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 quarter ended September 30, 2002

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number 000-26757

NetIQ CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**77-0405505** **(I.R.S. Employer Identification No.)**
3553 North First Street, San Jose CA **(Address of principal executive offices)**	**95134** **(Zip Code)**

(408) 856-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the 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 ☐

As of October 31, 2002, the Registrant had outstanding 51,099,354 shares of Common Stock.

NetIQ CORPORATION

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NetIQ CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	September 30, 2002 (Unaudited)	June 30, 2002(1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 72,327	$ 64,032
Short-term investments	425,659	411,861
Accounts receivable, net of allowance for uncollectible accounts and sales returns	29,804	35,095
Prepaid expenses and other	7,247	4,511
Total current assets	535,037	515,499
Property and equipment, net	56,775	55,518
Other intangible assets, net	44,703	57,537
Goodwill, net	338,652	915,813
Long-term investments	7,532	2,652
Other assets	1,464	1,624
Total assets	$ 984,163	$ 1,548,643
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,461	$ 5,612
Accrued compensation and related benefits	19,068	17,505
Other liabilities	15,435	15,363
Deferred revenue, current portion	48,793	46,603
Total current liabilities	88,757	85,083
Deferred revenue, net of current portion	2,402	2,100
Total liabilities	91,159	87,183
Stockholders' equity:		
Common stock-$0.001; 250,000,000 shares authorized, 54,732,493 issues and outstanding at September 30, 2002; and 54,588,258 issued and outstanding at June 30, 2002	2,879,806	2,876,462
Deferred employee stock-based compensation	(167)	(395)
Accumulated deficit	(1,899,820)	(1,327,592)
Accumulated other comprehensive income	1,825	1,625
Less treasury stock	(88,640)	(88,640)
Total stockholders' equity	893,004	1,461,460
Total liabilities and stockholders' equity	$ 984,163	$ 1,548,643

(1) Derived from audited consolidated financial statements

See notes to condensed consolidated financial statements.

NetIQ CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001
Software license revenue	$ 55,982	$ 45,128
Service revenue	21,106	15,566
Total revenue	77,088	60,694
Cost of software license revenue	2,427	901
Cost of service revenue	6,499	5,385
Total cost of revenue	8,926	6,286
Gross profit	68,162	54,408
Operating expenses:		
Sales and marketing	30,018	26,984
Research and development	16,128	12,978
General and administration	4,950	4,393
Employee stock-based compensation	209	1,367
Amortization of other intangible assets	9,007	10,269
Amortization of goodwill	—	188,293
Total operating expenses	60,312	244,284
Income (loss) from operations	7,850	(189,876)
Other income (expenses):		
Interest income	3,990	5,504
Other (expenses) income	(240)	115
Total other income, net	3,750	5,619
Income (loss) before income taxes and cumulative effect of change in accounting principle	11,600	(184,257)
Income taxes	4,490	2,110
Income (loss) before cumulative effect of change in accounting principle	7,110	(186,367)
Cumulative effect of change in accounting principle, net of income taxes	(579,338)	—
Net loss	(572,228)	(186,367)
Other comprehensive income (expense), net of income taxes:		
Foreign currency translation adjustments	(12)	15
Unrealized gain on short-term investments	212	1,227
Comprehensive loss	$(572,028)	$(185,125)
Basic earnings per share:		
Income (loss) before cumulative effect of change in accounting principle	$ 0.14	$ (3.51)
Cumulative effect of change in accounting principle	(11.49)	—
Net loss per share	$ (11.35)	$ (3.51)
Diluted earnings per share:		
Income (loss) before cumulative effect of change in accounting principle	$ 0.14	$ (3.51)
Cumulative effect of change in accounting principle	(11.24)	—
Net loss per share	$ (11.10)	$ (3.51)
Shares used to compute basic earnings per share	50,420	53,085
Shares used to compute diluted earnings per share	51,544	53,085

See notes to condensed consolidated financial statements.

NetIQ CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001
Cash flows from operating activities:		
Net loss	$(572,228)	$(186,367)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	11,953	202,175
Tax benefit from disqualifying dispositions	3,022	243
Amortization of employee stock-based compensation	208	1,367
Loss on sale of investments and property and equipment	92	515
Undistributed net loss in earnings of affiliate	120	—
Cumulative effect of change in accounting principle	579,338	—
Changes in:		
Accounts receivable	5,307	1,299
Prepaid expenses and other	(2,737)	3
Accounts payable	(158)	341
Accrued compensation and related benefits	1,559	(189)
Other liabilities	1,540	(2,555)
Deferred revenue	2,135	4,666
Net cash provided by operating activities	30,151	21,498
Cash flows from investing activities:		
Purchases of property and equipment	(4,292)	(2,427)
Purchases of short-term investments	(67,952)	(64,446)
Proceeds from maturities of short-term investments	54,364	89,775
Purchase of long-term investment	(5,000)	—
Other	161	5
Net cash (used in) provided by investing activities	(22,719)	22,907
Net cash flows from financing activities, sale of common stock	523	3,564
Effect of exchange rate changes on cash	340	(46)
Net increase in cash and cash equivalents	8,295	47,923
Cash and cash equivalents, beginning of period	64,032	89,494
Cash and cash equivalents, end of period	$ 72,327	$ 137,417
Supplemental disclosure of cashflow information-cash paid for:		
Interest	$ 1	$ 1
Income taxes	$ 231	$ 541

See notes to condensed consolidated financial statements.

NetIQ CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Three Months Ended September 30, 2002 and 2001
(Unaudited)

1. Basis of Presentation

Interim Financial Information—The accompanying unaudited condensed consolidated financial statements of NetIQ Corporation (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the rules and regulations of the Securities and Exchange Commission for interim financial statements. In the opinion of management, the condensed consolidated financial statements include all adjustments (consisting only of normal recurring accruals) that management considers necessary for a fair presentation of its financial position, operating results and cash flows for the interim periods presented. All significant intercompany accounts and transactions have been eliminated in consolidation. Operating results and cash flows for interim periods are not necessarily indicative of results for the entire year.

These interim financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2002.

2. Change in Accounting Principle

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets,* on July 1, 2002. SFAS No. 142 requires companies to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Instead, it requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment upon adoption of SFAS No. 142, and at least annually thereafter. Under SFAS No. 142, goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value.

Upon adoption of SFAS No. 142, the Company recorded an one-time, non-cash charge of $579.3 million to reduce the carrying value of its goodwill from previous acquisitions. The charge is non-operational in nature and is reflected as the cumulative effect of a change in accounting principle in the accompanying condensed consolidated statements of operations. In calculating the impairment charge, the fair values of the reporting units were estimated using a combination of the discounted cash flows and comparable transactions methodologies. There was no income tax effect of the change in accounting principle. As a result of the adoption of SFAS No. 142, $2.4 million was reclassified from other intangible assets to goodwill relating to acquired workforce.

In accordance with SFAS No. 142, the Company discontinued amortization of goodwill, effective July 1, 2002. A reconciliation of previously reported net loss and earnings per share to the amounts adjusted for the exclusion of the amortization of acquired workforce and goodwill net of the related income tax effect follows (in thousands, except per share amounts):

	Three Months Ended September 30,	
	2002	2001
Reported net loss	$(572,228)	$(186,367)
Add: Acquired workforce amortization, net of tax	—	436
Add: Goodwill amortization, net of tax	—	188,293
Adjusted net income (loss)	$(572,228)	$ 2,362
Reported basic earnings per share	$ (11.35)	$ (3.51)
Add: Acquired workforce amortization, net of tax	—	0.01
Add: Goodwill amortization, net of tax per basic share	—	3.55
Adjusted basic (loss) income per share	$ (11.35)	$ 0.05
Reported diluted earnings per share	$ (11.10)	$ (3.51)
Add: Acquired workforce amortization, net of tax	—	0.01
Add: Goodwill amortization, net of tax per diluted share	—	3.55
Adjusted diluted (loss) income per share	$ (11.10)	$ 0.05

Other intangible assets consist of the following (in thousands):

	Carrying Amount	Accumulated Amortization	Net
	September 30, 2002		
Purchased technology	$ 64,297	$36,100	$28,197
Customer lists	39,881	24,837	15,044
Tradenames	2,414	1,580	834
Patents	1,487	859	628
	$108,079	$63,376	$44,703
	June 30, 2002		
Purchased technology	$ 64,297	$30,741	$33,556
Customer lists	39,881	21,514	18,367
Acquired workforce	8,570	4,748	3,822
Tradenames	2,414	1,380	1,034
Patents	1,487	729	758
	$116,649	$59,112	$57,537

Estimated future amortization of other intangible assets as of September 30, 2002 is as follows (in thousands):

Fiscal year ending June 30,	
2003 (remaining 9 months)	$25,551
2004	18,833
2005	319
Total	$44,703

3. Recent Accounting Pronouncements

The Company adopted SFAS No. 144 on July 1, 2002. SFAS No 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of,* and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Adoption of this statement did not have a material impact on the Company's financial position or results of operations.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity*. The Company will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred, while under EITF Issue No. 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized.

