Let's talk about

what's happening

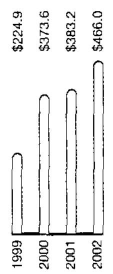
here and

now

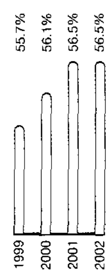
POLYCOM® 2002 Annual Report

This is our world

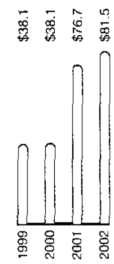
Net Revenue
(in millions)



Gross Margin



Operating Cash Flow
(in millions)



Financial Highlights

(dollars in millions, except per share data)	2002	2001	2000	1999
Operating Data:				
Net revenues	$ 466.0	$ 383.2	$ 373.6	$ 224.9
Gross margin	56.5%	56.5%	56.1%	55.7%
Pro forma operating margin	12.5%	15.9%	19.9%	19.3%
Pro forma net income	$ 49.7	$ 52.0	$ 56.7	$ 30.8
Pro forma diluted net income per share	$ 0.49	$ 0.59	$ 0.68	$ 0.40
Net income (loss)	$ 26.8	$ (27.7)	$ 37.5	$ 29.7
Diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45	$ 0.38
Balance Sheet Data:				
Cash and investments	$ 513.0	$ 218.9	$ 295.3	$ 81.6
Working capital	$ 202.9	$ 201.6	$ 326.0	$ 97.0
Total assets	$ 1,076.9	$ 821.2	$ 503.7	$ 185.2
Stockholders' equity	$ 903.7	$ 644.0	$ 422.8	$ 100.8
Operating cash flow	$ 81.5	$ 76.7	$ 38.1	$ 38.1
Reconciliation of GAAP Net Income (Loss) to Pro Forma Net Income:				
Net income (loss) including the effect of pro forma adjustments	$ 26.8	$ (27.7)	$ 37.5	$ 29.7
Acquisition-related costs	3.7	24.1	4.8	1.7
Purchased in-process research and development	0.9	52.6	–	–
Amortization of purchased intangibles and unearned stock-based compensation	17.7	4.1	–	–
Amortization of goodwill	–	2.1	–	–
Restructure costs	1.7	–	–	–
Grant repayment	–	–	5.9	–
Litigation settlement	(0.3)	–	6.5	–
Litigation reserve release	–	–	(1.8)	–
Loss on strategic investments	7.5	3.2	5.9	–
Combined income tax effect of pro forma adjustments	(8.3)	(6.4)	(2.1)	(0.6)
Pro forma net income	$ 49.7	$ 52.0	$ 56.7	$ 30.8

today

- In the private sector, companies are struggling to boost productivity while controlling costs.
- In the public sector, a new era of heightened vigilance and tightened security has arrived... just as budgets are being stretched to absorb these new requirements.
- Meanwhile, as organizations continue to fan out around the globe, essential personnel are often scattered among several far-flung offices.

Challenging times? No question about it. But impossible? Not by a long shot. Because when people share insights, ideas and information — when they cooperate, collaborate and communicate with a common goal in mind — the results can be astounding.

Fortunately, while bringing people together is harder than it used to be, connecting them *virtually* is no longer any trouble at all, thanks to rapid gains in IP connectivity that have made interaction through integrated voice, video, data and web communication easier — and more affordable — than ever before.

At the same time, Polycom-engineered advances in image and sound quality have transformed the virtual group or desktop meeting into an experience that's every inch the equal of an in-person interaction. That's why this is the best possible time to be the global leader in fully integrated, easy-to-use communications technology.

This is Polycom's moment.

From multipoint video conferences that connect dozens of executives in several different cities to one-to-one meetings over desktop PCs, Polycom makes the connection. Simple. Every time. Anytime.

Having spent the past year growing our public sector customer base, increasing our direct-touch to the enterprise, revamping our channel model, integrating acquisitions from previous years and gearing up for more widespread adoption of video, voice, and web communications by unveiling the most advanced new products on the market, we're confident that for Polycom, **the time is now.**


POLYCOM, INC. [PLCM]
one
POLYCOM
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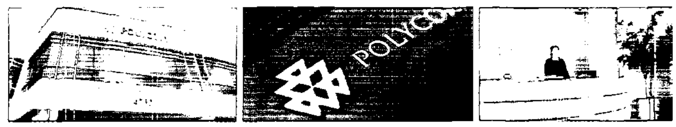
NASDAQ



to watch

What distinguishes leading communications companies in today's environment?

If what you do is develop and market the best technology available anywhere on Earth, you're still only about halfway there.

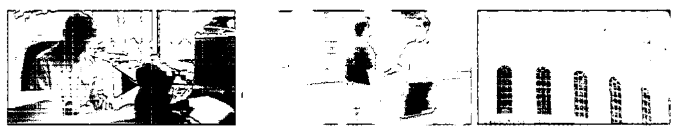
Far more important is understanding *people.* Since its founding in 1990, Polycom has excelled in creating best-in-class video, voice and web-based conferencing and collaboration systems and network infrastructure that *anticipate and conform* to the real needs of real people in real-life situations. Today, given the challenges posed by the geographic dispersal of knowledge workers throughout the extended enterprise, we know that what people need is the ability to connect, any way they want, with anyone, anywhere, quickly and easily, with no more effort than dialing a telephone requires.

Only The Polycom Office™ delivers that kind of strikingly seamless communications experience. With a range of components and networking options suited to rooms and offices of any size, operating over any type of network, the IT-friendly, highly flexible, affordable and scalable Polycom Office puts complete control where it belongs: in the hands of the people using it each and every day.

The results of our efforts are a series of superlatives. With approximately 1.2 million voice systems and 400,000* video systems installed, Polycom is the worldwide leader in group video conferencing, desktop video, network systems and voice conferencing products, and the only company that truly delivers an integrated conferencing and collaboration solution.

* Video systems installed include 200,000 Polycom systems and 200,000 pre-acquisition PictureTel systems.


far



and wide

You can't be everywhere at once. Or can you? More and more, students, educators, civil servants, elected officials, military personnel, corporate executives, health-care workers and many, many others are finding that until we human beings figure out some other way to bridge physical distance, Polycom technology is the best way to stay in touch and on top of things, wherever they're happening.

In recent months, Polycom has landed an astounding number of public- and private sector purchases worldwide, including major installations for: the Department of Homeland Security, various Department of Defense agencies, the U.S. Senate, the Mexican petroleum giant Pemex, NHK Japan Broadcasting, China Unicom, Chile's Corporacion del Cobre, the University of Notre Dame, the Centers for Medicare & Medicaid Services, the U.S. Immigration and Naturalization Service, China Construction Bank, Singapore Prisons and the U.S. Court of Appeals for the 4th Circuit. The governments of Ohio, New Mexico, Iowa, Montana and Texas joined our ever-expanding client roster, as did such corporate titans as Hoffman-LaRoche, Eli Lilly, Shell Information Technology International, Bristol-Myers Squibb, Verizon Wireless, BellSouth, Deloitte Consulting and Nestle Corporation.

And while leading organizations around the world are already migrating toward Polycom conferencing and collaboration communications to boost their productivity and maximize their overall effectiveness, this is likely to be just the tip of the iceberg. Annual spending on video, network systems, voice and network-access equipment is projected to reach $7.7 billion by 2005 from an estimated $4.3 billion in 2002.* And given that a majority of CEOs of companies with at least $1 billion in annual revenues indicated in a Booz Allen Hamilton survey released last year that increased use of videoconferencing was a key step their companies had taken, or planned to take, to ensure business continuity,** there's ample evidence to suggest we're at the foot of what could turn out to be a steep growth curve.

*Source: *Rich Media Conferencing Report*, copyright 2002, Wainhouse Research

**Source: *How Corporate Security is Reshaping the Post-9/11 Agenda*, copyright 2002, Booz, Allen & Hamilton Inc.


ready

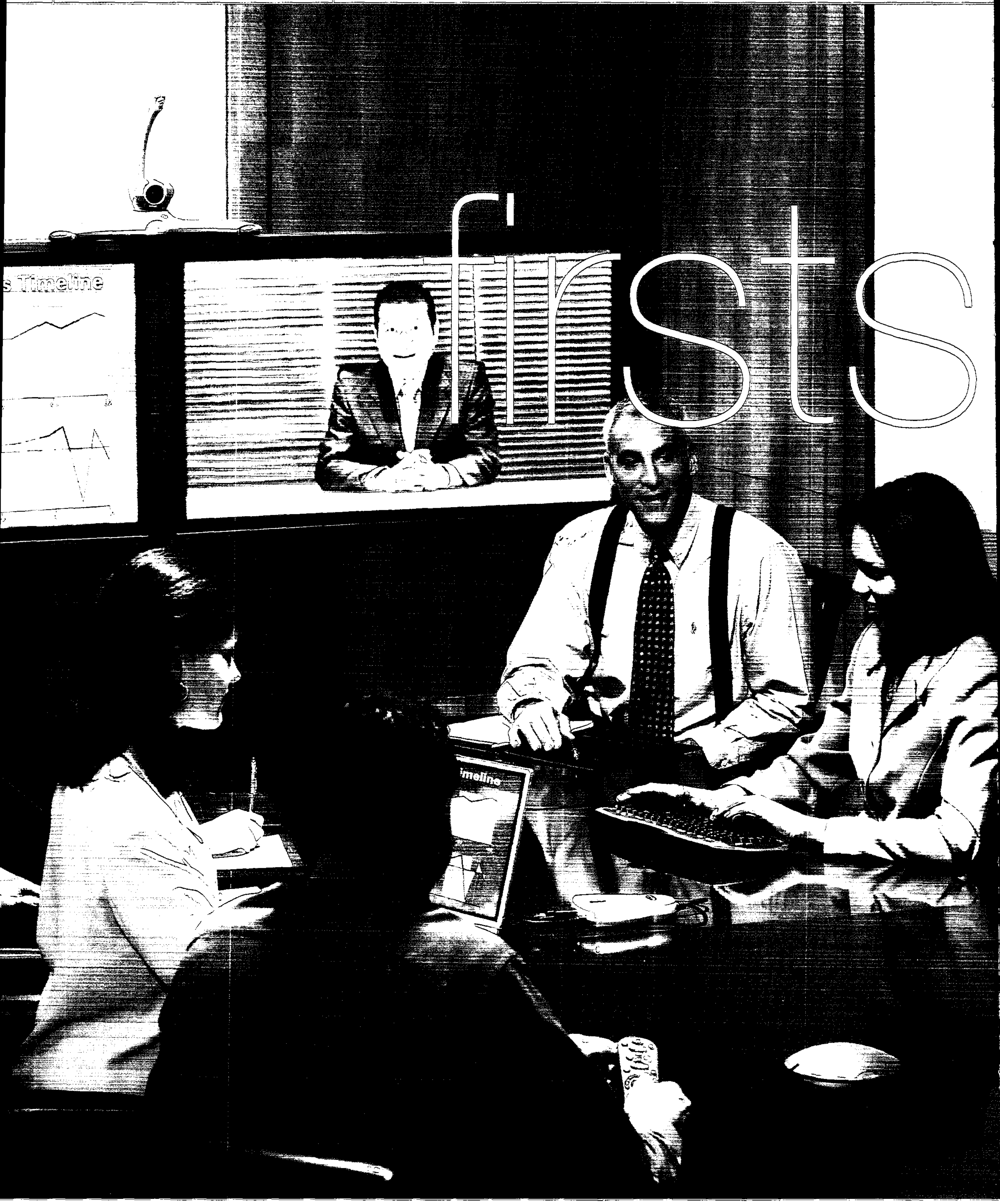
and able

With global demand for superior conferencing communications solutions on the rise, maintaining our worldwide leadership demands far more than just the industry's most sophisticated and adaptable technology. It also requires an organization and a plan of action that support Polycom's bid to drive widespread adoption of conferencing and collaboration technology for the benefit of a global user community.

In 2002, we took the dramatic step of reengineering our sales and marketing organization in order to ensure that Polycom is best positioned to support our growing customer base at the enterprise. Our job: to ensure modern organizations — whose expertise and operations often sprawl across cities, counties, countries and even entire continents — work better, smarter and faster with Polycom.

The watchwords for Polycom today are "high touch," meaning that we're working with a carefully selected network of channel partners and value-added resellers. These partners, including some of the world's true communications giants, have proven through their participation in our Certification and Training Programs that they recognize the unique advantages of Polycom technology and are equipped to offer the high level of customer service we consider essential to building mutually profitable long-term customer relationships.

Also during the year, Polycom solidified its across-the-board conferencing and collaboration strengths by fully integrating the four major acquisitions we undertook in 2001: Accord Networks, which extended Polycom's market leadership into network systems; PictureTel, which gave us added depth in the video collaboration arena; Circa Communications, which bolstered Polycom's IP telephony offerings; and ASPI Digital, which lent us a decisive edge in installed-room voice systems. Taken together, these organizations' integration into the Polycom fold have propelled our company to the forefront of modern workplace communications and are enabling us to face the future as our industry's only integrated end-to-end solution.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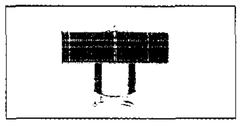
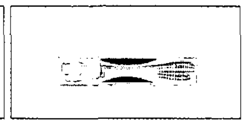




and bests

Polycom's discerning customers measure real progress in leaps and bounds. So when we announce new products and product-line extensions, as we did at the outset of 2003, there's no need for hype. The developments are both visible and audible.

By harnessing enormous leaps in worldwide IP connectivity, Polycom has delivered a host of truly stunning advances — a new generation of incomparable conferencing and collaboration solutions suited to every budget and every type of network. Among the most noteworthy developments:

Breaking down conference barriers: Until relatively recently, bringing together different groups and individuals using a variety of different voice, video or web-based systems was about as easy as arranging a superpower summit at the South Pole. Now, with Polycom's unified MGC conferencing platform, it's suddenly simple to connect audio, video, and web conferencing and collaboration systems across any network — even on the fly, as circumstances demand. At the same time, Polycom launched the MGC-25 system, which puts an industry-quality conferencing option within reach of small- and medium-sized enterprises for the very first time.

Sharper, clearer video without the added bandwidth: Polycom's Executive Collection represents the absolute summit of high fidelity, high resolution and high style. Quite simply, these systems are the most highly evolved ever developed for demanding executive environments. With plasma screens, rich, resonant sound and curb appeal to burn, the Executive Collection impresses on every level. The new ViewStation EX, meanwhile, sets a new price and performance standard for a midrange conference room system. Our iPower 9000-series video collaboration systems are the first in the industry to support H.264, a new video standard that permits high-quality imaging over lower bandwidths, but they won't be the last; we plan to include H.264 support with our other industry-leading video systems later in the year. Meanwhile, we added the dual-stream video capabilities that have proven so popular on our iPower units to the ViewStation EX, ViewStation FX, and VS4000 systems, thereby permitting the simultaneous display of high-quality video and high-resolution content.

Sound as clear as being there: In the voice-conferencing arena, Polycom unveiled the SoundStation VTX 1000 – the world's first wideband conference phone, whose unprecedented clarity and fidelity does for phones what color did for television.

Coupled with announcements of our industry's first comprehensive global enterprise support program and multi-vendor scheduling and network-management system, these initiatives proved that Polycom continues to break new ground for an integrated collaboration experience — at precisely the time when more and more people are asking themselves just how much more they could accomplish if they could connect … any way they want.

Advantage: Polycom

Doing more with less is now an imperative in almost every organization, so Polycom is helping them rise to the occasion with easy-to-install, easy-to-use, highly advanced and affordable conferencing and collaboration solutions for individuals and groups in every imaginable setting.

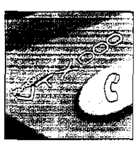
Since the early 1990s, we've been responsible for some of the most sweeping breakthroughs in the conferencing and collaboration arena. NOW, thanks to The Polycom Office™, organizations in both the public and private sectors are making some breakthroughs of their own.

Best products. Best performance. Best at making them all work seamlessly together.

Best of all, they're available here and NOW.

voice

Loud and clear.

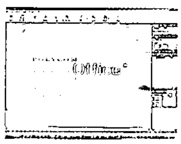


From desktop to tabletop to top-flight total-room installations, Polycom's best-in-class voice solutions offer the power to hear — and be heard — without missing a word. That's the sound of science.

video

Great viewpoints.

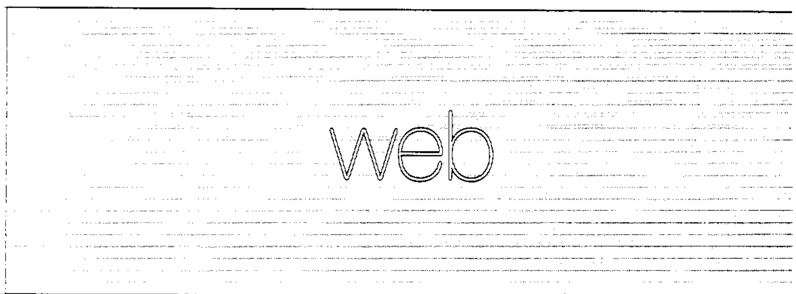
When there's important work to do, the focus has to be on the business at hand, not on the technology bringing you and your colleagues together. Because they deliver impeccable image quality and are remarkably simple to use, Polycom video conferencing and collaboration systems are quite literally your windows on the world.



The world within reach.

Polycom has both untangled the Web and unleashed its pure power to make the most of a rise in international IP network connectivity. Our WebOffice capitalizes on these "'Net" gains by putting users in the cockpit of a fully wired virtual office, where features such as multipoint face-to-face meetings and document-sharing capabilities are making today's work world future-perfect.

data



Keep everyone on the same page.

Polycom takes the devil right out of the details by ensuring that critical data is capable of being shared, scrutinized, streamlined and/or supplemented by several colleagues simultaneously.

Letter to shareholders

It is a measure of Polycom's unshakable faith in our products, people, progress and overarching business premise that we've devoted our 2002 annual report to talking about the present.

"Here and now" is a particularly promising place and time for Polycom: In recent years, we've undertaken — and successfully integrated — several strategic acquisitions that have transformed us from a highly successful niche player in our space to a company that is now the international standard-bearer for high-quality, easy-to-install and easy-to-use voice, video and web communications systems. As the only company capable of delivering a true "end-to-end" conferencing and collaboration solution, we've grown our customer base to include thousands of the world's most prominent public- and private-sector organizations. What's more, we've fundamentally changed the way millions of people work every day.

All of this activity has taken place against the backdrop of global circumstances that frankly play right into Polycom's hands: sweeping advances in IP connectivity, the continued dispersal of the modern enterprise, a universal need to boost productivity while adhering to strict budgets, the public sector's exponentially expanding interactive-communications needs, and the increasing challenges associated with long-distance travel. The convergence of all these factors places Polycom in an unprecedented sweet spot, a prime position to capitalize both on our own well-timed technological advances and on the conditions shaping the working world around us.

The impact of these various phenomena were evident in a snapshot of our year-end financials. Despite a chilly climate overall for technology spending, Polycom's 2002 net revenues were $466 million, 22 percent higher than our 2001 total of $383.2 million. Gross margins were a robust 56.5 percent, and operating cash flow grew to $81.5 million. While Polycom began 2002 with a strong balance sheet, we added additional muscle in the intervening 12 months to close out the year with $513 million of cash and investments ... and no debt. Solid overall profits, coupled with an improvement in day-sales outstanding (DSO) from 71 to 63 days and an increase in inventory turns from 4.5 to 5.2, left us in a strong cash position and provided us with a formidable financial base from which to build. It's important to note that the fourth quarter of 2002 was Polycom's 19th consecutive quarter of positive operating cash flow.

What's more, we're building fast. In 2002 and the first months of 2003, we took some of the boldest steps yet designed to prepare us for wider mainstream adoption of integrated conferencing technologies, among them:

Leadership

A series of key appointments to our executive team and board of directors dramatically expanded our ability both to meet and to further drive growing demand. Joining our board were Tom Stemberg, who pioneered the office superstore industry when he co-founded Staples in 1986 and turned it into an $11 billion industry giant, and Durk Jager, who as former chairman, president and CEO of Procter & Gamble brings to Polycom extensive branding and operating expertise. Patty Azzarello, a former member of the senior management team at Hewlett-Packard, was appointed Polycom's first chief marketing officer. She brings more than 18 years of marketing and management experience to our ranks. In addition, Kim Niederman was appointed senior vice president of worldwide sales. Kim is credited with building the sales force to launch Cisco's first business unit, which today accounts for approximately 50 percent of their revenues. Most recently, Ed Ellett, a former executive with Advanced Micro Devices who has also held management positions with Compaq, Cyrix, Dell and IBM, joined Polycom as senior vice president and general manager of video communications products.

