared to Second Quarter 2003:**

The increase of sales expenses was more than offset by lower marketing expenses. The changes of sales expenses is driven by recruiting fees, linked to the hiring of dedicated product line sales representatives, severance costs related to terminations of sales employees and higher travel expenses. Each of these factors contributed 15%, 32% and 42% to the \$0.4 million increase of sales expenses. The decrease of marketing expenses was mainly driven by lower headcount and lower spending on marketing programs. Each of these factors contributed 38% and 21% to the \$0.6 million decrease of marketing expenses.

**First Six Months 2004 Compared to First Six Months 2003:**

The increase of sales expenses was offset by lower marketing expenses. The changes of sales expenses is driven by recruiting fees, linked to the hiring of dedicated product line sales representatives, severance costs related to terminations of sales employees, increased headcount and higher travel expenses. Each of these factors contributed 20%, 22%, 23% and 20% to the \$1.2 million increase of sales expenses. The decrease of marketing expenses was mainly driven by lower headcount and related bonuses and lower travel expenses. Each of these factors contributed 51% and 11% to the \$1.3 million decrease of marketing expenses.

We expect, over time, 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 sales and marketing 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.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
General and Administrative	\$2,735	32.8%	\$2,060	\$5,378	24.9%	\$4,305
<i>Percent of Total Revenues</i>						
	10.2%		8.0%	10.6%		8.7%

General and  
Administrative

*Second Quarter 2004 Compared to Second Quarter 2003:*

The increase in general and administrative in both absolute dollars and percentage of revenues was primarily attributed to increased headcount in the Finance department, higher legal expenses related to patent filings and the opening and maintenance of international subsidiaries, higher audit and consulting fees associated with compliance with rules and regulations with the Sarbanes-Oxley Act and a net increase of bad debt expense resulting from a deterioration in our aging. Each factor contributed approximately 18%, 15%, 14% and 45%, respectively, to the variance.

**Table of Contents****First Six Months 2004 Compared to First Six Months 2003:**

The increase in general and administrative in both absolute dollars and percentage of revenues was primarily attributed to increased headcount in the Finance department, higher legal and audit expenses and increased bad debt partially offset by lower bonus expense. Each factor contributed approximately 25%, 22%, 14%, 42% and (25%) respectively, to the variance.

**Acquired In-Process Research & Development Expenses**

Acquired in-process research & development expenses relate to our licensing of components of Tavve's technology. Concord has licensed Tavve's root cause analysis and discovery of layer 2 and 3 network topology to build upon our current position in optimizing application availability and performance across networks and systems.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Acquired in-process research & development expenses	\$ 100	100.0%	\$	\$ 100	100.0%	\$
<b>Percent of Total Revenues</b>						
Acquired in-process research & development expenses	0.4%			0.2%		

There were no acquired in-process research & development expenses incurred in the three and six months ended June 30, 2003.

**Other Income, Net**

Other income, net consists primarily of interest income, interest expense, foreign currency exchange gains (losses) and miscellaneous foreign taxes.

(in thousands)	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Interest Income	\$ 1,073	51.3%	\$ 709	\$ 2,162	51.6%	\$ 1,426
Interest Expense	(819)	(100.0%)		(1,642)	(100.0%)	
Other Expense	(20)	(86.3%)	(146)	(189)	(48.9%)	(370)
Total Other Income, net	\$ 234	(58.4%)	\$ 563	\$ 331	(68.7%)	\$ 1,056

---

***Percent of Total Revenues***

Total Other Income, net	0.9%	2.2%	0.6%	2.1%
-------------------------	------	------	------	------

***Second Quarter 2004 Compared to Second Quarter 2003 and First Six Months 2004 Compared to First Six Months 2003:***

The \$0.4 million and \$0.7 million increase in interest income in the three and six months, respectively, ended June 30, 2004 as compared to the three and six months ended June 30, 2003 is attributable to the higher balance of

**Table of Contents**

marketable securities as a result of the approximately \$83 million in proceeds from the issuance of the Company's 3.0% Senior Convertible Notes due 2023 (the Notes) in December 2003.

Interest expense includes interest paid on the Notes and amortization of the issuance costs which primarily consist of investment banker fees, legal and other professional fees. Interest expense was \$0.6 million and \$1.2 million, respectively, while amortization expense was \$0.2 million and \$0.4 million, respectively, for the three and six months ended June 30, 2004. Issuance costs are being amortized over a five-year period to the first date holders of the Notes may require the Company to repurchase the outstanding Notes.

The decrease in other expenses in the three and six months ended June 30, 2004 as compared to the three and six months ended June 30, 2003 is due to smaller foreign currency transaction and translation losses attributable to the US dollar remaining flat or slightly weaker against certain foreign currencies offset by the US dollar strengthening against the Euro.

**Provision for (Benefit from) Income Taxes**

The provision for income taxes relates to federal, state and foreign taxes.

	Three Months Ended			Six Months Ended		
	June 30, 2004	Percent Change	June 30, 2003	June 30, 2004	Percent Change	June 30, 2003
Provision for (Benefit from) Income Taxes	\$204	15.3%	\$ 177	\$ (91)	(134.7%)	\$ 262
<i>Percent of Total Revenues</i>						
Provision for (Benefit from) Income Taxes	0.8%		0.7%	(0.2%)		0.5%

**Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2003:**

Our effective tax rate was 38% on a pre-tax profit of \$0.5 million in the three months ended June 30, 2004 compared to 13% on a pre-tax profit of \$1.4 million in the three months ended June 30, 2003. The difference between the statutory federal income tax rate provision of 35% and the effective tax rate provision of 38% in the three months ended June 30, 2004 and 13% tax rate provision in the three months ended June 30, 2003 is due primarily to prior year taxes relating to foreign taxes only whereas current year includes all jurisdictions due to the release of our valuation allowance in the fourth quarter of 2003.

