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**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

[Mark One]

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

For the quarterly period ended September 30, 2003.

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 No. 000-31003



**CORIO, INC.**

(Exact name of the Registrant as specified in its charter)

**Delaware**  
(state or other jurisdiction of  
Incorporation or organization)

**959 Skyway Road, Suite 100**  
**San Carlos, California**  
(Address of principal executive offices)

**77-0492528**  
(I.R.S. Employer  
Identification Number)

**94070**  
(Zip Code)

**650-232-3000**

(The 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 Act). Yes  No

As of October 31, 2003, there were 61,486,765 shares of the Registrant's common stock outstanding, which includes 2,921,390 shares issued in October 2003 in connection with the Registrant's purchase of substantially all of the assets of Nexus Technology, Inc.

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**CORIO, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2003**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**CORIO, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)  
(UNAUDITED)**

	<b>September 30,</b>	<b>December 31,</b>
	<b>2003</b>	<b>2002</b>
	<u>          </u>	<u>          </u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents.....	\$ 11,585	\$ 26,908
Short-term investments.....	24,128	17,031
Accounts receivable, net of allowance of \$361 and \$403 at September 30, 2003 and December 31, 2002, respectively.....	3,339	6,109
Prepaid expenses and other current assets.....	2,443	3,421
Total current assets.....	<u>41,495</u>	<u>53,469</u>
Restricted cash.....	7,717	7,717
Property and equipment, net.....	10,640	16,286
Other assets.....	1,044	2,820
Total assets.....	<u>\$ 60,896</u>	<u>\$ 80,292</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable.....	\$ 5,327	\$ 10,004
Accrued liabilities.....	5,485	7,723
Accrued restructuring.....	694	1,757
Deferred revenue.....	2,090	2,636
Current portion of notes payable.....	--	272
Current portion of capital lease obligations.....	785	4,460
Total current liabilities.....	<u>14,381</u>	<u>26,852</u>
Capital lease obligations less current portion.....	99	399
Accrued restructuring.....	4,245	2,472
Other liabilities.....	1,274	1,154
Total liabilities.....	<u>19,999</u>	<u>30,877</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: \$0.001 par value; 10,000,000 shares authorized, none issued and outstanding.....	--	--
Common stock: \$0.001 par value; 200,000,000 shares authorized; 58,254,954 and 56,516,435 shares issued and outstanding at September 30, 2003 and December 31, 2002, respectively.....	58	56
Additional paid-in capital.....	297,910	296,820
Accumulated other comprehensive income.....	18	98
Deferred stock-based compensation.....	(25)	(859)
Accumulated deficit.....	(257,064)	(246,700)
Total stockholders' equity.....	<u>40,897</u>	<u>49,415</u>
Total liabilities and stockholders' equity.....	<u>\$ 60,896</u>	<u>\$ 80,292</u>

See accompanying notes to condensed consolidated financial statements.

**CORIO, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**  
**(UNAUDITED)**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2003	2002	2003	2002
REVENUES:				
Application management services.....	\$ 14,295	\$ 9,399	\$ 45,762	\$ 28,417
Professional services and other.....	1,245	3,982	5,833	9,959
Total revenues.....	15,540	13,381	51,595	38,376
COSTS AND EXPENSES:				
Application management services *.....	11,210	9,704	36,333	27,024
Professional services and other *.....	730	3,708	4,455	10,583
Research and development *.....	1,123	1,316	3,819	5,092
Sales and marketing *.....	2,125	2,085	6,632	8,324
General and administrative *.....	2,339	2,693	6,917	8,682
Restructuring charges.....	--	4,036	2,334	4,036
Amortization of stock based compensation.....	(34)	690	445	1,791
Amortization of intangible assets.....	367	56	1,257	56
Total operating expenses.....	17,860	24,288	62,192	65,588
Loss from operations.....	(2,320)	(10,907)	(10,597)	(27,212)
Interest and other income.....	136	482	518	1,596
Interest and other expense.....	(73)	(203)	(285)	(753)
Net loss before income taxes.....	(2,257)	(10,628)	(10,364)	(26,369)
Tax benefit.....	--	400	--	400
Net loss.....	\$ (2,257)	\$ (10,228)	\$ (10,364)	\$ (25,969)
Basic and diluted net loss per share .....	\$ (0.04)	\$ (0.19)	\$ (0.18)	\$ (0.49)
Shares used in computation-basic and diluted.....	57,684	53,978	56,098	52,605
* Amortization (reversal) of stock-based compensation not included in expense line item:				
Application management services.....	\$ 7	\$ 50	\$ 65	\$ 226
Research and development.....	11	51	2	116
Sales and marketing.....	27	160	187	718
General and administrative.....	(79)	429	191	731
Total amortization of stock-based compensation.....	\$ (34)	\$ 690	\$ 445	\$ 1,791

See accompanying notes to condensed consolidated financial statements.

**CORIO, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2003</b>	<b>2002</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss.....	\$ (10,364)	\$ (25,969)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation.....	8,788	8,176
Amortization of intangible assets.....	1,257	56
Amortization of stock-based compensation.....	445	1,791
Amortization of warrants.....	426	(134)
Accretion of investments.....	515	361
Compensation for grants of stock, options and warrants in exchange for services.....	22	20
Loss on retirement of assets.....	--	52
Changes in assets and liabilities:		
Accounts receivable.....	2,735	(1,053)
Prepaid expenses and other current assets.....	978	301
Accounts payable.....	(3,345)	(253)
Accrued liabilities.....	(3,674)	--
Deferred revenue.....	(546)	(456)
Other liabilities.....	1,893	2,878
Net cash used in operating activities.....	(870)	(14,230)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of short-term investments.....	(37,318)	(41,539)
Sales of short-term investments.....	29,626	64,805
Purchase of property and equipment.....	(3,183)	(498)
Other assets.....	266	309
Cash paid for acquisition.....	(361)	(14,000)
Net cash (used in) provided by investing activities.....	(10,970)	9,077
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from sale of common stock and exercise of stock options.....	1,058	791
Payments on debt obligations.....	(272)	(362)
Payments on capital lease obligations.....	(4,269)	(5,545)
Net cash used in financing activities.....	(3,483)	(5,116)
Decrease in cash and cash equivalents.....	(15,323)	(10,269)
Cash and cash equivalents, beginning of period.....	26,908	36,317
Cash and cash equivalents, end of period.....	\$ 11,585	\$ 26,048
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid for interest.....	\$ 268	\$ 723
<b>SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Acquisition of property and equipment under capital leases.....	\$ --	\$ 407
Deferred stock-based compensation/forfeitures, net.....	\$ 389	\$ 2,213
Unrealized loss on investments.....	\$ (80)	\$ (277)

See accompanying notes to condensed consolidated financial statements.

# CORIO, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by Corio, Inc. (“Corio” or the “Company”) and reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the interim periods presented. Such adjustments are of a normal recurring nature. The results of operations for the interim periods presented are not necessarily indicative of the results for any future interim period or for the entire fiscal year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been omitted, although the Company believes that the disclosures included are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with the audited financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2002.

#### NET LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period (excluding shares subject to repurchase). Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock and potentially dilutive common securities outstanding during the period. Potentially dilutive common shares are excluded from the computation in loss periods, as their effect would be antidilutive.

The following table sets forth potential shares of common stock that are not included in the diluted net loss per share calculation as their effect would have been antidilutive for the periods indicated (in thousands except weighted average exercise price):

	September 30, 2003		September 30, 2002	
	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares
Preferred stock warrants.....	\$ --	--	\$ 2.52	900
Common stock subject to repurchase.....	\$ 0.01	200	\$ 0.01	2,310
Common stock options and warrants.....	\$ 1.85	17,779	\$ 2.12	15,912

#### STOCK-BASED COMPENSATION

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations and complies with the disclosure provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123, *Accounting for Stock-Based Compensation*. Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant between the fair value of the Company’s stock and the exercise price of the underlying option. Deferred compensation is amortized and expensed in accordance with the graded vesting approach provided for in Financial Accounting Standards Board (“FASB”) Interpretation No. 28.

The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and FASB Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The Company uses the Black-Scholes option pricing model to value options granted to non-employees. The expense is recorded over the period in which the related services are received.

If compensation cost for the Company's stock-based compensation plans had been determined based on fair value at the grant dates for the awards under a method prescribed by SFAS No. 123, the Company's net loss would have increased to the pro forma amounts indicated below (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2003	2002	2003	2002
Net loss as reported.....	\$ (2,257)	\$ (10,228)	\$ (10,364)	\$ (25,969)
Add stock-based employee compensation expense included in reported net loss, net of tax of \$0.....	-- (34)	-- 690	-- 445	-- 1,791
Deduct total stock-based employee compensation determined under the fair-value-based method for all awards, net of tax of \$0.....	-- -- (1,093)	-- -- (2,190)	-- -- (4,502)	-- -- (6,902)
Pro forma net loss.....	<u>\$ (3,384)</u>	<u>\$ (11,728)</u>	<u>\$ (14,421)</u>	<u>\$ (31,080)</u>
Basic and diluted net loss per share:				
As reported.....	\$ (0.04)	\$ (0.19)	\$ (0.18)	\$ (0.49)
Pro forma.....	\$ (0.06)	\$ (0.22)	\$ (0.26)	\$ (0.59)

The Company calculated the fair value of each option granted under the Company's stock option plans on the date of grant using the Black-Scholes option pricing model and calculated amortization using the graded vesting approach with the following weighted-average assumptions:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2003	2002	2003	2002
Expected life (in years).....	4.0	4.0	4.0	4.0
Risk free interest rate.....	2.99%	2.93%	2.47%	3.46%
Volatility.....	102%	105%	105%	105%
Dividend yield.....	0%	0%	0%	0%

Weighted-average fair values per share for options granted under the Company's stock option plans during the three and nine months ended September 30, 2003 and 2002 were:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2003	2002	2003	2002
Weighted-average fair values per share for options granted under the Company's stock option plans.....	\$ 1.99	\$ 0.40	\$ 0.80	\$ 0.68

The Company calculated the fair value of each option granted under the Company's employee stock purchase plan on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2003	2002	2003	2002
Expected life (in years).....	0.5	0.5	0.5	0.5
Risk free interest rate.....	1.00%	1.19%	1.06%	1.84%
Volatility.....	102%	105%	104%	105%
Dividend yield.....	0%	0%	0%	0%

Weighted-average fair values per share for options granted under the Company's employee stock purchase plan during the three and nine months ended September 30, 2003 and 2002 were:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2003	2002	2003	2002
Weighted-average fair values per share for options granted under the Company's employee stock purchase plan.....	\$ 0.83	\$ 0.22	0.45	\$ 0.30

## RESTRICTED CASH

In connection with two facility leases, the Company is required to provide letters of credit as security for the leases. The letters of credit are available for a period of one year with automatic one year renewals. The letters of credit are collateralized by a \$7.7 million cash deposit which is recorded as restricted cash on the accompanying condensed consolidated balance sheet.

## PRINCIPLES OF CONSOLIDATION

The condensed consolidated financial statements include the accounts of Corio and its wholly owned subsidiary. All intercompany accounts and transactions have been eliminated.

## RECLASSIFICATIONS

Certain reclassifications have been made to prior period amounts to be consistent with current year presentation.

## RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the EITF reached a consensus on Issue 00-21, *Revenue Arrangements with Multiple Deliverables*, addressing how to account for arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a stand-alone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values, with the amount allocated to the delivered item being limited to the amount that is not contingent on the delivery of additional items or meeting other specified performance conditions. The final consensus will be applicable to agreements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted. The provisions of this consensus did not have a significant effect on the Company's financial position or operating results.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No 51*. This interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the interpretation. The interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For public enterprises with a variable interest in a variable interest entity created before February 1, 2003, the interpretation applies to that enterprise no later than the beginning of the first interim or annual reporting period ending after December 15, 2003. The application of this interpretation is not expected to have a material effect on the Company's financial statements.

In April 2003, the FASB issued SFAS No. 149, *Amendments of Statement 133 on Derivative Instruments and Hedging Activities*, which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Company's financial condition or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope, many of which were previously classified as equity, as a liability. SFAS No. 150 is effective for financial instruments entered

into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material effect on the Company's financial condition or results of operations.

#### **NOTE 2—ACCOUNTS RECEIVABLE**

The Company records accounts receivable when amounts are billed in accordance with the contract terms or as services are performed under non-cancelable contractual services arrangements. At September 30, 2003 and December 31, 2002, the Company had outstanding invoices of \$2,078,000 and \$3,844,000, respectively, related to customers which the Company deemed as credit risks. Since the revenue related to the collection of these invoices is recognized on a cash basis, these amounts have not been included in the accounts receivable or deferred revenue balances. Included in accounts receivable at September 30, 2003 and December 31, 2002 were \$452,000 and \$1,443,000, respectively, of unbilled receivables under various application management and professional services contracts.

#### **NOTE 3—WARRANTS**

On September 27, 2000, Cap Gemini Ernst & Young U.S., L.L.C exercised its right to convert a portion of its initial warrant representing 2,333,333 shares into 960,810 shares of common stock through a cashless exercise. As these shares outstanding were repurchaseable under certain circumstances, the fair value of these shares subject to repurchase were remeasured each period until May 2003, when the repurchase rights lapsed. Therefore, for the three months ended September 30, 2003, no amortization expense was recorded. An amortization credit of (\$269,000) was recorded in sales and marketing expense for the three months ended September 30, 2002 related to these shares. Amortization expense (credit) of \$416,000 and (\$143,000) was recorded in sales and marketing expense for the nine months ended September 30, 2003 and 2002, respectively, related to these shares.

#### **NOTE 4—STOCK-BASED COMPENSATION**

In connection with stock options granted to employees to purchase common stock, the Company recorded reductions in deferred stock-based compensation of \$116,000 and \$60,000 for the three months ended September 30, 2003 and 2002, respectively, and \$389,000 and \$2.2 million for the nine months ended September 30, 2003 and 2002, respectively. Such amounts represent unamortized deferred stock compensation for unvested options that were forfeited upon termination of employment. The deferred charges for employee options are being amortized to expense using the graded vesting approach, prescribed by FASB Interpretation No. 28, through 2004. Amortization of deferred stock-based compensation expense (credit) was (\$34,000) and \$690,000 for the three months ended September 30, 2003 and 2002, respectively and \$445,000 and \$1.8 million for the nine months ended September 30, 2003 and 2002, respectively, net of stock options forfeited.

#### **NOTE 5—SIGNIFICANT CUSTOMER INFORMATION AND SEGMENT REPORTING INFORMATION**

The Company's operations have been classified into two reportable segments (i) application management services and (ii) professional services. Corporate expenses, including those for sales and marketing, general and administrative and research and development, are not allocated to reportable segments.

Disaggregated information is as follows (in thousands):

	Application Management Services		Professional Services		Unallocated	Total
<b>For the Three Months Ended September 30, 2003</b>						
Revenues.....	\$	14,295	\$	1,245	\$ --	\$ 15,540
Depreciation.....	\$	2,436	\$	2	\$ 263	\$ 2,701
Amortization of stock based compensation.....	\$	7	\$	--	\$ (41)	\$ (34)
Amortization of intangible assets.....	\$	367	\$	--	\$ --	\$ 367
Segment profit (loss).....	\$	2,711	\$	515	\$ (5,483)	\$ (2,257)
<b>For the Three Months Ended September 30, 2002</b>						
Revenues.....	\$	9,399	\$	3,982	\$ --	\$ 13,381
Depreciation.....	\$	2,140	\$	11	\$ 553	\$ 2,704
Amortization of stock based compensation.....	\$	50	\$	--	\$ 640	\$ 690
Amortization of intangible assets.....	\$	56	\$	--	\$ --	\$ 56
Segment profit (loss).....	\$	(411)	\$	274	\$ (10,091)	\$ (10,228)
<b>For the Nine Months Ended September 30, 2003</b>						
Revenues.....	\$	45,762	\$	5,833	\$ --	\$ 51,595
Depreciation.....	\$	7,625	\$	14	\$ 1,149	\$ 8,788
Amortization of stock based compensation.....	\$	65	\$	--	\$ 380	\$ 445
Amortization of intangible assets.....	\$	1,257	\$	--	\$ --	\$ 1,257
Segment profit (loss).....	\$	8,107	\$	1,378	\$ (19,849)	\$ (10,364)
<b>For the Nine Months Ended September 30, 2002</b>						
Revenues.....	\$	28,417	\$	9,959	\$ --	\$ 38,376
Depreciation.....	\$	6,437	\$	42	\$ 1,697	\$ 8,176
Amortization of stock based compensation.....	\$	226	\$	--	\$ 1,565	\$ 1,791
Amortization of intangible assets.....	\$	56	\$	--	\$ --	\$ 56
Segment profit (loss).....	\$	1,111	\$	(624)	\$ (26,456)	\$ (25,969)

The Company does not allocate all assets to its reportable segments, nor does it allocate interest income or interest expense.

Significant customer information is as follows:

	Percent of Total Revenue				Percent of Total Accounts Receivable	
	Three Months Ended		Nine Months Ended		September 30, 2003	September 30, 2002
	September 30,		September 30,			
	2003	2002	2003	2002		
Customer A.....	17%	--	12%	--	--	--
Customer B.....	--	11%	--	11%	--	--
Customer C.....	--	--	--	--	14%	--
Customer D.....	--	--	--	--	13%	--
Customer E.....	--	--	--	--	11%	--

Percentages are listed in the table above only when the result is 10% or greater. Customer A is a cash basis customer and therefore its outstanding invoices have not been included in the Company's accounts receivable balances. Customer B had less than 10% of total accounts receivable for the periods ended September 30, 2003 and 2002. Customers C, D and E had less than 10% of total revenue for the three and nine month periods ended September 30, 2003 and 2002.

#### NOTE 6—RESTRUCTURING AND IMPAIRMENT ACCRUAL

The following table sets forth the charges taken against the restructuring and impairment accrual in the nine months ended September 30, 2003 and the remaining restructuring and impairment accrual balance at September 30, 2003 (in thousands):

	December 31, 2002	Additions/ Adjustments	Cash Payments	September 30, 2003
Office lease obligations.....	\$ 3,355	\$ 2,473	\$ (889)	\$ 4,939
Employee severance.....	440	--	(440)	--
Asset abandonments.....	434	(139)	(295)	--
	<u>\$ 4,229</u>	<u>\$ 2,334</u>	<u>\$ (1,624)</u>	<u>\$ 4,939</u>

In May 2003, the Company signed an agreement to sublease the vacated portion of its headquarters facility through the end of its lease, which is March 2010. In the first quarter of 2003, the Company adjusted its estimated loss related to the vacated space and recorded an additional restructuring charge of \$2.5 million to reflect the terms of the sublease agreement. The impact of this charge was partially offset by the favorable resolution of a liability related to various leases which resulted in a reduction of \$139,000 to the previously established restructuring reserve.

#### NOTE 7—INCOME TAXES

Since inception, the Company has incurred net losses for federal and state tax purposes, and anticipates losses for the foreseeable future. The Company has therefore not recognized any tax provision or benefit for income taxes for the three and nine months ended September 30, 2003. The Company recognized a \$400,000 tax benefit for the three and nine months ended September 30, 2002 after determining that a tax provision related to an exposure item recorded in connection with the Company's acquisition of Data Systems Connectors, Inc. in 1998 was no longer needed due to the completion of a tax examination.

#### NOTE 8—COMMITMENTS AND CONTINGENCIES

##### *Litigation/Arbitration*

In November 2001, a securities class action lawsuit was filed in the U.S. District Court for the Southern District of New York against Corio, certain of its officers and certain of the underwriters involved in Corio's initial public offering. This is one of approximately 300 similar lawsuits in a coordinated proceeding sometimes referred to as "IPO allocation lawsuits" or "laddering lawsuits." The plaintiffs generally allege that the underwriters engaged in undisclosed improper practices by giving favorable allocations of IPO shares to certain investors in exchange for excessive brokerage commissions and/or agreements for those investors to purchase additional shares in the aftermarket at predetermined higher prices. The plaintiffs seek an unspecified amount of damages. In June 2003, the plaintiffs in these cases presented a settlement proposal to all of the issuer defendants. Under the proposed settlement, the plaintiffs proposed to dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers or companies will be required to pay the amount, if any, by which \$1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover \$1 billion and payment is required under the guaranty, Corio would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under its insurance policy, which is \$1 million. In July 2003, Corio tentatively agreed to accept this settlement proposal. The settlement is subject to acceptance by a substantial majority of the issuer defendants and execution of a definitive settlement agreement. The settlement is also subject to approval by the Court, which cannot be assured. If the settlement is not accepted by the requisite number of defendants or if it is not approved by the Court or if it otherwise is not consummated, Corio intends to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If the outcome of the litigation is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed. This lawsuit may be time consuming and expensive to defend and may divert management's attention and may be costly to Corio even if the plaintiff's settlement proposal is consummated.

In November 2001, Corio filed a demand for arbitration against LivePerson, Inc. with the American Arbitration Association in San Francisco County. The arbitration related to a dispute around a services contract between the parties. On July 23, 2003, the arbitrator in this dispute issued a judgment relating to the arbitration, awarding Corio damages of \$1,115,440 plus pre-judgment interest from September 21, 2001 (the interest is likely to total approximately \$210,000). LivePerson, Inc. has filed a motion to vacate the award in the Superior Court of California, County of San Francisco. Corio disputed the motion to vacate and is awaiting the judge's ruling on the motion. Any cash received pursuant to this award will be recorded as revenue only upon collection.

### *Service Level Agreements*

The Company's application management services contracts contain service level agreements that obligate the Company to provide its applications at certain levels of performance. If the Company fails to meet these service levels, the Company may be contractually obligated to provide its customers a partial credit for its services rendered. If the Company were to continue to fail to meet these service levels, certain of its customers may then have the right to cancel their contracts with the Company. The Company's contracts generally limit the scope and circumstances in which the Company would provide credits to its customers. The Company believes its policies and practices limit its exposure related to these service level obligations. Numerous factors can affect the service level provided by the Company. The Company cannot determine the maximum amount of future credits, if any, related to such service level obligations.

### **NOTE 9—SUBSEQUENT EVENTS**

In October 2003, the Company acquired substantially all of the assets and certain liabilities of Nexus Technology, Inc. ("Nexus"). At closing, the Company paid approximately \$10.0 million in consideration, consisting of \$1.9 million in cash and 2,921,390 shares of Corio common stock. In addition, Nexus will be entitled to receive an earn-out payment of up to \$2 million to be paid in Corio common stock based on achievement of financial goals. The Company is in the process of allocating the purchase price related to this acquisition. The Company expects the majority of the purchase price to be allocated to goodwill and other intangible assets.