4. Other Liabilities

Other liabilities consist of (in thousands):

	September 30, 2002	June 30, 2002
Accrued sales and marketing costs	$ 7,112	$ 6,556
Facilities reserves	1,451	1,799
Sales tax payable	1,163	1,579
Accrued merger costs	112	183
Other	5,597	5,246
Other liabilities	$15,435	$15,363

5. Earnings Per Share

The following is a reconciliation of the shares used to compute basic and diluted earnings per share (in thousands):

	Three months ended September 30,	
	2002	2001
Weighted average common shares outstanding	50,626	53,497
Weighted average common shares outstanding subject to repurchase	(206)	(412)
Shares used to compute basic earnings per share	50,420	53,085
Weighted average common shares outstanding	50,626	53,497
Weighted average common shares outstanding subject to repurchase	—	(412)
Outstanding options	918	—
Shares used to compute diluted earnings per share	51,544	53,085

During the three months ended September 30, 2001 the Company had securities outstanding which could potentially dilute earnings per share, but were excluded in the computation of diluted earnings per share, as their effect would have been antidilutive. Such outstanding securities consist of the following (in thousands):

Shares of common stock subject to repurchase	412
Outstanding options	1,950
Shares used to compute basic earnings per share	2,362

6. Major Customer

Microsoft Corporation accounted for 33% and 25% of total revenue during the three months ended September 30, 2002 and 2001, respectively. One other customer accounted for 12% of net accounts receivable at September 30, 2002. No single customer accounted for greater than 10% of net accounts receivable at September 30, 2001.

7. Agreement to Acquire PentaSafe Security Technologies, Inc.

On September 30, 2002, the Company entered into an agreement to acquire PentaSafe Security Technologies, Inc. (PentaSafe). The Company will pay a maximum of $192.5 million in cash and issue a maximum of 4,337,950 shares of the Company's common stock in exchange for all outstanding shares of PentaSafe. In addition, the Company agreed to assume all outstanding stock options and warrants to purchase shares of PentaSafe's capital stock. Based on the closing price of the Company's common stock as of September 30, 2002 the date of the merger agreement, the total value of the transaction would be approximately $255.0 million. The actual value of the transaction cannot be determined until after the closing, which is expected to occur during the quarter ending December 31, 2002, subject to customary closing conditions. In addition, the Company expects to eliminate redundant personnel of PentaSafe, which will result in an increase in the carrying value of the acquisition. The Company also expects to incur a restructuring charge related to the elimination of redundant NetIQ personnel and facilities. The Company expects to incur direct acquisition costs of approximately $5.5 million. PentaSafe is a provider of integrated security management solutions. The acquisition will be accounted for as a purchase.

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

The statements contained in this Quarterly Report on Form 1O-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, intentions, strategies, and expected operating results and financial condition. Forward-looking statements also include statements regarding events, conditions and financial trends that may affect our future plans of operations, business strategy, results of operations and financial position. All forward-looking statements included in this document are based on information available to us on the date hereof and we assume no obligation to update any such forward- looking statements. Investors are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties and that actual results may differ materially from those included within the forward-looking statements as a result of various factors. These forward-looking statements are made in reliance upon the safe harbor provision of The Private Securities Litigation Reform Act of 1995. Factors that could cause or contribute to such differences include, but are not limited to, those described in "Management's Discussion and Analysis of Financial Condition and Results of Operations", under the heading "Factors That May Affect Future Operating Results" and elsewhere in this Quarterly Report on Form 1O-Q.

Overview

NetIQ is a leading provider of enterprise systems management software solutions for managing, securing and analyzing the key components of corporate enterprise computing infrastructure—from back-end networks and servers to front-end applications and Web servers. Historically focused on Microsoft Windows applications management, we have become a leading provider of software to test, migrate, administer, monitor, secure and analyze complex, distributed Windows-centric computer systems. Our UNIX and Linux modules introduced in fiscal 2002 address our customers' growing need to manage heterogeneous environments with cross-platform solutions, and enable them to manage more applications, servers and operating systems with our products. Businesses rely on proper functioning of their networks, operating systems, servers, applications, databases and hardware. Our comprehensive, integrated solutions address three broad areas that are critical to manage the performance, availability, security and utilization of this complex computing infrastructure:

- Performance and Availability Management;
- Security Management and Administration; and
- Web Analytics.

We were founded in June 1995 and completed our initial public offering in July 1999 with a follow-on offering in December 1999.

Significant Events in Fiscal 2003

Change in Accounting Principle

We adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* on July 1, 2002. Upon adoption of SFAS No. 142, we recorded an one-time, non-cash charge of $579.3 million to reduce the carrying value of our goodwill from previous acquisitions. The charge is non-operational in nature and is reflected as the cumulative effect of a change in accounting principle in the accompanying condensed consolidated statements of operations. In calculating the impairment charge, the fair values of the reporting units were estimated using a combination of the discounted cash flows and comparable transactions methodologies. There was no income tax effect of the change in accounting principle. As a result of the adoption of the SFAS No. 142, $2.4 million was reclassified from other intangible assets to goodwill relating to acquired assembled workforce.

Agreement to Acquire PentaSafe Security Technologies, Inc.

On September 30, 2002, we entered into an agreement to acquire PentaSafe Security Technologies, Inc. (PentaSafe). We will pay a maximum of $192.5 million in cash and issue a maximum of 4,337,950 shares of the Company's common stock in exchange for all outstanding shares of PentaSafe. In addition, we agreed to assume all outstanding stock options and warrants to purchase shares of PentaSafe's capital stock outstanding at the acquisition date. Based on the closing price of our common stock as of September 30, 2002, the date of the merger agreement, the total value of the transaction would be approximately $255.0 million. The actual value of the transaction cannot be determined until after the closing, which is expected to occur during the quarter ending December 31, 2002, subject to customary closing conditions. We expect to incur direct acquisition costs of approximately $5.5 million. In addition, we expect to eliminate redundant personnel of PentaSafe, which will result in an increase in the carrying value of the acquisition. We also expect to incur a restructuring charge related to the elimination of redundant NetIQ personnel and facilities. PentaSafe is a provider of integrated security management solutions. The acquisition will be accounted for as a purchase.

Licensing Agreement with Microsoft Corporation

On September 25, 2000, we entered into a licensing agreement with Microsoft Corporation whereby Microsoft licensed our Operations Manager product technology and source code for core operations management of Windows 2000 and Microsoft server applications. Under the agreement Microsoft is obligated to pay us a total of $175.0 million in license fees over a three-year period ending August 2003. License revenue recognized and expected future revenue under the agreement is as follows (in thousands):

Fiscal year 2001	$ 25,000
Fiscal year 2002	85,000
Quarter ended September 30, 2002	25,000
Revenue recognized	$135,000
Quarter ending:	
December 31, 2002	$ 20,000
March 31, 2003	10,000
June 30, 2003	5,000
September 30, 2003	5,000
Expected future revenue	$ 40,000

Over the three-year life of the agreement, Microsoft has also agreed to spend $5.0 million per year and pay us an additional $5.0 million per year to market joint solutions of the parties. The $5.0 million paid to us is being recognized as a reduction in sales and marketing expenses as the related expenses are incurred.