High-touch strategy/channel optimization

Polycom successfully transitioned to a high-touch sales strategy and completed a wholesale channel realignment. Today, our direct-touch sales force is taking the first pivotal steps toward establishing and maintaining strong long-term relationships with end-user customers, then working hand-in-hand with our channel-management sales team to manage the fulfillment process. The result: Polycom is able to assume direct control of the enterprise relationship while continuing to benefit from our channel partners' experience and expertise in supply-management, distribution and logistics. During the fourth quarter of 2002, Polycom worked with our value-added resellers and distribution partners worldwide while adopting a network-systems certification requirement that helps uphold our exacting quality standards and ensure end-user satisfaction.

Product-line improvements

Polycom also introduced the finest products yet in our industry-leading arsenal. In February 2003, Polycom effectively redefined the high-end conferencing and collaboration market through our elegant new Executive Collection. At the same time, we remade the midrange market with our ViewStation EX, introduced the first-ever wideband conference phone and turned the vision of a unified conferencing experience from scientific theory to reality. We also unveiled our sector's only global service and support offering. These advances reaffirmed our position at the market's leading edge and should position us to fulfill our customers' extraordinarily high expectations.

A final note: Over the course of the past 18 months, we've seen significant growth in public-sector applications of conferencing and collaboration technology and notched a number of contract wins with organizations whose missions couldn't possibly be more critical. Now, a material portion of our revenues derives from these public-sector clients around the world, whose charges include everything from public safety and security to national defense, justice administration, distance-learning and emergency medical care.

We at Polycom take tremendous pride in the faith that international agencies and enterprises have placed in our technology, but we also see that vote of confidence as a challenge to keep improving our own performance, to continue pushing the technological envelope for the benefit of people and organizations worldwide who require the ability to connect, any way they want, every single day. Based on our achievements during the past year, I'm confident that Polycom has in place the essentials required to fulfill that promise.

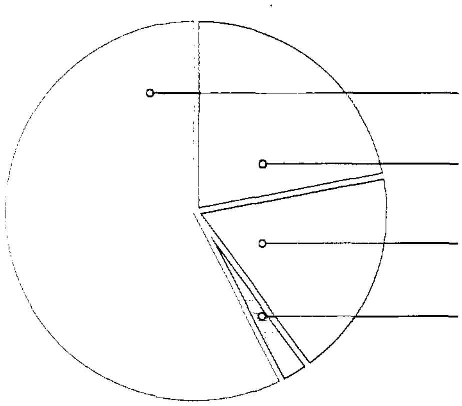
Sincerely yours,

Robert Hagerty
President and CEO

Strategic Partners and Global Sales Channels

Polycom has established partnerships with leading communications and technology firms to assist us in developing, marketing, distributing and manufacturing our products. For example, we have agreements with Alcatel, Cisco Systems and 3Com to develop and market voice-over-IP, or VoIP, communications products and have formed other strategic relationships with leading companies such as Avaya and Nortel Networks. We sell our products through a broad network of channel partners, including leading communications service providers, value-added resellers, distributors and retailers. We manufacture our products through a low-cost, outsourced model optimized for quality, reliability and fulfillment agility.

Global Approach – 2002 Sales by Region (in millions)



Financials

This Annual Report contains forward-looking statements regarding future events, future demand for our products, expansion into new and existing markets and our future growth prospects that involve risks and uncertainties. Readers are cautioned that these forward-looking statements are only predictions and may differ materially from actual future events or results. Many of these risks and uncertainties are discussed under "Other Factors Affecting Future Operations" beginning on page 35. Readers are also referred to the documents filed by Polycom with the SEC, including our Annual report on Form 10-K for 2002.

Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with Polycom's audited consolidated financial statements and related notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included elsewhere in this annual report. The consolidated statement of operations data for the years ended December 31, 2002, 2001 and 2000 and the consolidated balance sheet data at December 31, 2002 and 2001, are derived from, and are qualified by reference to, the audited consolidated financial statements that are included in this annual report. The consolidated statement of operations data for the years ended December 31, 1999 and 1998 and the consolidated balance sheet data at December 31, 2000, 1999 and 1998 are derived from audited consolidated financial statements which are not included in this annual report. This data gives retroactive effect to our acquisitions of Accord on February 28, 2001, and Atlas on December 1, 1999, which were treated as a pooling of interests. For 2001, 2000, 1999 and 1998 we used a 52 or 53-week fiscal year. As a result, our fiscal year may not have ended as of the calendar period. For 2002, we changed to a fiscal year ending on December 31. For convenience of presentation, the consolidated financial statements have been shown as ending on December 31 of each applicable period.

(in thousands, except per share data)	YEAR ENDED DECEMBER 31, 2002	2001	2000	1999	1998
Consolidated Statement of Operations Data:					
Net revenues	$ 465,959	$383,189	$373,554	$224,902	$129,483
Cost of net revenues	202,712	166,747	164,099	99,698	63,092
Gross profit	263,247	216,442	209,455	125,204	66,391
Operating expenses:					
Sales and marketing	98,998	74,653	70,745	43,366	25,845
Research and development	76,812	59,416	43,570	25,724	17,158
General and administrative	29,947	21,564	20,702	12,729	7,751
Acquisition-related costs	3,699	24,077	4,768	1,650	185
Purchased in-process research and development	900	52,642	—	—	—
Amortization of purchased intangibles	17,135	3,905	—	—	—
Amortization of goodwill	—	2,114	—	—	—
Restructure costs	1,657	—	—	—	—
Grant repayment	—	—	5,876	—	—
Litigation settlement	(257)	—	6,500	—	—
Litigation reserve release	—	—	(1,843)	—	—
Total operating expenses	228,891	238,371	150,318	83,469	50,939
Operating income (loss)	34,356	(21,929)	59,137	41,735	15,452
Interest income, net	9,492	12,755	8,419	1,629	927
Loss on strategic investments	(7,465)	(3,178)	(5,854)	—	—
Other income (expense), net	527	(608)	8	(31)	(9)
Income (loss) before provision for income taxes	36,910	(12,960)	61,710	43,333	16,370
Provision for income taxes	10,150	14,740	24,247	13,616	1,749
Net income (loss)	$ 26,760	$ (27,700)	$ 37,463	$ 29,717	$ 14,621
Basic net income (loss) per share	$ 0.27	$ (0.33)	$ 0.50	$ 0.45	$ 0.25
Diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45	$ 0.38	$ 0.20
Weighted average shares outstanding for basic net income (loss) per share	99,324	85,123	75,264	65,475	58,012
Weighted average shares outstanding for diluted net income (loss) per share	100,696	85,123	83,828	77,848	71,609

(in thousands)	DECEMBER 31, 2002	2001	2000	1999	1998
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 193,861	$150,180	$241,798	$ 66,554	$ 24,925
Working capital	202,913	201,649	325,969	97,006	51,307
Total assets	1,076,874	821,165	503,708	185,219	88,418
Mandatory redeemable convertible preferred stock	—	—	—	25,916	19,415
Total stockholders' equity	903,743	643,986	422,783	100,810	40,855

Management's Discussion And Analysis Of Financial Condition And Results Of Operations

YOU SHOULD READ THE FOLLOWING DISCUSSION IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES. EXCEPT FOR HISTORICAL INFORMATION, THE FOLLOWING DISCUSSION 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. THESE FORWARD-LOOKING STATEMENTS, INCLUDING, AMONG OTHER THINGS, STATEMENTS REGARDING OUR ANTICIPATED PRODUCTS, CUSTOMER AND GEOGRAPHIC REVENUE LEVELS AND MIX, GROSS MARGINS AND OPERATING COSTS AND EXPENSES, INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER SIGNIFICANTLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE FUTURE RESULTS TO DIFFER MATERIALLY FROM THOSE DISCUSSED IN THE FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN "OTHER FACTORS AFFECTING FUTURE OPERATIONS" IN THIS DOCUMENT AS WELL AS OTHER INFORMATION FOUND ELSEWHERE IN THIS ANNUAL REPORT.

Overview

We were incorporated in December 1990. We were engaged principally in research and development from inception through September 1992 when we began volume shipments of our first voice communications product, the SoundStation. In the second quarter of 2001 and the fourth quarter of 2001, we completed our acquisitions of Circa Communications, Ltd., or Circa, and Atlanta Signal Processors, Incorporated, or ASPI, respectively. These acquisitions added to our voice communications product line which currently consists of the SoundStation, VoiceStation, SoundPoint, Vortex and VoIP product families. In January 1998, we completed the acquisition of ViaVideo Communications, Inc., or ViaVideo, a development stage company that designed and developed high quality, low cost, easy-to-use, group video communications systems. In February 1998, we began customer shipments of our ViewStation products. In the fourth quarter of 2001, we completed our acquisition of PictureTel Corporation, adding to our video communications product line which currently consists of the ViewStation, iPower, Visual Concert, GMS and ViaVideo product families. In December 1999, we acquired Atlas Communication Engines, Inc., or Atlas, a privately held OEM supplier of integrated access devices, or IADs, and an emerging supplier of digital subscriber line, or DSL, routers which provide voice and data over DSL networks. In January 2003, we sold this product line to Verilink Corporation (See "Recent Developments" above). Our network access product offerings were comprised of our NetEngine line of IADs and DSL routers. In February 2001, we acquired Accord Networks Ltd., or Accord, a leading provider of next generation, rich-media network products that enable Internet Protocol and other network voice and video communications in both the customer premises and service provider markets. Accord's products were our initial network systems product offerings. In the second quarter of 2002, we completed our acquisition of MeetU.com, Inc., or MeetU, adding to our network systems product line which currently consists of the MGC and GW, Voice Bridge, PathNavigator and WebOffice product families which provide multipoint video connectivity and gateway capability through disparate networks.

Our consolidated financial statements for the year ended December 31, 2002 include the effects of the PictureTel, Circa and ASPI acquisitions. MeetU is included in our consolidated financial position, results of operations and cash flows from June 20, 2002, the date of acquisition.

In fiscal 2002, we derived a substantial majority of our net revenues from sales of our ViewStation, iPower, network systems and SoundStation products and iPower-related services. We anticipate that our video communications products, network systems, voice communications products and iPower-related services will account for a substantial majority of our net revenues for at least the next twelve months.

Any factor adversely affecting the demand or supply for these products would harm our business, financial condition, cash flows and results of operations. In fiscal 2002, our Network Systems segment contributed more to our profitability, as a percentage of net revenues, than our Communications segment due principally to higher gross margins on the network systems products. The Network Access segment had negative gross margins. See Note 18 to Notes to Consolidated Financial Statements.

Results of Operations for the Three Years Ended December 31, 2002

The following table sets forth, as a percentage of net revenues, consolidated statements of operations data for the periods indicated.

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Net revenues	100%	100%	100%
Cost of net revenues	44%	44%	44%
Gross profit	56%	56%	56%
Operating expenses:			
Sales and marketing	21%	19%	19%
Research and development	17%	15%	12%
General and administrative	6%	6%	5%
Acquisition-related costs	1%	6%	1%
Purchased in-process research and development	0%	14%	0%
Amortization of purchased intangibles	4%	1%	0%
Amortization of goodwill	0%	1%	0%
Restructure costs	0%	0%	0%
Grant repayment	0%	0%	2%
Litigation settlement	0%	0%	2%
Litigation reserve release	0%	0%	(1%)
Total operating expenses	49%	62%	40%
Operating income (loss)	7%	(6%)	16%
Interest income, net	2%	4%	2%
Loss on strategic investments	(1%)	(1%)	(2%)
Other income (expense), net	0%	0%	0%
Income (loss) before provision for income taxes	8%	(3%)	16%
Provision for income taxes	2%	4%	6%
Net income (loss)	6%	(7%)	10%

Net Revenues

Net revenues for the year ended December 31, 2002 increased 22% over the same period of 2001. Net revenues for the year ended December 31, 2002, in the Communications and Network Systems segments, increased 29% and 4%, respectively, while the Network Access segment decreased 16% over the same period in 2001. The increase in Communications was due primarily to increased sales volume of our video communications products and iPower-related services. The video communications products net revenues increased to $261.6 million for 2002 from $205.0 million in 2001. Although the ViewStation product line contributed to the increase in video communications net revenues, this growth was primarily due to the addition of the iPower video product line added through the acquisition of PictureTel in October 2001. Due to the timing of this acquisition, iPower product revenue is reflected in the prior year numbers only for the fourth quarter of 2001. Although overall in 2002, video revenue grew, we experienced sequential quarterly revenue decreases in the second, third and fourth quarters of 2002, primarily related to declines in our video communications product revenue in both the Viewstation and iPower product lines. The iPower-related services net revenues was $29.3 million for the year ended December 31, 2002 compared to $5.9 million reported in the same period of 2001, as this revenue stream was also added through the acquisition of PictureTel. Also contributing to the increase in net revenues was an increase in the service revenue related to our network systems products and an increase in sales of our voice over IP and installed voice products, offset by decreases in sales volumes of our circuit switch voice communications products and decreases in sales in the network access product line for 2002 when compared to 2001. The installed voice products were added through the acquisition of ASPI in the fourth quarter of 2001. In 2002, we began to implement a new direct-touch strategy in concert with a realignment of our channel partner strategy. As part of this new channel partner strategy, the channel inventory model is changing to reduce channel inventories to a more optimal level or to a drop-shipment method to certain channel partners' end user customers. During the third quarter and fourth quarter of 2002 we believe our channel partners' video and voice inventory decreased over the second and third quarter of 2002, respectively. This decrease was due in part to this shift in channel partner strategy resulting in us shipping fewer video and voice units to channel partners in the third and fourth quarter of 2002. The decreased channel inventory levels had less impact on sales of iPower units, which are not typically carried in inventory by our channel partners. On a regional basis, North America, Europe, Asia and Latin America revenues increased 10%, 40%, 44% and 67%, respectively, for the year ended December 31, 2002 over the year ended December 31, 2001. Included in product revenues for voice, non-iPower video and network systems products are immaterial amounts of related service revenue.

Net revenues for the year ended December 31, 2001 increased 3% over the same period of 2000. Net revenues for the year ended December 31, 2001, in the Communications, Network Systems and Network Access segments, decreased 6%, increased 97% and decreased 45%, respectively, over the same period in 2000. The increase in overall revenue was due to increased sales volume of our network systems products which increased from $42.3 million in 2000 to $83.1 million in 2001, and to iPower-related service revenue of $5.9 million resulting from our acquisition of PictureTel in October 2001. These increases were offset by decreases in volume of our network access, voice communications and video communications product revenue which decreased 45%, 15% and 5%, respectively, year over year. The decrease in ViewStation product sales was largely offset by iPower product sales in the fourth quarter of 2001. We believe that lower sales of our video, voice and network access products for 2001over 2000 were due principally to a reduction in capital spending in the United States due to the downturn in economic activity during 2001, which resulted in our channel partners reducing the level of inventory that they typically hold. On a regional basis, Asia and Europe revenues increased 39% and 3% respectively, in 2001 over 2000 while North America and Latin America revenues decreased slightly in 2001 over 2000. Included in product revenues for voice, non-iPower video and network systems products are immaterial amounts of related service revenue.

A major contributor to the expected growth of the broadband market has been the deployment of DSL. Beginning in the second half of 2000, the market for broadband services experienced a severe downturn, characterized by financial troubles for many telecommunications service providers and delays in delivering broadband services. This downturn continued through 2002 and negatively impacted sales of our network access products. These DSL providers were customers of our network access products through OEM providers that we used as channel partners. These service delays slowed the expected growth in this market which in turn slowed sales volumes of our network access products. As a result, network access product revenues decreased 15% in 2002 over 2001. In January 2003, we made the decision that this business was no longer strategic to our overall product offerings, and sold to Verilink Corporation certain fixed assets and intellectual property rights relating to our network access product line, including our line of NetEngine integrated devices, for a total of up to $3.0 million in cash, of which (i) $1.0 million was paid to us at closing, (ii) $0.25 million will be paid to us on the first anniversary of the closing, and (iii) up to $1.75 million will be paid to us quarterly based on ten percent of Verilink's revenues related to sale of NetEngine products. As a result of the sale of the network access product line to Verilink Corporation, we will have no future revenue associated with this product line.

In 2002, 2001, and 2000, we derived a substantial majority of our net revenues from sales of our video communication, voice communication and network systems products. No customer accounted for more than

10% of our net revenues for the fiscal years ended December 31, 2002, 2001 and 2000. For the year ended December 31, 2002, our network systems segment had two channel partners that represented approximately 20% of Network Systems Segment revenues. We believe it is unlikely that the loss of one or both of these channel partners would have a material adverse affect on the net revenues of this segment as we believe end-users would likely purchase our network systems products from a different channel partner. See Note 18 of Notes to Consolidated Financial Statements for business segment information.

Our business is subject to the risks arising from domestic and global economic conditions. During 2001 and 2002, the economic downturn in the United States slowed overall spending to the point where industries delayed or reduced technology purchases. If this economic downturn and uncertainty in technology spending continues through 2003, as it currently appears to be, it will likely have an adverse effect on our results of operations for 2003. If our channel partners delay or reduce orders for our products, we may fall short of our revenue expectations for 2003, as we did in the second and third quarters of 2002, and for the entire year. Further, if these conditions persist, our business and financial performance will continue to be negatively affected as they were in 2002 and 2001. For example, in the third quarter of 2002, these conditions resulted in sequentially weaker video communications, voice communications, network systems and network access product revenues from the second quarter of 2002. The extent of adverse economic conditions in 2003 is difficult to predict at this time, which represents a significant uncertainty with respect to our 2003 operating results. In addition, weakness in the end-user market for our products could negatively affect the revenue and cash flow of our channel partners who could, in turn, delay orders and delay paying their obligations to us. This could harm our revenues, profitability, financial condition and cash flow. Further, we believe that our plans to further reduce our channel inventories to a more optimal level may limit revenue growth and may cause a decrease in revenue in the near term, as they did in the fourth quarter of 2002. In addition, we plan to continue to implement changes to our channel partner strategy which will result in a smaller number of channel partners, a change in the mix of our channel partners and a shift to a model with more direct interaction between us and our direct end-user customers. These changes may cause additional disruptions in our channels and negatively impact revenue growth in the near term.

International net revenues, or revenues outside of the U.S. and Canada, accounted for 42%, 36%, and 32% of total net revenues for 2002, 2001 and 2000, respectively. See Note 18 of Notes to Consolidated Financial Statements. The absolute dollar increase in the international component of our revenues for 2002 over 2001 was primarily driven by increased sales volume of our video communications and network systems products in Europe, Asia and Latin America and an increase in network access products in Europe and Asia. Additionally, international, iPower-related services net revenues were $11.1 million and $2.5 in 2002 and 2001, respectively, as this revenue stream was added through the acquisition of PictureTel. The improvement in international revenues in 2001 over 2000 was due to growth in Asia of sales of our video communications products, growth in Asia and Europe of sales of our network systems products and by reductions in sales of video, voice and network access products in North America. In fiscal year 2000, we made investments in Europe, Asia and, to a lesser degree, in Latin America. This expansion of resources was the main reason for the increase in the international percentage of total net revenues in 2001 from 2000 despite the increase in net revenue from sales of our network systems products which were sold primarily in North America.

We anticipate that international sales will continue to account for a significant portion of total net revenues for the foreseeable future, and we plan to continue our expansion in Asia and Europe. International sales, however, are subject to certain inherent risks, including potential economic weakness in international markets, political instability, any adverse economic impact of terrorist attacks and incidents and any military response to those attacks, war or other hostilities, changes in foreign government regulations and telecommunications standards, export license requirements, tariffs and taxes, other trade barriers, fluctuations in currency exchange rates, difficulty in staffing and managing foreign operations, longer payment cycles, and difficulty in collecting accounts receivable. Significant adverse changes in currency exchange rates, as happened in the European market in 2000 and in the Asian market in late 1997, could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in revenue or profitability in that country. Additionally, international net revenues may fluctuate as a percentage of net revenues in the future as we introduce new products since we expect to initially introduce these products in North America, and also, because of the additional time required for product homologation and regulatory approvals of new products in international markets. To the extent we are unable to expand international sales in a timely and cost-effective manner our business could be harmed. We cannot make assurances that we will be able to maintain or increase international market demand for our products. Additionally, to date, a substantial majority of our international sales have been denominated in U.S. currency. However, if our international sales were denominated in local currencies in the future, these transactions would be subject to currency fluctuation.