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

The following Management's Discussion and Analysis of our Financial Condition and Results of Operations should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I-Item 1 of this Quarterly Report and the audited financial statements and notes thereto and Management's Discussion and Analysis in the Company's 2002 Annual Financial Report to Stockholders.

**THIS REPORT ON FORM 10-Q CONTAINS 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, AND THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, INCLUDING, WITHOUT LIMITATION, STATEMENTS REGARDING THE COMPANY'S EXPECTATIONS, BELIEFS, INTENTIONS OR FUTURE STRATEGIES THAT ARE SIGNIFIED BY THE WORDS "EXPECTS", "ANTICIPATES", "INTENDS", "BELIEVES", OR SIMILAR LANGUAGE. ALL FORWARD-LOOKING STATEMENTS INCLUDED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE TO THE COMPANY ON THE DATE HEREOF, AND THE COMPANY ASSUMES NO OBLIGATION TO UPDATE ANY SUCH FORWARD-LOOKING STATEMENTS AFTER THE DATE HEREOF AND CORIO SHALL HAVE NO DUTY TO UPDATE STATEMENTS MADE HEREIN. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS AS A RESULT OF MANY FACTORS, INCLUDING BUT NOT LIMITED TO THOSE SET FORTH UNDER "ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS" HEREIN. IN EVALUATING THE COMPANY'S BUSINESS, PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER THE INFORMATION SET FORTH BELOW UNDER THE CAPTION "ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS" IN ADDITION TO THE OTHER INFORMATION SET FORTH HEREIN AND IN THE COMPANY'S OTHER PUBLIC FILINGS. THE COMPANY CAUTIONS INVESTORS THAT ITS BUSINESS AND FINANCIAL PERFORMANCE ARE SUBJECT TO SUBSTANTIAL RISKS AND UNCERTAINTIES.**

### **OVERVIEW**

We are a leading enterprise application service provider, or ASP. We implement, integrate and manage a suite of enterprise software applications from leading vendors offered to our customers over a secure network. This suite of applications is designed to accommodate the requirements of medium to large, public, private, non-profit and public sector companies. We enable our customers to avoid many of the significant and unpredictable ongoing application management challenges and costs. Following the implementation of software applications by our partners or us, our customers pay a monthly service fee based largely on the number of applications used, total users, the level of service required and other factors. By providing application implementation, integration, management and various upgrade services and related hardware and network infrastructure, we reduce the information technology, or IT, burdens of our customers, enabling them to focus on their core businesses and react quickly to dynamic market conditions.

### **CRITICAL ACCOUNTING POLICIES**

Management's Discussion and Analysis of Financial Condition and Results of Operations are based on our condensed consolidated financial statements. The preparation of our condensed consolidated financial statements and related disclosures requires management to make judgments, assumptions and estimates that affect the amounts reported in the condensed consolidated financial statements and accompanying notes.

Estimates are used for, but not limited to, the accounting for revenue recognition, the allowance for doubtful accounts, certain loss contingencies, valuation allowances and other special charges. Actual results could differ from these estimates. We review these accounting policies we use in reporting our financial results on a regular basis. In addition, our senior management has reviewed these critical accounting policies and related disclosures with our Audit Committee. We have identified the policies below as critical to our business operations and the understanding of our financial condition and results of operations:

- Cash basis customers
- Allowance for doubtful accounts
- Loss contingencies
- Valuation allowance

### *Cash Basis Customers*

We recognize revenue as the services are provided to our customers provided that collection of the receivable is probable. We regularly monitor the payment activity and credit worthiness of our customers. If we determine that collection of revenue from a particular customer or contract is no longer probable, we revert to recognizing revenue as payment for services is received and we designate those customers as "cash basis customers". Revenues recognized from cash basis customers were \$5.9 million and \$4.3 million for the three months ended September 30, 2003 and 2002, respectively. Revenues recognized from cash basis customers were \$17.2 million and \$13.6 million for the nine months ended September 30, 2003 and 2002, respectively. At September 30, 2003 and December 31, 2002, we had outstanding invoices of \$2.1 million and \$3.8 million, respectively, related to services provided to cash basis customers. Since revenue related to these invoices is recognized on a cash basis, these amounts have not been included in our accounts receivable balances. Our revenue in the future could fluctuate significantly due to the timing and amount of payments received from cash basis customers as well as the change in composition of these customers.

### *Allowance For Doubtful Accounts*

The allowance for doubtful accounts is based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, our estimates of the recoverability of amounts due us could be adversely affected. We regularly review the adequacy of our allowance for doubtful accounts through the identification of specific receivables where we expect that payment will not be received, in addition to establishing an unallocated reserve that is applied to all amounts that are not specifically identified. In determining specific receivables where collection may not be received, we review past due receivables and give consideration to prior collection history, changes in the customer's overall business condition and the potential risk associated with the customer's industry, among other factors. An unallocated reserve is established for all amounts which have not been specifically identified, based on applying a graduated percentage to each invoice's relative aging category. The allowance for doubtful accounts reflects our best estimate as of the reporting dates. Changes may occur in the future, which may make us reassess the collectibility of amounts and at which time we may need to provide additional allowances in excess of that currently provided. At September 30, 2003 and December 31, 2002, our allowance for doubtful accounts was \$361,000 and \$403,000, respectively. The decrease was mainly due to a corresponding decrease in accounts receivable.

### *Loss Contingencies*

We are subject to various loss contingencies such as the risks associated with estimates included in both our restructuring liability and our professional services fixed fee contracts. We consider the likelihood of the loss or the incurrence of a liability as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated.

For our restructuring liability, we estimate the amounts for employee severances, impaired assets and vacated office space. We evaluate long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of any asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. For our office lease restructuring liability, our estimate is based on our assessment of our predicted sublease income over the remaining lease term. We increased our office lease restructuring liability in the first quarter of 2003 as a result of the sublease agreement signed in May 2003.

In addition, since we perform some of our professional services on a fixed fee basis, if we incur more costs than estimated, our profitability will suffer. Our process for tracking our progress to completion on such arrangements is through individual detailed project plans and the regular review of labor hours incurred compared to estimated hours to complete the project. We believe this process results in a reasonable estimate of our progress to completion. When estimates of costs to complete the project indicate that a loss will be incurred, these losses are estimated and recognized immediately. We regularly evaluate current information available to us to determine whether such recorded losses should be adjusted. In the third quarter of 2003, we determined that our professional services provision for contract losses that we had recorded during fiscal years 2001 and 2002 was no longer appropriate due to our decreased number of fixed fee contracts. We reduced our provision for contract losses by \$668,000 which resulted in a corresponding reduction to professional services expenses for the three and nine month periods ended September 30, 2003.

### *Valuation Allowance*

We provided a valuation allowance against our entire net deferred tax asset, primarily consisting of net operating loss carryforwards as of December 31, 2002. The valuation allowance was recorded given the losses we incurred through December 31,

2002, and our uncertainties regarding future operating profitability and taxable income. If we do not achieve profitability, we will not fully realize the deferred tax benefits.

### Selected Financial Data

The following tables set forth, for the periods presented, certain data from our condensed consolidated statements of operations as percentages of total revenues.

	Three Months Ended September 30, 2003		Three Months Ended September 30, 2002		Three Months Ended September 30, 2003 versus September 30, 2002	
	Amount	Percentage	Amount	Percentage	Dollar Change	Percentage Change
		of Total Revenues		of Total Revenues		
REVENUES:						
Application management services.....	\$ 14,295	92 %	\$ 9,399	70 %	\$ 4,896	52 %
Professional services and other.....	1,245	8 %	3,982	30 %	(2,737)	(69)%
Total revenues.....	<u>15,540</u>	<u>100 %</u>	<u>13,381</u>	<u>100 %</u>	<u>2,159</u>	<u>16 %</u>
COSTS AND EXPENSES:						
Application management services .....	11,210	72 %	9,704	73 %	1,506	16 %
Professional services and other .....	730	5 %	3,708	28 %	(2,978)	(80)%
Research and development .....	1,123	7 %	1,316	10 %	(193)	(15)%
Sales and marketing .....	2,125	14 %	2,085	16 %	40	2 %
General and administrative .....	2,339	15 %	2,693	20 %	(354)	(13)%
Restructuring charges.....	--	0 %	4,036	30 %	(4,036)	(100)%
Amortization of stock based compensation.....	(34)	0 %	690	5 %	(724)	(105)%
Amortization of intangible assets.....	367	2 %	56	0 %	311	555 %
Total operating expenses.....	<u>17,860</u>	<u>115 %</u>	<u>24,288</u>	<u>182 %</u>	<u>(6,428)</u>	<u>(26)%</u>
Loss from operations.....	<u>(2,320)</u>	<u>(15)%</u>	<u>(10,907)</u>	<u>(82)%</u>	<u>8,587</u>	<u>(79)%</u>
Interest and other income.....	136	0 %	482	4 %	(346)	(72)%
Interest and other expense.....	(73)	0 %	(203)	(2)%	130	(64)%
Tax benefit.....	--	0 %	400	3 %	(400)	(100)%
Net loss.....	<u>\$ (2,257)</u>	<u>(15)%</u>	<u>\$ (10,228)</u>	<u>(77)%</u>	<u>\$ 7,971</u>	<u>(78)%</u>

	Nine Months Ended September 30, 2003		Nine Months Ended September 30, 2002		Nine Months Ended September 30, 2003 versus September 30, 2002	
	Amount	Percentage	Amount	Percentage	Dollar Change	Percentage Change
		of Total Revenues		of Total Revenues		
REVENUES:						
Application management services.....	\$ 45,762	89 %	\$ 28,417	74 %	\$ 17,345	61 %
Professional services and other.....	5,833	11 %	9,959	26 %	(4,126)	(41)%
Total revenues.....	<u>51,595</u>	<u>100 %</u>	<u>38,376</u>	<u>100 %</u>	<u>13,219</u>	<u>34 %</u>
COSTS AND EXPENSES:						
Application management services .....	36,333	70 %	27,024	70 %	9,309	34 %
Professional services and other .....	4,455	9 %	10,583	28 %	(6,128)	(58)%
Research and development .....	3,819	7 %	5,092	13 %	(1,273)	(25)%
Sales and marketing .....	6,632	13 %	8,324	22 %	(1,692)	(20)%
General and administrative .....	6,917	13 %	8,682	23 %	(1,765)	(20)%
Restructuring charges.....	2,334	5 %	4,036	11 %	(1,702)	(42)%
Amortization of stock based compensation.....	445	1 %	1,791	5 %	(1,346)	(75)%
Amortization of intangible assets.....	1,257	2 %	56	0 %	1,201	2,145 %
Total operating expenses.....	<u>62,192</u>	<u>120 %</u>	<u>65,588</u>	<u>172 %</u>	<u>(3,396)</u>	<u>(5)%</u>
Loss from operations.....	<u>(10,597)</u>	<u>(20)%</u>	<u>(27,212)</u>	<u>(72)%</u>	<u>16,615</u>	<u>(61)%</u>
Interest and other income.....	518	1 %	1,596	4 %	(1,078)	(68)%
Interest and other expense.....	(285)	(1)%	(753)	(2)%	468	(62)%
Tax benefit.....	--	0 %	400	1 %	(400)	(100)%
Net loss.....	<u>\$ (10,364)</u>	<u>(20)%</u>	<u>\$ (25,969)</u>	<u>(69)%</u>	<u>\$ 15,605</u>	<u>(60)%</u>

## RESULTS OF OPERATIONS

### THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003 and 2002

#### OVERVIEW

Our net loss for the three months ended September 30, 2003 and 2002 was \$2.3 million and \$10.2 million, respectively. Our net loss for the nine months ended September 30, 2003 and 2002 was \$10.4 million and \$26.0 million, respectively. Our net loss for the three and nine months ended September 30, 2003 was favorably impacted by a \$413,000 reduction in various application management expenses associated with reimbursements received related to the final settlement of contingencies associated with our purchase of Qwest Cyber.Solutions ("QCS") and a \$668,000 reduction in professional services expenses related to the reduction of our provision for contract losses.