Investment

In July 2002, we purchased $5.0 million of preferred stock of @Stake, Inc., a privately held services company. The investment is accounted for under the cost method.

Tender Offer

Our stock option program is a broad-based, long-term retention program that is intended to attract and retain talented employees and align stockholder and employee interests. We consider our option program critical to our operations and productivity; essentially all of our employees participate in our option plan. Because many of the options held by our employees are underwater and therefore do not have the intended retentive effect, our Board of Directors approved an offer to exchange employees' existing options for new options to be granted at least six months and one day after cancellation of the existing options. We completed a similar option exchange program in December 2001. The exercise price of the new options will be the greater of the fair market value on the cancellation date and the new grant date. The offer will be open to all employees other than our chief executive officer, chief financial officer, chief operating officer, and chief technology officer. Replacement options will have a five-year term from the original grant date and vest on the same schedule as the tendered options, and be subject to a six-month restriction on exercisability following the new grant date. The replacement options will be granted according to exchange ratios which depend upon the exercise price of the tendered options as follows:

- all outstanding options with an exercise price less than or equal to $24.00 per share may be exchanged for new options to purchase the same number of shares as the option being exchanged;
- all outstanding options with an exercise price greater than $24.00 per share but less than $30.00 per share may be exchanged for new options to purchase two shares of common stock for every three shares of the option being exchanged; and
- all outstanding options with an exercise price greater than or equal to $30.00 per share may be exchanged for new options to purchase one share of common stock for every two shares of the option being exchanged.

In addition, 50% of the shares subject to the tendered options recaptured as a result of the exchange ratios will be retired from the option plans. We expect to initiate this offer in November 2002. We estimate that if 70% of the outstanding options are tendered in the offer the incremental weighted average shares outstanding for purposes of calculating diluted earnings per share could increase as much as 2% as a result of the lower strike price of the new options. We further estimate that the shares removed from the plan will be approximately 2% of total shares outstanding, assuming 70% participation, resulting in lower dilution to shareholders over time.

Comparison of Three Months Ended September 30, 2002 and 2001

Total Revenue. Total revenue increased by $16.4 million to $77.1 million during the three months ended September 30, 2002 from $60.7 million during the three months ended September 30, 2001, representing growth of 27%.

Software License Revenue. Software license revenue increased by $10.9 million to $56.0 million during the three months ended September 30, 2002 from $45.1 million during the three months ended September 30, 2001, representing growth of 24%. The increase was primarily due to an increase of $10.0 million in the revenue received from Microsoft during the three months ended September 30, 2002, from the comparable quarter in fiscal 2001. Software license revenue from the Microsoft agreement will start to decline in the quarter ending December 31, 2002 and will continue to decline in the subsequent three quarters during which payments are to be received under the agreement.

Service Revenue. Service revenue increased by $5.5 million to $21.1 million during the three months ended September 30, 2002 from $15.6 million during the three months ended September 30, 2001, representing growth of 36%. The increase was primarily due to additional maintenance fees associated with new software licenses and maintenance renewals by our existing customers. We expect our service revenue to grow as a percentage of total revenue as the license revenue from Microsoft decreases, our installed base increases, and existing customers renew maintenance contracts.

Total Cost of Revenue. Total cost of revenue increased by $2.6 million to $8.9 million during the three months ended September 30, 2002 from $6.3 million during the three months ended September 30, 2001, representing 12% and 10% of total revenue, respectively.

Cost of Software License Revenue. Our cost of software license revenue includes the costs associated with royalties, software packaging, documentation such as user manuals, CDs, and other fulfillment costs, and non-employee commissions. Cost of software license revenue was $2.4 million and $901,000 during the three months ended September 30, 2002 and 2001, respectively, representing 4% and 2% of related software license revenue in the respective periods. The increase is primarily due to increases in royalty expense and fulfillment costs. We expect our fulfillment costs to decrease as a percentage of related revenue as we change our shipping terms and gain greater efficiencies with our third-party fulfillment partner. We expect other costs of software license revenue to increase as a percentage of software license revenue in the future as the revenue from Microsoft declines.

Cost of Service Revenue. Cost of service revenue consists primarily of personnel costs and expenses incurred in providing telephonic support, on-site consulting services, and training services. Costs associated with training consist principally of labor, travel expenses and training materials. Cost of service revenue was $6.5 million and $5.4 million during the three months ended September 30, 2002 and 2001, respectively, representing 31% and 35% of related service revenue in the respective periods. The decrease in cost of service revenue as a percentage of service revenue is primarily attributable to maintenance renewals from a larger installed base of customers and greater efficiencies in providing technical support services. We expect service revenue to increase as our installed license base grows and, as a consequence, our cost of service revenue to increase in absolute dollars.

Sales and Marketing. Our sales and marketing expenses consist primarily of personnel costs, including salaries and employee commissions, and expenses relating to travel, facilities, information technology, advertising, public relations, seminars, marketing programs, trade shows, and lead generation activities. Sales and marketing expenses increased by $3.0 million to $30.0 million during the three months ended September 30, 2002 from $27.0 million during the three months ended September 30, 2001. This increase in dollar amount resulted principally from hiring of additional field sales, inside sales, and marketing personnel, which increased from 470 at September 30, 2001 to 517 at September 30, 2002; expanding our sales infrastructure; increasing the number of third-party channel partners; and incurring higher sales commissions. Sales and marketing expenses represented 39% and 45% of total revenue for the three months ended September 30, 2002 and 2001, respectively. The decline in sales and marketing expenses as a percentage of total revenue was principally the result of revenue increases from the Microsoft agreement, which does not require significant sales or marketing efforts. Excluding revenue from the Microsoft agreement, sales and marketing expenses remained relatively constant as a percentage of total revenue at 59% during the three months ended September 30, 2001, and 58% during the three months ended September 30, 2002. We expect to continue hiring additional sales personnel and expect sales and marketing expenses to increase in absolute dollars in future periods.

Research and Development. Our research and development expenses consist primarily of salaries and other personnel-related costs, as well as facilities and information technology costs, consulting fees, and depreciation. Research and development expenses increased by $3.1 million to $16.1 million during the three months ended September 30, 2002 from $13.0 million during the three months ended September 30, 2001. This increase in dollar amount resulted principally from increases in personnel from 343 at September 30, 2001 to 385 at September 30, 2002. Research and development expenses represented 21% of total revenue in each of the periods. Excluding revenue from the Microsoft agreement, research and development expenses increased as a percentage of total revenue from 28% during the three months ended September 30, 2001 to 31% during the three months ended September 30, 2002. This increase was in accordance with our strategy to use the additional revenue to aggressively expand our product offerings. As revenues from the Microsoft agreement decline, we expect to hold research and development costs relatively constant so that over time such costs will represent a lower percentage of non-Microsoft revenue.

General and Administrative. Our general and administrative expenses consist primarily of personnel costs for finance and administration, as well as directors and officers insurance, professional services expenses such as legal and accounting, and facilities and information technology costs. General and administrative expenses increased by $557,000 to $5.0 million during the three months ended September 30, 2002 from $4.4 million during the three months ended September 30, 2001. The increase in dollar amount was due primarily to increased staffing necessary to manage and support our growth and to higher premiums for directors and officers insurance. General and administrative personnel increased from 141 at September 30, 2001 to 166 at September 30, 2002. We believe that our general and administrative expenses will increase in absolute dollars as we expand our administrative staff, add new financial and accounting systems, and pay increased professional fees to manage our growth.

Employee Stock-Based Compensation. During the three months ended September 30, 2002 and 2001, we recognized stock-based compensation expense of $209,000 and $1.4 million, respectively. Deferred stock-based compensation is amortized based on the vesting schedules principally related to stock options assumed in our previous acquisition. As most of these assumed options are now fully vested, the employee stock-based compensation expense related to such acquisition is expected to decline in future periods. If our planned acquisition of PentaSafe is completed we will assume all outstanding stock options and warrants of PentaSafe, which will result in an increase in the related employee stock-based compensation.