**First Six Months 2004 Compared to First Six Months 2003:**

Our effective tax rate benefit was 38% on a pre-tax loss of \$0.2 million in the six months ended June 30, 2004 compared to 11% on a pre-tax profit of \$2.3 million in the six months ended June 30, 2003. The difference between the statutory federal income tax rate benefit of 35% and the effective tax rate benefit of 38% in the six months ended June 30, 2004 and 11% tax rate provision in the six months ended June 30, 2003 is due primarily to prior year taxes relating to foreign taxes only whereas current year includes all jurisdictions due to the release of our valuation allowance in the fourth quarter of 2003.





**Table of Contents****Liquidity and Capital Resources**

<b>(in thousands)</b>	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>December 31, 2003</b>
Working Capital	\$ 150,123	0.5%	\$ 149,433
Cash, cash equivalents and marketable securities (net of restricted cash)	\$ 158,439	(2.1%)	\$ 161,891

<b>(in thousands)</b>	<b>Six Months Ended</b>		
	<b>June 30, 2004</b>	<b>Percent Change</b>	<b>June 30, 2003</b>
Net cash (used for) provided by operating activities	\$ (1,342)	(116.8%)	\$ 7,972
Net cash used in investing activities	\$ (37,236)	(445.2%)	\$ (6,830)
Net cash provided by financing activities	\$ 1,626	28.0%	\$ 1,270

*Working Capital*

Working capital did not change significantly since December 31, 2003 due to the change of unrealized loss in marketable securities following the increase of interest rates; this decrease was offset by the decrease of accrued expenses, following the bi-annual interest payment 2004 relating to the Company's \$86.25 million in convertible senior notes.

*Cash, cash equivalents and marketable securities (net of restricted cash)*

Cash and cash equivalents consist of highly liquid investments in time deposits held at major banks, commercial paper, United States government agency discount notes, money market mutual funds and other money market securities with original maturities of 90 days or less. Marketable securities include similar highly liquid investments. The decrease in cash, cash equivalents and marketable securities in the six months ended June 30, 2004 was primarily due to the \$2.0 million change of unrealized loss in marketable securities following the increase of interest rates and \$1.4 million interest payment made in June 2004 relating to the Company's \$86.25 million in convertible senior notes.

*Cash provided by operating activities*

Accounts receivable as of June 30, 2004 is consistent with the December 31, 2003 balance of \$22.2 million. Average daily sales outstanding ( DSO ) for the quarter increased to 75 days at June 30, 2004 compared to 72 days at December 31, 2003. DSO is calculated by dividing the period end accounts receivable by the quarterly revenue. DSO measures both the age, in terms of days, of our accounts receivable and the average time it takes to turn the receivable into cash. There are a number of factors affecting DSO, including our payment terms, collection ability and the timing of sales made during a quarter. Deferred revenue as of June 30, 2004 as compared to December 31, 2003 increased by \$1.4 million, mainly due to an increase in new and renewed maintenance contracts to our larger customer base.

*Cash used for investing activities*

Investing activities have consisted of the investments in marketable securities, acquisition of property and equipment, most notably computer and networking equipment to support the corporate infrastructure, and business

acquisitions. The Company manages its market risk on its investment securities by selecting investment grade securities with the highest credit ratings and relatively short duration that trade in highly liquid markets. The negative cash flow from investing activities in the first six months of fiscal 2004 primarily relates to an increase in the purchase of marketable securities from the proceeds of the convertible senior notes.

*Cash provided by financing activities*

Net cash provided by financing activities consisted of the issuance of common stock from the exercise of stock options.

**Table of Contents****Contractual Obligations**

The following is a summary of our contractual obligations as of June 30, 2004:

(in thousands)	Year Ending December 31,						Total
	2004	2005	2006	2007	2008	Thereafter	
Facility and certain equipment leases	\$2,101	\$3,703	\$2,167	\$ 776	\$ 149	\$ 2	\$ 8,898
Minimum royalties payments	100						100
Convertible notes					86,250		86,250
Interest payments on the Convertible Notes	1,294	2,588	2,588	2,588	2,588		11,646
Total commitments	\$3,495	\$6,291	\$4,755	\$3,364	\$88,987	\$ 2	\$106,894

The Company leases its facilities and certain equipment under operating lease agreements extending through July 2009.

The Company has entered into several software license agreements that provide the Company with exclusive worldwide licenses to distribute or utilize certain patented computer software. The Company bundles third-party software in some of its products when it determines that bundling such software is cost-effective or increases the effectiveness of Concord's products. The minimum royalties payment is \$0.1 million.

On December 8, 2003, the Company raised \$82.7 million, net of fees and commissions, following the issuance of convertibles senior notes with a principal of \$86.25 million. The convertible senior notes mature in 2023 and bear interest of 3.0%, payable semi-annually in June and December of each year. Concord intends to use the net proceeds of the offering for working capital, general corporate purposes and potentially for future acquisitions of complementary businesses and technologies. Holders of the convertible senior notes may elect to convert some or all of the outstanding convertible senior notes upon certain events, including a change in control or if during a conversion period, the closing price of our stock exceeds \$32.24, which is 120% of the conversion price (\$26.87) for 20 trading days in a period of 30 trading days, which starts on the first business day of a quarter. If the threshold is met, then holders may convert their convertible senior notes into our common stock at any time during the succeeding 90 days, beginning on the 30th trading day of the quarter. We may redeem some or all of the convertible senior notes at any time on or after December 15, 2008. Holders have the right to require the Company to purchase all or a portion of their notes for cash on December 15, 2008, December 15, 2013 and December 15, 2018.