#### REVENUES

Total revenue was \$15.5 million and \$13.4 million for the three months ended September 30, 2003 and 2002, respectively. Total revenue was \$51.6 million and \$38.4 million for the nine months ended September 30, 2003 and 2002, respectively. For the twelve month period ended September 30, 2003, Expanets, Inc. ("Expanets") accounted for 11% of total revenues. Expanets recently announced that it has entered into an agreement to sell substantially all of its assets. Although we have a long term contract with Expanets, there are no assurances at this time that the acquirer will continue to purchase our services following the completion of the acquisition.

In the ordinary course of business, we recorded revenue of \$16,000 and \$32,000 for the three and nine months ended September 30, 2003, respectively, arising from transactions with one company with which we have directors in common. At September 30, 2003, we had no accounts receivable arising from such transactions. We recorded no revenue for the three months ended September 30, 2002, and \$2.1 million for the nine months ended September 30, 2002 arising from transactions with four companies with which we had directors in common. At September 30, 2002, we had no accounts receivable arising from such transactions.

**APPLICATION MANAGEMENT SERVICES REVENUES.** Revenues from our application management services were \$14.3 million for the three months ended September 30, 2003, including \$1.5 million in non-recurring revenues from customer contract terminations. Included in the three months ended September 30, 2003 revenues of \$14.3 million is \$5.9 million recognized as a result of payments from cash basis customers. For the three months ended September 30, 2002, our revenues of \$9.4 million included approximately \$2.0 million in non-recurring revenues from customer contract terminations. Included in the three months ended September 30, 2002 revenues of \$9.4 million was \$4.2 million recognized as a result of payments from cash basis customers. For the nine months ended September 30, 2003, revenues from our application management services were \$45.8 million, including approximately \$2.5 million in non-recurring revenues from customer contract terminations. Included in the nine months ended September 30, 2003 revenues of \$45.8 million was \$16.8 million recognized as a result of payments from cash basis customers. For the nine months ended September 30, 2002, revenues from our application management services were \$28.4 million, including \$4.5 million in non-recurring revenues from customer contract terminations. Included in the nine months ended September 30, 2002 revenues of \$28.4 million was \$13.1 million recognized as a result of payments from cash basis customers. The increase in application management services revenues for the three and nine months ended September 30, 2003 was primarily due to the additional customer revenue acquired as a result of our September 2002 acquisition of QCS. At both September 30, 2003 and December 31, 2002, we had a balance of \$1.9 million for deferred application management services revenues primarily from several customers who prepaid a portion of their contract. These deferred revenues are recognized in our statement of operations as the related services are provided over the life of the contract.

**PROFESSIONAL SERVICES AND OTHER REVENUES.** Our professional services and other revenues were \$1.2 million for the three months ended September 30, 2003, including \$51,000 recognized as a result of payments from cash basis customers, and \$4.0 million for the three months ended September 30, 2002, including \$144,000 recognized as a result of payments from cash basis customers. Our professional services and other revenues were \$5.8 million for the nine months ended September 30, 2003, including \$486,000 recognized as a result of payments from cash basis customers and \$10.0 million for the nine months ended September 30, 2002, including \$564,000 recognized as a result of payments from cash basis customers. The decrease in professional services revenues for the three and nine months ended September 30, 2003 was primarily due to the decreased number of new customer implementations. At September 30, 2003 and December 31, 2002, we had balances of \$186,000 and \$647,000, respectively, for deferred professional services revenues resulting from customer payments that we required in advance of providing our professional services work. We anticipate that professional services revenue and the associated margins will fluctuate significantly from period to period depending on the timing and size of projects, the amount of such work completed by independent third party integrators and other factors.

## COSTS AND EXPENSES

Total expenses were \$17.9 million and \$24.3 million for the three months ended September 30, 2003 and 2002, respectively. Total expenses were \$62.2 million and \$65.6 million for the nine months ended September 30, 2003 and 2002, respectively. We anticipate total expenses to increase in the fourth quarter compared to the third quarter of 2003 due to the additional costs associated with integrating, administering and supporting the customers acquired from Nexus Technology, Inc. in October 2003.

**APPLICATION MANAGEMENT SERVICES EXPENSES.** Application management services expenses, excluding non-cash stock based compensation of \$7,000 and \$50,000 for the three months ended September 30, 2003 and 2002, respectively, were \$11.2 million for the three months ended September 30, 2003 and \$9.7 million for the three months ended September 30, 2002. Application management services expenses, excluding non-cash stock based compensation of \$65,000 and \$226,000 for the nine months ended September 30, 2003 and 2002, respectively, were \$36.3 million for the nine months ended September 30, 2003 and \$27.0 million for the nine months ended September 30, 2002. The increase in application management services expenses for the three and nine months ended September 30, 2003 and 2002 was mainly attributable to the additional costs associated with integrating, administering, and supporting the customers acquired from QCS in September 2002. The \$1.5 million increase in expenses for the three months ended September 30, 2003 compared to the three months ended September 30, 2002 was mainly attributable to a \$1.5 million increase in data center fees, a \$179,000 increase in payroll expenses and a \$296,000 increase in depreciation expense offset by a \$413,000 decrease in various application management expenses associated with reimbursements received related to the final settlement of contingencies associated with our QCS acquisition. The \$9.3 million increase for the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 was attributable to a \$5.2 million increase in data center fees, a \$1.8 million increase in payroll expenses, a \$1.2 million increase in depreciation expense, a \$623,000 increase in outside contractor expenses, a \$625,000 increase in equipment maintenance and a \$220,000 increase in facility costs, and partially offset by a \$413,000 decrease in various application management expenses associated with reimbursements received related to the final settlement of contingencies associated with our QCS acquisition.

**PROFESSIONAL SERVICES AND OTHER EXPENSES.** Professional services and other expenses were \$730,000 for the three months ended September 30, 2003 and \$3.7 million for the three months ended September 30, 2002. The \$3.0 million decrease was due primarily to a reduction in the number of active contracts, which resulted in a reduction of \$896,000 in personnel costs, a \$1.0 million decrease in outside contractor expenses, a \$272,000 decrease in travel related expenses and a \$118,000 decrease in allocated facilities expenses. In addition, during the third quarter of 2003, as a result of the conclusion of the majority of our significant fixed fee professional services contracts, we adjusted our provision for contract losses and decreased the balance by \$668,000 which resulted in a corresponding reduction to professional services expenses for the three and nine months ended September 30, 2003. Our professional services and other expenses were \$4.5 million for the nine months ended September 30, 2003 and \$10.6 million for the nine months ended September 30, 2002. The \$6.1 million decrease in expenses was primarily attributable to the reduction in the number of contracts in process which resulted in a reduction of \$2.7 million in personnel costs, a \$1.4 million decrease in outside contractor expenses, a \$574,000 decrease in travel related expenses and a \$376,000 reduction in facilities expenses. The remaining difference was primarily attributable to adjustments to decrease our provision for contract losses related to our fixed fee professional services implementations. There were no professional services stock based compensation charges for the three and nine months ended September 30, 2003 or 2002.

**RESEARCH AND DEVELOPMENT.** Research and development expenses, excluding non-cash stock based compensation of \$11,000 and \$51,000 for the three months ended September 30, 2003 and 2002, respectively, were \$1.1 million for the three months ended September 30, 2003 and \$1.3 million for the three months ended September 30, 2002. Research and development expenses as a percentage of total revenues were 7% for the three months ended September 30, 2003 and 10% for the three months ended September 30, 2002. The \$200,000 expense decrease was mainly due to a \$53,000 reduction in personnel costs and a \$107,000 reduction in depreciation expense.

Research and development expenses, excluding non-cash stock based compensation of \$2,000 and \$116,000 for the nine months ended September 30, 2003 and 2002, respectively, were \$3.8 million for the nine months ended September 30, 2003 and \$5.1 million for the nine months ended September 30, 2002. Research and development expenses as a percentage of total revenues were 7% for the nine months ended September 30, 2003 and 13% for the nine months ended September 30, 2002. The \$1.3 million decrease in expense was mainly attributable to a \$1.0 million reduction in personnel costs and a \$207,000 reduction in depreciation expense mainly due to certain assets being fully depreciated in 2003.

**SALES AND MARKETING EXPENSES.** Sales and marketing expenses, excluding non-cash stock based compensation of \$27,000 and \$160,000 for the three months ended September 30, 2003 and 2002, respectively, were \$2.1 million for both the three months ended September 30, 2003 and 2002. Sales and marketing expenses as a percentage of total revenues were 14% for the three months ended September 30, 2003 and 16% for the three months ended September 30, 2002. Personnel expenses decreased \$179,000, marketing program expenses decreased \$51,000 and outside contractor expenses decreased \$24,000. These decreases in expenses were offset by a \$269,000 increase in amortization expenses for non-cash costs associated with repurchasable shares issued to Cap Gemini

Ernest & Young. No amortization expense was recognized for the three months ended September 30, 2003 as the repurchase rights related to these shares lapsed in May 2003.

Sales and marketing expenses, excluding non-cash stock based compensation of \$187,000 and \$718,000 for the nine months ended September 30, 2003 and 2002, respectively, were \$6.6 million for the nine months ended September 30, 2003 and \$8.3 million for the nine months ended September 30, 2002. Sales and marketing expenses as a percentage of total revenues were 13% for the nine months ended September 30, 2003 and 22% for the nine months ended September 30, 2002. The \$1.7 million expense decrease was attributable to a \$1.1 million decline in payroll expenses, a \$302,000 decrease in advertising and marketing programs, a \$119,000 reduction in travel related expenses, a \$70,000 decrease in facility costs and a \$558,000 reduction in amortization expense associated with a marketing alliance that was fully amortized in April 2002. These expense decreases were offset by a \$559,000 increase in amortization expenses for non-cash costs associated with repurchasable shares issued to Cap Gemini Ernest & Young.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses, excluding non-cash stock based compensation of (\$79,000) and \$429,000 for the three months ended September 30, 2003 and 2002, respectively, were \$2.3 million for the three months ended September 30, 2003 and \$2.7 million for the three months ended September 30, 2002, respectively. General and administrative expenses as a percentage of total revenues were 15% for the three months ended September 30, 2003 and 20% for the three months ended September 30, 2002. The \$400,000 decrease in general and administrative expenses was mainly due to a \$164,000 reduction in telecommunication expenses and a \$175,000 decrease in depreciation expense.

General and administrative expenses, excluding non-cash stock based compensation of \$191,000 and \$731,000 for the nine months ended September 30, 2003 and 2002, respectively, were \$6.9 million for the nine months ended September 30, 2003, and were \$8.7 million for the nine months ended September 30, 2002. General and administrative expenses as a percentage of total revenues were 13% for the nine months ended September 30, 2003 and 23% for the nine months ended September 30, 2002. The \$1.8 million decrease in general and administrative expenses is mainly attributable to a \$437,000 decline in payroll expenses, a \$417,000 decrease in telecommunications costs, a \$363,000 decrease in office expenses, a \$223,000 decrease in depreciation expense and a \$465,000 decrease in rent expense due to the rent related to the vacated portion of our headquarters facility being already charged to restructuring expense in the third quarter of 2002.