Amortization of Other Intangible Assets. During the three months ended September 30, 2002 and September 30, 2001 we amortized $9.0 million and $10.3 million, respectively, of other intangible assets recognized in a previous acquisition. The decline in the amortization from the comparable period in the prior fiscal year was due to the reclassification of the carrying value of acquired workforce in place from other intangible assets to goodwill, as part of our adoption of SFAS No. 142.

Amortization of Goodwill. During the three months ended September 30, 2001 we amortized $188.3 million of goodwill recognized in our acquisitions. We adopted SFAS No. 142 on July 1, 2002 and accordingly stopped amortizing goodwill. See additional information under *Significant Events*.

Income (Loss) from Operations. Our income from operations was $7.9 million during the three months ended September 30, 2002 compared to a loss of $190.0 million during the three months ended September 30, 2001. The decline in the loss was mainly due to the adoption of SAFS No. 142 as a result of which we have stopped the amortization of goodwill. We anticipate that income from operations will decline starting in calendar year 2003 until revenues achieved from new products or other sources substantially exceed the revenue decline under the Microsoft agreement.

Total Other Income, Net. Total other income, net, principally represents interest income earned on our cash and cash equivalents and short-term investments. Total other income, net, decreased by $1.9 million to $3.8 million during the three months ended September 30, 2002 from $5.6 million during the three months ended September 30, 2001. The decrease in total other income is the result primarily of decreases in the yield on new investments as earlier investments mature.

Income Taxes. We recorded income tax expense of $4.5 million and $2.1 million for the three months ended September 30, 2002 and 2001, respectively. The increase in the income tax expense incorporates a decrease in our effective tax rate from 39% during the three months ended September 30, 2001 to 38% during the three months ended September 30, 2002 together with increased income in the current quarter. The tax benefit associated with the premature dispositions of stock by employees obtained pursuant to employee stock plans reduced federal and certain state income taxes currently payable to zero in the periods presented.

Critical Accounting Policies and Estimates

The accompanying discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We believe there are several accounting policies that are critical to understanding our consolidated financial statements as these policies affect the reported amounts of revenue and other significant estimates involving management's judgment. The critical accounting policies and estimates are described below.

Revenue Recognition—Revenues are generated from licensing software and providing services. We recognize revenue in accordance with accounting principles generally accepted in the United States of America, as set forth in American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, and AICPA SOP 98-9, *Modification of SOP* 97-2, *Software Revenue Recognition*, *With Respect to Certain Transactions*, and Securities and Exchange Commission Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. In accordance with these statements, revenue is recognized upon generally meeting each of the following criteria:

- Existence of persuasive evidence of an arrangement. Persuasive evidence is generally a written purchase order, license agreement or contract;
- Delivery of product and authorization keys. Delivery has occurred when media containing the software is shipped or, in the case of electronic delivery, the customer is given access to the software, and the authorization keys are shipped or made available to the customer electronically;
- Fee is fixed or determinable. A fee is deemed to be fixed and determinable when it is not subject to subsequent refund or adjustment. If the fee is not fixed or determinable, revenue is recognized when the amounts become due and payable;
- Collection is deemed probable; and
- Vendor-specific objective evidence exists to allocate the total fee to all elements of the arrangement.

Software revenue is recognized using the residual method under which revenue is recognized when vendor-specific objective evidence of fair value exists for all of the undelivered elements in an arrangement, but may not exist for one or more of the delivered elements. Revenue is allocated to each element based on relative fair values. Vendor-specific objective evidence of fair value is based on the price generally charged when the element is sold separately or, if not yet sold separately, is established by authorized management. In situations where vendor-specific objective evidence of fair value for an undelivered element does not exist, the entire amount of revenue from the arrangement is deferred and recognized when fair value can be established for all undelivered elements or when all such elements are delivered.

Service revenue includes maintenance revenue, usage and subscription-based revenue from our WebTrends Live product, consulting, and training services.

Generally, sales made through distributors, resellers, and original equipment manufacturers are recognized at the time these partners report that they have sold the software or, alternatively, when we drop-ship the product to the end user, in each case after all revenue recognition criteria have been met. Sales made to master distributors of Web Analytics products are recognized when sold to the master distributor, as sell-through information is not available for those sales. Additionally, distributor inventory levels are monitored and we maintain a reserve for potential sales returns.

When licenses and services are sold together, license fees are recognized upon shipment, provided that (1) the above criteria have been met, (2) payment of the license fee is not dependent upon the performance of the services, and (3) the services do not provide significant customization of the software and are not essential to the functionality of the software that was sold. For arrangements that do not meet the above criteria, license and related service revenue are recognized upon completion of all contractual obligations.

Deferred Revenue—License revenue is deferred when the criteria noted above are not met for revenue recognition purposes. Maintenance revenue is deferred and recognized ratably over the maintenance term, typically one year. Advance payments for our WebTrends Live services are deferred and revenue is recognized based on customer usage, generally page views. Deferred consulting and training revenues are recognized as those services are performed.

Use of Estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Significant estimates made in the accompanying financial statements are:

Allowance for Uncollectible Accounts—We provide an allowance for uncollectible accounts as part of our general and administrative expenses based on our assessment of the collectibility of specific customer accounts and an analysis of the remaining accounts receivable. The actual write-offs for uncollectible accounts during the three months ended September 30, 2002 were $98,000 and recoveries from previously written-off amounts were $77,000, for a net decrease in the allowance of $21,000. In the future, if our actual collections differ significantly from our assumptions it may result in additional charges to or decreases in our general and administrative expenses.

Sales Returns Reserve—We provide a reserve for sales returns based on historical trends in product returns. Revenue is recognized net of the provision for sales returns. During the three months ended September 30, 2002 we increased our reserve for sales returns by approximately $427,000 reducing revenues commensurately, and recorded approximately $427,000 as a reduction of that reserve for actual product returns. If the actual future returns differ from our estimates, it may result in a decrease or increase in our revenue.

Goodwill and Other Intangible Assets—We record intangible assets when we acquire companies. The cost of the acquisition is allocated to the assets and liabilities acquired, including identifiable intangible assets, with the remaining amount being classified as goodwill. Certain identifiable intangible assets such as purchased technology and customer lists are amortized to operating expenses over time, while in-process research and development is recorded as a one-time charge on the date of acquisition. Under current accounting guidelines adopted on July 1, 2002, goodwill will not be amortized to expense but rather periodically assessed for impairment.

Accordingly, the allocation of the acquisition cost to identifiable intangible assets and goodwill has a significant impact on our future operating results. The allocation process requires extensive use of estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets. Further, when impairment indicators are identified with respect to previously recorded intangible assets, the values of the assets are determined using valuation techniques that require significant management judgment. Should conditions be different than management's current assessment, material write downs of intangible assets may be required.

Upon adoption of SFAS No. 142, we ceased amortization of approximately $919.6 million of goodwill, including the reclassification of approximately $2.4 million of acquired workforce to goodwill. We also recorded a charge of $579.3 million because we determined that the carrying value of existing goodwill on July 1, 2002 exceeded its fair value. In the future we will test goodwill for impairment at least annually. We periodically review the estimated remaining useful lives of our other intangible assets. A reduction in our estimate of remaining useful lives could result in increased amortization expense in future periods.

Facility Reserves—We lease approximately 100,000 square feet of office space under five-year leases expiring in 2004 and 2006 in Portland, Oregon. In September 2001, we determined that we would not need a portion of this space for our operations in the foreseeable future. The quarterly rent for the unused space is approximately $129,500. Based on management's assessment of market conditions, including the time required to sub-lease the facility, a liability of $1.3 million was accrued in fiscal 2002. If we are unable to sub-lease the facility we will be required to expense up to an additional $1.2 million, which may adversely affect our results of operations.

We also lease approximately 32,000 square feet of office space under a five-year lease expiring June 2003 in Santa Clara, California. In fiscal 2001, upon the acquisition of our headquarters building in San Jose, California, we determined that we would not need this space for our operations in the foreseeable future. The quarterly rent for the unused space is approximately $192,500. Based on management's assessment of market conditions, including the time required to sub-lease the facility a liability of $1.5 million was accrued in fiscal 2001 and an additional $411,000 was accrued in fiscal 2002. The remaining accrual of $547,000 at September 30, 2002, represents our total remaining liability under the agreement.