As of June 30, 2004, the Company's stock had not exceeded 120% of the conversion price on any trading day since December 8, 2003 and no other events had occurred which would make the convertible senior notes convertible. Holders may convert the notes into shares of our common stock at an initial conversion rate of 37.2148 shares of common stock per \$1,000 principal amount of notes (representing a conversion price of approximately \$26.87 per share which converts into 3,209,776 shares of common stock), subject to adjustment. We may redeem some or all of the convertible senior notes on or after December 15, 2008.

## Edgar Filing: CONCORD COMMUNICATIONS INC - Form 10-Q

As of June 30, 2004, the Company had available for U.S. federal income tax purposes net operating loss carryforwards of approximately \$17.7 million, which expire at various dates through 2021. In addition, as of June 30, 2004, the Company had U.S. federal research and development tax credit carryforwards of approximately \$3.0 million, which expire at various dates through 2023. Under current tax law, the utilization of net operating loss and research and development tax credit carryforwards may be subject to annual limitations in the event of certain changes in ownership.

As required by SFAS No. 109, management of the Company has evaluated the positive and negative evidence bearing upon the realizability of the Company's deferred tax assets. The Company has reserved for a portion of its deferred tax assets by recording a valuation allowance. The resulting net deferred tax asset of \$10.45 million as of June 30, 2004 is based on the Company's estimate of future taxable income it expects to generate. The reversal of the deferred tax assets valuation allowance is based upon management's expectation that the Company will generate sufficient taxable income in future periods to allow it to realize its deferred tax assets resulting from the tax benefits associated with its net operating loss carryforwards and its research and development tax credit carryforwards, as well as certain other tax benefits related to book and tax income timing. In the event that actual results differ from

**Table of Contents**

these estimates or the Company adjusts these estimates in future periods, the Company may need to establish an additional valuation allowance. Establishing new or additional valuation allowances could materially adversely impact the Company's financial position and results of operations.

As of June 30, 2004, the Company has recorded a deferred tax asset of approximately \$4.5 million reflecting the benefit of deductions from the exercise of stock options. The Company realized approximately \$2.7 million of this benefit as a credit to additional paid in capital during 2003. The remaining valuation allowance of \$1.8 million relates to stock option deductions and will be credited to additional paid-in capital when released. If we continue to be sufficiently profitable in 2004, the reserve will be released in 2004.

As of June 30, 2004, we did not have any purchase commitments other than obligations incurred in the normal course of business. These amounts are accrued when services or goods are received. Since our operating results may fluctuate significantly, a decrease in customer demand or a decrease in the acceptance of our future products and services may impact our ability to generate positive cash flow from operations.

In the future, we expect cash will continue to be generated from our operations. We do not expect the level of cash used in investing activities to acquire property and equipment in 2004 to change significantly from fiscal 2003. We currently plan to reinvest our cash generated from operations in new short- and long-term investments in high quality financial, government, and corporate securities or other investments, consistent with past investment practices, and therefore net cash used in investing activities may increase. Cash could be used in the future for acquisitions or strategic investments. There are no transactions, arrangements, or other relationships with non-consolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of our requirements for capital resources.

As of June 30, 2004, our principal sources of liquidity included cash, cash equivalents and marketable securities and we believe that our current cash, cash equivalents, marketable securities and cash provided by future operations will be sufficient to meet our working capital, anticipated capital expenditures, contractual obligations and investment needs for at least the next 12 months. Although operating activities may provide cash in certain periods, to the extent the Company experiences growth in the future, our operating and investing activities may require additional cash. Consequently, any such future growth may require the Company to obtain additional equity or debt financing.

**Recent Accounting Pronouncements**

The Emerging Issues Task Force (EITF) has recently added to its agenda Issue 04-8, *Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share*. The Company's convertible senior notes fall under the proposed scope of this EITF Issue. The issue under consideration concerns whether the dilutive effect of contingently convertible debt with a market price trigger should be included in diluted earnings per share. The EITF discussion to date has not been sufficiently definitive to allow the Company to assess its possible impact. The Company continues to monitor developments with regards to this agenda item.

**Table of Contents**

**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 Quarterly Report includes or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). For example, statements regarding our financial position, business strategy and other plans and objectives for future operations, and assumptions and predictions about future product demand, supply, manufacturing, costs, marketing and pricing factors are all forward-looking statements. We make such forward-looking statements under the provisions of the safe harbor section of the Private Securities Litigation Reform Act of 1995. When we use words such as intend, anticipate, believe, estimate, plan, will or expect, and other like import, we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable, based on information available to us on the date hereof, but we cannot assure you that these assumptions and expectations will prove to have been correct or that we will take any action that we may presently be planning. We have disclosed certain important factors that could cause our actual future results to differ materially from our current expectations, including:

- variations in our quarterly operating results;
- integration of acquired products and technologies;
- announcements of technological innovations or new products by us or our competitors;
- introduction of new products or new pricing policies by us or our competitors;
- announcements by us or our competitors of significant customer orders;
- acquisitions or strategic alliances by us or others in our industry;
- changes in global economic and political conditions;
- decreases in the purchases of services by our customers;
- relationships with strategic partners and other evolving distribution channels;
- the hiring or departure of key personnel;
- decreases in sales of products and services outside the United States
- our failure to continue to expand into international markets;
- failure to obtain or protect our intellectual property rights;
- changes in the software industry cycle;
- changes in the market for our products and services;

changes in market valuations of companies within the software industry;

changes in estimates of our performance or recommendations by financial analysts; and

-31-

---

**Table of Contents**

the other risks and uncertainties described under Factors That Could Affect Future Results.

You should understand that forward-looking statements made in connection with this report are necessarily qualified by these factors. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

**Our future operating results are uncertain.**

Our product functionality has expanded to include business service management features to penetrate the networks, systems and application performance markets. We have a limited operating history in these expanded markets upon which we can evaluate our business. These markets are highly competitive and rapidly evolving. Our limited operating history, intense competition in the market, and an uncertain economic climate make the accurate prediction of future results of operations difficult or impossible.