**RESTRUCTURING CHARGES.** During the third quarter of 2002, we reviewed our facilities requirements and vacated a portion of our headquarters in San Carlos, California. Related to this action, we took a third quarter impairment charge of \$3.8 million to record the estimated loss associated with a portion of the remaining lease stream of the unoccupied space. During the third quarter of 2002, we also incurred \$272,000 for severance benefits.

In May 2003, we signed an agreement to sublease the vacated portion of our headquarters facility through the end of our lease, which is March 2010. During the quarter ended March 31, 2003, we adjusted our estimated loss related to the vacated space and recorded an additional restructuring charge of \$2.5 million to reflect the terms of this new sublease agreement. The impact of this charge was partially offset by the favorable resolution of our liability with respect to various capital leases which resulted in a reduction of \$139,000 to reduce the previously established restructuring reserve. There were no additional restructuring charges recorded during the three months ended September 30, 2003.

**AMORTIZATION OF STOCK-BASED COMPENSATION.** Amortization of deferred stock-based compensation was (\$34,000) and \$690,000 for the three months ended September 30, 2003 and 2002, respectively. The credit was due primarily to significant forfeitures during the three months ended September 30, 2003. The amortization of deferred stock-based compensation was \$445,000 and \$1.8 million for the nine months ended September 30, 2003 and 2002, respectively. The deferred charges for employee options are being amortized to expense using the graded vesting approach prescribed by FASB Interpretation No. 28. Our remaining deferred compensation balance at September 30, 2003 is \$25,000.

**AMORTIZATION OF OTHER INTANGIBLES.** Related to our Qwest Cyber.Solutions' (QCS) acquisition, we recorded an intangible asset for our acquired customer contracts of \$2.7 million, which is included in other assets in the accompanying condensed consolidated balance sheet. This intangible asset is being amortized over an estimated life of 18 months. Amortization of the intangible asset was \$367,000 for the three months ended September 30, 2003 and \$1,257,000 for the nine months ended September 30, 2003. Amortization of the intangible asset was \$56,000 for the three and nine months ended September 30, 2002 as the acquisition occurred in September 2002.

**INTEREST AND OTHER INCOME AND EXPENSE.** Net interest and other income and expense were \$63,000 for the three months ended September 30, 2003 and \$279,000 for the three months ended September 30, 2002. Net interest and other income and expense were \$233,000 for the nine months ended September 30, 2003 and \$843,000 for the nine months ended September 30, 2002. The three and nine month decreases in net interest income were due primarily to lower average cash and investment balances at September 30, 2003 and were offset, in part, by a decrease in interest expense due to lower average debt balances.

**INCOME TAXES.** Since inception, we have incurred net losses for federal and state tax purposes, and anticipate losses for the foreseeable future. We have therefore not recognized any material tax provision or benefit for income taxes for the three and nine months ended September 30, 2003. We recognized a \$400,000 tax benefit for the three and nine months ended September 30, 2002 after determining that a tax provision related to an exposure item recorded in connection with our acquisition of Data Systems Connectors, Inc. in 1998 was no longer needed due to the completion of a tax examination.

## **LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2003, we had cash and cash equivalents, short-term investments, and restricted cash of \$43.4 million, a decrease of \$8.2 million from December 31, 2002. At September 30, 2003, we had cash and cash equivalents of \$11.6 million compared to \$26.9 million at December 31, 2002. The \$15.3 million decrease was primarily the result of \$10.5 million used in investing activities, \$3.5 million to repay debt and \$1.4 million used in operating activities.

Net cash used in operating activities was \$870,000 for the nine months ended September 30, 2003 compared to \$14.2 million used in operating activities for the nine months ended September 30, 2002. The \$13.4 million net change was primarily due to the reduction of our net loss.

Net cash used in investing activities was \$11.0 million for the nine months ended September 30, 2003 compared to \$9.1 million provided by investing activities in the nine months ended September 30, 2002. For the nine months ended September 30, 2003, investing activities consisted primarily of \$3.2 million in equipment purchases and \$7.7 million of net purchases of short-term investments. For the nine months ended September 30, 2002, investing activities consisted primarily of \$23.3 million of net sales of short-term investments offset by \$14.0 million used for our QCS acquisition.

Net cash used by financing activities was \$3.5 million and \$5.1 million for the nine months ended September 30, 2003 and 2002, respectively. Financing activities consisted primarily of the proceeds from the issuance of common stock and exercise of stock options, offset by repayments of notes and capital leases. The decrease in our cash used by financing activities is mainly due to our decreases in debt repayments due to our lower debt balances at September 30, 2003.

Except for equipment operating leases, we have no off balance sheet financing arrangements (see Note 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2002).

In October 2003, we acquired substantially of the assets and certain liabilities of Nexus Technology, Inc. ("Nexus"). At closing, we paid approximately \$10.0 million in consideration, consisting of \$1.9 million in cash and 2,921,390 shares of Corio common stock. In addition, Nexus will be entitled to receive an earn-out payment of up to \$2 million to be paid in Corio common stock based on achievement of financial goals.

We expect that our current cash balances and existing debt arrangements will be sufficient to meet our cash requirements for at least the next 12 months. However, any major changes in the nature of our business, or a significant reduction in demand for our services, the acquisition of products, the need for significant new capital expenditures of an existing business, could further utilize our cash reserves. To the extent we require additional cash, there can be no assurances that we will be able to obtain such financing on terms favorable to Corio, or at all.

## **ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS**

### **Risks Related to Our Business**

**We have a history of losses and expect that we will continue to incur losses and negative cash flow and may never be profitable.**

We have spent significant funds to date to develop and refine our current services, to create and run our operations organization, to build and run a professional services organization and to develop and run our sales and marketing resources. We have incurred significant operating and net losses and negative cash flow and have not achieved profitability. As of September 30, 2003, we had an accumulated deficit of \$257 million.

We expect to continue to invest significantly in our organization to provide services, enhance current services and expand our service offerings. We also may hire additional people in certain areas of our company in order to support our business and promote and sell our services. In addition, we expect to continue to incur significant fixed and other costs associated with customer acquisitions and with the implementation and configuration of software applications, and ongoing services, for customers. As a result of all of these factors, to achieve operating profitability on a consistent basis, excluding non-cash charges, we will need to increase our customer base and number of customers, to increase our revenue, to decrease our overall costs of providing services, including the costs of our licensed technology, our operations and the costs of customer acquisitions. We cannot assure you that we will be able to increase our revenues or increase our operating efficiencies in this manner. Also, because we may continue to invest in our business faster than we anticipate growth in our revenues, we may continue to incur significant losses and negative cash flow for the foreseeable future and we may never be profitable.

**The middle-market and technology companies that currently comprise a significant portion of our revenue base may be volatile, which could continue to result in greater than expected customer loss and continued difficulty in collecting fees from some customers, and uncertainty regarding the stability of the economy in general could continue to adversely affect demand for our services.**

A significant portion of our current revenue consists of revenue from technology and middle-market companies. These companies are more likely to be acquired, experience financial difficulties or cease operations than other companies that are larger and better established or are in more stable industries. In particular, these companies may experience difficulties in raising capital needed to fund their operations. In the past we have terminated our agreements with a substantial number of customers who were unable or unwilling to continue to meet their financial obligations to us and we expect to terminate additional customers in the future. As a result, our client base will likely be more volatile than those companies whose customers consist of more mature and established entities. If we continue to experience greater than expected customer loss or an inability to collect fees from our customers in a timely manner because of this volatility, our operating results could be seriously harmed. In addition, uncertainty regarding the stability of the economy in general could continue to diminish and delay demand for our services. Also, as we move up market and away from high-growth and middle market companies, revenue from termination fees resulting from high-growth and middle market companies may diminish. Moreover, one of our customers represented 11% of total revenues in fiscal 2002 and its contract expired in May 2003. Although this customer renewed for a short term contract, the new contract is for significantly less recurring revenue and the loss of revenue from this customer and of any other significant customers will adversely affect our business.

**Any failure to replace revenue from lost customers may result in Corio failing to achieve profitability and positive cash flow.**

We have experienced customer attrition in the past and expect to experience it in the future. Customers may leave for a number of reasons, including the acquisition of a customer by a company which does not need access to the kinds of services we provide, either because the acquiring company has in-house capabilities, existing contractual arrangements that preclude them from using our services or for a variety of other reasons. If we do not grow our revenue, we may never achieve profitability or positive cash flow and therefore the loss of any significant customers could adversely affect our operating results. One of our customers, Expanets, Inc., accounted for 11% of our total revenues for the twelve month period ended September 30, 2003. Expanets recently announced that it has signed an agreement to be acquired. The acquisition has not been consummated. Although we have a long term contract with Expanets, we are unsure of the acquirer's intentions around whether to retain our services, and this presents risks regarding how long Expanets will remain a customer, if, for example, the acquiring entity decides to replace our system with its current system or another system. If we lose Expanets, or any other significant customer, and are unable to replace this revenue with revenue from new or existing clients, this will have an adverse effect on our ability to achieve profitability and positive cash flow.

**Our limited history of offering ASP services to customers and the fact that we operate in a new industry for application services expose us to risks that affect our ability to execute our business model.**

We have offered our services for a relatively short period of time, and our industry is relatively new. Prior to September 1998, our predecessor company, DSCI, carried on a different business. Accordingly, we have a limited operating history as a provider of ASP services. Because our business model is relatively new, it continues to evolve. In the future, we may revise our pricing model for different services, and our model for our customers to gain access to third-party software applications and other third-party services has evolved. Changes in our anticipated business and financial model could materially impact our ability to become profitable in the future. Additionally, especially as we move up-market to larger, more established customers, the demand for our services is uncertain and the sales process takes longer than with smaller potential customers. An investor in our common stock must consider these facts as well as the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets such as the market for Internet-based software application services. Some of the risks and difficulties relate to our potential inability to:

- acquire and retain customers, particularly larger, more established companies required to create a stable revenue and customer base;
- acquire new customers at a rate sufficient to create growth taking into account loss of customers;
- reduce costs associated with the delivery of services to our customers;
- expand and maintain our pipeline of sales prospects in order to promote greater predictability in our period-to-period sales levels;
- acquire or license third-party software applications at a reasonable cost or at a structure beneficial to us;
- complete successful implementations of our software applications in a manner that is repeatable and scalable;
- integrate successfully software applications we manage with each other and with our customers' existing systems;
- continue to offer new services that complement our existing offerings;
- increase awareness of our brand; and
- maintain our current, and develop new, strategic relationships.

We cannot assure you that we will successfully address these risks or difficulties. If we fail to address any of these risks or difficulties adequately, we will likely be unable to execute our business model.

**Because we may spend significant sums to run our business and to try to grow our business, we may be unable to adjust spending to offset any future revenue shortfall, which could cause our quarterly operating results to fluctuate and our stock price to fall.**

Although we are monitoring our spending, in order to promote future growth, we expect we may continue to expend significant sums in our business, in our operations, professional services, research and development, and sales and marketing organizations. Because the expenses associated with these activities are relatively fixed in the short-term, we may be unable to adjust spending quickly enough to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. As our quarterly results fluctuate, they may fall short of the expectations of public market analysts or investors. If this occurs, the price of our common stock may fall.