Provision for Income Taxes—The provision for income taxes includes taxes currently payable and changes in deferred tax assets and liabilities. Deferred tax assets and liabilities are recorded for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. If we do not generate sufficient taxable income, the realization of these deferred tax assets may be impaired resulting in additional income tax expense. A valuation allowance is recorded to reduce net deferred tax assets to amounts that are more likely than not to be recognized. Substantially all of the valuation allowance is attributable to the tax benefit of disqualifying dispositions of stock options and will be credited to equity when realized. The valuation allowance has been established to fully reserve these deferred tax assets due to uncertainty regarding their realizability.

Recent Accounting Pronouncements

The Company adopted SFAS No. 144 on July 1, 2002. SFAS No 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Adoption of this statement did not have a material impact on the Company's financial position or results of operations.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity*. We will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred, while under EITF Issue No. 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized.

Liquidity and Capital Resources

At September 30, 2002, we had $72.3 million in cash and cash equivalents and $425.7 million in short-term investments representing an increase of $22.1 million from June 30, 2002. We expect to use approximately $198.0 million in our acquisition of PentaSafe, which is expected to close during the quarter ending December 31, 2002, subject to customary closing conditions. This use of cash will result in lower interest income in the future.

Our operating activities resulted in net cash inflows of $30.2 million and $21.5 million during the three months ended September 30, 2002 and 2001, respectively. Sources of cash during these periods were primarily from net income, after adjusting for non-cash charges related to depreciation and amortization, tax benefit from disqualifying dispositions, employee stock-based compensation, and the cumulative effect of a change in accounting principle; decreases in accounts receivable; and increases in deferred revenue. In addition, increases in liabilities contributed to cash from operations during the three months ended September 30, 2002 and decreases in other liabilities reduced cash from operations during the three months ended September 30, 2001. The principal use of cash during the three months ended September 30, 2002 was an increase in prepaid expenses.

Our investing activities resulted in net cash outflows of $22.7 million during the three months ended September 30, 2002 and net cash inflows of $22.9 million during the three months ended September 30, 2001. The principal uses of cash during the three months ended September 30, 2002 and 2001, were acquisitions of property and equipment of $4.3 million and $2.4 million, respectively, and purchases of short-term investments of $68.0 million and $64.5 million, respectively. Cash outflows also included a long-term investment of $5.0 million during the three months ended September 30, 2002. The principal source of cash during the three months ended September 30, 2002 and 2001, were maturities of short-term investments of $54.4 million and $90.0 million, respectively.

Financing activities generated cash of $523,000 and $3.6 million during the three months ended September 30, 2002 and 2001, respectively, from the proceeds of the exercise of stock options and issuance of shares under our employee stock purchase plan.

As of September 30, 2002, we do not have any significant debt commitments outstanding other than under operating leases.

Long-term Obligations

The following summarizes our significant contractual obligations as of September 30, 2002 and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

	2003(1)	2004	2005	2006
Operating lease payments	$ 4,135	$3,940	$1,941	$615
Cash to be paid in the acquisition of PentaSafe	192,500	—	—	—
Cash to be paid for merger expenses in the acquisition of PentaSafe	5,500	—	—	—
Contingent payment under technology purchase agreement	1,625	—	—	—
	$203,760	$3,940	$1,941	$615

(1) Represents remaining 9 months

We believe that our cash and cash equivalent balances, short-term investments, and cash flows generated by operations will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for the next 12 months. Thereafter, we may require additional funds to support our working capital requirements, or for other purposes, and may seek to raise such additional funds through public or private equity financings or from other sources, however, we may not be able to obtain adequate or favorable financing at that time.

From time to time, in the ordinary course of business, we may evaluate potential acquisitions of businesses, products or technologies. A portion of our cash may be used to acquire or invest in complementary businesses or products or to obtain the right to use complementary technologies.

Factors That May Affect Future Operating Results

The following risk factors and other information included in this report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem less significant also may impair our business operations. If any of the following risks actually occur, our business, financial condition and operating results could be materially and adversely affected.

Our quarterly operating results may fluctuate for a number of reasons, some of which are beyond our control. These fluctuations may result in volatility in our stock price.

Our quarterly operating results have varied substantially from quarter to quarter in the past and likely will vary significantly in the future due to revenue fluctuations caused by many factors. Those factors include:

- general economic conditions and the discretionary nature of our customers' purchasing practices, IT budgets, and budget cycles;
- the timing of new product introductions or enhancements by us, our competitors, and our platform vendors (such as Microsoft), resulting in purchase deferrals by our customers in anticipation of new products;
- competitive conditions in the industry, including new products, product announcements, and special pricing offered by our competitors;
- our success in introducing new products and enhancements, and the timing of their release;
- our ability to complete specific sales transactions in a given quarter or fiscal year; and
- the nature of the fees we charge to our customers (one-time perpetual license fees or periodic subscription or service fees).

We have experienced seasonality in our license bookings, with the fourth quarter of our fiscal year typically having the largest volume of bookings in each fiscal year. We believe that this seasonality results from the budgeting and work cycles of our customers and from the structure of our direct sales commission program. We expect this seasonality to continue in the future. As a consequence, we have typically increased backlog in June and December quarters and have decreased backlog in September and March quarters, resulting in more moderate fluctuations in our reported license revenue.

In addition, the risk of quarterly fluctuations relative to our expectations is increased by the fact that a significant portion of our revenues, typically between 50% and 60%, has historically been generated during the last month of each fiscal quarter. Many customers tend to make a majority of their purchases at the end of a fiscal quarter and many enterprise customers negotiate licenses near the end of the quarter. In part, this is because these customers believe that they are able to negotiate lower prices and more favorable terms at that time. Our reliance on a large portion of revenue occurring at the end of the quarter and the increase in the dollar value of transactions that occur at the end of a quarter can result in increased uncertainty relating to quarterly revenues. Due to this end-of-period buying pattern, forecasts may not be achieved, either because expected sales do not occur or because they occur at lower prices or on terms that are less favorable to us. These factors increase the chances that our results could diverge from the expectations of investors and securities analysts.

While we have traditionally focused on sales of our products to workgroups and divisions of a customer, we are increasingly making enterprise sales, resulting in a sales cycle ranging between 30 and 180 days. In addition, in recent quarters we have experienced longer financial and purchasing review cycles from many of our customers, which we believe to be a result of the economic slowdown.

We base our operating expenses on our expectations regarding future revenue. Because our operating expenses are relatively fixed in the short term, even a relatively small revenue shortfall can materially impact our short-term profitability.

Given the above factors, we believe that quarter-to-quarter financial comparisons may not necessarily be meaningful, and should not be relied upon as single indicators of our future operating results and performance. If our quarterly operating results fail to meet the expectations of analysts or investors, the trading price of our common stock could be negatively affected.

The market price of our common stock has been volatile and we expect that our stock price will continue to fluctuate. The value of an investment in our stock could decline due to the impact of a number of factors upon the market price of our common stock, including: growth rate expectations for the technology sector generally; variations in our actual and anticipated operating results and revenues; changes in our earnings estimates by securities analysts; and our failure to meet securities analysts' performance expectations.

We face several risks in connection with our license, development and marketing agreement with Microsoft.

In September 2000, we licensed a substantial portion of our Operations Manager technology to Microsoft for $175.0 million, payable over three years. Microsoft may use the technology broadly with respect to Windows 2000, but its use is limited with respect to Windows NT. Microsoft has used that technology as the basis for its Microsoft Operations Manager 2000 or "MOM" product. We also agreed to provide limited engineering resources for a fee and to develop and market new products, or extended management packs ("XMPs") that operate with MOM. We have received significant benefits from the agreement, but it also poses significant risks and challenges, including:

- quarterly license revenue from Microsoft has grown over the past several quarters and peaked at $25.0 million per quarter in the March, June, and September 2002 quarters. License revenue recognized and expected future revenue under the agreement are as follows (in thousands):

Fiscal year 2001	$ 25,000
Fiscal year 2002	85,000
Quarter ended September 30, 2002	25,000
Revenue recognized	$135,000
Quarter ending:	
December 31, 2002	$ 20,000
March 31, 2003	10,000
June 30, 2003	5,000
September 30, 2003	5,000
Expected future revenue	$ 40,000

  We must generate significant incremental revenue from other sources to maintain overall revenue growth. Should Microsoft delay or withhold a scheduled license payment during a quarter, it could materially impact our revenue and profitability in that quarter.