In addition to sales of our *eHealth*<sup>®</sup> Suite, we will continue to sell *netViz*<sup>®</sup> products, which enable customers to visualize business processes and map relationships within the supporting technology infrastructure through data-driven icons. We have a limited operating history in this market making the accurate prediction of future results of operations difficult or impossible.

**Failure to successfully integrate acquisitions may adversely impact our business.**

In July 2003, we completed the acquisition of *netViz*, a developer of software that enables customers to visualize business processes and allows them to map relationships within the supporting technology infrastructure through data-driven icons. The acquisition of *netViz* provides us the opportunity to integrate the *netViz*<sup>®</sup> products and our existing products and to continue to market and sell the *netViz*<sup>®</sup> products as a distinct product set. Additionally, we must integrate the *netViz* personnel, manage operations and personnel in multiple locations, and retain and add new *netViz* customers. Our efforts to integrate *netViz* may not be successful, which could adversely impact our business. Future acquisition targets will likely present integration challenges similar to the challenges encountered in connection with the acquisition of *netViz*. The *netViz* acquisition and future acquisitions, if any, may adversely impact our business through:

failure to successfully integrate the acquired products;

failure to successfully integrate personnel and management structures;

failure to retain key customers;

failure to retain key employees;

failure to effectively control costs associated with the integration (including research and development costs);

failure to maintain and grow the business of the acquired company when continuing that company's operations

failure to meet expected timelines for product development and commercialization; and

exposure to liabilities of the acquired company that were not known or accurately evaluated by us prior to consummating the acquisition.

Even if our acquisitions are fully and successfully integrated, we may not fully realize all of the expected benefits of such acquisitions, including the expected financial results or the expected benefits to our product line.



**Failure to successfully incorporate new technologies may adversely impact our business.**

During the third fiscal quarter of 2003, we completed the acquisition of netViz and entered into a license

**Table of Contents**

agreement with Tavve to acquire Tavve's technology relating to root cause analysis and discovery of layers 2 and 3 of the network topology. We are integrating the netViz technology, the eHealth® Suite technology, and the Tavve technology to enable customers to employ data-driven icons to visualize and take action on the critical relationships between business processes, application services, and network and system infrastructures.

We currently offer an enhanced VoIP solution, which is designed to enable customers to manage the voice traffic carried on their IP networks, and extended support for mobile wireless offerings.

While we believe the incorporation of these technologies into our products will increase our products and services revenue, the markets for these integrated products are at an early stage of development and are evolving, thereby making it difficult to assess:

the size of the markets;

the competitive landscape;

the appropriate features and prices for products to address the markets;

the optimal distribution and marketing strategy; and

the markets that will develop and the impact of large competitors within the markets.

**We cannot ensure that our revenues will grow or that we will continue to be profitable.**

We have expended considerable resources to the research and development of new technologies and new or improved product features that have enabled us to retain existing customers and penetrate new markets both in the United States and internationally. We cannot ensure that we can generate revenue growth on a quarterly or annual basis, or that we can achieve or sustain any revenue growth in the future.

In an effort to achieve profitability and adequately fund research and development, we continue to work to reduce or maintain our operating expenses as a percentage of total revenues while maintaining necessary funding for company operations. 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;

increase sales staff and sales training programs;

develop new distribution channels;

broaden our customer support capabilities; and

respond to unforeseeable economic or business circumstances.

To the extent that increases in our operating expenses precede or are not followed by increased revenues, our ability to achieve profitability will be at risk.

**Our operating results may fluctuate.**

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

changes in the demand for our products by customers or groups of customers;

-33-

---

**Table of Contents**

the acceptance by customers of our products, including our business service management products;

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 (including the fiscal year end);

difficulties penetrating new markets for our products;

costs associated with the integration of acquired companies and/or new technologies;

our customers' spending patterns and budgetary resources for our products;

geopolitical conditions in the world;

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, including maintaining an adequately staffed sales team;

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

changes in general economic conditions; and

changes in accounting rules.

Though our service revenues continue to increase as a percentage of total revenues, we do not have a significant ongoing revenue stream that may mitigate quarterly fluctuations in operating results.

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.

**We have increased our leverage as a result of the sale of the 3.0% Convertible Senior Notes due 2023.**

In connection with the sale of the Notes, we have incurred \$86.25 million of indebtedness. As a result of this indebtedness, our interest payment obligations have increased. The degree to which we are now leveraged could adversely affect our ability to obtain further financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations will be dependent upon our future performance, which may be subject to the financial, business and other factors affecting our operations, many of which are beyond our control.

**Our debt service obligations may adversely affect our cash flow.**

A higher level of indebtedness increases the risk that we may default on our debt obligations. We cannot assure that we will be able to generate sufficient cash flow to pay the interest on our debt or that future working capital, borrowings or equity financing will be available to pay or refinance such debt. If we are unable to generate sufficient

**Table of Contents**

cash flow to pay the interest on our debt, we may have to delay or curtail our research and development programs.

The level of our indebtedness among other things, could:

make it difficult for us to make payments on the Convertible Senior Notes;

make it difficult for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete; and

make us more vulnerable in the event of a downturn in our business.

**Our success is dependent upon sales to telecommunication carriers and service providers.**

We derive and likely will continue to derive a significant portion of our revenues from the sales of our products to telecommunication carriers and service providers. In general, we have been negatively affected by the general weakness in capital spending within the aforementioned markets, particularly in the telecommunications market worldwide and the service provider market in Europe, making future results difficult to predict. The volume of sales of our products and services to telecommunication carriers and service providers may increase at a slower rate than we expect or our sales to these customers may decrease.