Cost of Net Revenues

	YEAR END DECEMBER 31,			INCREASE FROM PRIOR YEAR	
$ in thousands	2002	2001	2000	2002	2001
Cost	$202,712	$166,747	$164,099	22%	2%
% of Net Revenues	44%	44%	44%	0%	0%

Cost of net revenues consists primarily of contract manufacturer costs, including material and direct labor, our manufacturing organization, tooling depreciation, warranty expense, freight expense, royalty payments and an allocation of overhead expenses. The cost of net revenues as a percentage of total net revenues for fiscal 2002 was 44% which is consistent with fiscal 2001. Overall, margins remained flat as a result of a more favorable product mix generated from increased shipments of higher margin video products and more favorable network access margins due to less write-downs of inventory in 2002 over 2001, offset by higher service revenue at lower margins. As a result of the sale of the network access product line to Verilink Corporation, we will have no future cost of sales associated with this product line. In fiscal 2002, our Network Systems segment, as a percentage of net revenues, contributed more to our profitability than our Communications segment due principally to higher gross margins on the network systems products. The Network Access segment had negative gross margins. See Note 18 to Notes to Consolidated Financial Statements.

When comparing the cost of net revenues as a percentage of net revenues in 2001 to 2000, the percentage was again the same at 44%. Overall, a more favorable product mix generated from increased shipments of higher margin network systems products was offset by a write-down of network access inventory to net realizable value.

Forecasting future gross margin percentages is difficult, and there are a number of risks associated with maintaining our current gross margin levels. For example, uncertainties surrounding revenue levels and related production level variances, competition, changes in technology, changes in product mix, manufacturing efficiencies of subcontractors, manufacturing and purchased part variances, warranty costs and timing of sales over the next few quarters can cause our cost of net revenues percentage to fluctuate significantly. Additionally, our iPower products, VoIP products and other desktop products have a significantly higher cost of net revenue percentage than our network systems, ViewStation and SoundStation products. Accordingly, any significant revenue growth in our iPower, VoIP and other desktop products will have a negative effect on our cost of net revenues percentages. Also, we may reduce prices on our products in the future for competitive reasons, as a result of a difficult economy or to stimulate demand which could increase our cost of net revenues percentage, and there is the risk that any of these potential price reductions would not offset competitive pressures or stimulate demand. In addition, cost variances associated with the manufacturing ramp of new products, or the write-off of initial inventory purchases due to product launch delays or the lack of market acceptance of our new products such as our iPower 9000 series, VoicePlus bridging solution, VoIP telephony products, VTX 1000, ViewStation EC, Viewstation EX, MGC 25 or any other new product under development could occur, which would increase our cost of net revenues percentage in any quarter. In addition to the uncertainties listed above, cost of net revenues as a percentage of net revenues may increase due to a change in our mix of distribution channels and the mix of international versus North American revenues,$ or revenues from Canada and the United States.

Sales and Marketing Expenses

	YEAR END DECEMBER 31,			INCREASE FROM PRIOR YEAR	
$ in thousands	2002	2001	2000	2002	2001
Expense	$98,998	$74,653	$70,745	33%	6%
% of Net Revenues	21%	19%	19%	2%	0%

Sales and marketing expenses consist primarily of salaries and commissions for our sales force, advertising and promotional expenses, product marketing, and an allocation of overhead expenses, including facilities and IT costs. The 33% increase in absolute dollars in 2002 over 2001 was due primarily to the increase in headcount in our sales force and increased product sales driven largely by the PictureTel acquisition in the fourth quarter of 2001 and to a lesser extent our focus on the public sector market. As a result, we had increases in salaries, commissions and headcount-related expenses, such as travel. Also contributing to the absolute dollar increase was our overall efforts to expand our marketing efforts, including the addition of a Chief Marketing Officer and related staffing, increased spending on promotional materials, trade shows, and outside consultants. This increase was partially offset by cost containment measures and expense controls implemented in the second half of 2002 due to the continued economic downturn and uncertainty in technology spending. The 6% increase in absolute dollars in 2001 over 2000 was due primarily to increased marketing efforts related to our network systems products and to an increase in our investment in our worldwide sales effort. The sale of the network access product line will not have a significant impact on our sales and marketing expense.

We expect to continue to increase our sales and marketing expenses in absolute dollar amounts as we expand North American and international markets, market new products and expand the public sector market. Further, our acquisitions of PictureTel, Accord, Circa, MeetU and ASPI expanded our product portfolio into new products and markets which require significant additional marketing expenditures to communicate the value of the new product offerings as well as significant additional sales expenditures to develop our sales organization to market these products. Due to the innovative nature of our products, such as ViaVideo, ViewStation, iPower, MGC, GW, WebOffice, PathNavigator, Vortex and VoIP products, we believe we will incur additional expenses for sales and marketing, especially advertising, to expand the overall market for, to drive penetration of, and increase the adoption rate of this technology and our products, and to educate potential end-users as to the desirability of these products over competing products.

Research and Development Expenses

	YEAR END DECEMBER 31,			INCREASE FROM PRIOR YEAR	
$ in thousands	2002	2001	2000	2002	2001
Expenses	$76,812	$59,416	$43,570	29%	36%
% of Net Revenues	17%	15%	12%	2%	3%

Research and development expenses consist primarily of compensation costs, outside services, expensed materials, depreciation and an allocation of overhead expenses, including facilities and IT costs. Increases in research and development expenses occurred for all product lines in both 2002 and 2001 except network access products, which declined by 39% in 2002 over 2001 and declined slightly in 2001 compared with 2000. The 2% and 3% increase in research and development expense as a percentage of net revenues in 2002 and 2001, respectively, reflects our continued investments in our existing products as well as new investments in our iPower products, which were acquired through the PictureTel acquisition, investments in integrating all of our existing and acquired products and developing new products which were launched in the first quarter of 2003. This increase was partially offset by cost containment measures and expense controls implemented in the second half of 2002 due to the continued economic downturn and uncertainty in technology spending. In 2002, individually, video product development expenditures accounted for 93% of the total increase due to the addition of the PictureTel research and development team for the full year versus just part of the fourth quarter in 2001, voice product development expenditures accounted for 15% of the total increase, network systems product development expenditures accounted for 9% of the total increase, corporate product development expenses accounted for 1% of the change and the decrease in network access product development expenses accounted for 18% of the change. In 2001, individually, the increase in network systems product development expenditures accounted for 43% of the total increase, video product development expenditures accounted for 52% of the total increase, voice product development expenditures accounted for 6% of the total increase and the decrease in network access product development accounted for 1% of the change. We are currently devoting a significant portion of our research and development expenses toward the product lines gained through the PictureTel, Accord, Circa, ASPI and MeetU acquisitions. In addition, we are investing research and development resources to enhance and upgrade our Polycom Office suite of products which provides a complete end-to-end communications solution. Such products include our ViewStation, iPower, GMS, MGC, WebOffice, PathNavigator, SoundStation, VoiceStation and Vortex which provide multipoint video and voice connectivity and gateway capability through disparate networks. In all years presented, all research and development costs have been expensed as incurred.

We believe that technological leadership is critical to our success and we are committed to continuing a high level of research and development to develop new technologies and combat competitive pressures. Also, continued investment in new product initiatives will require significant research and development spending. Consequently, we intend to increase research and development expenses in absolute dollars in the future. As a result of the sale of the network access product line, we will have no future research and development expense associated with this product line.

General and Administrative Expenses

	YEAR END DECEMBER 31,			INCREASE FROM PRIOR YEAR	
$ in thousands	2002	2001	2000	2002	2001
Expenses	$29,947	$21,564	$20,702	39%	4%
% of Net Revenues	6%	6%	5%	0%	1%

General and administrative expenses consist primarily of compensation costs, professional service fees, allocation of overhead expenses, including facilities and IT costs, and bad debt expense. The increase in absolute dollars spending in general and administrative in 2002 over 2001 was primarily the result of higher costs associated with increased infrastructure costs, outside services, including increased costs associated with regulatory requirements, and an increase in bad debt expense. This increase was partially offset by cost containment measures and expense controls implemented in the second half of 2002 due to the continued economic downturn and uncertainty in technology spending. Individually, the increase in infrastructure costs accounted for 24% of the total increase, outside services accounted for 38% of the total increase, bad debt expense accounted for 27% of the total increase, with the remaining increase related to numerous smaller items. The increase in general and administrative expenses in the year ended December 31, 2001 over the same period of 2000 was due to higher costs associated with increased staffing and other infrastructure costs offset slightly by lower expenditures associated with the implementation of our enterprise resource planning system implemented in 2000 and expense controls initiated in 2001.

We believe that our general and administrative expenses will likely continue to increase in absolute dollar amounts in the future primarily as a result of expansion of our administrative staff and costs related to supporting a larger company, increased costs associated with regulatory requirements and our continued investments in international regions. These additional expenses principally relate to expansion of our information system and infrastructure charges related to the significant investments being made in international regions. Additionally, predicting the timing of bad debt expense associated with uncollectible receivables is difficult, particularly during the current economic environment, and material charges due to uncollectability of our receivables could increase our general and administrative expenses and negatively affect our profitability in the quarter they are recorded. The sale of the network access product line will not have any impact on our general and administrative expense.

Acquisition-related Costs

We recorded a charge to operations of $3.7 million in 2002, $24.1 million in 2001, and $4.8 million in 2000 for acquisition-related costs. For 2002, the acquisition-related charges related primarily to the acquisition of PictureTel and consisted primarily of professional services costs to complete the integration of the companies. In 2001, these costs were associated with the acquisitions of Accord, Circa, PictureTel and ASPI. The 2001 costs were made up of $3.7 million of restructuring charges related to facility closings and severance costs, $6.7 million of asset impairment charges and $13.7 million of other acquisition costs including outside financial advisory, legal, accounting and consulting services. In 2000, these costs were related to the acquisition of Accord completed in February 2001. These charges include the cost of actions designed to improve our combined competitiveness, productivity, and future profitability, and primarily relate to the elimination of redundant and excess facilities and workforce in our combined businesses and the elimination of redundant assets. If we acquire another business in the future, we may incur material acquisition expenses related to such transactions. See Note 5 of Notes to Consolidated Financial Statements.

Purchased In-process Research and Development

In the years ended December 31, 2002 and 2001, we incurred charges totaling $0.9 million and $52.6 million, respectively, for in-process research and development. This research and development was acquired in 2002 as part of the acquisition of MeetU.com, Inc. and in 2001 as part of the acquisitions of PictureTel, Circa and ASPI, and comprised $49.3 million, $2.4 million and $0.9 million for each of these respective acquisitions. See Note 3 of Notes to Consolidated Financial Statements. The amounts allocated to purchased in-process research and development were determined by management, after considering among other factors, the results of an independent appraisal based on established valuation techniques in the high-technology communications industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed for these in-process research and development projects. The cost approach, which uses the concept that replacement cost is an indicator of fair value, was the primary technique utilized in valuing the in-process research and development acquired in the MeetU transaction. The cost approach is based on the premise that a prudent investor would pay no more for an asset than the cost to replace that asset with a new one. Replacement cost was based on total costs, net of the unrealized income tax deduction benefit, spent developing the in-process technology from MeetU's inception through the date the valuation was performed. The income approach, which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and in-process research and development in 2001. The estimated net cash flows from the products are based upon estimates of revenue, cost of revenue, research and development costs, sales and marketing costs and income taxes from such projects and were discounted at rates ranging from 30 to 40 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. Our efforts to develop the purchased in-process research and development into commercially viable products principally relate to the completion of all planning, designing, prototyping and testing activities that are necessary to establish that the products can be produced to meet its design specifications including function, features and technical performance requirements. It is reasonably possible that the development of this technology could fail because of either prohibitive cost, inability to perform the required efforts to complete the technology or other factors outside of our control such as a change in the market for the resulting developed products. In addition, at such time that the project is completed it is reasonably possible that the completed products do not receive market acceptance or that we are unable to produce and market the product effectively.

The following are the values assigned to each acquired PictureTel in-process research and development project at the time of acquisition and the estimated completion percentages, expected technology lives and estimated time and costs to complete as of December 31, 2002 (in thousands):

IN PROCESS RESEARCH AND DEVELOPMENT PROJECT	VALUE ASSIGNED TO IN PROCESS PROJECT	PERCENTAGE COMPLETE	EXPECTED LIFE OF TECHNOLOGY	ESTIMATED TIME TO COMPLETE	ESTIMATED COST TO COMPLETE
Project A	$ 5,161	100%	4 years	Complete	$ —
Project B	12,250	100%	5 years	Complete	—
Project C	24,750	60%	5 years	12-15 months	4,000
Other projects	7,131	74%	3-5 years	9-12 months	2,500
Total	$49,292				$6,500

During 2002, the Company completed and shipped product associated with Projects A, B and two of the Other projects. The costs to complete these projects were in line with our expectations. The Company terminated one of the Other projects and is continuing to develop Project C and some smaller Other projects. The remaining projects are for next generation products to enhance PC based voice and video conferencing features.

Amortization of Purchased Intangibles

In year ended December 31, 2002, we recorded $17.1 million in amortization of purchased intangibles acquired in the PictureTel, Circa, ASPI and MeetU acquisitions and in the year ended December 31, 2001, we recorded $3.9 million in amortization of purchased intangibles acquired in the PictureTel, Circa and ASPI acquisitions. Purchased intangible assets are being amortized to expense over their estimated useful lives of three years. Under Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets," (SFAS 142), purchased intangibles no longer meeting the criteria to be recorded separately from goodwill must be reclassified to goodwill, and purchased intangibles deemed to have indefinite lives must no longer be amortized. In the first quarter of 2002, we reclassified approximately $0.5 million of unamortized acquired workforce recorded as part of the purchase price allocation of the Circa acquisition as it did not meet the criteria to be recorded separately from goodwill. This resulted in a permanent reduction in amortization expense of $58,300 per quarter through the first quarter of 2004. Also under SFAS 142, intangible assets with indefinite lives are no longer amortized. As a result, we determined that a previously recorded trade name intangible has an indefinite life. Consequently, the trade name intangible is no longer amortized, resulting in a permanent reduction in amortization expense of $25,000 per quarter through April 2011. In June 2002, we completed the transitional purchased intangible impairment test outlined under SFAS 142 which required the assessment of purchased intangibles for impairment as of January 1, 2002 and in October 2002, we completed our annual impairment test. Both of these tests were conducted by determining and comparing the fair value of our reporting units, as defined in SFAS 142, to the reporting unit's carrying value as of that date. Based on the results of these impairment tests, we determined that our purchased intangible assets were not impaired as of January 1, 2002 or during 2002.

Amortization of Goodwill

In the year ended December 31, 2001, we recorded $2.1 million of amortization of goodwill related to the Circa acquisition. Beginning January 1, 2002, under SFAS 142 we no longer amortize goodwill related to the Circa acquisition. This resulted in a permanent decrease in goodwill amortization expense of approximately $0.7 million per quarter through the first quarter of 2004. Under the transition rules of SFAS 142, business combinations completed after July 1, 2001, but prior to January 1, 2002, were accounted for in accordance with SFAS 142, and consequently, goodwill balances from the PictureTel and ASPI acquisitions have never been amortized. In June 2002, we completed the transitional goodwill impairment test outlined under SFAS 142 which required the assessment of goodwill for impairment as of January 1, 2002 and in October 2002, we completed our annual impairment test. Both of these tests were conducted by determining and comparing the fair value of our reporting units, as defined in SFAS 142, to the reporting unit's carrying value as of that date. Based on the results of these impairment tests, we determined that our goodwill assets were not impaired as of January 1, 2002 or during 2002. We plan to conduct our annual impairment tests in the fourth quarter of every year, unless impairment indicators exist sooner. Screening for and assessing whether impairment indicators exist or if events or changes in circumstances have occurred, including market conditions, operating fundamentals, competition and general economic conditions, requires significant judgment. Additionally, changes in the high-technology industry occur frequently and quickly. Therefore, there can be no assurance that a charge to operations will not occur as a result of future goodwill impairment tests.

Restructure costs

In the third and fourth quarters of 2002, we approved restructuring actions in response to the continued global economic downturn and to improve our overall cost structure by prioritizing resources in strategic areas of the business and reducing operating expenses. We recorded a restructuring charge of $1.7 million in 2002 as a result of these actions. This charge consisted of severance and other employee termination benefits related to a workforce reduction of approximately six percent of our employees worldwide. As of December 31, 2002, we had paid approximately $1.2 million of the $1.7 million charge. A liability has been recorded in "Other accrued liabilities" in the consolidated balance sheet for the remaining amount which is to be paid through fiscal 2003. We expect that, due to these restructuring actions, operating expenses will grow at a much smaller rate than what otherwise would have been, as the headcount affected by the restructuring will be added back over time as our operations expand in connection with the growth of our business. If the current economic downturn and uncertainty in technology spending continues, we may take additional restructuring actions to reduce our operating expenses, while simultaneously implementing additional cost containment measures and expense control programs. Such restructuring actions are subject to significant risks, including delays in implementing expense control programs or workforce reductions and the failure to meet operational targets due to the loss of employees or a decrease in employee morale, all of which would impair our ability to achieve anticipated cost reductions. If we do not achieve the anticipated cost reductions our business could be harmed.

Grant Repayment

In the fourth quarter of 2000, Accord incurred a charge of $5.9 million relating to the repayment of all outstanding grants from the Office of the Chief Scientist in Israel, or OCS, and the Israel-U.S. Binational Industrial Research and Development foundation, or BIRD. The payments to OCS and BIRD were derived directly from the commercial success of Accord products resulting from research and development funding received from those organizations.

Litigation Settlement

We reached a favorable settlement with a former PictureTel customer during the first quarter of 2002. The dispute involved certain services provided by PictureTel in 2001 and amounts owed to us for providing these services. The amount received was approximately $0.3 million, net of legal fees incurred to litigate and settle the case.

On November 20, 1998, a patent infringement claim was filed against Accord's U.S. subsidiary, Accord Networks, Inc., in the United States District Court, District of Massachusetts, alleging that the U.S. subsidiary had and was willfully and deliberately infringing on one of Ezenial's patents. The complaint was later amended to allege that the U.S. subsidiary also had and was willfully and deliberately infringing on other patents. On June 10, 1999, Accord was added as a defendant in the lawsuit. On June 16, 2000, Accord and its U.S. subsidiary entered into a written settlement agreement, and the Court entered an order dismissing the case. The lawsuit settlement cost of $6.5 million, which final payment was made on December 28, 2000, represents a one-time charge resulting from this settlement and was reported under "Litigation settlement" in the consolidated statement of operations in June 2000.

Litigation Reserve Release

On September 3, 1997, VTEL Corporation, or VTEL, filed a lawsuit in the State District Court in Travis County, Texas against ViaVideo Communications, Inc. and its founders, who were formerly employed by VTEL. On May 27, 1998, following our acquisition of ViaVideo, VTEL amended its suit to add Polycom as a defendant. In the lawsuit, VTEL alleged breach of contract, breach of confidential relationship, disclosure of proprietary information and related allegations. ViaVideo, its founders and Polycom answered the suit, denying in their entirety VTEL's allegations. On March 3, 2000, VTEL voluntarily dismissed the allegations against Polycom and ViaVideo with prejudice for no consideration. As a one-time item in the first quarter of 2000, the excess accrual associated with the expenses we estimated we would incur in connection with this lawsuit totaling $1.8 million was released since no further material expenses were to be incurred. See Note 12 of Notes to Consolidated Financial Statements.