- revenue from sales of Operations Manager and AppManager products may decline until we generate higher levels of revenue from XMPs, due to a phasing out of sales of Operations Manager products and customer concern regarding potential overlap between MOM and AppManager. The faster the rate of customer adoption of MOM, the greater the potential loss of revenue from our Operations Manager and AppManager products. Although such adoption may increase our opportunity to earn additional revenue from licenses of XMPs, such additional revenue may not be sufficient to offset the loss of revenue from our Operations Manager and AppManager products; and

- we must also prepare for potential competition from Microsoft and other systems management providers for our existing or new XMPs.

We may not be able to sustain the revenue growth rates we have previously experienced.

Most of our revenue growth in the past year has come from scheduled fee increases pursuant to our agreement with Microsoft, and from added revenue related to our acquisition of WebTrends. Excluding revenues from Microsoft, during fiscal 2002 revenues grew only modestly due in part to the continued softness of the U.S. and European economies. Revenue from Web analytics products, acquired pursuant to the WebTrends acquisition, also declined significantly through September 2001 as a result of the collapse in the dot-com and managed services markets, then grew for three successive quarters before declining again in the most recent quarter.

We have used the revenue resulting from our license with Microsoft to fund increased development of new products that came to market in calendar year 2002. Revenue resulting from these new products will require greater sales and marketing efforts resulting in higher operating expenses. However, to maintain profitability we must increase revenue from non-Microsoft sources while reducing overall operating expenses. As a consequence, we anticipate that operating profit will decline starting in calendar year 2003 until revenues achieved from new products or other sources substantially exceed the revenue decline from Microsoft.

We are increasing our reliance on indirect distribution channels as a means of increasing product sales and are increasing our emphasis on international sales made through those channels. These relationships, both domestically and internationally, are non-exclusive and typically are terminable upon short notice. This strategy presents a number of risks including: the ability of resellers or integrators to cease marketing or integrating our products with little or no notice; the ability of our resellers or integrators to market or use competitive products or services from third parties and to promote such third party products or services in preference to ours; the effectiveness of our resellers and integrators in marketing our products; the difficulty in attracting and replacing high quality resellers and integrators; and the potential of conflicts between our direct and indirect sales channels resulting in lost sales and customer confusion or dissatisfaction.

To increase our revenue we also must continue to enhance our existing products and services and continue to develop new products and services to address the increasingly sophisticated and varied needs of our existing and prospective customers. The development of new products and services, and enhancement of existing products and services, entail significant technical and business risks and require substantial lead-time and significant investments in product development. The market for some of our products is in the early stage of development, and we are recent entrants to such markets and face competition from established competitors. As is common in new and evolving industries, demand and market acceptance for recently introduced products and new market entrants are subject to high levels of uncertainty and risk. Furthermore, new products can quickly render obsolete products that were formerly in high demand, which may include products that currently provide us with significant revenue.

We have a history of losses and may experience losses in the future.

Since our inception, we have incurred significant net losses. For the three months ended September 30, 2002, and for fiscal 2000, 2001 and 2002, we reported net losses of $572.2 million, $65.3 million, $523.8 million and $730.5 million, respectively, in accordance with accounting principles generally accepted in the United States of America. These losses principally resulted from amortization of goodwill and other intangible assets and other acquisition related charges. Effective July 1, 2002, we adopted SFAS No. 142, and accordingly for the three months ended September 30, 2002 we recorded an impairment charge of $579.3 million. We expect to experience continued losses in the remainder of fiscal 2003. We ceased regular amortization of goodwill on July 1, 2002, and will instead test goodwill for impairment at least annually. If in the future we determine that goodwill has become impaired, we will be required to record additional charges which would negatively effect our operating results.

We have recently experienced several changes in our senior management team.

In January 2002, Charles M. Boesenberg joined the Company as President and Chief Executive Officer, and on August 1, 2002 was named Chairman of the Board, in each instance replacing Ching-Fa Hwang, a co-founder of NetIQ who remains a member of the Board. Other changes in senior management in fiscal 2002, include the departures of Thomas P. Bernhardt, Senior Vice President, Chief Technology Officer, and Director, who resigned in February 2002; Her-Daw Che, co-founder of NetIQ, who resigned in October 2001; and Glen Boyd and Eli Shapira, co-founders of WebTrends, who resigned in August 2001 and September 2001, respectively. Mr. Shapira is continuing on our Board. Additions to our executive team in fiscal 2002, included Dr. Richard Schell, Chief Technology Officer and General Manager, Performance and Availability Products in June 2002; Mark Marron, Senior Vice President Worldwide Sales in August 2001; and Betsy E. Bayha, Vice President, General Counsel and Secretary in November 2001. We expect additional management changes as a result of the proposed acquisition of PentaSafe.

Our success will depend to a significant extent on our ability to assimilate these changes in our leadership team and to retain the services of our executive officers and other key employees. We do not have employment contracts for a defined term with our employees, including our executives and key employees. If we lose the services of one or more of our executives or key employees, including if one or more of our executives or key employees decided to join a competitor or otherwise compete directly or indirectly with us, this could harm our business and could affect our ability to successfully implement our business objectives.

Failure to manage our growth, improve our infrastructure, and satisfactorily implement new information and fulfillment systems may adversely affect our business.

We have grown rapidly, including through our acquisition of Mission Critical Software in May 2000 and WebTrends Corporation in March 2001, and we presently are in the process of acquiring PentaSafe. Our growth has resulted in new and increased responsibilities for our management personnel and the need to effectively manage multiple geographic locations, develop new products that utilize the assets and resources of the combined entities, and to further develop cost-effective standards, controls, procedures and policies. If we do not succeed in addressing these risks or any other problems encountered in connection with our growth, our business, operating results and financial condition could be adversely affected.

Our growth has resulted in a need to upgrade our operational, financial, and management information systems. In particular, we need to improve our accounting and financial reporting systems, in order to accommodate our growth on a global basis and to meet the requirements of a changing regulatory environment. To meet these challenges we implemented a new customer relationship management system in fiscal 2002, and are continuing the process of modifying and refining it to better meet our needs. As well, we currently are in the process of implementing an enterprise resource planning system. Implementation of these systems will inevitably result in certain disruption of our normal business processes. While we believe that these systems will enable us to operate more efficiently and will enhance our ability to provide timely and accurate reporting, failure to manage a smooth transition to the new systems and to successfully operate and support the new systems could materially and adversely impact our business and our operating results.

Our growth also has resulted in the need to implement new processes and vendors for the reproduction and distribution of our products. We presently are in the process of transferring these fulfillment operations to a new third party vendor that will provide fulfillment services from the United States, Europe, and Japan. If our new fulfillment system is not successfully and timely implemented, it can result in shipment delays, stoppages, increased costs and errors, and consequent channel and customer dissatisfaction.

Changes in accounting regulations could negatively affect market perception of our results and the way we do business.

The accounting rules applicable to our business have undergone significant changes in recent years, and future changes in accounting regulations and related interpretations and policies, particularly those related to expensing of employee stock option plans, could cause us to account for our business in ways that may adversely affect our operating results. As permitted by SFAS No. 123 *Accounting for Stock-Based Compensation*, currently we apply Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for our employee stock option plans. Under APB No. 25, no compensation expense is recognized for options granted to employees where the exercise price equals the market price of the underlying stock on the date of grant. A change in accounting rules that would require us to change the way we account for such options to include a deferred compensation liability on our balance sheet and to include the deemed expense associated with such options in our statement of operations may necessitate our reporting operating losses as a result of these non-cash expenses. In such an event, investor perception of our results of operations may be adversely affected and our stock price may fall.