**The market for business service management software is emerging.**

The market for our business service management software is in an early stage of development. Targeting this market is central to the development and marketing of our products, but this market is emerging, and it is difficult to assess:

the size of the business service management market;

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

the optimal distribution strategy; and

the market that will develop and the impact of large competitors within the market.

Presently, this market is very competitive and we are in direct competition with larger companies that have substantially greater resources to fund the development of competitive products and the creation and maintenance of direct and indirect sales channels. The rapidly evolving application performance market and the continued presence of larger companies in this market may impact our ability to retain or increase our market share.

**Market acceptance of our eHealth® products and services is critical to our success.**

We currently derive significant revenues from the sale of eHealth® Suite products and services, and we expect that revenues from these products and services will continue to account for a significant portion of our revenues in the foreseeable future. Broad market acceptance of these products and services is critical to our future success. We cannot ensure that market acceptance of our eHealth® Suite products and services will increase or even remain at current levels. Factors that may affect the market acceptance of our products and services include:

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

our ability to continue to provide product functionality and related services to meet the needs of our market;

our ability to continue research and development at levels necessary for the growth of our business;

-35-

---

**Table of Contents**

our ability to provide services that meet the needs of the market;

the demand for integrated, as opposed to stand-alone, solutions; and

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

Moreover, if demand for integrated availability and performance management software products and services increases, we anticipate that our competitors will introduce additional competitive products and services and new competitors could enter our market and offer alternative products and services resulting in decreased market acceptance of our products and services.

**Our success is dependent upon continued purchases of services by our customers.**

We derive and likely will continue to derive a significant portion of our revenues from the sales of our services, specifically including the sale of technical support services, to our customers. A decrease in the number of customers purchasing services may adversely impact our company. The company continually assesses our services offerings to enable us to provide services that are desired by our customers. In general, most of our customers purchase services when buying our products, but we cannot ensure that our future services offerings will meet the demands of the market and a corresponding decrease in services revenue may occur.

**Increased royalty costs could adversely impact our business.**

We license from third parties, generally on a non-exclusive basis, certain technologies used in our products, including the Oracle® database. The incorporation of third party technology is an important component of our product development and an increase in royalty costs associated with our distribution of third party technologies could adversely impact our business. Additionally, the termination of any such licenses, or the failure of the third-party licensors to adequately maintain or update their products, could require us to implement technology offered by alternative sources, and any required replacement licenses and associated royalties could prove costly and adversely impact our business.

**The market for application availability and performance management software is emerging.**

The market for our application availability and performance products is in an early stage of development. Although the rapid expansion and increasing complexity of computer applications, systems, and networks in recent years have increased the demand for availability (i.e. fault) and performance management software products, the awareness of, and the demand for, an integrated fault and performance solution is a recent development; 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 market that will develop and the impact of large competitors within the market.

The development of this market and our growth will depend significantly upon the desire and success of telecommunication carriers, managed services providers, and enterprise customers to integrate availability and performance management functionality into their applications, systems, and networks. Moreover, this market is very competitive and we are in direct competition with larger companies that have substantially greater resources to fund the development of competitive products and the creation and maintenance of direct and indirect sales channels that



may impact our ability to successfully grow in this market.

**The markets for our products are intensely competitive and rapidly evolving.**

We sell software products designed to help companies effectively manage their applications, systems, and

**Table of Contents**

networks. As we offer application availability and performance products to manage the IT infrastructure, we compete both with companies that market comprehensive products to manage the IT infrastructure and with companies that market products for particular segments of the IT infrastructure (e.g., applications and networks). The markets for our products are intensely competitive and rapidly evolving. Our competitors include:

application performance and availability management software vendors;

business service management solution vendors

fault management software vendors;

IT visualization software vendors;

report toolset niche vendors;

enterprise management software, framework and platform providers;

software vendors providing service assurance for the wireless market;

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 that provide, as a service, some of the functionality of our products.

We expect competition to persist, increase, and intensify in the future, which will likely result in price competition within our relevant market. If we do not provide products that achieve success in our market in the short term, we could suffer an insurmountable loss in market share and brand name acceptance. We cannot ensure that we will compete effectively with current and future competitors.

**Market acceptance of our netViz® products is critical to our success.**

We market and sell netViz® products and services. Our revenue is derived primarily from the sale of eHealth® Suite products and services, but revenue derived from the sale of netViz® products and services constitutes an important component of our quarterly and annual results. Market acceptance of the netViz® products and services is critical to our future success. We cannot ensure that market acceptance of netViz® products and services will increase or even remain at current levels. Factors that may affect the market acceptance of netViz® products and services include:

the availability and price of competitive products and services;

the ability of others to develop products and services that meet the needs of the market;

our ability to continue to provide product functionality and related services to meet the needs of our market;

our ability to continue research and development at levels necessary for the growth of our business;

our ability to partner with third parties as needed to deliver a product that meets the needs of our customers

-37-

---

**Table of Contents**

the demand for data-driven visualization software; and

the success of our sales efforts and those of our channel partners.

Moreover, if demand for data-driven visualization products increases, we anticipate increased competition in the market from existing and new competitors that could enter our market and offer alternative products resulting in decreased market acceptance of our products.

**Limitations on the effectiveness of controls.**

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, does not expect that our disclosure controls or our internal controls will prevent all errors and intentional misrepresentations. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Because of the inherent limitations in a cost-effective control system, misstatements due to error or intentional conduct may occur and not be detected.