Interest Income, Net

Interest income, net consists of interest earned on our cash, cash equivalents and investments less bank charges resulting from the use of our bank accounts and imputed interest expense related to the present value of costs associated with closing facilities as part of the PictureTel acquisition and related integration plan. Imputed interest expense for 2002 and 2001 was $1.8 million and $40,000, respectively. Interest income, net of interest expense, was $9.5 million, $12.8 million and $8.4 million in 2002, 2001 and 2000, respectively. Interest income decreased in 2002 over the comparable period in the prior year due primarily to the imputed interest expense related to facility closings and interest rate reductions resulting from the monetary policy actions taken by the United States Federal Reserve Board to stimulate economic growth in the United States during 2001 and 2002. Partially offsetting these negative effects was an increase in our average cash and investment balances, which was due primarily to our common stock offering which raised $237.5 million in the first quarter of 2002. The average interest rate return on our cash and cash equivalents was 1.86% and on our investments was 3.01% in 2002 compared to 3.07% and 4.80%, respectively, for 2001. The increases in interest income, net, in 2001 and 2000 are due primarily to changes in average cash and investment balances throughout the year, the most significant of which relates to our common stock offering in 2000 and Accord's initial public offering which together raised $203.2 million in the third quarter of 2000. Interest income, net could fluctuate in 2003 due to movement in our cash balances and changes in interest rates in 2003 related to monetary policy actions taken by the United States Federal Reserve Board to stimulate economic growth in the United States.

Loss on Strategic Investments

For strategic reasons we have made various investments in public and private companies in 2002, 2001 and 2000. The private company investments are carried at cost less any impairment write-downs and are recorded in "Other assets" in our consolidated balance sheets. We review these investments for impairment when events or changes in circumstances indicate that impairment may exist and make appropriate reductions in carrying value, if necessary. These private company investments had no carrying value as of December 31, 2002 and a carrying value of $4.3 million as of December 31, 2001. These investments have been permanently written down a total of $12.0 million from original cost, including $3.0 million, $3.1 million and $5.9 million in 2002, 2001 and 2000, respectively, which is reflected in "Loss on strategic investments" in the consolidated statements of operations.

Our strategic public company investments are recorded at fair value in "Short-term investments" and "Long-term investments" in our consolidated balance sheets and are marked to market each period through unrealized gains and losses recorded as a component of stockholders' equity, except our warrants to purchase publicly traded equity securities which are marked to market through the statement of operations. If these investments are sold at a loss or have permanently declined in value, a charge to operations is recorded. Realized gains and losses on these strategic investments are reflected in "Loss on strategic investments" in the consolidated statements of operations. During 2002 and 2001, the Company recorded a loss totaling $4.4 million and $0.1 million, respectively, related to the sale of its strategic investments in equity securities of publicly traded companies, impairment of equity securities of publicly traded companies and the write-down of its warrants to purchase publicly traded equity securities.

Provision for Income Taxes

The provision for income taxes was $10.2 million, $14.7 million, and $24.2 million in 2002, 2001 and 2000, respectively. The decrease in the provision for income taxes in 2002 over 2001 was attributable to a decrease in nondeductible acquisition-related costs and an increase in foreign earnings subject to relatively lower tax rates. The decrease in the provision for income taxes in 2001 over 2000 was attributable to a decrease in U.S. tax and an increase in foreign tax due to an increase in foreign income.

As of December 31, 2002, we had approximately $61.0 million in net operating loss carryforwards, $13.1 million in tax credit carryovers and $3.8 million in capital loss carryforwards as well as other deferred tax assets arising from temporary differences. See Note 17 of Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

As of December 31, 2002, our principal sources of liquidity included cash and cash equivalents of $155.2 million, short-term investments of $38.7 million and long-term investments of $319.1 million. Short-term and long-term investments consisted primarily of U.S. government securities, state and local government securities and corporate debt and equity securities of which $0.4 million was invested in equity securities of publicly traded companies. See Note 7 of Notes to Consolidated Financial Statements. In addition, we have a $25.0 million line of credit with a bank which was unused at December 31, 2002.

We generated cash from operating activities totaling $81.5 million in 2002, $76.7 million in 2001 and $38.1 million in 2000. The increase in cash provided from operating activities in 2002 over 2001 was due primarily to larger decreases in trade receivables over the prior period, larger increases in taxes payable and a smaller increase in prepaids and other current assets offset partially by smaller reductions in inventories, increases in deferred taxes and larger decreases in accounts payable and other accrued liabilities over the comparable period. When comparing the increase in cash from operating activities in 2001 over 2000, improvements were a result of a net reduction in trade receivables, inventories and deferred taxes in 2001 compared to increases for these items in 2000 and a smaller increase in prepaid and other current assets compared to 2000, offset by a net reduction in total liabilities such as accounts payable, taxes payable and other liabilities and lower net income before non-cash items.

The total net change in cash and cash equivalents for the year ended 2002 was an increase of $28.4 million. The primary uses of cash during this period were $268.6 million of net purchases of investments, $12.9 million for purchases of property and equipment and $15.9 million for repurchases of our common stock. The primary sources of cash were $81.5 million from operating activities, $237.5 million of proceeds from our offering, net of issuance costs and $6.7 million associated with the exercise of stock options and purchases under the employee stock purchase plan. The positive cash from operating activities was primarily the result of net income before considering non-cash expenses, such as depreciation, amortization, the provision for doubtful accounts, loss on strategic investments, the write-off of purchased in-process research and development and the tax benefits from the exercise of employee stock options, lower trade receivables and inventories, offset by a net decrease in total liabilities, including accounts payable, taxes payable and other liabilities, and an increase in prepaid expenses and other current assets and deferred taxes. The positive cash impact due to net trade receivables and inventory reductions may not occur in 2003 as it did in 2002.

In February 2002, we completed a public offering in which we sold 8,050,000 shares of our common stock, including an over-allotment option of 1,050,000 shares exercised by the underwriters, at a price of $31.20 per share. Our net proceeds from this offering were approximately $237.5 million after taking into account underwriting discounts and commissions and our expenses. We intend to use the net proceeds from this sale primarily for general corporate purposes, including working capital and capital expenditures, as well as for acquisitions of complementary businesses or technologies.

In June 2002, the Board of Directors approved a plan to repurchase up to 3.5 million shares of our common stock and as of December 31, 2002, we had repurchased approximately 1,483,000 shares for cash of $15.9 million. In the fourth quarter of 2002, the Company retired and reclassified these shares of common stock as authorized and unissued. In 2003, we plan to continue to repurchase shares in the open market or in privately negotiated transactions.

At December 31, 2002, we had open purchase orders related to our contract manufacturers and other contractual obligations of approximately $21.1 million primarily related to inventory purchases. We also have material commitments that consist of obligations under our operating leases. In the event that we decided to cease using a facility and seek to sublease such facility or terminate a lease obligation through a lease buyout or other means, we may incur a material cash outflow at the time of such transaction, which will negatively impact our operating results and overall cash flows. In addition, if facilities rental rates decrease or if it takes longer than expected to sublease these facilities, we could incur a significant further charge to operations and our operating and overall cash flows could be negatively impacted in the period that these changes or events occur. These commitments and obligations are reflected in our consolidated financial statements once goods or services have been received or at such time when we are obligated to make payments related to these requested goods or services. In addition, our bank has issued letters of credit to secure the leases on some of our offices. These letters of credit total approximately $0.8 million and are secured by our credit facilities or cash deposits with our banks.

As of December 31, 2002, the following future minimum lease payments, net of sublease income are due under our current lease obligations. For example, the Company has an approximately 152,000 square foot building which is fully subleased to a third party for which the sublease runs concurrent with the Company's lease obligation. As a result the Company is not currently showing a lease obligation related to this facility. In addition to these minimum lease payments, we are contractually obligated under the majority of our operating leases to pay certain operating expenses during the term of the lease such as maintenance, taxes and insurance. This table excludes leases subject to cancellation within twelve months of December 31, 2002 (in thousands):

YEAR ENDING DECEMBER 31,	MINIMUM LEASE PAYMENTS	PROJECTED ANNUAL OPERATING COSTS
2003	$ 13,392	$ 4,272
2004	13,343	4,644
2005	11,750	4,011
2006	11,578	4,032
2007	8,636	3,249
Thereafter	35,416	13,575
Minimum future lease payments	$94,115	$33,783

We believe that our available cash, cash equivalents, investments, and bank line of credit will be sufficient to meet our operating expenses and capital requirements for the foreseeable future. However, we may require or desire additional funds to support our operating expenses and capital requirements or for other purposes, such as acquisitions or competitive reasons and may seek to raise such additional funds through public or private equity financing or from other sources. We cannot assure you that additional financing will be available at all or that, if available, such financing will be obtainable on terms favorable to us and would not be dilutive. Our future liquidity and cash requirements will depend on numerous factors, including the introduction of new products and potential acquisitions of related businesses or technology.

Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. We review the accounting policies used in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our process used to develop estimates, including those related to product returns, accounts receivable, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. These estimates and judgments are reviewed by management on an ongoing basis and by the Audit Committee at the end of each quarter prior to the public release of our financial results. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition and Product Returns

We recognize hardware product revenue using the guidance from SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" and Statement of Financial Accounting Standards, or SFAS, No. 48, "Revenue Recognition When Right of Return Exists." We recognize software revenue in accordance with the AICPA Statement of Position No. 97-2, or SOP 97-2, "Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions." Under these guidelines, we defer revenue recognition on transactions where persuasive evidence of an arrangement does not exist, title has not transferred, product payment is contingent upon performance of installation or service obligations, the price is not fixed or determinable or payment is not reasonably assured. In addition, we estimate what future product returns may occur based upon actual historical return rates and reduce our revenues by these estimated future returns. If the historical data we use to calculate these estimates does not properly reflect future returns, these estimates could be revised. In addition, we defer revenue associated with long-term customer maintenance contracts. The value of these contracts is recognized ratably over the length of the customer contract.

Channel Partner Programs and Incentives

We record estimated reductions to revenues for channel partner programs and incentive offerings including special pricing agreements, trade-in credits, promotions and other volume-based incentives. If market conditions were to decline further, we may take actions to increase channel partner incentive offerings possibly resulting in an incremental reduction of revenues at the time the incentive is offered.

Warranty

We provide for the estimated cost of hardware product warranties at the time revenue is recognized. While we engage in product quality programs and processes, our warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from our estimates, revision of the estimated warranty liability would be required.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers or channel partners were to deteriorate, particularly in the current economic environment, resulting in an impairment of their ability to make payments, additional allowances may be required as was the case with Global Crossing and WorldCom in 2002.

Excess and Obsolete Inventory

We write down our excess and obsolete inventory equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future product life-cycles, product demand and market conditions. If actual product life-cycles, product demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Deferred and Refundable Taxes

We estimate our actual current tax exposure together with our temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance against these tax assets. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. To the extent we establish a valuation allowance in a period, we must include and expense the allowance within the tax provision in the consolidated statements of operations. At December 31, 2002, we had no valuation allowance established against our deferred tax assets.

Fair Value of Assets Acquired and Liabilities Assumed in Purchase Combinations

The purchase combinations completed require us to identify and estimate the fair value of the assets acquired, including intangible assets other than goodwill, and liabilities assumed in the combinations. These estimates of fair value are based on our business plan for the entities acquired including planned redundancies, restructuring, use of assets acquired and assumptions as to the ultimate resolution of obligations assumed for which no future benefit will be received. For example, in the PictureTel acquisition, we identified vacated or redundant facilities that we intended to sublease or negotiate a lease termination settlement. For all material acquisitions the allocation period, as defined in Statement of Financial Accounting Standards No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises", has been completed. Therefore, if actual costs exceed our estimates these charges would be recognized in our consolidated statements of operations. If actual costs are less than our estimates, these charges would continue to be recognized as an adjustment to goodwill.

Goodwill and Purchased Intangibles

We assess the impairment of goodwill and other identifiable intangibles whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Some factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends.

If we determine that the carrying value of goodwill and other identified intangibles may not be recoverable based upon the existence of one or more of the above indicators of impairment, we would typically measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. In accordance with SFAS 142, "Goodwill and Other Intangible Assets," we accounted for the PictureTel, ASPI and MeetU acquisitions, all of which were completed after July 1, 2001, under the new guidance, and on January 1, 2002, we ceased to amortize goodwill arising from the Circa acquisition which was completed prior to July 1, 2001. We were required to perform a transitional impairment review of our goodwill prior to June 30, 2002 and an impairment review at least annually thereafter.

In June 2002, we completed our transitional goodwill and purchased intangibles impairment tests outlined under SFAS 142 which required the assessment of goodwill and purchased intangibles for impairment as of January 1, 2002 and in October 2002, we completed our annual impairment tests. These tests were conducted by determining and comparing the fair value of our reporting units, as defined in SFAS 142, to the reporting unit's carrying value as of that date. Based on the results of these impairment tests, we determined that our goodwill assets and purchased intangible assets were not impaired as of January 1, 2002 or during 2002. We plan to conduct our annual impairment tests in the fourth quarter of every year, unless impairment indicators exist sooner. Screening for and assessing whether impairment indicators exist or if events or changes in circumstances have occurred, including market conditions, operating fundamentals, competition and general economic conditions, requires significant judgment. Additionally, changes in the high-technology industry occur frequently and quickly. Therefore, there can be no assurance that a charge to operations will not occur as a result of future goodwill impairment tests.

Non-marketable Securities

We periodically make strategic investments, or have acquired these investments through business acquisitions, in companies whose stock is not currently traded on any stock exchange and for which no quoted price exists. The cost method of accounting is used to account for these investments as we hold a non-material ownership percentage. We review these investments for impairment when events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Examples of events or changes in circumstances that may indicate to management that an impairment exists may be a significant decrease in the market value of the company, poor or deteriorating market conditions in the public and private equity capital markets, significant adverse changes in legal factors or within the business climate the company operates, and current period operating or cash flow losses combined with a history of operating or cash flow losses or projections and forecasts that demonstrate continuing losses associated with the company's future business plans. Impairment indicators identified during the reporting period could result in a significant write down in the carrying value of the investment if we believe an investment has experienced a decline in value that is other than temporary. These investments had no carrying value as of December 31, 2002, and have been permanently written down a total of $12.0 million from original cost in 2002, 2002 and 2000.

Recent Accounting Pronouncements

In October 2001, the FASB issued SFAS No. 144, (SFAS 144)"Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 amends existing accounting guidance on asset impairment and provides a single accounting model for long-lived assets to be disposed of. Among other provisions, the new rules change the criteria for classifying an asset as held-for-sale. The standard also broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations, and changes the timing of recognizing losses on such operations. We adopted SFAS 144 effective January 1, 2003 and do not expect the adoption to have a material effect on our results of consolidated operations, financial condition or cash flows.

In April 2002, the FASB issued SFAS No. 145, (SFAS 145) "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Among other provisions, SFAS 145 rescinds SFAS No. 4, (SFAS 4) "Reporting Gains and Losses from Extinguishment of Debt." Accordingly, gains or losses from extinguishment of debt shall not be reported as extraordinary items unless the extinguishment qualifies as an extraordinary item under the criteria of Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Gains or losses from extinguishment of debt that do not meet the criteria of APB No. 30 should be reclassified to income from continuing operations in all prior periods presented. We adopted SFAS 145 effective January 1, 2003 and do not expect the adoption to have a material effect on our results of consolidated operations, financial condition or cash flows.

In June 2002, the FASB issued SFAS No. 146, (SFAS 146) "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 provides guidance related to accounting for costs associated with disposal activities covered by SFAS 144 or with exit or restructuring activities previously covered by EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 supercedes EITF Issue No. 94-3 in its entirety. SFAS 146 requires that costs related to exiting an activity or to a restructuring not be recognized until the liability is incurred. SFAS 146 will be applied prospectively to exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS 146 to have a material effect on our results of consolidated operations, financial condition or cash flows.

In November 2002, the FASB issued Financial Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a rollforward of the entity's product warranty liabilities. We will apply the recognition provisions of FIN 45 prospectively to guarantees issued after December 31, 2002. The disclosure provisions of FIN 45 are effective for financial statements for fiscal year 2002. As is customary in our industry, as provided for in local law in the U.S. and other jurisdictions, our standard contracts provide remedies to our customers, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of our products. From time to time, we indemnify customers against combinations of loss, expense, or liability arising from various trigger events related to the sale and the use of our products and services. In addition, from time to time we also provide protection to customers against claims related to undiscovered liabilities, additional product liability or environmental obligations. In our experience, claims made under such indemnifications are rare. We believe that the adoption of this standard will have no material impact on our results of consolidated operations, financial condition or cash flows.

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We are currently evaluating the effect that the adoption of EITF Issue No. 00-21 will have on our results of consolidated operations, financial condition or cash flows.

In December 2002, the FASB issued SFAS No. 148, (SFAS 148) "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS 148 requires disclosure of the pro forma effect in interim financial statements. The annual disclosure requirements of SFAS 148 are included in these notes while the transition disclosure requirements are effective for our fiscal 2003. We do not expect SFAS 148 to have a material effect on our results of consolidated operations, financial condition or cash flows.

In January 2003, the FASB issued Financial Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We do not expect FIN 46 to have a material effect on our results of consolidated operations, financial condition or cash flows.

Other Factors Affecting Future Operations

Investors should carefully consider the risks described below before making an investment decision. The risks described below are not the only ones we face. Additional risks we are not presently aware of or that we currently believe are immaterial may also impair our business operations. Our business could be harmed by any or all of these risks. The trading price of our common stock could decline due to any of these risks, and investors may lose all or part of their investment.

Our quarterly operating results may fluctuate significantly and are not a good indicator of future performance.

Our quarterly operating results have fluctuated significantly in the past and may vary significantly in the future as a result of a number of factors, many of which are out of our control. These factors include:

- difficult general economic conditions, as has been the case with the current economic downturn and uncertainty in technology industries, and specific economic conditions prevailing in the communications industry and other technology industries;
- the near and long-term impact of terrorist attacks and incidents and any military response or uncertainty regarding any military response to those attacks, or the outbreak of war or other hostilities;
- changes to our channel partner contracts and channel partner strategy, including a change in the number and mix of channel partners, which will result in a smaller number of channel partners and likely reduce channel partner orders;
- market acceptance of new product introductions, including those products launched in the first quarter of 2003, and product enhancements by us or our competitors;
- the prices and performance of our products and those of our competitors;
- the timing and size of the orders for our products;
- our distribution channels reducing their inventory levels;
- slowing sales by our channel partners to their customers which places further pressure on our channel partners to minimize inventory levels and reduce purchases of our products;
- the level and mix of inventory that we hold to meet future demand;
- the impact of the unstable political situation in Israel and recent military action by the Israeli government and other hostilities in the Middle East and their impact on our Israeli operations;
- the mix of products we sell;
- fluctuations in the level of international sales and our exposure to international currency fluctuations;
- the cost and availability of components;
- manufacturing costs;
- the level and cost of warranty claims;
- the impact of disruptions at the sites of our primary manufacturing partners in Thailand and Israel for any reason;
- the impact of seasonality on our various product lines and geographic regions;
- the level of royalties we must pay to third parties; and
- adverse outcomes to intellectual property claims.

We experienced sequential quarterly revenue growth from 1998 through 2000. Since that time we have experienced fluctuations in our quarterly operating results due to these or other factors. These and other factors could further prevent us from attaining or sustaining sequential quarterly growth or meeting our expectations, and investors should not use our past results to predict future operating margins and results. For example, we experienced sequential quarterly revenue decreases in the second, third and fourth quarters of 2002, primarily related to declines in our video communications product revenue. In addition, we incurred a significant net loss in 2001 due to charges related to acquisitions completed in that year.

As a result of these and other factors, we believe that period-to-period comparisons of our historical results of operations are not a good predictor of our future performance. If our future operating results are below the expectations of stock market securities analysts or investors, our stock price will likely decline.

Because a disproportionate amount of our sales occur at the end of a quarter, our operating results are unpredictable.

The timing of our channel partner orders and product shipments can harm our operating results.

Our quarterly revenues and operating results depend upon the volume and timing of channel partner orders received during a given quarter and the percentage of each order that we are able to ship and recognize as revenue during each quarter, each of which is extremely difficult to forecast. Moreover, the majority of our orders in a given quarter historically have been shipped in the last month of that quarter and sometimes in the last few weeks of the quarter. This trend is likely to continue, and any failure or delay in the closing of orders during the last part of a quarter would materially harm our operating results, as occurred in the second and third quarter of 2002. Furthermore, due to this trend, we may be unable to ship products in the period we receive the order, which would have an adverse impact on our operating results. In such events, the price of our common stock would decline.

Difficulty in estimating channel partner orders can harm our operating results.