**Our quarterly operating results may fluctuate due to the nature of our ASP business, timing of payments received from cash basis customers and other factors affecting our revenues and costs, which could cause our stock price to fall.**

Our financial results will vary over time as our ASP business matures. For individual customers, we may recognize professional services revenues associated with the implementation of our applications during the early months of our engagement. We then recognize monthly fees from the customer, consisting primarily of application management services revenues, over the balance of the contractual relationship. As a result, for some customers we have a high proportion of up-front professional services revenues associated with implementation. We expect that our financial results may continue to vary over time as monthly fees increase as a portion of total revenue. Third parties also provide professional services for some of our application management services customers,

and whether professional services will be provided by us or by third parties may be difficult to predict. Changes in our revenue mix from professional services revenues to application management services revenues could be difficult to predict and could cause our quarterly results and stock price to fluctuate.

Other important factors that could cause our quarterly results and stock price to fluctuate materially include:

- the timing of obtaining, implementing and establishing connectivity with individual customers;
- the loss of or change in our relationship with important customers and our ability or inability to collect termination fees from terminating customers;
- any increase or decrease in termination fees, settlement fees or judgments paid in a quarter versus other quarters;
- the timing and magnitude of expanding our operations and of other capital expenditures;
- the timing and amount of payments received from cash basis customers as well as the change in composition of these customers
- costs, including license fees, relating to the software applications we use;
- changes in our pricing policies or those of our competitors;
- potential changes in the accounting standards associated with accounting for stock options, stock or warrant issuances and for revenue recognition; and
- accounting charges we may incur in the future relating to stock options, stock or warrant issuances.

**Our financial results could vary over time as our business model evolves, which could cause our stock price to fall.**

Our financial results could vary over time as our business and financial model evolves. For example, we historically included a broad range of customer support in our fixed monthly fees but now bill certain customers for support services in excess of specified limits in certain circumstances. As another example, we are increasingly unbundling from our fixed monthly fee the cost of software licenses and currently require our customers to obtain licenses to enterprise software applications directly from third-party software providers. Any such changes to our business or financial model would likely cause financial results to vary, which could cause our stock price to fall.

In this regard, from time to time we negotiate with some of our major third-party software vendors to modify the pricing and other terms currently in place with these vendors. We may agree to restructure our current arrangements with some of our third-party software providers. For example, we are migrating customers, and currently plan to eventually migrate all customers, from a model whereby some rent enterprise application licenses from us to a model whereby they all purchase the licenses directly from independent software vendors. Such pricing structures or business models may not in fact be more beneficial to us and may ultimately hinder our ability to become profitable.

**We depend on software vendors to supply us with the software necessary to provide our services, and the loss of access to this software or any decline or obsolescence in its functionality could cause our customers' businesses to suffer, which, in turn, could harm our revenues and increase our costs.**

We offer our customers software application services for applications from third parties such as PeopleSoft, Oracle, SAP and Siebel Systems. We have agreements in place with certain of our third-party software vendors, and our agreements with third-party software vendors are non-exclusive, are for limited terms and typically permit termination in the event of our breach of the agreements. Additionally, as we move more to "host-only" relationships, whereby our customers must obtain licenses directly from independent software vendors such as PeopleSoft, Oracle, SAP and Siebel, we may rely on the independent software vendors to consent to allow us to access the software to provide our services. If we lose the right to host the software that we host from third-parties, if the cost of licensing the software applications becomes prohibitive, or if we change the vendors from whom we currently license software, our customers' businesses could be significantly disrupted, which could harm our revenues and increase our costs. Our financial results may also be harmed if the cost structure we negotiate with the third-party software vendors changes in a manner that is less beneficial to us compared to our current cost structure with software vendors. We cannot assure you that our services will continue to support the software of our third-party vendors, or that we will be able to adapt our own offerings to changes in third-party software. In addition, if our vendors were to experience financial or other difficulties, it could adversely affect the availability of their

software. It is also possible that improvements in software by third-parties with whom we have no relationship could render the software we offer to our customers less compelling or obsolete.

**Our licenses for the third-party software we use to deliver our services contain limits on our ability to use them that could impair our growth and operating results.**

The licenses we have for the third-party software for which we provide hosting or application management services typically restrict our ability to sell our services in specified countries and to customers with revenue above or below specified revenue levels. For example, one of our licenses restricts us from selling our services to customers with annual revenues greater than \$1 billion, and restricts our ability to sell to customers outside of North America. In addition, some of these licenses contain limits on our ability to sell our services to certain types of customers. Our operating results and ability to grow could be harmed to the extent these licenses prohibit us from selling our services to customers to which we would otherwise sell our services, or in countries in which we would otherwise sell our services.

**Poor performance of the software we deliver to our customers or disruptions in our business-critical services could harm our reputation, delay market acceptance of our services and subject us to liabilities.**

Our customers depend on our hosted software applications for their critical systems and business functions, including enterprise resource planning, customer relationship management and e-commerce. Our customers' businesses could be seriously harmed if the applications we provide to them work improperly or fail, even if only temporarily. Accordingly, if the software that we license from our vendors or our implementation or ongoing management of such software performs poorly, experiences errors or defects or is otherwise unreliable, our customers would likely be extremely dissatisfied, which could cause our reputation to suffer, force us to divert research and development and management resources, cause a loss of revenues or hinder market acceptance of our services. It is also possible that any customer disruptions resulting from failures in our applications could force us to refund all or a portion of the fees customers have paid for our services or result in other significant liabilities to our customers.

**We may fail to implement, host or manage enterprise software applications successfully due to the complicated nature of the services we provide, which would harm our reputation and sales.**

Implementations and management of enterprise software applications can be very complex. We cannot assure you that we can convince customers that we have the requisite expertise required to implement, host or manage these applications. Our reputation will be harmed and sales of our services would decline significantly if we are not able to complete successfully repeated implementations of our enterprise software applications or if we are not able to successfully manage enterprise applications, including those applications with which we have limited or no implementation, hosting or management experience to date.

**Any inability to expand sufficiently our enterprise software implementation and systems consulting capabilities could harm our ability to service our customers effectively and could hinder our growth.**

A failure to maintain and expand relationships with third-party systems integrators that we use to implement our services could harm our ability to service our customers effectively. As we seek to provide applications management services for larger, more established customers, they may frequently utilize the systems integration and consulting services of independent, third-party systems integrators rather than Corio. In such cases, we may receive only modest revenue for implementation and integration services if any. In addition, we frequently contract with our customers for implementation on a fixed price basis. As a result, unexpected complexities in implementing software applications for our customers could result in unexpected losses for us or increases in losses. Our business and reputation could also be seriously harmed if third party systems integrators were unable to perform their services for our customers in a manner that meets customer expectations.

**Increased demand for customization of our services beyond what we currently provide or anticipate could reduce the scalability and profitability of our business.**

Companies may prefer more customized applications and services than our business model contemplates. Most of our customers have required some level of customization of our services, and our customers may continue to require customization in the future, perhaps to a greater extent than we currently provide or anticipate. If we do not offer the desired customization, there may be less demand for our services. Conversely, providing customization of our services increases our costs and reduces our flexibility to provide similar services to many customers. Accordingly, increased demand for customization of our services could reduce the scalability and profitability of our business and increase risks associated with completing software upgrades.

**Growth could strain our operations and require us to incur costs to upgrade our infrastructure and expand our personnel.**

If our customer base grows significantly, we cannot be sure that we will successfully manage our growth. In order to manage any such growth successfully, we must:

- expand our management team, financial and information systems and controls and operations team;
- maintain a high level of customer service and support;
- expand our implementation and consulting resources internally and with third-parties; and
- expand, train, manage and retain our employee base effectively.

If our customer base grows significantly, there will be additional demands on our customer service support, research and development, sales and marketing and administrative resources as we try to increase our service offerings and expand our target markets. Any delay in the implementation of, or disruption in the transition to, new or enhanced systems and controls could harm our ability to accurately forecast demand for our services, manage our billing of customers, manage our sales cycle and implementation services and record and report management and financial information on a timely and accurate basis. Moreover, any inability to expand our service offerings and employee base commensurate with any increase in the demand for our services could cause our revenues to decline.

**We will need to perform software upgrades for our customers, and any inability to successfully perform these upgrades could cause interruptions or errors in our customers' software applications, which could increase our costs and delay market acceptance of our services.**

Our software vendors from time to time will upgrade their software applications, and at such time we will be required to implement these software upgrades for certain of our customers. Implementing software upgrades can be a complicated and costly process, particularly implementation of an upgrade simultaneously across multiple customers. Accordingly, we cannot assure you that we will be able to perform these upgrades successfully or at a reasonable cost. We may also experience difficulty implementing software upgrades to a large number of customers, particularly if different software vendors release upgrades simultaneously. If we are unable to perform software upgrades successfully and to a large customer base, our customers could be subject to increased risk of interruptions or errors in their business-critical software, our reputation and business would likely suffer and the market would likely delay the acceptance of our services. It will also be difficult for us to predict the timing of these upgrades, the cost to us of these upgrades and the additional resources that we may need to implement these upgrades. Additionally, as we continue to evolve our business model to charge customers for the cost of software upgrades, we may lose prospective customers who choose not to pay for these upgrades. Therefore, any such upgrades could strain our development and engineering resources, require significant unexpected expenses and cause us to miss our financial forecasts or those of securities analysts. Any of these problems could impair our customer relations and our reputation and subject us to litigation.

**Security risks and concerns may decrease the demand for our services, and security breaches with respect to our systems may disrupt our services or make them inaccessible to our customers.**

Our services involve the storage and transmission of business-critical, proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. Anyone who circumvents our security measures could misappropriate business-critical proprietary information or cause interruptions in our services or operations. In addition, computer "hackers" could introduce computer viruses into our systems or those of our customers, which could disrupt our services or make them inaccessible to customers. We may be required to expend significant capital and other resources to protect against the threat of security breaches or to alleviate problems caused by breaches. Our security measures may be inadequate to prevent security breaches, and our business and reputation would be harmed if we do not prevent them.

**If we are unable to adapt our services to rapidly changing technology, our reputation and our ability to grow our revenues could be harmed.**

The markets we serve are characterized by rapidly changing technology, evolving industry standards, emerging competition and the frequent introduction of new services, software and other products. We cannot assure you that we will be able to enhance existing or develop new services that meet changing customer needs in a timely and cost-effective manner. For example, as software application architecture changes, the software for which we provide services could become out of date or obsolete and we may be forced to upgrade or replace our technology. For example, this is of particular concern with regard to our enterprise resource planning, or ERP, software, including PeopleSoft, Oracle and SAP. The architecture of the software we currently use for ERP applications is not designed to be hosted. We believe that future software may be written to be hosted. Our existing software application providers may

face competition from new vendors who have written hostable software. It may be difficult for us to acquire hostable ERP software from these new vendors and for our software application providers to develop this software quickly or successfully. In either event, the services we offer would likely become less attractive to our customers, which could cause us to lose revenue and market share. Performing upgrades may also require substantial time and expense and even then we cannot be sure that we will succeed in adapting our business to these technological developments. Prolonged delays resulting from our efforts to adapt to rapid technological change, even if ultimately successful, could harm our reputation within our industry and our ability to grow our revenues.

**Our application management agreements are typically long-term, fixed-price contracts, which may hinder our ability to become profitable.**

We enter into agreements with our customers to provide application management services for long periods, typically two to three years. Most of these agreements are in the form of fixed-price contracts that do not provide for price adjustments to reflect any cost overruns associated with providing our services, such as potential increases in the costs of software applications we license from third parties, the costs of upgrades or inflation. As a result, unless we are able to provide our services in a more cost-effective manner than we do today and unless the number of users at individual customers increases to provide us higher revenue levels per customer, we may never achieve profitability for a particular customer. In addition, customers may not be able to pay us or may cancel our services before becoming profitable for us.