**We may need future capital funding.**

We plan to continue to expend substantial funds on the continued development, marketing, and sale of our products. While we have approximately \$158.4 million in short term investments (cash, cash equivalents and marketable securities) as of June 30, 2004, 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, potential changes in the architecture of the IT infrastructure, changes in the software markets in which our product and services are sold, and changes in industry standards, the market acceptance of updated versions of our products is difficult to estimate. We cannot ensure that:

we will successfully develop and market enhancements to our 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 enhancements or new products; or

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 map, measure, and manage computer applications, systems, and networks. Presently, manufacturers of both hardware and software have not implemented these 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 functions into their products, specifically including application vendors, it may decrease the value of our products and have a substantial impact on our business.

**Table of Contents**

**Current geopolitical instability and the continuing threat of domestic and international terrorist attacks may adversely impact our revenues.**

International tensions, exacerbated by the war in Iraq and the war against global terrorism, 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. As we sell products both in the United States and internationally, the threat of future terrorist attacks may adversely affect our business.

**An adverse impact on our outsourcing activities may affect our business.**

We currently outsource, on a limited basis, development and testing of certain software products to locations in Europe and Asia. Our efforts to outsource development and testing of software may be adversely affected by various factors, including: geopolitical instability, increased costs associated with outsourcing, relationships with independent contractors performing such product development and testing, and the enforceability of legal arrangements by which we protect our intellectual property rights in connection with these activities. The occurrence of any event that would adversely affect our outsourcing of development and testing of software may have a substantial impact on our business.

**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 of results of operations by other companies;

announcements by government or other agencies regarding the economic health of the United States and the rest of the world;

announcements relating to financial improprieties by public companies; or

other events or factors.

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.

**Table of Contents**

The introduction of products embodying new technologies and the emergence of new industry standards can render existing products and integrated product solutions obsolete and unmarketable. While we actively work to develop products that operate with standard protocols, any change in industry standards or the emergence of new network technologies could affect the compatibility of our products, which in turn could affect the demand for, or the pricing of, our products and services.

**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;

service providers;

system integrators;

telecommunication carriers;

original equipment manufacturers; and

independent software vendors.

We have developed a number of these relationships and intend to continue to develop new channel partner relationships. We have focused on identifying and developing our key distribution partners worldwide to maximize the success of our indirect sales. Our success will depend in large part on our development of these more focused distribution relationships and on the performance and success of other third parties that distribute our products and services. We sell our products and services in the United States through both direct sales to customers and indirect sales to customers through our channel partners. Outside the United States, we sell our products and services primarily through indirect sales via our channel partners, but direct sales to customers have been increasing as we have expanded our sales personnel in our markets. 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 and services are sold. While we have implemented policies and procedures to achieve this and will continue to undertake efforts to improve our channel business, 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 and services. 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 and services offered by other companies, products and services developed internally by these channel partners, their financial insolvency or otherwise.

**We may fail to manage successfully the growth of our business.**

We have experienced employee turnover in our sales force; our products and services have become increasingly complex, and our distribution channels are being developed and expanded. The rapid evolution of our markets and the increasing complexity of our products and services have 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.

**Table of Contents**

**Our success depends on our retention of key personnel.**

Our performance depends substantially on the performance of our key technical, senior management, finance, sales and marketing personnel. We may lose the services of any of such persons. 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. 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 collections;
- potentially adverse tax consequences;
- compliance 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; and
- exposure to foreign currency fluctuations.

Our successful expansion into certain countries will require additional modification of our products and services, 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 United States 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 our Asia-Pacific region, we have introduced pricing in Australian dollars. 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.

**Our failure to protect our intellectual property rights may harm our competitive position.**

-41-

---

## **Table of Contents**

Our success depends significantly upon our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, product and services agreements, non-disclosure agreements, and other contractual provisions to establish, maintain, and protect our proprietary rights. These means afford only limited protection.

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, some of our products are licensed under end user license agreements (also known as shrink-wrap licenses) that are not signed by licensees. The law governing the enforceability of shrink-wrap license agreements is not settled in most jurisdictions. There can be no guarantee that we would achieve success in enforcing one or more shrink-wrap license agreements if we sought to do so in a court of law.

### **Involvement in litigation may adversely impact our business.**

In addition to the risks associated with intellectual property infringement litigation, our operations include new product offerings and expanding distribution channels that may increase the risk of litigation. Any litigation can be time-consuming and expensive regardless of merit. In addition to the expense incurred in litigation, corporate resources, including key employees, may be needed to prepare for litigation and could require a temporary diversion from daily responsibilities that could impact product development, sales activities, and management of the company. Therefore, any litigation could adversely affect our business and financial condition and decrease future revenues.

### **We license intellectual property from third parties.**

We license from third parties, generally on a non-exclusive basis, certain technologies used in our products, including the root cause analysis and discovery of layer 2 and 3 network topology technology from Tavve that is expected to be integrated with Concord technology to expand the functionality of our products. In addition, we license intellectual property from Altima Technologies for use in our netViz products. The incorporation of third party technology is an important component of our product development and 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.

We ship Oracle® software as the database on which the eHealth® Suite runs. As with any vendor, 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 with our eHealth® Suite of products.

### **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,

**Table of Contents**

require us to redesign our products, or require us to enter into royalty or license agreements which may not be available on terms acceptable to us or at all.

**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 IT infrastructure 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. 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.

**The conviction of Arthur Andersen LLP may limit potential recoveries related to their prior service as our independent auditors.**

Arthur Andersen LLP served as our independent auditors until June 10, 2002. On June 10, 2002, we dismissed Arthur Andersen LLP and on June 11, 2002, we retained PricewaterhouseCoopers LLP as our independent auditors. On June 15, 2002, Arthur Andersen LLP was found guilty on federal obstruction of justice charges arising from the government's investigation of Enron Corporation. Following this conviction, on August 31, 2002, Arthur Andersen LLP ceased operations and can no longer reissue its audit reports or provide its consent to include the financial statements to be included in this quarterly report. Accordingly, Arthur Andersen LLP has not performed any procedures in connection with the preparation and filing of this report. Events arising out of the indictment and conviction will likely preclude Arthur Andersen LLP from satisfying any claims arising from the provision of auditing services to us, including claims that may arise out of Arthur Andersen LLP's audit of financial statements incorporated by reference in this quarterly report.