We typically ship products within a short time after we receive an order and historically have had no material backlog. Therefore, backlog is not a good indicator of future net revenues. As a result, net revenues for any particular quarter are extremely difficult to predict. Additionally, orders from our channel partners are based on the level of demand from end-users. The uncertainty of end-user demand means that any quarter could be significantly negatively impacted by lower end-user orders which could in turn negatively affect orders we receive from our channel partners. Accordingly, our expectations for both short and long-term future net revenues are based almost exclusively on our own estimate of future demand and not on firm channel partner orders. Our expense levels are based largely on these estimates. Because we receive a majority of our channel partner orders in the last month of a quarter and often in the last few weeks of the quarter, we are limited in our ability to reduce expenses quickly if for any reason orders and net revenues do not meet our expectations in a particular period. Accordingly, any significant shortfall in demand for our products in relation to our expectations would have an adverse impact on our operating results.

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

As our business has grown, we have become increasingly exposed to adverse changes in general economic conditions which can result in reductions in capital expenditures by end-user customers for our products, longer sales cycles, deferral or delay of purchase commitments for our products and increased competition. These factors adversely impacted our operating results in 2001, where we experienced a sequential revenue decrease in each of the first three quarters. We also experienced a sequential revenue decreases in the second, third and fourth quarters of 2002 due in part to these factors. All of 2003 is subject to similar risks, particularly if the current economic downturn and uncertainty in technology spending continues.

In addition, we also face the risk that some of our channel partners have inventory levels in excess of future anticipated sales growth. If such sales growth does not occur in the time frame anticipated by these channel partners for any reason, including the continuation of the current economic downturn and uncertainty in technology spending throughout 2003, these channel partners may substantially decrease the amount of product they order from us in subsequent periods, or product returns may exceed historical or predicted levels which would harm our business. For example, our channel partners reduced their inventory levels during 2001 in anticipation of lower end-user demand. Also, in 2002, we began to implement a new direct-touch strategy in concert with a realignment of our channel partner strategy. As part of this new channel partner strategy, the channel inventory model is changing to reduce channel inventories to a more optimal level or to a drop shipment method to certain channel partners' end user customers. During the third quarter and fourth quarter of 2002 we believe our channel partners' video and voice inventory decreased over the second and third quarter of 2002, respectively. This decrease was due in part to this shift in channel partner strategy resulting in us shipping fewer video and voice units to channel partners in the third and fourth quarter of 2002. The decreased channel inventory levels had less impact on sales of iPower units, which are not typically carried in inventory by our channel partners. Our channel partners are likely to further reduce their inventory levels in 2003 based on a continuation of this distribution strategy to move to reduce channel inventory levels. In addition, any softness in end-user demand, which is likely in the current economic environment, could cause our channel partners to reduce their inventory levels even further.

We face risks related to our dependence on channel partners to sell our products.

We are subject to risks associated with our channel partners' product inventories and product sell-through.

We sell a significant amount of our products to channel partners who maintain their own inventory of our products for sale to dealers and end-users. We often provide special cost or early payment incentives for channel partners to purchase the minimum or more than the minimum quantities contemplated under their agreements with us. If these channel partners are unable to sell an adequate amount of their inventory of our products in a given quarter to dealers and end-users or if channel partners decide to decrease their inventories for any reason, such as the current economic downturn and uncertainty in technology industries, the volume of our sales to these channel partners and our net revenues would be negatively affected. For example, the economic downturn negatively affected our business and operating results in 2001 and in 2002. If these conditions continue in the future, our business and operating results will continue to be negatively affected. Moreover, if we choose to eliminate or reduce stocking incentive programs, quarterly revenues may fail to meet our expectations or be lower than historical levels. Further, we believe that our plans to reduce our channel inventories to a more optimal level may limit revenue growth and may cause a decrease in revenue in the near term. In addition, we plan to continue to implement changes to our channel partner strategy which will continue to result in a smaller number of channel partners, a change in the mix of our channel partners and a shift to a model with more direct interaction between us and our direct end-user customers. These changes may continue to cause disruptions in our channels and negatively impact revenue growth in the near term.

Our revenue estimates are based largely on end-user sales reports that our channel partners provide to us on a monthly basis. To date, we believe this data has been accurate. To the extent that this sales-out and channel inventory data is inaccurate, we may not be able to make revenue estimates for future periods.

We are subject to risks associated with the success of the businesses of our channel partners.

Many of our channel partners that carry multiple Polycom products, and from whom we derive significant revenues, are undercapitalized. The failure of these businesses to establish and sustain profitability or obtain financing could have a significant negative effect on our future revenue levels and profitability and our ability to collect our receivables. Further, the current economic downturn and uncertainty in technology spending in the United States and other regions could cause more of our channel partners' businesses to suffer or fail, which would harm our business.

Our business would also be harmed if our large channel partners were affected by the current economic downturn and uncertainty in technology spending. For example, we have experienced a decline in revenues from WorldCom and Global Crossing due to their financial troubles. This drop in the amount of orders we have received from these two channel partners has negatively affected our revenues and profitability.

To avoid confusion among our channel partners regarding our product offerings, we need to devote significant resources to educating and training them.

When we take any significant actions regarding our product offerings, it is important to educate and train our channel partners to avoid any confusion. For example, when we began shipping the ViewStation FX product, the timing of this delivery date likely created confusion in our channel partner customer base and the end-user customer market as these groups waited to see if this new ViewStation product was more desirable than the existing products. Therefore, the timing of this new product release likely had a negative effect on our sales-in to channel partners and sales-out to end-users. We cannot assure you that a similar situation will not happen again. In the first quarter of 2003 we launched new products. This new product launch could cause confusion amongst our channel partners as we educate and train them on, and as they take time to evaluate, these new product offerings.

In addition, we acquired PictureTel Corporation, or PictureTel, in October 2001, and integrating PictureTel's product offerings with ours has created confusion among our channel partners. We will need to continue to devote significant resources to educate and train our channel partners about our combined product offerings. Ongoing confusion may lead to delays in ordering our products which would negatively affect our revenues.

Conflicts with our channel partners could hurt sales of our products.

We have various OEM agreements with major telecommunications equipment manufacturers, such as Avaya, Cisco Systems and Nortel Networks, whereby we manufacture our products to work with the equipment of the OEM. These relationships can create conflicts with our other channel partners who directly compete with our OEM partners which could adversely affect revenues from these other channel partners. Because many of our channel partners also sell equipment that competes with our products, these channel partners could devote more attention to these other products which could harm our business. For example, a significant amount of our network systems revenues in 2001 were generated from sales to Tandberg, Sony and VCON, which compete with us in the video communications product market. We believe that because of this conflict, they significantly reduced their orders of our network systems products in 2002, which has impacted our sales of this product line. Further, other channel conflicts could arise which cause channel partners to devote resources to other non-Polycom communications equipment which would negatively affect our business or results of operations.

Some of our current and future products are directly competitive with the products of our channel and strategic partners. For example, we have an agreement with Cisco Systems under which we ship SoundStation IP phones for resale by Cisco Systems. During the first quarter of 2002, we introduced a VoIP end-point under the Polycom brand that incorporates technology we license from Cisco Systems. This product competes directly with the VoIP products sold by Cisco Systems. As a consequence of conflicts such as these, competition with our partners in all of the markets in which we operate is likely to increase, potentially resulting in strains on our existing relationships with these companies. Any such strain could limit the potential contribution of our strategic relationships to our business, restrict our ability to form strategic relationships with these companies in the future and create additional competitive pressures on us, any of which could harm our business.

Our channel partner contracts are typically short-term and early termination of these contracts may harm our results of operations.

We do not typically enter into long-term contracts with our channel partners, and we cannot be certain as to future order levels from our channel partners. When we do enter into a long-term contract, the contract is generally terminable at the convenience of the channel partner. In the event of an early termination by or loss of one of our major channel partners, it is unlikely that we will be able to rapidly replace that revenue source which would harm our results of operations.

We experience seasonal fluctuations in our revenues.

Sales of some of our products have experienced seasonal fluctuations which have affected sequential growth rates for these products, particularly in our third and first quarters. For example, there was a slowdown in the third quarter of 2001 for sales of our products in the European region. In addition, sales of our video communications products have typically declined in the first quarter of the year compared to the fourth quarter of the prior year. Even though our revenues sequentially increased in the first quarter of 2002 from the fourth quarter of 2001, seasonal fluctuations could negatively affect our business which could cause our operating results to fall short of anticipated results for such quarters.

Difficulties in integrating our acquisitions could adversely impact our business.

Our acquisition of PictureTel could adversely impact our business.

We completed the acquisition of PictureTel in October 2001. The PictureTel acquisition is the largest acquisition we have completed, and the complex process of integrating PictureTel has required significant resources. We continue to face ongoing business challenges that include principally the geographic dispersion of our operations and generating market demand for an expanded product line that includes PC-based systems and collaboration-intensive applications.

In addition, we have incurred significant costs and committed significant management time integrating PictureTel's operations, technology, development programs, products, information systems, customers and personnel. Although the integration of PictureTel is complete, we will continue to incur cash outflows and additional costs in completing the integration process, such as:

- identifying duplicative or redundant resources and facilities, developing plans for resource consolidation and implementing those plans;
- fees and expenses of professionals and consultants involved in dissolving legal entities no longer being used;
- settling existing PictureTel liabilities;
- costs associated with vacating, subleasing and closing facilities and terminating leases;
- employee severance costs; and
- upgrading our customer service information systems to accommodate PictureTel's larger customer service function.

Further, we have a significant liability of approximately $36.5 million at December 31, 2002 related to vacant and redundant facilities in connection with our acquisition of PictureTel which is net of estimated sublease income we expect to generate. Our estimate of sublease income is based on current comparable rates for leases in the respective markets. If actual sublease income is lower than our estimates for any reason, if it takes us longer than we estimated to sublease these facilities, or if the associated cost of subleasing or terminating our lease obligations for these facilities is greater than we estimated, we would incur additional charges to operations which would harm our business, results of operations and cash flows. For example, the Company has an approximately 152,000 square foot building which is fully subleased to a third party for which the sublease runs concurrent with the Company's lease obligation. If this tenant is unable to fulfill, for any reason, their contractual obligations under the sublease, we would incur additional charges to operations which would harm our business. In addition, until our vacated and redundant facilities are subleased or the lease obligations for these facilities are terminated, we will continue to pay the contractual lease and facility operating expense obligations without any sublease income to offset these costs. Further, in the event that we agree to sublease a facility or terminate a lease obligation through a lease buyout or other means, we may incur a material cash outflow up to and potentially exceeding our recorded liability at the time of such transaction, which would harm our operating cash flows. To the extent that any such cash outflows or additional costs exceed the amount of our recorded liability related to the sublease or termination of these lease obligations, we could incur a charge to operations which would harm our business and adversely impact our results of operations.

Difficulties in integrating past or future acquisitions could adversely affect our business.

We have spent and will continue to spend significant resources identifying and acquiring businesses. The efficient and effective integration of our acquired businesses into our organization is critical to our growth. In addition to PictureTel, we acquired the following businesses in our prior fiscal year: Accord Networks Ltd., or Accord, in February 2001, Circa Communications, Ltd., or Circa, in April 2001 and Atlanta Signal Processors, Incorporated, or ASPI, in November 2001. Further, we acquired MeetU.com, Inc., or MeetU, in June 2002. These and any future acquisitions involve numerous risks including difficulties in integrating the operations, technologies and products of the acquired companies, the diversion of our management's attention from other business concerns and the potential loss of key employees of the acquired companies. Failure to achieve the anticipated benefits of these and any future acquisitions or to successfully integrate the operations of the companies we acquire could also harm our business, results of operations and cash flows. Additionally, we cannot assure you that we will not incur material charges in future quarters to reflect additional costs associated with past acquisitions or any future acquisitions we may make.

Difficulties we may encounter managing a substantially larger business could adversely affect our operating results.

We experienced significant growth in our business and operations due to internal expansion and business acquisitions during the last five years, and if we do not appropriately manage this growth and any future growth, our operating results will be negatively affected.

Our business has grown in recent years through both internal expansion and business acquisitions, and continued growth may cause a significant strain on our infrastructure, internal systems and managerial resources. For example, our annual revenues increased from $52 million in 1997 to $466 million in 2002, and during the past eight fiscal quarters, we acquired Accord, Circa, PictureTel, ASPI and MeetU. Further, our headcount increased from 175 employees at December 31, 1997 to 526 employees at December 31, 1999 and to 1,271 employees at December 31, 2002. To manage our growth effectively, we must continue to improve and expand our infrastructure, including operating and administrative systems and controls, and continue managing headcount, capital and processes in an efficient manner. Our productivity and the quality of our products may be adversely affected if we do not integrate and train our new employees quickly and effectively and coordinate among our executive, engineering, finance, marketing, sales, operations and customer support organizations, all of which add to the complexity of our organization and increase our operating expenses. In addition, our revenues may not grow at a sufficient rate to absorb the costs associated with a larger overall headcount. In addition, because of our acquisition of PictureTel, our video communications product development group is now located in multiple locations, and we have limited experience coordinating a large, geographically separated product development group.

Our future growth may require significant additional resources. We cannot assure you that resources will be available when we need them or that we will have sufficient capital to fund these potential resource needs. Also, as we assess our resources following our acquisitions, we will likely determine that redundancy in certain areas will require consolidation of these resources. Any organizational disruptions associated with the consolidation process could require further management attention and financial expenditures. If we are unable to manage our growth effectively, if we experience a shortfall in resources or if we must take additional restructuring charges, our results of operations will be harmed.

Some of our officers and key personnel have worked together for only a short period of time or have only recently joined us.

Some of our officers and key personnel have worked together for only a short period of time. For example, our Senior Vice President, Worldwide Sales and our Senior Vice President and General Manager, Video Communications joined us within the past three months. In addition, some of our executive officers have recently assumed significant new responsibilities, and they may require some time to transition into these new roles.

If we fail to successfully attract and retain qualified personnel, our business will be harmed.

Our future success will depend in part on our continued ability to hire, assimilate and retain qualified personnel. Competition for such personnel is intense, and we may not be successful in attracting or retaining such personnel. The loss of any key employee, the failure of any key employee to perform in his or her current position or our inability to attract and retain skilled employees, particularly technical and management, as needed, could harm our business. In addition, many of our key employees in Israel, who are responsible for development of our network systems products, are obligated to perform annual military reserve duty and may be called to active duty at any time under emergency conditions. The loss of the services of any executive officer or other key technical or management personnel could harm our business.

If we fail to compete successfully, our business and results of operations would be significantly harmed.

We face significant competition in the communications industry which is subject to rapid technological change. In video communications, our major competitors include Tandberg and a number of other companies including Aethra, ClearOne, Huawei, NEC, Panasonic, Philips, Sony, VCON and VTEL, as well as various smaller or new industry entrants. Some of these companies have substantial financial resources and production, marketing, engineering and other capabilities with which to develop, manufacture, market and sell their products. In addition, with advances in telecommunications standards, connectivity and video processing technology and the increasing market acceptance of video communications, other established or new companies may develop or market products competitive with our video communications products. We believe we will face increasing competition from alternative video communications solutions that employ new technologies or new combinations of technologies from companies such as 3Com, Cisco Systems, Hewlett-Packard, Dell, Microsoft, Nortel Networks, RealNetworks and WebEx, that enable web-based or network-based video and collaboration communications. The market for voice communications equipment, including voice conferencing and desktop equipment, is highly competitive and also subject to rapid technological change, regulatory developments and emerging industry standards. We expect competition to persist and increase in the future in this area. In voice communications, our major competitors include Aethra, Cisco Systems, ClearOne Communications, Konftel, Mitel, Soundgear and other companies that have in the past offered lower cost, full-duplex speakerphones. In the VoIP desktop space, there are several low cost manufacturers in Asia and Europe that are emerging. In addition, there are notable PBX and IP Call Manager manufacturers that compete on the standards based IP space including Cisco, Mitel and Siemens. Furthermore, all major telephony manufacturers produce hands-free speakerphone units that are lower cost than our voice communications products. Our network systems business has significant competition from RADVISION, and a number of other companies, including Avaya, Cisco Systems, First Virtual and Tandberg.

We cannot assure you that we will be able to compete successfully against our current or future competitors. We expect our competitors to continue to improve the performance of their current products and to introduce new products or new technologies that provide improved performance characteristics. New product introductions by our competitors could cause a significant decline in sales or loss of market acceptance of our existing products and future products. We believe that the possible effects from ongoing competition may be the reduction in the prices of our products and our competitors' products or the introduction of additional lower priced competitive products. We expect this increased competitive pressure may lead to intensified price-based competition, resulting in lower prices and gross margins which would significantly harm our results of operations.

We face risks related to our international operations and sales.

Because of our significant operations in Israel, we are subject to risks associated with the military, political and regulatory environment in Israel and the Middle East region.

The principal research and development and manufacturing facilities of our network systems group and many of that group's suppliers are located in Israel. Additionally, our acquisition of MeetU further concentrates our research and development activities for our network systems product line in Israel. Political, economic and military conditions in Israel and the Middle East region directly affect our network systems group's operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its geographic neighbors. Current and future-armed conflicts or political instability in the region may impair our ability to produce and sell our network systems products and could disrupt research or developmental activities. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. The future of peace efforts between Israel and its geographic neighbors remains uncertain and there has been a marked increase in civil unrest and hostility and military action between Israelis and Palestinians. This hostility could have an adverse impact on our results of operations. Further, a war with Iraq or other countries in the region perceived as a threat by the United States government could result in additional unrest or cause Israel to be attacked which would adversely affect our results of operations and harm our business.

The technology used to develop our current network systems products was developed in part with grants from the Israeli Office of the Chief Scientist. Under Israeli law, technology developed pursuant to grants from the Office of the Chief Scientist cannot be transferred to any person without the prior written consent of the Office of the Chief Scientist. The grants also contain restrictions on the ability to manufacture products developed with these grants outside of Israel. Approval to manufacture such products outside of Israel, if granted, is generally subject to an increase in the total amount to be repaid to the Office of the Chief Scientist of between 120% to 300% of the amount granted, depending on the extent of the manufacturing to be conducted outside of Israel. These restrictions on the ability to transfer certain of our technology to third parties or manufacture products outside Israel may adversely affect our operating results and the development of additional network systems products and significantly reduce the value of the technology.

International sales represent an increasing portion of our net revenues and risks inherent in international sales could harm our business.

International sales represent an increasing portion of our net revenues, and we anticipate that international sales will continue to account for a significant portion of our net revenues for the foreseeable future. International sales are subject to certain inherent risks, including the following:

- adverse economic conditions in international markets;
- unexpected changes in regulatory requirements and tariffs;
- adverse economic impact of terrorist attacks and incidents and any military response to those attacks, or the outbreak of war or other hostilities;
- difficulties in staffing and managing foreign operations;
- longer payment cycles;
- problems in collecting accounts receivable;
- potentially adverse tax consequences; and
- potential foreign currency exchange rate fluctuations.

International net revenues may fluctuate as a percentage of total net revenues in the future as we introduce new products. These fluctuations are primarily the result of our practice of introducing new products in North America first and the additional time required for product homologation and regulatory approvals of new products in international markets. To the extent we are unable to expand international sales in a timely and cost-effective manner, our business could be harmed. We cannot assure you that we will be able to maintain or increase international market demand for our products.

Although, to date, a substantial majority of our international sales has been denominated in U.S. currency, we expect that a growing number of sales could be denominated in non-U.S. currencies as more international customers request billing in their currency. As a result, we expect our business will be significantly more vulnerable to currency fluctuations which could adversely impact our results of operations. While we do not hedge for speculative purposes, as a result of our increased exposure to currency fluctuations, we from time to time engage in currency hedging activities solely to mitigate temporary currency fluctuation exposure. However, we have limited experience with these hedging activities, and they may not be successful which could harm our operating results and financial condition. In addition, significant adverse changes in currency exchange rates, as happened in the European market in 2000 and in the Asian market in late 1997, could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in revenue or profitability in that country.

We have limited supply sources for some key components of our products, and our operations could be harmed by supply interruptions, component defects or unavailability of these components.