Changes in the way we do business may impact our operating results by changing the manner in which we are required to account for sales.

There have been various changes in the enterprise software business that may impact the manner in which we recognize revenue received from software licensed to our customers. We currently sell most of our software licenses on a "perpetual" basis, which enables us to recognize the majority of revenue received in connection with the sale promptly upon consummation of the sale. However, certain software vendors are moving towards a subscription-based model in which periodic fees are charged for use of the software. If customers increasingly demand that we sell licenses to our software on a subscription basis, or otherwise charge a periodic fee for its use, it will delay our recognition of revenue for that sale and will decrease the revenues attributable to that sale during the reporting period in which the sale is made (although the revenue will continue to be recognized in subsequent periods). If substantial portions of our license sales are converted to a subscription basis, this could materially impact our revenues during the initial quarters in which the change is implemented.

We base a substantial portion of our marketing, sales strategy, and product development on our relationship with Microsoft.

We believe that our success in penetrating target markets for our systems management products depends in part on our ability to maintain a strong strategic relationship with Microsoft. Our relationship with Microsoft is important to validate our technology, facilitate broad market acceptance of our products, and enhance our sales, marketing, and distribution capabilities. On the other hand, Microsoft provides various products and management features that provide competitive and overlapping capabilities to some of the solutions we offer on the Microsoft platform, and may expand its presence in this and other markets in the future. For example, Microsoft Operations Manager 2000 provides various manageability capabilities also provided by our AppManager product. Microsoft also may determine to discontinue or diminish our relationship at the conclusion of our current agreement.

We participate with Microsoft in a number of joint sales and marketing initiatives. It is possible that Microsoft may decline to participate in joint initiatives in the future. We also attempt to coordinate our systems management product offerings with the future releases of Microsoft's operating systems and software. It is possible that in the future Microsoft may not notify us of feature enhancements to its products prior to new releases of its operating systems or may not provide us with necessary development tools and information or may choose to work more closely with our competitors. In that case, we may not be able to introduce products on a timely basis that capitalize on new Microsoft operating system releases and feature enhancements.

Our international sales and operations subject us to additional risks that can adversely affect our operating results.

We derive a substantial portion of our revenues from customers outside the United States and are continuing to expand our international operations. We recently have established operations in Ireland to provide customer support and shared administrative services for the Europe-Middle East-Africa region. We also maintain offices in the United Kingdom and Japan, as well as a number of other foreign locations, to provide sales and sales support. Our international operations are subject to a variety of risks, including:

- the overlap of different tax regimes;

- the difficulty of managing and staffing foreign offices;
- differing regulatory and legal requirements and employment schemes, and our ability to identify and timely comply with such requirements and schemes;
- longer payment cycles and difficulties in collecting accounts receivable;
- fluctuations in currency exchange rates and difficulties in transferring funds from certain countries;
- the need to localize and internationalize our products and licensing programs;
- significant reliance on our distributors and other resellers who do not offer our products exclusively;
- import and export licensing requirements, including export controls on encryption technology;
- political and economic instability in some countries;
- seasonal reductions in business activity during the summer months in Europe and certain other regions; and
- reduced protection for intellectual property rights in some countries.

To date, a substantial portion of our sales have been denominated in U.S. dollars, and we have not used risk management techniques or "hedged" the risks associated with fluctuations in foreign currency exchange rates. In the future, if we do not engage in hedging transactions, our results of operations will be subject to losses from fluctuations in foreign currency exchange rates to the extent our sales are denominated in foreign currencies.

Acquisitions and investments present many risks, and we may not realize the financial and strategic goals that were contemplated at the time of the transaction.

We have in the past and expect in the future to acquire or make investments in complementary companies, products, services, and technologies, including our pending acquisition of PentaSafe. The risks we commonly encounter in connection with an acquisition include:

- we may find that the acquired company or assets do not further our business strategy, or that we paid more than what the company or assets are later worth, or economic conditions change, all of which may generate a future impairment charge;
- we may have difficulty integrating the operations and personnel of the acquired business, and may have difficulty retaining the key personnel of the acquired business;
- we may have difficulty in incorporating the acquired technologies or products with our existing product lines;
- there may be customer confusion where our products overlap with those of the acquired company;
- we may have product liability associated with the sale of the acquired company's products;
- our ongoing business and management's attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations;
- we may have difficulty maintaining uniform standards, controls, procedures and policies across locations;
- the acquisition may result in litigation from terminated employees; and
- we may experience significant problems or liabilities associated with product quality, technology and legal contingencies, among other matters.

These factors could have a material adverse effect on our business, results of operations and financial condition or cash flows, particularly in the case of a larger acquisition or multiple acquisitions. From time to time, we may enter into negotiations for acquisitions or investments that are not ultimately consummated. Such negotiations could result in significant diversion of management time, as well as out of pocket costs. In addition, should we fail to consummate an acquisition, we may be required to pay a break-up fee which will be charged to our costs of operation and we may be exposed to litigation as a consequence of our failure to go forward with the proposed acquisition.

The consideration paid in connection with an investment or acquisition also impacts our financial results. To the extent we pay cash for acquisitions our cash reserves are reduced. To the extent we issue shares of stock or other rights to purchase stock, including options and other rights, existing stockholders may be diluted and earnings per share may decrease. In addition, acquisitions may result in the incurrence of debt, large one-time write-offs (such as of acquired in-process research and development costs), restructuring charges, and may result in goodwill and other intangible assets that are subject to impairment and could result in future impairment charges.

Our restructurings may result in management distraction, customer uncertainty, and increased costs.

In 2002 we restructured much of our sales force, both direct and indirect, as we do periodically, in response to factors such as management changes, product changes, performance issues, and other business considerations. This may result in a temporary distraction of management or operational disruption, with some negative impact on customer service. In fiscal 2001 and 2002 we terminated a small percentage of our employees as a consequence of restructuring activity, resulting in the payment of severance compensation and the assertion of a few claims by certain employees alleging that the termination of their employment was unlawful. Additionally, we plan to terminate approximately 100 personnel as a result of our acquisition of PentaSafe. To the extent we engage in any future restructuring, we anticipate having to incur additional charges.

We face competition from a number of existing competitors, as well as potential new competitors, which could result in loss of market share and diminished profits.

We currently face competition from a number of sources, including:

- Customers' internal information technology departments that develop or integrate system and application monitoring tools for their particular needs;
- Application vendors who bundle management solutions with their products;
- Providers of network and systems management framework products such as Computer Associates International, Inc., Hewlett-Packard Company, and International Business Machines Corporation;
- Providers of performance and availability management solutions such as BMC Software, Inc., Concord Communications, Inc., and Precise Software Solutions, Ltd.;
- Vendors of Internet servers, operating systems, and networking hardware. In particular, Microsoft Corporation, Oracle Corporation, Sun Microsystems, Inc., and others that bundle systems management solutions with their products;
- Providers of administration products such as Quest Software, Inc. and BindView Corporation;
- Providers of security solutions such as Internet Security Systems, Inc., Network Associates Technology, Inc., Symantec Corporation, and BindView Corporation;
- Providers of hosted web analytics solutions such as WebSideStory, Inc.;
- Providers of eBusiness intelligence solutions such as Accrue Software, Inc. and the NetGenesis products from SPSS Inc.; and
- Web management service providers and vendors, such as consulting firms, web design firms, Internet audit firms, site management vendors, Internet service providers, and independent software vendors.

In the future potential competitors may bundle their products with products similar to ours, or incorporate functionality into existing products that renders certain of our products unmarketable or obsolete. In addition, our ability to sell our products depends, in part, on the compatibility of our products with other third party products, such as operating systems and messaging, Internet and database applications. Some of these third party software developers may change their products so that they compete with our products or are no longer compatible with our products. Any of the foregoing could lead to price reductions or a potential loss of sales of the affected products.

Errors in our products could result in significant costs to us and could impair our ability to sell our products.