**Our long-term, fixed-price application management contracts may hinder our ability to evolve our business and to ultimately become profitable.**

Our business is relatively new and, accordingly, our business and financial models may evolve as the understanding of our business evolves. We may be unable to adjust our pricing or cost structure with respect to our current customers in response to changes we make in our business or financial model due to the long-term, fixed price nature of the application management agreements we have with our customers. This potential inflexibility may result in our inability to become profitable as rapidly as we would like or at all.

**If we do not meet the service levels provided for in our contracts with customers, we may be required to give our customers credit for free service, and our customers may be entitled to cancel their service contracts, which could adversely affect our reputation and hinder our ability to grow our revenues.**

Our application management services contracts contain service level guarantees that obligate us to provide our applications at a guaranteed level of performance. If we fail to meet those service levels, we may be contractually obligated to provide our customers credit for free service. If we were to continue to fail to meet these service levels, our customers would then have the right to cancel their contracts with us. These credits or cancellations could harm our reputation and hinder our ability to grow our revenues.

**If we cannot obtain additional software applications that meet the evolving business needs of our customers, the market for our services may not grow and may decline, and sales of our services may suffer.**

Part of our strategy may be to expand our services by offering our customers services related to additional software applications that address their evolving business needs. We cannot be sure, however, that we will be able to license these applications at a commercially viable cost or at all or that we will be able to cost-effectively develop the applications in-house. If we cannot obtain these applications on a cost-effective basis or otherwise cannot effectively expand our service offering and, as a result, cannot expand the range of our service offerings, the market for our services may not grow and may decline, and sales of our services may suffer.

**We have many competitors and expect new competitors to enter our market, which could adversely affect our ability to increase revenues, maintain our margins or grow our market share.**

The market for our services is extremely competitive and the barriers to entry in our market are relatively low. We currently have no patented technology that would bar competitors from our market.

Our current and potential competitors primarily include:

- application service providers and business process outsourcers, such as Bluestar Solutions, CSC, Electronic Data Systems, Hewlett-Packard, IBM Global Services, Surebridge and USInternetworking;
- systems integrators, such as Accenture and, Bearing Point;
- offshore providers such as Wipro, Tata and Infosys;

- software vendors, such as Oracle, PeopleSoft, SAP and Siebel Systems; and
- major technology providers, such as Microsoft.

Many of our competitors and potential competitors have substantially greater financial, customer support, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we do. We cannot be sure that we will have the resources or expertise to compete successfully in the future. Our competitors may be able to:

- develop and expand their network infrastructures and service offerings more quickly;
- adapt to new or emerging technologies and changing customer needs faster;
- take advantage of acquisitions and other opportunities more readily;
- negotiate more favorable agreements with software application vendors;
- devote greater resources to the marketing and sale of their products; and
- address customers' service-related issues more effectively.

Some of our competitors may also be able to provide customers with additional benefits at lower overall costs or to reduce their application service charges aggressively in an effort to increase market share. We cannot be sure that we will be able to match cost reductions by our competitors.

Our competitors and other companies may form strategic relationships with each other to compete with us. These relationships may take the form of strategic investments, joint-marketing agreements, licenses or other contractual arrangements, which arrangements may increase our competitors' ability to address customer needs with their product and service offerings. We believe that there is likely to be consolidation in our markets, which could lead to increased price competition and other forms of competition that could cause our business to suffer.

**We may be unable to deliver effectively our services if our data center management services providers, computer hardware suppliers or software providers do not provide us with key components of our technology infrastructure in a timely, consistent and cost-effective manner.**

We depend on third-parties, such as XO Communications, Qwest and (i) Structure, for our data center management services and for key components of our network infrastructure. Our contracts with these data center and network infrastructure providers are for a fixed term and for a specified amount of services, which may be insufficient to meet our needs. The services we provide could be materially disrupted by any disruption in the services provided by our data center management service providers to us. For example, downtime caused by our data center providers could materially disrupt our services, and, in the event any of these data center providers terminate or decline to renew their contracts with us, we could experience significant disruption and costs related to migrating customers to a different data center. We depend on suppliers such as Sun Microsystems for our computer hardware and WebMethods and Netegrity and others for our software technology platform. If any of these relationships fail to provide needed products or services in a timely and consistent manner or at an acceptable cost, we may be unable to deliver effectively our services to customers. Some of the key components of our infrastructure are available only from sole or limited sources in the quantity and quality we demand. We do not carry significant inventories of those components that we obtain from third-parties and have no guaranteed supply arrangements for some of these components. Additionally, some of our service and product providers have recently experienced financial difficulty, and financial problems they experience may cause disruptions in our service, loss of customers and expose us to additional costs.

**System failures caused by us or factors outside of our control could cause us to lose our customers and subject us to liability and increased expenses.**

Our operations depend upon our ability and the ability of our third-party data center and network services providers to maintain and protect the computer systems on which we host our customers' applications. Any loss of customer data or an inability to provide service for a period of time could cause us to lose our customers and subject us to significant potential liabilities. We currently use three data centers to house our hardware and to provide network services, but each of our customers is serviced at a single site. While our data center and network providers maintain back-up systems and we have disaster recovery processes, a natural disaster or other disruption at their site could impair our ability to provide our services to our customers until the site is repaired or back-up systems become operable. Some of our data center providers, as well as our corporate headquarters, are located in Northern California, near

known earthquake fault zones. Our systems and the data centers are also vulnerable to damage from fire, flood, power loss, telecommunications failures, terrorist attacks and similar events.

**If we are unable to retain our executive officers and key personnel, or to integrate new members of our senior management that are critical to our business, we may not be able to successfully manage our business or achieve our objectives.**

Our future success depends upon the continued service of our executive officers and other key personnel. None of our executive officers or key employees is bound by an employment agreement for any specific term. Key personnel may voluntarily terminate due to various reasons such as the 10% salary decrease which we implemented in January 2003. If we lose the services of one or more of our executive officers or key employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives.

**If we are unable to hire and retain sufficient sales, marketing, technical and operations personnel, we may be unable to grow our business or to service our customers effectively.**

In the future, we may expand our sales operations and marketing efforts in order to try to increase market awareness and sales of our services. We may also need to increase our technical staff in order to service customers and perform research and development. There is competition for qualified and effective sales, marketing, technical and operations personnel as these personnel are in limited supply and in high demand and we might not be able to hire and retain sufficient numbers of these personnel to grow our business or to service our customers effectively. Also, recent reductions in our workforce, although designed to not affect service levels and demand generation, may adversely affect these areas of our business.

**We may never achieve the anticipated benefits from our acquisition of Nexus Technology, Inc.**

In October 2003, we acquired substantially all of the assets of Nexus Technology, Inc. as part of our efforts to expand our applications management business and product offerings. We may experience difficulties in achieving and may never fully realize the anticipated benefits of our acquisition of Nexus Technology. Potential risks with this acquisition include, among others:

- Possible impairment of relationships with employees and customers as a result of the acquisition of Nexus Technology;
- Inability to retain key employees of Nexus Technology.
- Inability to retain customers of Nexus Technology;
- Diversion of management's attention from other business concerns;
- Difficulties in assimilation of acquired personnel, operations, technologies or products.

In addition, Corio has an obligation to issue additional shares of its common stock to Nexus Technology upon Corio's attainment of specific revenue milestones for the 3-month period ending December 31, 2004. Any such issuance would dilute our existing stockholders.

**Any acquisitions of businesses, technologies or services may result in distraction of our management and disruptions to our business and additional costs.**

In September 2002 and October 2003, we completed the acquisition of the ASP assets of Qwest Cyber Solutions LLC and Nexus Technology, Inc., respectively. The integration of the ASP assets of Qwest Cyber Solutions and Nexus Technology into our business is ongoing, and we may experience disruption and distraction related thereto and unexpected costs associated therewith. We have lost, and may continue to lose, customers acquired from Qwest Cyber Solutions, and we may experience similar losses of customers acquired from Nexus Technology.

We expect that further consolidation in our industry may occur. We may acquire or make investments in additional complementary businesses, technologies or services if appropriate opportunities arise. From time to time we may engage in discussions and negotiations with companies regarding acquiring or investing in their businesses, technologies or services. We cannot make assurances that we will be able to identify suitable acquisition or investment candidates, or that if we do identify suitable candidates, we will be able to make the acquisitions or investments on commercially acceptable terms or at all. If we acquire or invest in another company, we could have difficulty assimilating that company's personnel, customers, operations, technology or products and service offerings. In addition, the key personnel of the acquired company may decide not to work for us. These difficulties could disrupt our ongoing business, distract our management and employees, cause customer loss, increase our expenses and adversely affect our results of operations. Furthermore, we may incur indebtedness or issue equity securities to pay for any future acquisitions. The issuance of equity or convertible debt securities could be dilutive to our existing stockholders.

**Any inability to protect our intellectual property rights could reduce our competitive advantage, divert management attention, require additional intellectual property to be developed or cause us to incur expenses to enforce our rights.**

We cannot assure you that we will be able to protect or maintain our intellectual property from infringement or misappropriation from others. In particular, our business would be harmed if we were unable to protect our technology platform and processes, our trademarks or our other software and confidential and proprietary information. Agreements on which we rely to protect our intellectual property rights and the trade secret, copyright and other laws on which we rely may only afford limited protection to these rights. In addition, we currently have no patents issued, which limits significantly our ability to protect our proprietary rights in the event they are infringed. Any infringement or misappropriation of our intellectual property could reduce our competitive advantage, divert management attention, require us to develop technology and cause us to incur expenses to enforce our rights.

**Any infringement claims involving our technology or the applications we offer or other lawsuits could cost a significant amount of money and could divert management's attention away from our business.**

If the number of software applications used by us and our customers increases and the functionality of these products further overlaps and integrates, software industry participants may become increasingly subject to infringement claims. In addition, we have agreed, and may agree in the future, to indemnify some of our customers against claims that our services infringe upon the intellectual property rights of others. Someone may claim that our technology or the applications or services we offer infringes their proprietary rights. Someone may also claim that we do not have adequate licenses to perform the services we offer. Any infringement claims, even if without merit, can be time consuming and expensive to defend, may divert management's attention and resources and could cause service delays. Such claims could require us to enter into costly royalty or licensing agreements. If successful, a claim of infringement against us and our inability to modify or license the infringed or similar technology could adversely affect our business. In addition, if our software vendors cease to offer their software applications to us because of infringement claims against us or them, we would be forced to license different software applications to our customers that may not meet our customers' needs. This could result in a loss of customers and a decline in our revenues.

In November 2001, a securities class action lawsuit was filed in the U.S. District Court for the Southern District of New York against Corio, certain of its officers and certain of the underwriters involved in Corio's initial public offering. This is one of approximately 300 similar lawsuits in a coordinated proceeding sometimes referred to as "IPO allocation lawsuits" or "laddering lawsuits." In June 2003, the plaintiffs in these cases presented a settlement proposal to all of the issuer defendants. Under the proposed settlement, the plaintiffs proposed to dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers or companies will be required to pay the amount, if any, by which \$1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover \$1 billion and payment is required under the guaranty, Corio would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under its insurance policy, which is \$1 million. In July 2003, Corio tentatively agreed to accept this settlement proposal. The settlement is subject to acceptance by a substantial majority of the issuer defendants and execution of a definitive settlement agreement. The settlement is also subject to approval by the Court, which cannot be assured. If the settlement is not accepted by the requisite number of defendants or if it is not approved by the Court or if it otherwise is not consummated, Corio intends to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If the outcome of the litigation is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed. This lawsuit may be time consuming and expensive to defend and may divert management's attention and may be costly to Corio even if the plaintiff's settlement proposal is consummated.