Some key components used in our products are currently available from only one source and others are available from only a limited number of sources, including some key integrated circuits and optical elements. We also obtain certain plastic housings, metal castings and other components from suppliers located in China and other Asian countries, and any political or economic instability in that region in the future, or future import restrictions, may cause delays or an inability to obtain these supplies. Further, we have suppliers in Israel and a war with Iraq or other Middle Eastern countries perceived as a threat by the United States government may cause delays or an inability to obtain supplies for our network systems products. We have no raw material supply commitments from our suppliers and generally purchase components on a purchase order basis either directly or through our contract manufacturers. We have had limited experience purchasing supplies of various components for our products, and some of the components included in our products, such as microprocessors and other integrated circuits, have from time to time been subject to limited allocations by suppliers. In addition, companies with limited or uncertain financial resources manufacture some of these components. In the event that we, or our contract manufacturers, are unable to obtain sufficient supplies of components, develop alternative sources as needed, or companies with limited financial resources go out of business, our operating results could be seriously harmed. Moreover, our operating results would be seriously harmed by receipt of a significant number of defective components, an increase in component prices or our inability to obtain lower component prices in response to competitive price reductions. Additionally, our video communications products are designed based on integrated circuits produced by Philips Semiconductor, or Philips, and cameras produced by Sony. If we could no longer obtain integrated circuits or cameras from these suppliers, we would incur substantial expense and take substantial time in redesigning our products to be compatible with components from other manufacturers, and we cannot assure you that we would be successful in obtaining these components from alternative sources in a timely or cost-effective manner. Additionally, both Sony and Philips compete with us in the video communications industry which may adversely affect our ability to obtain necessary components. The failure to obtain adequate supplies of vital components could prevent or delay product shipments which could harm our business. We also rely on the introduction schedules of some key components in the development or launch of new products. Any delays in the availability of these key components could harm our business.

Manufacturing disruption or capacity constraints would harm our business.

We subcontract the manufacture of our voice and video product lines to Celestica, a third-party contract manufacturer. We use Celestica's Thailand facilities, and should there be any disruption in services due to natural disaster or economic or political difficulties in Thailand or Asia or any other reason, such disruption would harm our business and results of operations. Also, Celestica's Thailand facility is currently the sole source manufacturer of these products, and if Celestica experiences an interruption in operations or otherwise suffers from capacity constraints, we would experience a delay in shipping these products which would have an immediate negative impact on our revenues. As a result, we may not be able to meet any demand for our products which could negatively affect revenues in the quarter of the disruption and harm our reputation. In addition, operating in the international environment exposes us to certain inherent risks, including unexpected changes in regulatory requirements and tariffs, difficulties in staffing and managing foreign operations and potentially adverse tax consequences, all of which could harm our business and results of operations.

Further, our network systems products are manufactured in Israel which is currently experiencing internal and external conflicts that include terrorist acts and military action. Also, a war with Iraq or other Middle Eastern countries perceived as a threat by the United States government could cause us to experience a manufacturing disruption due to acts associated with these conflicts which could harm our business. In addition, certain technology used in our network systems products was developed through grants from the Office of the Chief Scientist in Israel. Under Israeli law, it is prohibited to transfer technology developed pursuant to these grants to any person without the prior written consent of the Office of the Chief Scientist. The grants also contain restrictions on the ability to manufacture products developed with these grants outside of Israel. Approval to manufacture such products outside of Israel, if granted, is generally subject to an increase in the total amount to be repaid to the Office of the Chief Scientist of between 120% to 300% of the amount granted, depending on the extent of the manufacturing to be conducted outside of Israel. These restrictions on the ability to transfer technology to third parties or manufacture products outside Israel may adversely affect our operating results and significantly reduce the value of the technology developed under these grants.

We face risks associated with our products and product development.

We may experience delays in product introductions and our products may contain defects which could adversely affect market acceptance for these products and our reputation and seriously harm our results of operations.

From 1998 through 2002, our revenue was due in large part to sales of new video communications products. Although we intend to continue to introduce new video and voice products, such as our Visual Concert products, SoundSation VTX 1000, ViewStation EC, ViewStation EX, MGC 25, Vortex EF2241, PathNavigator and WebOffice products, we cannot assure you that new product releases will be timely or that they will be made at all. For example, the ViewStation FX and ViaVideo were delayed from their original release dates which we believe negatively affected our net revenues in 2000. Additionally, any new or existing product introductions may contain defects and may not produce the revenue growth we experienced from 1998 through 2002.

With our acquisition of PictureTel, our video communications product development group is now located in Massachusetts and Texas. Since we do not have significant experience coordinating a large geographically separated product development group, we may experience product delays in the future, due to communications, logistics or other issues. Similarly, our acquisition of ASPI may contribute to voice communications product delays, as our voice communications product development group is now dispersed among California, Georgia and Canada.

In the past, we have experienced other delays in the introduction of certain new products and enhancements, and we believe that such delays may occur in the future. For instance, we experienced delays in introducing the ViewStation MP and WebStation from their original expected release dates due to unforeseen technology and manufacturing ramping issues. Similar delays occurred during the introduction of the ShowStation, ShowStation IP and SoundStation Premier which affected the first customer ship dates of these products. We also had delays in introducing our SoundStation IP product which we believe negatively impacted our sales revenue in the first quarter of 2001. Further, our SoundPoint IP product introduction was delayed which we believe negatively impacted our sales in the third and fourth quarters of 2001. Any similar delays in the future for other new product offerings currently under development could adversely affect market acceptance for these products and our reputation, and seriously harm our results of operations.

We face risks related to the adoption rate of new technologies.

We have invested significant resources developing products that are dependent on the adoption rate of new technologies. For example, our SoundStation IP and SoundPoint IP products are dependent on the roll out of voice-over-IP, or VoIP, technologies. The success of our ViaVideo product depends on the increased use of desktop video collaboration technologies. The success of our WebOffice product is dependent on the increased use and acceptance of web collaboration technologies in concert with audio and video conferencing. If the use of new technologies that our current and future products are based on does not occur, or occurs more slowly than expected, we may not be able to sell certain of our products in significant volumes and our business may be harmed.

Lower than expected market acceptance of our products, price competition and other price decreases would negatively impact our business.

If the market does not accept our products, including the new products launched in the first quarter of 2003, our profitability could be harmed.

Our profitability could also be negatively affected in the future as a result of continuing competitive price pressures in the sale of video and voice conferencing equipment and network systems which could cause us to reduce the prices for any of these products. Further, we have reduced prices in the past in order to expand the market for our products, and in the future, we may further reduce prices or introduce new products that carry lower margins in order to expand the market or stimulate demand for our products. While we cannot assure you that these actions would have the desired result, any of these actions could have an adverse impact on our product margins and profitability.

Our success depends on our ability to assimilate new technologies in our products and to properly train our channel partners in the use of those products.

The markets for video and voice communications products and network systems products are characterized by rapidly changing technology, evolving industry standards and frequent new product introductions. The success of our new products depends on several factors, including proper new product definition, product cost, timely completion and introduction of new products, differentiation of new products from those of our competitors and market acceptance of these products. Additionally, properly addressing the complexities associated with compatibility issues, channel partner training, technical and sales support as well as field support are also factors that may affect our success in this market. Further, the shift in communications from circuit-switched to IP-based technologies over time may require us to add new channel partners and gain new core technological competencies. We are attempting to address these needs and the need to develop new products through our internal development efforts, joint developments with other companies and through acquisitions. We may not identify successful new product opportunities and develop and bring products to market in a timely manner. Additionally, we cannot assure you that competing technologies developed by others will not render our products or technologies obsolete or noncompetitive. The failure of our new product development efforts and any inability to service or maintain the necessary third-party interoperability licenses would harm our business and results of operations.

Product obsolescence, excess inventory and other asset impairment can negatively affect our results of operations.

We operate in a high technology industry which is subject to rapid and frequent technology and market demand changes. These changes can often render existing technologies obsolete. These obsolescence issues can require write-downs in inventory value when it is determined that the recorded value of existing inventory is greater than its fair market value. For example, this situation occurred in 2001, and again in the first six months of 2002, when we recorded material excess and obsolescence charges associated with our inventory of network access products. This situation also occurred during the first quarter of 2000 for the ShowStation IP. Also, our ViewStation product and iPower products offer certain comparable functionality and may compete with each other for customers. In addition, we launched several new products in the first quarter of 2003. If sales of one of these products have a negative effect on sales of the other product, it could significantly increase the inventory levels of the negatively impacted product. The potential for new products to render existing products obsolete, cause inventories of existing products to increase or reduce the demand for existing products exists for every one of our products.

We purchased several businesses in 2001 and 2002 which included goodwill valued at approximately $300 million and other purchased intangible assets valued at approximately $33 million as of December 31, 2002. This represents a significant portion of our recorded assets. Generally accepted accounting principles related to goodwill and other intangibles changed with the issuance of Statement of Financial Accounting Standards No. 142, or SFAS 142, "Goodwill and Other Intangible Assets" which we adopted effective January 1, 2002. Under SFAS 142, goodwill and indefinite lived intangible assets are no longer amortized, but must be reviewed for impairment at least annually or sooner under certain circumstances. Other intangible assets that are deemed to have finite useful lives will continue to be amortized over their useful lives, but must be reviewed for impairment when events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Screening for and assessing whether impairment indicators exist, or if events or changes in circumstances have occurred, including market conditions, operating fundamentals, competition and general economic conditions, requires significant judgment. Additionally, changes in the high-technology industry occur frequently and quickly. Therefore, we cannot assure you that a charge to operations will not occur as a result of future goodwill impairment tests. If impairment is deemed to exist, we would write down the recorded value of these intangible assets to their fair values which could result in a full write-off of their book value. If these write-downs do occur, they could harm our business and results of operations.

In addition, we have made investments in private companies which we classify as "Other assets" in our balance sheet. The value of these investments is influenced by many factors, including the operating effectiveness of these companies, the overall health of these companies' industries, the strength of the private equity markets and general market conditions. Due to these and other factors, we have recorded charges against earnings totaling $12.0 million from fiscal 2000 through 2002 associated with the impairment of these investments, which has been reflected in "Loss on strategic investments" in the statements of operations. These investments have been fully written-off as of December 31, 2002. We may make additional investments in private companies which would be subject to similar impairment risks, and which may cause us to write down the recorded value of any such investments. Further, we cannot assure you that future inventory, investment, license, fixed asset or other asset write-downs will not happen. If future write-downs do occur, they could harm our business and results of operations.

Failure to adequately service and support our products could harm our results of operations.

Our recent growth has been due in large part to an expansion into products with more complex technologies, including our network systems products and our iPower products. This has increased the need for product warranty and service capabilities. If we cannot develop and train our internal support organization or maintain our relationship with our outside technical support, it could harm our business.

If we have insufficient proprietary rights or if we fail to protect those rights we have, our business would be materially impaired.

We rely on third-party license agreements and termination or impairment of these agreements may cause delays or reductions in product introductions or shipments which would harm our business.

We have licensing agreements with various suppliers for software incorporated into our products. For example, we license video communications source code from ADTRAN, EBSNet, Mitsubishi, Omnitel, RADVISION and Telesoft, video algorithm protocols from Ezenia! and Real Networks, development source code from Cisco Systems and Philips Semiconductor, audio algorithms from Lucent Technologies, Nortel Networks and Texas Instruments, communication software from DataBeam and Windows software from Microsoft. These third-party software licenses may not continue to be available to us on commercially reasonable terms, if at all. The termination or impairment of these licenses could result in delays or reductions in new product introductions or current product shipments until equivalent software could be developed, licensed and integrated, if at all possible which would harm our business and results of operations.

We rely on patents, trademarks, copyrights and trade secrets to protect our proprietary rights which may not be sufficient to protect our intellectual property.

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality procedures to protect our proprietary rights. Others may independently develop similar proprietary information and techniques or gain access to our intellectual property rights or disclose such technology. In addition, we cannot assure you that any patent or registered trademark owned by us will not be invalidated, circumvented or challenged in the U.S. or foreign countries or that the rights granted thereunder will provide competitive advantages to us or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. Furthermore, others may develop similar products, duplicate our products or design around our patents. In addition, foreign intellectual property laws may not protect our intellectual property rights. Litigation may be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity of and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation could result in substantial costs and diversion of resources which could harm our business, and could ultimately be unsuccessful in protecting our intellectual property rights.

We face and might in the future face intellectual property infringement claims that might be costly to resolve.

We have from time to time received, and may in the future receive, communications from third parties asserting patent or other intellectual property rights covering our products. For example, on September 23, 2002, a suit captioned *Collaboration Properties, Inc. v. Polycom, Inc.* was filed in the United States Court in the Northern District of California. The complaint alleges that our ViewStation, ViaVideo, iPower, WebOffice and Path Navigator products infringe 4 U.S. Patents owned by plaintiff. The complaint seeks unspecified compensatory and exemplary damages for past and present infringement and to permanently enjoin us from infringing on the patents in the future, On November 14, 2002 we filed an answer asserting, among other things, no infringement and that plaintiff's patents are invalid and unenforceable. We believe that we have meritorious defenses and counterclaims, and intend to vigorously defend this action. However, litigation involves significant inherent risks and uncertainties, and if an adverse outcome was to occur it could significantly harm our business.

In addition, our industry is characterized by uncertain and conflicting intellectual property claims and vigorous protection and pursuit of intellectual property rights or positions which have resulted in significant and protracted and expensive litigation. In the past, we have been involved in such litigation which adversely affected our operating results. For example, in November 1998, Videoserver, Inc., now known as Ezenia! Inc., filed a patent infringement claim against Accord's U.S. subsidiary, and Accord was subsequently added as a defendant. In September 2000, Accord and its U.S. subsidiary entered into a settlement agreement with Ezenia! under which the case was dismissed and Accord paid $6.5 million to Ezenia!. We cannot assure you that we will prevail in any such litigation, that intellectual property claims will not be made against us in the future or that we will not be prohibited from using the technologies subject to any such claims or be required to obtain licenses and make corresponding royalty payments. In addition, the necessary management attention to, and legal costs associated with, litigation can have a significant adverse effect on our operating results and financial condition.

Business interruptions could adversely affect our operations.

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, national catastrophe, such as the terrorist attacks which occurred on September 11, 2001, an attack on Israel and other events beyond our control. We do not have a fully implemented detailed disaster recovery plan. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business and results of operations.

Our cash flow could fluctuate due to the potential difficulty of collecting our receivables.

Over the past few years, we initiated significant investments in Europe and Asia to expand our business in these regions. In Europe and Asia, as with other international regions, credit terms are typically longer than in the United States. Therefore, as Europe, Asia and other international regions grow as a percentage of our net revenues, as happened from 1999 through 2002, accounts receivable balances will likely increase as compared to previous years. Additionally, sales in the network systems and video communications industries typically have longer payment periods as compared to the voice communications market. Therefore, if network systems and video products constitute a greater percentage of net revenues, accounts receivable balances will likely increase. These increases would cause our days sales outstanding to increase as compared to prior years and will negatively affect future cash flows. Although we have been able to largely offset the effects of these influences through additional incentives offered to channel partners at the end of each quarter in the form of prepaid discounts, these additional incentives have lowered our profitability and, given the continued downturn in the United States economy and uncertainty in technology spending, many companies are opting to not take advantage of our incentives and instead preserve their liquidity. In addition, the continued economic downturn in the United States may restrict the availability of capital which may delay our collections from our channel partners beyond our historical experience or may cause companies to file for bankruptcy, which occurred with Global Crossing and WorldCom. Either of these conditions would harm our cash flow and days sales outstanding performance. Although in recent quarters our experience in collecting receivables has been good and we expect this trend to continue, there can be assurance that it will continue.

Our stock price fluctuates as a result of the conduct of our business and stock market fluctuations.

The market price of our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price of our common stock may be significantly affected by a variety of factors, including:

- statements or changes in opinions, ratings or earnings estimates made by brokerage firms or industry analysts relating to the market in which we do business, including competitors, partners, suppliers or telecommunications industry leaders or relating to us specifically, as has occurred recently;
- the announcement of new products or product enhancements by us or our competitors;
- technological innovations by us or our competitors;
- quarterly variations in our results of operations;
- general market conditions or market conditions specific to technology industries; and
- domestic and international macroeconomic factors.

In addition, the stock market continues to experience extreme price and volume fluctuations. These fluctuations have had a substantial effect on the market prices for many high technology companies like us. These fluctuations are often unrelated to the operating performance of the specific companies.

Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and bank borrowings. We do not use derivative financial instruments in our investment portfolio which only includes highly liquid, high quality instruments, with the exception of the $0.4 million invested in equity securities of publicly traded companies. We may occasionally use forward contracts as a hedge against currency exchange rate fluctuations which may affect the value of trade receivables billed in currencies other than the United States dollar. As of December 31, 2002, we have no open foreign currency hedging contracts.

The estimated fair value of our cash and cash equivalents approximates the principal amounts reflected above based on the short maturities of these financial instruments. Short-term and long-term investments consist of U.S., state and municipal government obligations and foreign and domestic public corporate debt and equity securities, of which a total of $0.4 million was strategically invested in certain equity securities of publicly traded companies at December 31, 2002. These investments are subject to market price fluctuations which are primarily influenced by changes in interest rates and credit quality and are marked to market each period by recording an unrealized gain or loss in stockholders' equity, except for our warrants to purchase publicly traded equity securities which are marked to market through the consolidated statement of operations. If we sell our short-term or long-term investments prior to their maturity, we may incur a charge to operations in the period the sale took place. For 2002, we realized $4.4 million in losses related to the sale or write-down of our strategic investments in certain equity securities of publicly traded companies, which is reflected in "Loss on strategic investments" in the consolidated statements of operations.

The following tables present the hypothetical changes in fair values in the securities, excluding cash and cash equivalents and investments in equity securities of publicly traded companies, held at December 31, 2002 that are sensitive to the changes in interest rates. The modeling technique used measures the change in fair values arising from hypothetical parallel shifts in the yield curve of plus or minus 50 basis points (BPS) and 100 BPS over six and twelve-month time horizons.

The following table estimates the fair value of the portfolio at a twelve-month time horizon (in thousands):

ISSUER	VALUATION OF SECURITIES GIVEN AN INTEREST RATE INCREASE OF X BASIS POINTS		CURRENT FAIR MARKET VALUE	VALUATION OF SECURITIES GIVEN AN INTEREST RATE INCREASE OF X BASIS POINTS	
	100 BPS	50 BPS		50 BPS	100 BPS
U.S. Government Securities	$208,480	$208,060	$206,693	$205,790	$204,850
State and local governments	2,940	2,920	2,906	2,890	2,880
Corporate debt securities	149,200	148,490	147,783	147,080	146,380
Total	$360,620	$359,470	$357,382	$355,760	$354,110

The following table estimates the fair value of the portfolio at a six-month time horizon (in thousands):

ISSUER	VALUATION OF SECURITIES GIVEN AN INTEREST RATE INCREASE OF X BASIS POINTS		CURRENT FAIR MARKET VALUE	VALUATION OF SECURITIES GIVEN AN INTEREST RATE INCREASE OF X BASIS POINTS	
	100 BPS	50 BPS		50 BPS	100 BPS
U.S. Government Securities	$207,590	$207,380	$206,693	$206,250	$205,780
State and local governments	2,920	2,910	2,906	2,900	2,890
Corporate debt securities	148,490	148,140	147,783	147,430	147,080
Total	$359,000	$358,430	$357,382	$356,580	$355,750

A substantial majority of our sales are denominated in U.S. dollars. Only a minor amount of foreign invoices are paid in currencies other than the US dollar and these invoices are funded at the time of payment. However, in connection with the acquisition of PictureTel, we are selling iPower products and related services in some local currencies, primarily Euros, British Pounds, Hong Kong Dollars, Singapore Dollars and Japanese Yen, which have increased our foreign currency exchange rate fluctuation risk. We may also decide to expand the type of products we sell in foreign currencies thereby further increasing our foreign exchange risk. While we do not hedge for speculative purposes, in the event of a significant transaction due in a foreign currency, we may enter into a foreign currency forward exchange contract for hedging purposes.

In connection with the acquisition of PictureTel completed in October 2001, we assumed PictureTel's existing hedging program to hedge intercompany receivables between PictureTel and its foreign subsidiaries. Two forward contracts were entered during the month of December 2001 for $1.7 million and matured during the first quarter of 2002 and did not have a material effect on our consolidated financial position, results of operations and cash flows. There were no forward contracts outstanding as of December 31, 2002.