Securities and Exchange Commission (SEC) rules require us to present historical audited financial statements in various SEC filings, along with consents from Arthur Andersen LLP to include its audit report in those filings. In light of the cessation of Arthur Andersen LLP's SEC practice, we will not be able to obtain the consent of Arthur Andersen LLP for the inclusion of its audit report in our relevant current and future filings. The SEC has provided regulatory relief designed to allow companies that file reports with the SEC to dispense with the requirement to file a consent of Arthur Andersen LLP in certain circumstances, but purchasers of securities sold under our registration statements, which were not filed with the consent of Arthur Andersen LLP for the inclusion of its audit report will not be able to file suit against Arthur Andersen LLP pursuant to Section 11(a)(4) of the Securities Act and therefore their right of recovery under that section may be limited as a result of the lack of our ability to obtain the consent of Arthur Andersen LLP. If the SEC ceases to accept financial statements from a prior period audited by Arthur Andersen LLP for which Arthur Andersen LLP will not reissue an audit report prior to the date on which our periodic reports are due, our ability to make timely filings with the SEC and access the capital markets could be impaired. In that case, we would not be able to make timely filings with the SEC or access the public capital markets unless another independent accounting firm were able to audit the financial statements originally audited by Arthur Andersen LLP.

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*****(a) Market and Interest Rate Risk***

Most of Concord's current export sales are denominated in United States dollars. To the extent that a majority of our 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 our products and services more expensive and, therefore, potentially less competitive in international markets. Substantially all of our business outside the United States is conducted in U.S. dollar-denominated transactions, whereas our operating expenses in our foreign operations are denominated in local currency. We believe that the operating expenses of our foreign operations are immaterial and therefore any associated market risk is unlikely to have a material adverse effect on our business, results of operations or financial condition.

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.

***(b) Foreign Currency Exchange Rate Risk***

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 June 30, 2004, the Company had one forward contract outstanding, which is presented in the table below. The Company has determined that this forward contract qualifies for hedge accounting. The notional exchange rate is quoted using market conventions where the currency is expressed in currency units per U.S. dollar:

<b>Currency</b>	<b>Position</b>	<b>Maturity Date</b>	<b>Notional Amount</b>	<b>Notional Exchange Rate</b>	<b>Fair Market Value as of June 30, 2004</b>
Australian Dollars	Sell	7/12/04	AUD\$302,000	0.6894	US\$208,000

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.



**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures.

As of the end of the period covered by 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 record, process, summarize, and report information required to be included in the Company's periodic SEC filings within the required time period.

(b) Changes in Internal Control over Financial Reporting.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the fiscal quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or would be reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

**CONCORD COMMUNICATIONS, INC.**

**FORM 10-Q, June 30, 2004**

**PART II: OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company is not a party to any legal proceedings 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, USE OF PROCEEDS AND REGISTRANT PURCHASES OF EQUITY SECURITIES**

**(a) Use of Proceeds**

On October 16, 1997, Concord commenced an initial public offering ( IPO ) of 2,900,000 shares of our common stock 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 registered, 2,300,000 shares were offered and sold by the Company and 600,000 shares were offered and sold by certain stockholders 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. The managing underwriters for the IPO were Nationsbank Montgomery Securities Inc., BancAmerica Robertson Stephens and Wessels, Arnold and Henderson, L.L.C (the Representatives ). 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 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.

None of the expenses paid by the Company in connection with the IPO or the exercise of the Underwriters' Option was paid, directly or indirectly, to directors, officers, persons owning ten percent or more of the Company's equity securities, or affiliates of the Company.

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. None of the net proceeds from the IPO was used to pay, directly or indirectly, directors, officers, persons owning ten percent or more of the Company's equity securities, or affiliates of the Company.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

*None.*

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

*No matters were submitted to a vote of security holders during the three months ended June 30, 2004.*

-46-

---

**Table of Contents**

**ITEM 5. OTHER INFORMATION**

*None.*

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

The exhibits listed in the accompanying Exhibit Index are filed, furnished or incorporated by reference as part of this Report.

(b) Reports on Form 8-K

Current Report on Form 8-K furnished to the Commission on April 5, 2004; information furnished under Item 12, Results of Operations and Financial Condition.

Current Report on Form 8-K furnished to the Commission on April 13, 2004; information furnished under Item 5, Other Events and Required FD Disclosure.

Current Report on Form 8-K furnished to the Commission on April 14, 2004; information furnished under Item 12, Results of Operations and Financial Condition.

Current Report on Form 8-K furnished to the Commission on May 4, 2004; information furnished under Item 5, Other Events and Required FD Disclosure.

Current Report on Form 8-K furnished to the Commission on July 15, 2004; information furnished under Item 12, Results of Operations and Financial Condition and Item 7, Financial Statements, Pro Forma Financial Information and Exhibits.