### **Risks Related to our Industry**

**We cannot assure you that the ASP market will become viable or grow at a rate that will allow us to achieve profitability.**

Growth in demand for and acceptance of ASPs and their hosted business software applications is highly uncertain. This is especially true given the current uncertain macroeconomic environment. Companies in the ASP industry, such as Pandesic and Red Gorilla and others, have ceased operations. Other companies in the ASP industry, such as USinternetworking, have filed for bankruptcy. We cannot assure you that this market will become viable or, if it becomes viable, that it will grow at a rate that will allow us to achieve profitability. The market for Internet services, private network management solutions and widely distributed Internet-enabled application software has only recently begun to develop and is now evolving rapidly. We believe that many of our potential customers are not fully aware of the benefits of hosted and managed solutions. It is possible that these solutions will never achieve market acceptance. It is also possible that potential customers will decide that the risks associated with hiring ASPs in general (or smaller service providers in particular) to implement and manage their critical systems and business functions outweigh the efficiencies associated with the products and services we provide. Concerns over transaction security and user privacy, inadequate

network infrastructure for the entire Internet and inconsistent performance of the Internet and the financial viability of ASPs could also limit the growth of Internet-based business software solutions.

**Increasing government regulation could limit the market for, or impose sales and other taxes on the sale of, our services, which could cause our revenues to decline or increase our expenses.**

We offer our suite of software applications over networks, which subject us to government regulation concerning Internet usage and electronic commerce. We expect that state, federal and foreign agencies will adopt and modify regulations covering issues such as user and data privacy, pricing, taxation of goods and services provided over the Internet, the use and export of cryptographic technology and content and quality of products and services. It is possible that legislation could expose us and other companies involved in electronic commerce to liability or require permits or other authorizations, which could limit the growth of electronic commerce generally. Legislation could dampen the growth in Internet usage and decrease its acceptance as a communications and commercial medium. If enacted, these laws, rules or regulations could limit the market for or make it more difficult to offer our services.

The taxation of commerce activities in connection with the Internet has not been established, may change in the future and may vary from jurisdiction to jurisdiction. One or more states or countries may seek to impose sales or other taxes on companies that engage in or facilitate electronic commerce. A number of proposals have been made at the local, state, national and international levels that would impose additional taxes on the sale of products and services over the Internet. These proposals, if adopted, could substantially impair the growth of electronic commerce and could subject us to taxation relating to our use of the Internet as a means of delivering our services. Moreover, if any state or country were to assert successfully that we should collect sales or other taxes on the exchange of products and services over the Internet, our customers may refuse to continue using our services, which could cause our revenues to decline significantly.

**As we expand our business outside the United States we may be subject to unfavorable international conditions and regulations that could cause our international business to fail.**

We have customers with international operations, have established a subsidiary in India and may further expand our business outside of the United States in the future. Conducting our business in international markets is subject to complexities associated with foreign operations and to additional risks related to our business, including the possibility that the scarcity of cost-effective, high-speed Internet access and the slow pace of future improvements in access to the Internet will limit the market for hosting software applications over the Internet or adversely affect the delivery of our services to customers. Additionally, some countries outside of the United States do not permit hosting applications on behalf of companies. The European Union has adopted a privacy directive that regulates the collection and use of information. This directive may inhibit or prohibit the collection and sharing of personal information in ways that could harm us. The globalization of Internet commerce may be harmed by these and similar regulations since the European Union privacy directive prohibits transmission of personal information outside the European Union unless the receiving country has enacted individual privacy protection laws at least as strong as those enacted by the European Union privacy directive.

**General political and economic conditions may reduce our revenues and harm our business.**

Because of the economic downturn and political environment, many industries have delayed or reduced technology expenditures. If this trend continues, we may fall short of our revenue expectations, and ultimately may fail to achieve profitability. Moreover, weakness in the technology sector as a whole could negatively affect the cash flow of some of our customers, which in turn could impact their ability to meet their obligations to us as they come due. This could increase our credit risk exposure and harm our overall financial position.

In addition, global and domestic political conditions, terrorist acts, or acts of war (wherever located in the world) may damage or disrupt global and domestic markets and negatively affect our business, employees, customers, and suppliers, which in turn could have an adverse effect on our operations and our overall profitability.

**Market prices of Internet and technology companies have been highly volatile, and the market for our stock may be volatile as well.**

The stock market has experienced significant price and trading volume fluctuations, and the market prices of technology companies generally, and Internet-related software companies particularly, have been volatile. The market prices of technology companies generally, and technology service companies in particular, have been subject to significant downward pressure. In the past, following periods of volatility in the market price of a public company's securities, securities class action litigation has often been instituted against that company. Such litigation could result in substantial costs to us and a diversion of our management's attention and resources.

**Many significant corporate actions are controlled by our officers, directors and affiliated entities regardless of the opposition of other investors or the desire of other investors to pursue an alternative cause of action.**

Our executive officers, directors and entities affiliated with them, in the aggregate, beneficially own approximately 41% of our common stock at September 30, 2003. If they were to act together, these stockholders would be able to exercise control over most matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying or preventing a change in control of our company, which could cause our stock price to drop. These actions may be taken even if they are opposed by the other investors, including those who purchased shares in the initial public offering.

**Delaware law and our charter, bylaws and contracts provide anti-takeover defenses that could delay or prevent an acquisition of us, even if an acquisition would be beneficial to our stockholders.**

Provisions of Delaware law, our certificate of incorporation, bylaws and contracts could delay, defer or prevent an acquisition or change of control of us, even if an acquisition would be beneficial to our stockholders, and this could adversely affect the price of our common stock.

- Our bylaws limit the ability of our stockholders to call a special meeting and do not permit stockholders to act by written consent.
- We are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which prohibits us from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner.
- Several members of our senior management have contracts with us that provide for the acceleration of the vesting of their stock options upon termination following a change of control, and several members of our board of directors have contracts with us that provide for the acceleration of vesting of their stock options upon a change of control.
- Our certificate of incorporation permits our board to issue shares of preferred stock without stockholder approval. In addition to delaying or preventing an acquisition, the issuance of a substantial number of shares of preferred stock could adversely affect the price of the common stock.
- Additional provisions of our certificate of incorporation that may serve to delay or prevent an acquisition include a staggered board, advance notice procedures for stockholders to nominate candidates for election as directors, authorization of our board to alter the number of directors without stockholder approval and lack of cumulative voting.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT FINANCIAL MARKET RISK**

We develop and market our services primarily in the United States. As we expand our operations outside of the United States, our financial results could be affected by factors such as changes in foreign currency rates or weak economic conditions in foreign markets. Because all of our revenues are currently denominated in U.S. dollars, a strengthening of the dollar could make our services less competitive in international markets.

**Interest Rate Risk**

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio primarily consisting of debt instruments with high credit quality and relatively short average maturities of one to eighteen months in accordance with the Company’s investment policy. The policy also limits the amount of credit exposure to any one issuer. Notwithstanding our efforts to manage interest rate risks, there can be no assurances that we will be adequately protected against the risks associated with interest rate fluctuations.

**ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports

that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

#### *Litigation/Arbitration*

In November 2001, a securities class action lawsuit was filed in the U.S. District Court for the Southern District of New York against Corio, certain of its officers and certain of the underwriters involved in Corio's initial public offering. This is one of approximately 300 similar lawsuits in a coordinated proceeding sometimes referred to as "IPO allocation lawsuits" or "laddering lawsuits." The plaintiffs generally allege that the underwriters engaged in undisclosed improper practices by giving favorable allocations of IPO shares to certain investors in exchange for excessive brokerage commissions and/or agreements for those investors to purchase additional shares in the aftermarket at predetermined higher prices. The plaintiffs seek an unspecified amount of damages. In June 2003, the plaintiffs in these cases presented a settlement proposal to all of the issuer defendants. Under the proposed settlement, the plaintiffs proposed to dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers or companies will be required to pay the amount, if any, by which \$1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover \$1 billion and payment is required under the guaranty, Corio would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under its insurance policy, which is \$1 million. In July 2003, Corio tentatively agreed to accept this settlement proposal. The settlement is subject to acceptance by a substantial majority of the issuer defendants and execution of a definitive settlement agreement. The settlement is also subject to approval by the Court, which cannot be assured. If the settlement is not accepted by the requisite number of defendants or if it is not approved by the Court or if it otherwise is not consummated, Corio intends to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If the outcome of the litigation is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed. This lawsuit may be time consuming and expensive to defend and may divert management's attention and may be costly to Corio even if the plaintiff's settlement proposal is consummated.

In November 2001, Corio filed a demand for arbitration against LivePerson, Inc. with the American Arbitration Association in San Francisco County. The arbitration related to a dispute around a services contract between the parties. On July 23, 2003, the arbitrator in this dispute issued a judgment relating to the arbitration, awarding Corio damages of \$1,115,440 plus pre-judgment interest from September 21, 2001 (the interest is likely to total approximately \$210,000). LivePerson, Inc. has filed a motion to vacate the award in the Superior Court of California, County of San Francisco. Corio disputed the motion to vacate and is awaiting the judge's ruling on the motion.

### **ITEM 2. CHANGE IN SECURITIES AND USE OF PROCEEDS**

On July 20, 2000, the Company effected an initial public offering (the "IPO"), of 10,000,000 shares of its common stock at \$14.00 per share, pursuant to a registration statement (No. 333-35402) declared effective by the Securities and Exchange Commission on July 20, 2000. The IPO has been terminated, and all shares have been sold. The managing underwriters for the IPO were Goldman, Sachs & Co., Merrill Lynch & Co., Robertson Stephens and Epoch Partners. Aggregate proceeds from the IPO were \$140,000,000.

The Company incurred the following expenses in connection with the IPO: underwriters' discounts and commissions of \$9,800,000 and approximately \$2,000,000 in other expenses, for a total expense of \$11,800,000. No payments constituted direct or indirect payments to directors, officers or general partners of the Company or their associates, to persons owning 10% or more of any class of equity securities of the Company, or to any affiliates of the Company.

After deducting expenses of the IPO, the net offering proceeds to the Company were approximately \$128,200,000. From July 20, 2000, the effective date of the Registration Statement, to September 30, 2003, the ending date of the reporting period, the approximate amount of net offering proceeds used were \$23.3 million to repay outstanding debt and approximately \$70.9 million to fund operations. The remaining net proceeds are invested in short-term financial instruments.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

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

None

**ITEM 5. OTHER INFORMATION**

None

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

(a) Exhibits

- 31.1 Section 302 Certification of Chief Executive Officer
- 31.2 Section 302 Certification of Chief Financial Officer
- 32.1 Section 906 Certification of Chief Executive Officer
- 32.2 Section 906 Certification of Chief Financial Officer

- (b) On July 22, 2003, the Company furnished a Current Report on Form 8-K in connection with the press release of the Company's financial results for the quarter ended June 30, 2003

## SIGNATURES

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

Dated: November 14, 2003

CORIO, INC.

By:           /s/  GEORGE KADIFA            
George Kadifa  
President and Chief Executive Officer

By:           /s/  BRETT WHITE            
Brett White  
Executive Vice President and  
Chief Financial Officer

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
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32.2	Section 906 Certification of Chief Financial Officer