Report Of Independent Accountants

To the Board of Directors and Stockholders of Polycom, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Polycom, Inc. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule presents fairly, in all material aspects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Jose, California

January 21, 2003

Consolidated Balance Sheets

(in thousands, except share and per share data)	DECEMBER 31, 2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 155,191	$ 126,832
Short-term investments	38,670	23,348
Trade receivables, net of allowance for doubtful accounts of $4,440 and$4,816 in 2002 and 2001, respectively	65,470	89,309
Inventories	32,308	48,173
Deferred taxes	29,787	49,941
Prepaid expenses and other current assets	16,622	14,646
Total current assets	338,048	352,249
Property and equipment, net	28,428	28,945
Long-term investments	319,147	68,682
Goodwill	300,039	299,445
Purchased intangibles, net	32,827	47,618
Deferred taxes	53,446	15,184
Other assets	4,939	9,042
Total assets	$ 1,076,874	$ 821,165
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 29,788	$ 31,418
Accrued payroll and related liabilities	7,540	9,864
Taxes payable	44,338	24,053
Deferred revenue	16,950	20,878
Other accrued liabilities	36,519	64,387
Total current liabilities	135,135	150,600
Long-term liabilities	37,996	26,579
Total liabilities	173,131	177,179
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, $0.001 par value:		
Authorized: 5,000,000 shares in 2002 and 2001 Issued and outstanding:one share in 2002 and 2001	—	—
Common stock, $0.0005 par value:		
Authorized: 175,000,000 shares		
Issued: 98,987,386 shares in 2002 and 91,475,974 shares in 2001; outstanding 98,987,386 shares in 2002 and 91,112,417 shares in 2001	50	46
Additional paid-in capital	866,044	641,298
Cumulative other comprehensive income	2,152	328
Unearned stock-based compensation	(573)	(1,244)
Treasury stock, at cost, none in 2002 and 363,557 in 2001	—	(11,182)
Retained earnings	36,070	14,740
Total stockholders' equity	903,743	643,986
Total liabilities and stockholders' equity	$1,076,874	$ 821,165

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

Consolidated Statements of Operations

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED DECEMBER 31, 2002	2001	2000
Net revenues	$465,959	$383,189	$373,554
Cost of net revenues	202,712	166,747	164,099
Gross profit	263,247	216,442	209,455
Operating expenses:			
Sales and marketing	98,998	74,653	70,745
Research and development	76,812	59,416	43,570
General and administrative	29,947	21,564	20,702
Acquisition-related costs	3,699	24,077	4,768
Purchased in-process research and development	900	52,642	—
Amortization of purchased intangibles	17,135	3,905	—
Amortization of goodwill	—	2,114	—
Restructure costs	1,657	—	—
Grant repayment	—	—	5,876
Litigation settlement	(257)	—	6,500
Litigation reserve release	—	—	(1,843)
Total operating expenses	228,891	238,371	150,318
Operating income (loss)	34,356	(21,929)	59,137
Interest income, net	9,492	12,755	8,419
Loss on strategic investments	(7,465)	(3,178)	(5,854)
Other income (expense), net	527	(608)	8
Income (loss) before provision for income taxes	36,910	(12,960)	61,710
Provision for income taxes	10,150	14,740	24,247
Net income (loss)	$ 26,760	$ (27,700)	$ 37,463
Basic net income (loss) per share	$ 0.27	$ (0.33)	$ 0.50
Diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45
Weighted average shares outstanding for basic net income (loss) per share calculation	99,324	85,123	75,264
Weighted average shares outstanding for diluted net income (loss) per share calculation	100,696	85,123	83,828

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

Consolidated Statements Of Stockholders' Equity

(in thousands, except share data)

	Common Stock	
	Shares	Amount
Balances, December 31, 1999	69,254,118	$34
Comprehensive income:		
Change in unrealized loss on marketable securities	—	—
Net income	—	—
Total comprehensive income		
Issuance of stock, net of issuance costs	5,184,323	3
Conversion of mandatorily redeemable preferred stock into common stock	3,693,761	2
Issuance of stock related to exercise of warrants	324,833	—
Exercise of stock options under stock option plan	3,288,859	2
Shares purchased under employee stock purchase plan	223,094	—
Cost of registration statements	—	—
Valuation of options granted to outside consultants	—	—
Reversal of unearned stock-based compensation upon termination of employment	—	—
Amortization of stock-based compensation	—	—
Tax benefit from stock option activity	—	—
Balances, December 31, 2000	81,968,988	$41
Comprehensive loss:		
Change in unrealized gain on marketable securities	—	—
Cumulative translation adjustment	—	—
Net loss	—	—
Total comprehensive loss		
Issuance of stock for purchase acquisitions	6,937,355	4
Exercise of stock options under stock option plan	2,399,381	1
Shares purchased under employee stock purchase plan	170,250	—
Purchase of treasury stock shares at cost	(363,557)	—
Cost of registration statements	—	—
Stock-based compensation	—	—
Reversal of unearned stock-based compensation upon termination of employment	—	—
Amortization of stock-based compensation	—	—
Tax benefit from stock option activity	—	—
Balances, December 31, 2001	91,112,417	$46
Comprehensive income:		
Reclassification adjustments for losses (gains) realized in net income	—	—
Change in unrealized gain on marketable securities	—	—
Cumulative translation adjustment	—	—
Net income	—	—
Total comprehensive income		
Issuance of stock, net of issuance costs	8,050,000	4
Issuance of stock for purchase acquisitions	417,345	—
Exercise of stock options under stock option plan	606,266	—
Shares purchased under employee stock purchase plan	283,858	—
Purchase of treasury stock shares at cost	(1,482,500)	—
Retirement of treasury stock shares at cost	—	—
Reversal of unearned stock-based compensation upon termination of employment	—	—
Amortization of stock-based compensation	—	—
Tax benefit from stock option activity	—	—
Balances, December 31, 2002	98,987,386	$50

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

ADDITIONAL PAID-IN CAPITAL	UNEARNED STOCKBASED COMPENSATION	TREASURY STOCK	CUMULATIVE OTHER COMPREHENSIVE INCOME (LOSS)	RETAINED EARNINGS (DEFICIT)	TOTAL
$ 97,837	$(1,953)	$ —	$ (85)	$ 4,977	$100,810
—	—	—	22	—	22
—	—	—	—	37,463	37,463
					37,485
203,235	—	—	—	—	203,238
27,079	—	—	—	—	27,081
—	—	—	—	—	—
12,531	—	—	—	—	12,533
2,433	—	—	—	—	2,433
(85)	—	—	—	—	(85)
122	—	—	—	—	122
(498)	498	—	—	—	—
—	845	—	—	—	845
38,321	—	—	—	—	38,321
$380,975	$ (610)	$ —	$ (63)	$42,440	$422,783
—	—	—	555	—	555
—	—	—	(164)	—	(164)
—	—	—	—	(27,700)	(27,700)
					(27,309)
230,404	(1,534)	—	—	—	228,874
13,442	—	—	—	—	13,443
3,871	—	—	—	—	3,871
—	—	(11,182)	—	—	(11,182)
(189)	—	—	—	—	(189)
661	—	—	—	—	661
(343)	343	—	—	—	—
—	557	—	—	—	557
12,477	—	—	—	—	12,477
$641,298	$(1,244)	$(11,182)	$ 328	$14,740	$643,986
—	—	—	2,441	—	2,441
—	—	—	(781)	—	(781)
—	—	—	164	—	164
—	—	—	—	26,760	26,760
					28,584
237,491	—	—	—	—	237,495
628	—	—	—	—	628
2,603	—	—	—	—	2,603
4,063	—	—	—	—	4,063
—	—	(15,911)	—	—	(15,911)
(21,663)	—	27,093	—	(5,430)	—
(127)	127	—	—	—	—
—	544	—	—	—	544
1,751	—	—	—	—	1,751
$866,044	$ (573)	$ —	$2,152	$36,070	$903,743

Consolidated Statements Of Cash Flows

$ in thousands	YEAR END DECEMBER 31, 2002	2001	2000
Cash flows from operating activities:			
Net income (loss)	$ 26,760	$ (27,700)	$ 37,463
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	14,001	17,699	9,406
Amortization of purchased intangibles	17,135	3,905	—
Amortization of goodwill	—	2,114	—
Provision for doubtful accounts	3,213	948	1,739
Provision for excess and obsolete inventories	3,133	8,394	3,101
Tax benefit from exercise of stock options	1,751	12,477	38,321
Loss on strategic investments	7,465	3,178	5,854
Amortization of unearned stock-based compensation	544	557	956
Purchase of in-process research and development	900	52,642	—
Loss on asset dispositions	—	933	—
Changes in assets and liabilities, net of the effect of acquisitions:			
Trade receivables	23,061	16,616	(23,855)
Inventories	9,761	11,738	(32,150)
Deferred taxes	(10,688)	9,033	(18,829)
Prepaid expenses and other current assets	(2,127)	(3,792)	(6,343)
Accounts payable	(1,632)	(1,369)	4,961
Taxes payable	20,085	266	6,555
Other accrued liabilities	(31,862)	(30,950)	10,916
Net cash provided by operating activities	81,500	76,689	38,095
Cash flows from investing activities:			
Purchases of property and equipment	(12,893)	(12,759)	(18,267)
Purchases of licenses	—	(300)	(9,249)
Purchases of investments	(971,370)	(190,831)	(142,189)
Proceeds from sale and maturity of investments	702,779	211,657	60,134
Purchase of convertible note receivable	—	(41,500)	—
Net cash received (paid) in purchase acquisitions	93	(121,852)	—
Purchase of trade name	—	(1,000)	—
Net cash used in investing activities	(281,391)	(156,585)	(109,571)
Cash flows from financing activities:			
Proceeds from stock offering, net of issuance costs	237,495	—	203,238
Proceeds from issuance of common stock under employee option and stock purchase plans	6,666	17,280	14,903
Proceeds from exercise of warrants	—	49	—
Proceeds from issuance of preferred stock, net of issuance costs	—	—	995
Repurchase of common stock	(15,911)	—	—
Net cash provided by financing activities	228,250	17,329	219,136
Net increase (decrease) in cash and cash equivalents	28,359	(62,567)	147,660
Cash and cash equivalents, beginning of period	126,832	189,399	41,739
Cash and cash equivalents, end of period	$ 155,191	$ 126,832	$ 189,399
Supplemental disclosures of cash flow information:			
Cash paid during the period for interest	$ 27	$ 152	$ 63
Income taxes paid	$ 2,094	$ 736	$ 337
Supplemental schedule of noncash investing and financing:			
Conversion of preferred shares to common stock	$ —	$ —	$ 27,081

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

Notes To Consolidated Financial Statements

1. Business of the Company:

Polycom, Inc. and subsidiaries (the Company), a Delaware corporation, develops, manufactures, markets and services a full range of high-quality, easy-to-use voice and video communication endpoints, video management software, web collaboration software, multi-network gateways, and multi-point conferencing and network access solutions that enables business users to immediately realize the benefits of integrated video, voice, data and web collaboration over rapidly growing converged networks. The Company's products are distributed and serviced globally. The Company sells its products through marketing and sales relationships with a wide network of value-added resellers, distributors, service providers and retailers. Subsequent to December 31, 2002, the Company sold its network access product line to Verilink Corporation. See Note 20 of Notes to Consolidated Financial Statements.

2. Summary of Significant Accounting Policies:

Fiscal Year:

On September 27, 2002, the Company changed its fiscal year from a 52-53 week fiscal year ending on the Sunday closest to December 31, to a fiscal year ending on December 31. Accordingly, the Company's fiscal quarters will end on the last day of the calendar quarter, or March 31, June 30, September 30 and December 31. This change was effective beginning with the fiscal quarter ended September 30, 2002. As result of this election, the year ended December 31, 2002 included two additional business days, December 30 and 31, 2002. The operating activities for the two additional business days in the period ended December 31, 2002 are included in this Annual Report on Form 10-K. For the year ended December 31, 2002, this change in fiscal year increased revenue by $13.0 million and increased basic and diluted net income per share by approximately five cents per share, but did not have a material impact on the Company's consolidated financial position or cash flows.

For the years ended December 31, 2001 and 2000, the Company used a 52-53 week fiscal year. As a result, these periods may not have ended on the same day as the calendar period. However, for convenience of presentation, the accompanying consolidated financial statements have been shown as ending on December 31 of each applicable period.

Reclassifications:

Certain items in the prior year's consolidated financial statements have been reclassified to conform to the current year's format.

Principles of Accounting and Consolidation:

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The consolidated financial statements of the Company have been prepared to give retroactive effect to the merger with Accord Networks Ltd. on February 28, 2001 which was treated as a pooling of interests for financial reporting purposes.

Use of Estimates:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cash and Cash Equivalents:

The Company considers all highly liquid investments with original or remaining maturities of 90 days or less at the time of purchase to be cash equivalents.

Investments:

The Company's investments are comprised of U.S., state and municipal government obligations and foreign and domestic public corporate debt and equity securities. Investments with maturities of less than one year are considered short-term and are carried at fair value. Nearly all investments are held in the Company's name at a limited number of major financial institutions. The specific identification method is used to determine the cost of securities disposed of, with realized gains and loses reflected in interest income, net. At December 31, 2002 and 2001, all of the Company's investments were classified as available-for-sale. Unrealized gains and losses on these investments are included as a separate component of cumulative other comprehensive income in stockholders' equity.

The Company also has investments in private companies. These investments are included in "Other assets" in the Company's consolidated balance sheets and are carried at cost less any impairment loss. The Company monitors these investments for impairment and makes appropriate reductions in carrying value when the fair value is determined to be less than the reported value. During 2002 and 2001, the Company determined that the value of these investments was impaired and reduced the carrying amount by $3.0 million and $3.1 million, respectively. The Company determined that these investments were impaired based on the financial and operating performance of these private companies. At December 31, 2002, these investments are carried at zero value.

Inventories:

Inventories are stated at the lower of cost or market. Cost is determined on a standard cost basis which approximates the first-in, first-out (FIFO) method. Consideration is given to obsolescence, excessive levels, deterioration and other factors in evaluating net realizable value.

Property and equipment:

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which is one to seven years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful life of the related assets, typically three to twelve years. Disposals of capital equipment are recorded by removing the costs and accumulated depreciation from the accounts and gains or losses on disposals are included in the results of operations.

Goodwill and Purchased Intangible Assets:

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, generally three years. Goodwill and purchased intangible assets determined to have indefinite useful lives are not amortized but are regularly reviewed for potential impairment.

Impairment of Long-Lived Assets:

Long-lived assets including identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use are based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

Product Warranty Obligations:

The Company provides for the estimated costs of hardware and software product warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold. In the case of hardware manufactured by us, our warranties generally start from the delivery date and continue for one to three years depending on the product purchased. Software products generally carry a 90-day warranty from the date of shipment. Our liability under these warranties is to provide a corrected copy of any portion of the software found not to be in substantial compliance with the specifications previously agreed to. Factors that affect our warranty obligation include product failure rates, material usage and service delivery costs incurred in correcting product failures. We assess the adequacy of our recorded warranty liabilities every quarter and make adjustments to the liability if necessary.

Changes in the warranty obligation, which is included as a component of "Other Accrued Liabilities" on the consolidated balance sheet, during the period are as follows (in thousands):

	DECEMBER 31, 2002
Balance at December 31, 2001	$ 9,123
Accruals for warranties issued during the period	9,485
Actual warranty expenses	(8,384)
Balance at December 31, 2002	$10,224

Changes in deferred service revenue on the consolidated balance sheet during the period are as follows (in thousands):

	DECEMBER 31, 2002
Balance at December 31, 2001	$17,906
Additions to deferred service revenue	26,377
Amortization of deferred service revenue	(27,820)
Balance at December 31, 2002	$16,463

The Company is unable to provide the cost of providing the extended warranty programs as its internal financial reporting systems did not track this information at this level of detail in 2002.

Revenue Recognition:

The Company recognizes revenue from its hardware product sales, including freight charges, in accordance with SEC Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" and Statement of Financial Accounting Standards, or SFAS, No. 48 "Revenue Recognition When Right of Return Exists." The Company recognizes software revenue in accordance with SOP 97-2, "Software Revenue Recognition," as amended by SOP 98-9, "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions." Under these guidelines, the Company recognizes revenue on transactions where persuasive evidence of an arrangement exists, title has transferred, product payment is not contingent upon performance of installation or service obligations, the price is fixed or determinable and payment is reasonably assured. The Company accrues for sales returns, co-op advertising and other allowances as a reduction to net revenues upon shipment based upon its historical experience. Additionally, the Company recognizes extended service revenue on its hardware products over the life of the service contract.

Research and Development Expenditures:

Research and development expenditures are charged to operations as incurred. Software development costs incurred prior to the establishment of technological feasibility are included in research and development and are expensed as incurred. After technological feasibility is established, material software development costs are capitalized. The capitalized cost is amortized on a straight-line basis over the estimated product life, or on the ratio of current revenues to total projected product revenues, whichever is greater. To date, the period between achieving technological feasibility, which the Company has defined as the establishment of a working model, which typically occurs when the beta testing commences, and the general availability of such software has been short and software development costs qualifying for capitalization have been insignificant. Accordingly, the Company has not capitalized any software development costs.

Advertising:

The Company expenses the production costs of advertising as the expenses are incurred. The production costs of advertising consist primarily of trade shows, magazine and radio advertisements, agency fees and other direct production costs. The advertising expense for the years ended December 31, 2002, 2001 and 2000 was $14.2 million, $11.7 million, and $14.9 million, respectively.

Income Taxes:

Income tax expense is based on pre-tax financial accounting income. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Translation of Foreign Currencies:

The financial statements of the Company's foreign subsidiaries that operate where the functional currency is the U.S. dollar are translated to U.S dollars at year-end exchange rates for monetary assets and liabilities while non-monetary items are translated at historical rates. Income and expense accounts are translated at the average rates in effect during the year, except for depreciation which is translated at historical rates. Foreign exchange gains and losses have not been significant to date and have been recorded in the results of operations.

Assets and liabilities of the Company's foreign subsidiaries where the local currency is the functional currency are translated to U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense accounts are translated at the average exchange rates during the year. Translation gains and losses have not been significant to date and have been recorded in cumulative other comprehensive income within stockholders' equity.

Foreign Exchange Contracts:

The Company and its subsidiaries have entered into foreign currency forward contracts as a hedge against specific intercompany and foreign currency receivable transactions. Forward contracts involve agreements to purchase or sell foreign currencies at specific rates at future dates. The Company does not hold or issue derivative financial instruments for speculative trading purposes. The Company enters into derivatives only with counterparties which are one of the largest U.S. banks, ranked by assets, in order to minimize credit risk. The Company's hedging activities do not subject the Company to exchange rate risk because the gains and losses on these contracts are designed to offset the losses and gains on the intercompany and foreign currency receivable transactions being hedged. The carrying amount of the forward contracts is the fair value, which is determined by obtaining quoted market prices. Gains and losses on forward contracts are recognized each reporting period and are offset against the gain or loss on the hedged item in the same period that the underlying transactions are settled. In 2002, the Company had two contracts mature in the first quarter. The first matured on February 6, 2002 and the second on March 6, 2002 to purchase $769,000 and $925,000, respectively, in British pounds and Japanese yen. No new forward contracts were entered into during 2002 and there are no contracts outstanding on December 31, 2002.

Computation of Net Income (Loss) Per Share:

Basic net income (loss) per share is computed by dividing net income by the weighted average number of common shares outstanding for the period less the weighted average shares of treasury stock and common stock subject to repurchase. Diluted net income (loss) per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options and warrants outstanding, or the conversion of preferred stock to common stock and shares of common stock subject to repurchase. Common equivalent shares (including shares issued under the Stock Option Plan which are subject to repurchase) are excluded from the computation of fully diluted net loss per share when their effect is antidilutive.

Fair Value of Financial Instruments:

Carrying amounts of certain of the Company's financial instruments including cash and cash equivalents, accounts receivable, accounts payable and other accrued liabilities approximate fair value due to their short maturities. Estimated fair values of short-term and long-term investments are based on quoted market prices for the same or similar instruments.

Stock-based Compensation:

In accordance with SFAS No. 123, (SFAS 123) "Accounting for Stock-Based Compensation," the Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees", and Financial Interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock-Based Compensation, an interpretation of APB Opinion No. 25" and related interpretations in accounting for its stock-based compensation plans. Stock-based compensation related to non-employees is based on the fair value of the related stock or options in accordance with SFAS 123 and its interpretations. Expense associated with stock-based compensation is amortized over the vesting period of each individual award.