**Table of Contents**

**CONCORD COMMUNICATIONS, INC.**

**FORM 10-Q, June 30, 2004**

**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

August 6, 2004

---

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

-48-

---

**Table of Contents****EXHIBIT INDEX**

The following designated exhibits are either filed herewith or, where information is provided under the SEC Document Reference heading corresponding to such exhibit, incorporated by reference to such filing

<b>Exhibit No.</b>	<b>Description</b>	<b>SEC Document Reference</b>
3.01	Restated Articles of Organization of the Company	Exhibit No. 3.01 on Form 10-K, for the period ended December 31, 1997
3.02	Restated By-laws of the Company	Exhibit No. 3.02 on Form 10-K, for the period ended December 31, 1998
4.01	Indenture by and between the Company and Wilmington Trust Company, as Trustee dated as of December 8, 2003.	Exhibit No. 4.3 to Registration Statement on Form S-3 (No. 333-112091)
4.02	Registration Rights Agreement by and between the Company and Bear, Stearns & Co. Inc. dated as of December 8, 2003.	Exhibit No. 4.4 to Registration Statement on Form S-3 (No. 333-112091)
10.03	Equipment Line of Credit Letter Agreement between the Company and Fleet Bank dated as of June 9, 1997	Exhibit No. 10.03 to Registration Statement on Form S-1 (No. 333-33227)
10.04	1995 Stock Plan of the Company	Exhibit No. 10.04 to Registration Statement on Form S-1 (No. 333-33227)
10.05	1997 Stock Plan of the Company	Exhibit No. 10.01 on Form 10-Q, for the period ended June 30, 1998
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 on Form 10-K, for the period ended December 31, 2000
10.07	1997 Employee Stock Purchase Plan of the Company	Exhibit No. 10.06 to Registration Statement on Form S-1 (No. 333-33227)
10.08	1997 Non-Employee Director Stock Option Plan as amended on March 8, 2000 and April 25, 2001	
10.09	The Profit Sharing/401(K) Plan of the Company	Exhibit No. 10.08 to Registration Statement on Form S-1 (No. 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,	Exhibit No. 10.09 to Registration Statement on Form S-1 (No. 333-33227)

1997

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 to Registration Statement on Form S-1 (No. 333-33227)
10.12	Form of Indemnification Agreement for directors and officers of the Company	Exhibit No. 10.11 to Registration Statement on Form S-1 (No. 333-33227)
10.13	Restated Common Stock Registration Rights Agreement between the Company and certain investors dated August 7, 1986	Exhibit No. 10.12 to Registration Statement on Form S-1 (No. 333-33227)

-49-

---

**Table of Contents**

<b>Exhibit No.</b>	<b>Description</b>	<b>SEC Document Reference</b>
10.14	Amended and Restated Registration Rights Agreement between the Company and certain investors dated December 28, 1995	Exhibit No. 10.13 to Registration Statement on Form S-1 (No. 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 to Registration Statement on Form S-1 (No. 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 to Registration Statement on Form S-1 (No. 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 to Registration Statement on Form S-1 (No. 333-33227)
10.19	Management Change in Control Agreement dated as of June 12, 2000	Exhibit No. 10.18 on Form 10-Q filed on
10.21	Stock Option Agreement dated January 1, 1996 between the Company and John A. Blaeser	Exhibit No. 10.19 to Registration Statement on Form S-1 (No. 333-33227)
10.22	Stock Option Agreement dated January 1, 1996 between the Company and John A. Blaeser	Exhibit No. 10.20 to Registration Statement on Form S-1 (No. 333-33227)
10.24	Form of Shrink-Wrap License	Exhibit No. 10.22 to Registration Statement on Form S-1 (No. 333-33227)
10.28	2000 Non-Executive Employee Equity Incentive Plan	Exhibit 10.28 on Form 10-K, for the period ended December 31, 2000
10.31	2001 Non-Executive Employee Stock Purchase Plan	Exhibit No. 10.31 on Form 10-Q filed on November 5, 2001
10.34	Management Change in Control Agreement between the Company and Douglas Batt dated as of November 18, 2002	Exhibit No. 10.34 on Form 10-K filed on March 19, 2003
10.35	Management Change in Control Agreement between the Company and Daniel Sheahan dated as of November 18, 2002	Exhibit No. 10.35 on Form 10-K filed on March 19, 2003
10.36	Employment Agreement between the Company and Daniel Sheahan dated August 10, 2001	Exhibit No. 10.36 on Form 10-K filed on March 19, 2003
10.37		



Edgar Filing: CONCORD COMMUNICATIONS INC - Form 10-Q

	Registration Rights Agreement by and between the Company and Vo Ngoc Tran dated as of July 17, 2003.	Exhibit No. 4.1 to Registration Statement on Form S-3 (No. 333-108068)
10.38	Registration Rights Agreement by and between the Company and Bear, Stearns & Co. Inc. dated as of December 8, 2003.	Exhibit No. 4.5 to Registration Statement on Form S-3 (No. 333-112091)
10.39	Management Agreement between the Company and Ellen	Exhibit No. 10.39 on Annual Report

**Table of Contents**

<b>Exhibit No.</b>	<b>Description</b>	<b>SEC Document Reference</b>
	(Kokos) Rogers dated October 22, 2003	on Form 10-K for the period ended December 31, 2003
*10.40	Management Change in Control Agreement between the Company and Dayton Semerjian dated as of April 30, 2004	Exhibit No. 10.40 on Form 10-Q for the period ended June 30, 2004
12.01	Statement regarding Computation of Ratio of Earnings to Fixed Charges	Exhibit No. 12.01 to Registration Statement on Form S-3 (No. 333-112091)
21.01	Subsidiaries of the Company	Exhibit No. 21.01 on Form 10-K for the period ended December 31, 2003
*31.1	Certification of John A. Blaeser pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Exhibit No. 31.1 on Form 10-Q for the period ended June 30, 2004
*31.2	Certification of Melissa H. Cruz pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Exhibit No. 31.2 on Form 10-Q for the period ended June 30, 2004
*32.1	Certification of John A. Blaeser pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Exhibit No. 32.1 on Form 10-Q for the period ended June 30, 2004
*32.2	Certification of Melissa H. Cruz pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Exhibit No. 32.2 on Form 10-Q for the period ended June 30, 2004

\* filed herewith

Indicates a management contract or compensatory plan or arrangement.