Because our software products are complex, they may contain errors, or "bugs," that could be detected at any point in a product's life cycle. These errors could materially and adversely affect our business reputation, result in significant costs to us, and impair our ability to sell our products in the future. The costs incurred in correcting any product errors may be substantial and could decrease our profit margins. While we expect to continually test our products for errors and work with customers through our customer support services organization to identify and correct bugs, errors in our products may be found in the future. Because it is difficult to simulate the highly complex computing environments in which our customers use our products and because of the increasing functionality of our product offerings, testing may be complicated and fail to identify all errors. Moreover, because our products support and interoperate with third party operating systems and applications, any errors or bugs in that software may result in errors in the performance of our products and may require cooperation from the third party to resolve.

Detection of any significant errors may result in, among other things, lost or delayed market acceptance and sales of our products, diversion of development resources, injury to our reputation, and increased service and warranty costs. Errors in our software also may result in expensive and time-consuming litigation, and the potential award of substantial damages. While our software license agreements typically contain limitations and disclaimers that purport to limit our liability for damages for errors in our software, there is no assurance that such limitations and disclaimers will be enforced by a court or other tribunal or will otherwise effectively protect us from such claims. This is particularly true with respect to those of our products licensed under "shrink wrap" or "clickwrap" license agreements that are not signed by licensees, but also may apply to negotiated license agreements. We presently carry errors and omissions insurance against such claims, but there is no assurance that such insurance coverage will be adequate to cover any losses as a result of bugs or errors or will be available in the future on commercially reasonable terms.

Natural disasters or other incidents may affect our network and data centers or otherwise disrupt our business.

We rely on our network and data center infrastructure for internal communications, communications with customers and partners, direct sales of our software products, sales lead generation and direct provision of fee-based services. That infrastructure, as well as our other facilities, is vulnerable to damage from human error, physical or electronic security breaches, power loss and other utility failures, fire, earthquake, flood, sabotage, vandalism and similar events. Despite precautions, a natural disaster or other incident could result in interruptions in our service or significant damage. In addition, failure of any of our telecommunications providers to provide consistent data communications capacity, including as a result of business failure, could result in interruptions in our services and disruption of our business operations. Any of the foregoing could impact our provision of services and fulfillment of product, and our ability to process product orders and invoices and otherwise timely conduct our business operations.

If we fail to protect our intellectual property rights, competitors may be able to use our technology or trademarks and this could weaken our competitive position, reduce our revenue and increase costs.

Our success is heavily dependent on proprietary technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our intellectual property rights in our products and services. These laws and procedures provide only limited protection. We presently have 13 issued patents in the United States, 19 pending patent applications in the United States, 1 issued foreign patent, and 18 pending patent applications in certain foreign jurisdictions. However, these patents may not provide sufficiently broad protection or they may not be enforceable in actions against alleged infringers. As well, despite precautions that we take, it may be possible for unauthorized third parties to copy or reverse engineer aspects of our current or future products or to independently develop similar or superior technology or design around the patents we own. Policing unauthorized use and transfer of our software is difficult and software piracy can be expected to be a persistent problem. In licensing our products, other than in enterprise license transactions, we typically rely on "shrink wrap" or "clickwrap" licenses that are not signed by licensees. Such licenses may be unenforceable, in whole or in part, under the laws of certain jurisdictions. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States.

Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation would be costly and potentially distracting to management, and there is no assurance that we will be successful in such litigation.

Third parties could assert that our products infringe their intellectual property rights. Such claims could injure our reputation and adversely affect our ability to sell our products.

Third parties may claim that our current or future products infringe their proprietary rights, and these claims, whether they have merit or not, could harm our business by increasing our costs or reducing our revenue. Such claims could affect our relationships with existing customers and may discourage future customers from purchasing our products. The intensely competitive nature of our industry and the importance of technology to our competitors' businesses may enhance the likelihood of being subject to third party claims of this nature. Any such claims, even if without merit, could be time consuming, result in potentially significant litigation costs or damages, cause product shipment delays and require us to enter into royalty or licensing agreements. Royalty or license agreements may not be available on commercially favorable terms or at all. Such claims could also force us either to stop selling, incorporating or using products or services that incorporate the challenged intellectual property or to redesign those products or services that incorporate such technology. We expect that software developers will increasingly be subject to infringement claims as the number of products and competitors in the software industry grows and the functionality of products in different industry segments overlaps.

We incorporate software licensed from third parties into some of our products and any significant interruption in the availability of these third-party software products or defects in these products could reduce the demand for, or prevent the sale or use of, our products.

Certain of our software products contain components developed and maintained by third-party software vendors. We also expect that we may incorporate software from third-party vendors in our future products. Our business would be disrupted if this software, or functional equivalents of this software, were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to either redesign our software to function with alternate third-party software or develop these components ourselves, which would result in increased costs and could result in delays in our software shipments. Furthermore, we might be forced to limit the features available in our current or future software offerings.

We have various mechanisms in place that may discourage takeover attempts.

Certain provisions of our certificate of incorporation and bylaws and certain provisions of Delaware law could delay or make difficult a change in control of the Company that a stockholder may consider favorable. We have a classified board of directors, with staggered, three-year terms, that may lengthen the time required to gain control of the board of directors. In addition, certain of our officers are parties to a Change of Control Agreement or other agreements with the Company, which provide for the acceleration of stock option vesting and the payment of certain compensation in the event such officer's employment is terminated within a specified period after a change of control. In addition, our 1995 Stock Plan provides for acceleration of stock option vesting in the event an employee's employment is terminated within a specified period after a change of control, which may make us a less attractive acquisition candidate for potential acquirors.

Compliance with certain regulatory requirements may prove difficult and costly and, should we be unsuccessful, may subject us to penalties.

We are subject to laws relating to the use and transfer of personally identifiable information about our customers, employees and other individuals, especially outside of the United States. Violation of these laws, which in many cases apply not only to third-party transfers, but also to transfers of information between our subsidiaries and ourselves, and between and among ourselves, our subsidiaries and our commercial partners, could subject us to significant penalties and negative publicity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, short-term investments, trade accounts, and accounts payable. We consider investments in highly liquid debt instruments purchased with a remaining maturity of three months or less to be cash equivalents. Our exposure to market risk for changes in interest rates relates primarily to our short-term investments; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities.

Principally our business is transacted in United States dollars. During the quarter ended September 30, 2002, 7% of our invoices were in currencies other than the United States dollar. Accordingly, we are subject to exposure from adverse movements in foreign currency exchange rates. This exposure is primarily related to local currency denominated revenue and operating expenses in Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. We believe that a natural hedge exists in some local currencies, as local currency denominated revenue will substantially offset the local currency denominated operating expenses. We assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis. However, as of September 30, 2002, we had no hedging contracts outstanding.

At September 30, 2002 we had $72.3 million in cash and cash equivalents, and $425.7 million in short-term investments. Based on our cash, cash equivalents and short-term investments at September 30, 2002, a 10% change in interest rates would change our annual interest income and cash flows by approximately $1.5 million.

ITEM 4. CONTROLS AND PROCEDURES

Within 90 days prior to the date of this report, we, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in the reports we file under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. Our management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management's control objectives.

There have been no significant changes in our internal controls or other factors that could significantly affect internal controls subsequent to the date of their evaluation.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibit Number	Description
99.1	Sarbanes-Oxley Section 906 Certification

(b) Reports on Form 8-K

A current report on Form 8-K was filed on October 9, 2002, reporting our agreement to acquire PentaSafe Security Technologies, Inc.

SIGNATURES

Pursuant to the requirements of the Securities Act, NetIQ Corporation has duly caused this Quarterly Report Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 13th day of November, 2002.

NETIQ CORPORATION

By: /s/ CHARLES M. BOESENBERG

Charles M. Boesenberg,
President and Chief Executive Officer

By: /s/ JAMES A. BARTH

James A. Barth,
Senior Vice President Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Charles M. Boesenberg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NetIQ Corporation;

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

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

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

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

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

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

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

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

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

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

/s/ CHARLES M. BOESENBERG

Charles M. Boesenberg,
President and Chief Executive Officer

November 13, 2002

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, James A. Barth, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NetIQ Corporation;

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

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

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

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

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

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

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

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

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

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

/s/ JAMES A. BARTH

James A. Barth,
Senior Vice President Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

November 13, 2002