Consistent with the disclosure provisions of SFAS 123, the Company's net income (loss) and basic and diluted net income (loss) per share would have been adjusted to the pro forma amounts indicated below (in thousands, except per share amounts):

	YEAR ENDING DECEMBER 31,		
	2002	2001	2000
Net income (loss)—as reported	$ 26,760	$(27,700)	$ 37,463
Less stock based compensation expense determined under fair value based method, net of tax effects	(54,265)	(45,534)	(48,531)
Net income (loss)—pro forma	$(27,505)	$(73,234)	$(11,068)
Basic net income (loss) per share—as reported	$ 0.27	$ (0.33)	$ 0.50
Basic net income (loss) per share—pro forma	$ (0.28)	$ (0.86)	$ (0.15)
Diluted net income (loss) per share—as reported	$ 0.27	$ (0.33)	$ 0.45
Diluted net income (loss) per share—pro forma	$ (0.28)	$ (0.86)	$ (0.15)

The impact on pro forma net income (loss) per share and net income (loss) in the table above may not be indicative of the effect in future years as options vest over several years and the Company continues to grant stock options to new and current employees.

Recent Pronouncements:

In October 2001, the FASB issued SFAS No. 144, (SFAS 144) "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 amends existing accounting guidance on asset impairment and provides a single accounting model for long-lived assets to be disposed of. Among other provisions, the new rules change the criteria for classifying an asset as held-for-sale. The standard also broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations, and changes the timing of recognizing losses on such operations. We adopted SFAS 144 effective January 1, 2003 and do not expect the adoption to have a material effect on our results of consolidated operations, financial condition or cash flows.

In April 2002, the FASB issued SFAS No. 145, (SFAS 145) "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Among other provisions, SFAS 145 rescinds SFAS No. 4, Reporting Gains and Losses from Extinguishment of Debt." Accordingly, gains or losses from extinguishment of debt shall not be reported as extraordinary items unless the extinguishment qualifies as an extraordinary item under the criteria of Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Gains or losses from extinguishment of debt that do not meet the criteria of APB No. 30 should be reclassified to income from continuing operations in all prior periods presented. We adopted SFAS 145 effective January 1, 2003 and do not expect the adoption to have a material effect on our results of consolidated operations, financial condition or cash flows.

In June 2002, the FASB issued SFAS No. 146, (SFAS 146) "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 provides guidance related to accounting for costs associated with disposal activities covered by SFAS 144 or with exit or restructuring activities previously covered by EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 supercedes EITF Issue No. 94-3 in its entirety. SFAS 146 requires that costs related to exiting an activity or to a restructuring not be recognized until the liability is incurred. SFAS 146 will be applied prospectively to exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS 146 to have a material effect on our results of consolidated operations, financial condition or cash flows.

In November 2002, the FASB issued Financial Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a rollforward of the entity's product warranty liabilities. We will apply the recognition provisions of FIN 45 prospectively to guarantees issued after December 31, 2002. The disclosure provisions of FIN 45 are effective for financial statements for fiscal year 2002. As is customary in our industry, as provided for in local law in the U.S. and other jurisdictions, our standard contracts provide remedies to our customers, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of our products. From time to time, we indemnify customers against combinations of loss, expense, or liability arising from various trigger events related to the sale and the use of our products and services. In addition, from time to time we also provide protection to customers against claims related to undiscovered liabilities, additional product liability or environmental obligations. In our experience, claims made under such indemnifications are rare. We believe that the adoption of this standard will have no material impact on our results of consolidated operations, financial condition or cash flows.

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We are currently evaluating the effect that the adoption of EITF Issue No. 00-21 will have on our results of consolidated operations, financial condition or cash flows.

In December 2002, the FASB issued SFAS No. 148, (SFAS 148) "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS 148 requires disclosure of the pro forma effect in interim financial statements. The annual disclosure requirements of SFAS 148 are included in these notes while the transition disclosure requirements are effective for our fiscal year 2003 We do not expect SFAS 148 to have a material effect on our results of consolidated operations, financial condition or cash flows.

In January 2003, the FASB issued Financial Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We do not expect FIN 46 to have a material effect on our results of consolidated operations, financial condition or cash flows.

3. Business Combinations:

MeetU.com, Inc.

On June 20, 2002, the Company completed the acquisition of privately-held development stage MeetU.com, Inc. ("MeetU"), a leading developer of web collaboration software. The primary reason for the acquisition and the factors that contributed to the recognition of goodwill relate to MeetU's ability to deliver core technology in the web collaboration arena. The Company expects this technology to provide synergies between MeetU's web collaboration software and the Company's voice, video and network systems product lines thereby enabling the Company to deliver complete end-to-end collaboration solutions. Since June 21, 2002, the results of operations of MeetU have been included in the Company's consolidated statements of operations. Pro forma results of operations have not been presented, as the effect of this acquisition was not material.

The Company acquired all the outstanding capital stock of MeetU for a total consideration of $2.7 million consisting of 41,553 shares of Polycom common stock, with an aggregate value of $0.6 million, $1.8 million of previous cash investments by the Company, approximately $30,000 in cash at closing and approximately $0.2 million of acquisition costs. Additional shares of Polycom common stock are issuable upon the successful completion of five revenue based earn-out thresholds prior to June 20, 2005. The Company may be required to issue additional shares of the Company's common stock each time an earn-out threshold is achieved. Assuming all earn-out thresholds are achieved prior to June 20, 2005, the Company would be required to issue a total of $3.5 million to $10.5 million of common stock depending upon the average closing price of the Company's common stock during the thirty days prior to achievement of each earn-out threshold. This additional consideration would increase goodwill and the total purchase consideration. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date.

The amounts allocated to in-process research and development were determined by management, after considering among other factors, the results of an independent appraisal based on established valuation techniques in the high-technology communications industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed for those in-process research and development projects. The cost approach, which uses the concept that replacement cost is an indicator of fair value, was the primary technique utilized in valuing the in-process research and development. The cost approach is based on the premise that a prudent investor would pay no more for an asset than the cost to replace that asset with a new one. Replacement cost was based on total costs, net of the unrealized income tax deduction benefit, spent developing the in-process technology from MeetU's inception to the acquisition date. It is reasonably possible that the development of this technology could fail because of either prohibitive cost, inability to perform the required efforts to complete the technology or other factors outside of the Company's control such as a change in the market for the resulting developed products. In addition, at such time that the project is completed it is reasonably possible that the completed products do not receive market acceptance or that the Company is unable to produce and market the product cost effectively.

In accordance with SFAS 142, goodwill originating from the MeetU acquisition has not been amortized. Purchased intangible assets are being amortized on a straight-line basis over a period of three years. For the year ended December 31, 2002, amortization associated with the purchased intangible assets totaled approximately $0.5 million. The purchase price allocation related to the MeetU acquisition is final as of December 31, 2002, except for the resolution of certain earn-out contingency payments which would result in an increase in total consideration paid in the period the earn-out is achieved and a corresponding adjustment to goodwill. A summary of the purchase price allocation is outlined as follows (in thousands):

Tangible assets, less liabilities assumed	$(1,151)
In-process research and development	900
Goodwill	41
Identifiable intangible assets	2,900
Total consideration	$ 2,690

Atlanta Signal Processors, Incorporated

On November 30, 2001, the Company completed the acquisition of Atlanta Signal Processors, Incorporated (ASPI), a manufacturer of voice products for the installed voice systems market, in exchange for $4.9 million in cash for all of the outstanding ASPI shares and assumption of outstanding options exercisable into 30,687 shares of Polycom common stock, with an aggregate value of $0.9 million plus acquisition costs of approximately $0.2 million. The acquisition was accounted for using the purchase method of accounting and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. The consolidated financial statements include the operating results of the business from the date of acquisition. Pro forma results of operations have not been presented because the effects of this acquisition were not material on an individual basis.

The amounts allocated to in-process research and development were determined by management, after considering among other factors, the results of an independent appraisal using established valuation techniques in the high-technology communications industry and were expensed upon acquisition because the technological feasibility had not been established and no future alternative uses existed for those in-process research and development projects. The income approach, which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and in-process research and development projects. The estimated net free cash flows generated by the in-process research and development projects were discounted at 35% percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. It is reasonably possible that the development of this technology could fail because of either prohibitive cost, inability to perform the required efforts to complete the technology or other factors outside of the Company's control such as a change in the market for the resulting developed products. In addition, at such time that the project is complete it is reasonably possible that the completed products do not receive market acceptance or that the Company is unable to produce and market the product effectively. Goodwill originating from the acquisition has not been amortized in accordance with SFAS 142. Other intangible assets are being amortized on a straight-line basis over periods not exceeding three years. The Company recorded unearned stock-based compensation of approximately $754,000 associated with unvested stock options assumed in conjunction with the acquisition. This amount is included as a component of stockholders' equity and is being amortized over the vesting period of the options consistent with the guidance stated in FIN 44. For the year ended December 31, 2002 and 2001, amortization associated with unearned stock based compensation and other intangible assets associated with this acquisition totaled approximately $1.6 million and $0.1 million, respectively. The purchase price allocation related to the ASPI acquisition was final as of December 31, 2002. A summary of the final purchase price allocation is outlined as follows (in thousands):

Tangible assets, less liabilities assumed	$ (131)
In-process research and development	900
Goodwill	2,062
Identifiable intangible assets	4,100
Unearned stock-based compensation	754
Deferred tax liability	(1,693)
Total consideration	$ 5,992

PictureTel Corporation

On October 18, 2001, the Company completed the acquisition of PictureTel Corporation (PictureTel), a leader in visual collaboration, in exchange for 0.1177 shares of Polycom common stock and $3.11 in cash for each outstanding share of PictureTel common stock. In total, approximately 6.6 million shares of the Company's common stock, net of 363,557 treasury shares obtained through the acquisition, and approximately $183 million in cash were exchanged for all outstanding shares of PictureTel's common stock. The primary reason for the acquisition and the factors that contributed to the recognition of goodwill is that Polycom expects to be better equipped with the financial, technological, operational and marketing resources and capabilities necessary to compete in the communications market. In addition, Polycom expects to expand product and service offerings while reducing costs through economies of scale. In addition, the Company assumed outstanding options and warrants, which became exercisable for approximately 1.2 million shares of the Company's common stock. The acquisition was accounted for using the purchase method of accounting and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. Since October 18, 2001, the results of operations of PictureTel have been included in the Company's condensed consolidated statements of operations.

The accompanying consolidated financial statements reflect a purchase price of approximately $413 million, consisting of cash and Polycom common stock valued using the average fair value of Polycom's outstanding common stock from May 22, 2001 to May 29, 2001, the five trading days surrounding the date the acquisition agreement was announced, and the fair value of the options and warrant to be assumed by Polycom in the acquisition, and other costs directly related to the acquisition as follows (in thousands):

Cash	$183,368
Fair value of Polycom's common stock	195,475
Fair value of options and warrants assumed	24,117
Acquisition-related costs	9,908
Total consideration	$412,868

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For purposes of computing the estimated fair value of the options and warrants assumed, the Black-Scholes pricing model was used with the following assumptions: fair value of Polycom's stock of $27.74, expected life of 5.5 years, risk-free rate of 5.5%, expected dividend yield of 0% and volatility of 90%. The purchase price allocation related to the PictureTel acquisition was final as of September 30, 2002, except for the resolution of certain tax related pre-acquisition contingencies which would result in an adjustment to goodwill in the period the contingency is resolved. The following is a summary of the final allocation of purchase price (in thousands):

Tangible assets:	
Current assets	$ 122,945
Property, plant and equipment	4,907
Other assets	50,975
Total tangible assets acquired	178,827
Liabilities:	
Current liabilities	(144,149)
Long-term liabilities	(17,573)
Total liabilities assumed	(161,722)
Treasury stock	11,182
In-process research and development	49,292
Goodwill	292,468
Other intangible assets consisting of:	
Core technology	14,581
Developed technology	2,847
Patents	8,668
Product customer relationships	3,211
Service customer relationships	13,514
Total consideration	$ 412,868

The amount allocated to in-process research and development and other intangible assets was determined by management, after considering among other factors, the results of an independent appraisal based on established valuation techniques in the high-technology communications industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed for those in-process research and development projects. The income approach, which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and in-process research and development. The estimated net free cash flows generated by the in-process research and development projects were discounted at rates ranging from 30 to 40 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. It is reasonably possible that the development of this technology could fail because of either prohibitive cost, inability to perform the required efforts to complete the technology or other factors outside of the Company's control such as a change in the market for the resulting developed products. In addition, at such time that the project is completed it is reasonably possible that the completed products do not receive market acceptance or that the Company is unable to produce and market the product effectively.

Goodwill originating from the acquisition of PictureTel has not been amortized in accordance with the guidance contained in Statement of Financial Accounting Standard No. 142 (SFAS 142), "Goodwill and Other Intangible Assets." None of the goodwill is expected to be deductible for tax purposes. Other intangible assets are being amortized over their estimated useful lives of three years. For the years ended December 31, 2002 and 2001, amortization associated with the acquisition totaled approximately $14.3 million and $2.9 million, respectively.

The following unaudited pro forma financial information is presented to reflect the results of operations for the three years ended December 31, 2002 as if the acquisition had occurred on January 1, 2000. The pro forma results exclude purchased in-process research and development and the impairment of licenses arising from the acquisition of PictureTel of $5.5 million due to their nonrecurring nature. The pro forma financial information includes nonrecurring items incurred by PictureTel as follows: $14.5 million of nonrecurring charges incurred in 2001 and $15.3 million of nonrecurring gains and $42.3 million of non recurring charges in 2000. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the acquisition actually taken place on January 1, 2000, and may not be indicative of future operating results, (unaudited, in thousands, except per share amounts):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Net revenues	$465,959	$518,260	$612,803
Net income (loss)	$ 26,760	$ (22,512)	$ (59,274)
Net income (loss) per share:			
Basic	$ 0.27	$ (0.25)	$ (0.72)
Diluted	$ 0.27	$ (0.25)	$ (0.72)
Weighted average shares:			
Basic	99,324	90,379	81,848
Diluted	100,696	90,379	81,848

Circa Communications Ltd.

On April 2, 2001 the Company completed the acquisition of privately-held development stage Circa Communications Ltd. (Circa), a leading developer of voice over internet protocol (VoIP) telephony products, in exchange for the right to 665,884 shares of common stock and assumption of outstanding options exercisable into 248,597 shares of Polycom common stock, with an aggregate value of $9.8 million, and $4.0 million cash for preferred stock plus acquisition costs of approximately $0.8 million. An additional 421,555 shares of Polycom common stock are issuable upon the successful completion of certain revenue based earn-out thresholds which expire in 2010. The acquisition was accounted for using the purchase method of accounting and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. During 2002, the right to exchange 375,792 shares into common stock was exercised leaving a balance of 290,092 still to be exchanged.

Since April 2, 2001, the results of operations of Circa have been included in the Company's consolidated statements of income. The Company recorded unearned stock-based compensation of approximately $780,000 associated with unvested stock options assumed to employees in conjunction with the acquisition. This amount is included as a component of stockholders' equity and is being amortized over the vesting period of the options.

The purchase price allocation related to the Circa acquisition is final, except for the resolution of certain earn-out contingency payments which would result in an increase in the total consideration paid in the period the earn-out is achieved and a corresponding adjustment to goodwill. The following is a summary of the allocation of purchase price in the acquisition of Circa (in thousands):

Tangible assets, less liabilities assumed	$ (730)
In-process research and development	2,450
Identifiable intangible assets	3,650
Goodwill	8,454
Unearned stock-based compensation	780
Total purchase price	$14,604

The amount allocated to purchased in-process research and development was determined by management, after considering among other factors, the results of an independent appraisal based on established valuation techniques in the high-technology communications industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed for those in-process research and development projects. The income approach, which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and in-process research and development projects. The estimated net free cash flows generated by the in-process research and development projects were discounted at 30% percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. It is reasonably possible that the development of this technology could fail because of either prohibitive cost, inability to perform the required efforts to complete the technology or other factors outside of the Company's control such as a change in the market for the resulting developed products. In addition, at such time that the project is completed it is reasonably possible that the completed products do not receive market acceptance or that the Company is unable to produce and market the product effectively.

Goodwill and acquired intangible assets, primarily representing existing partnerships and acquired workforce, are being amortized over the estimated useful lives of three years. For the year ended December 31, 2002 and 2001, amortization of goodwill, unearned stock-based compensation and other intangible assets associated with this acquisition totaled approximately $1.2 million and $3.2 million, respectively.

The following unaudited pro forma financial information reflects the results of operations for the three years ended December 31, 2002 as if the acquisition had occurred on January 1, 2000. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the acquisition actually taken place on January 1, 2000, and may not be indicative of future operating results, (unaudited, in thousands, except per share amounts):

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Net revenues	$465,959	$383,189	$373,554
Net income (loss)	$ 26,760	$ (29,490)	$ 35,151
Net income (loss) per share:			
Basic	$ 0.27	$ (0.35)	$ 0.46
Diluted	$ 0.27	$ (0.35)	$ 0.41
Weighted average shares:			
Basic	99,324	85,290	75,930
Diluted	100,696	85,290	84,743

Accord Networks Ltd.

On February 28, 2001, the Company completed the acquisition of Accord Networks Ltd. (Accord). Accord is a leading provider of next-generation, rich-media network products that enable Internet Protocol (IP) and other network voice and video communications in both the customer premises and service provider markets. Under the terms of the merger, Polycom exchanged approximately 6.5 million shares of common stock for all outstanding Accord shares and assumed Accord options exercisable into approximately 1.3 million shares of Polycom's common stock. The exchange and assumption was at a rate of 0.3065 Polycom shares for each Accord share. The transaction was treated as a pooling of interests for financial reporting purposes and consequently, the Company's historical consolidated financial statements have been restated as if the combined entity existed for all periods presented. All intercompany transactions between the two companies have been eliminated in consolidation. The Company and Accord had the same fiscal year ends of December 31. Further, adjustments required to conform accounting policies between the two companies, primarily associated with the classification of expenses, were insignificant.

The following table reconciles the Company's original revenues and earnings to the combined (in thousands, except per share data):

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Net revenues:			
Polycom	$465,959	$373,413	$331,302
Accord	—	9,776	42,252
Combined net revenues	$465,959	$383,189	$373,554
Net income (loss):			
Polycom	$ 26,760	$ (27,782)	$ 49,228
Accord	—	82	(11,765)
Combined net income (loss)	$ 26,760	$ (27,700)	$ 37,463
Basic net income (loss) per share:			
Polycom	$ 0.27	$ (0.33)	$ 0.69
Accord	—	0.00	(0.19)
Combined basic net income (loss) per share	$ 0.27	$ (0.33)	$ 0.50
Diluted net income (loss) per share:			
Polycom	$ 0.27	$ (0.33)	$ 0.64
Accord	—	0.00	(0.19)
Combined diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45

4. Goodwill and Purchased Intangibles:

The following table presents details of the Company's goodwill (in thousands):

Balance at December 31, 2001	$299,445
Add: Reclassification of acquired workforce intangible to goodwill	525
Add: Goodwill acquired in the MeetU purchase acquisition	56
Add: Changes in fair value estimates of assets acquired and liabilities assumed	13
Balance at December 31, 2002	$300,039

The unamortized balance of acquired workforce totaling $0.5 million, recorded as part of the purchase price allocation of the Circa acquisition, was reclassified from purchased intangibles to goodwill, as it did not meet the criteria outlined in SFAS 142 to be recorded separately from goodwill. The fair value adjustments to assets acquired and liabilities assumed during the year ended December 31, 2002 resulted primarily from revisions to net cost estimates associated with the elimination of redundant facilities, resolution of certain other pre-acquisition contingencies and changes in estimates of the fair value of certain PictureTel assets recorded during the initial purchase price allocation. Within the allocation period, the Company finalized its purchase price allocation of the PictureTel acquisition resulting in a net increase in goodwill of approximately $1.3 million. These adjustments to goodwill resulted primarily from an increase in the facility closings liability of approximately $15.0 million partially offset by a $7.9 million increase in deferred tax assets, a $3.5 million net decrease in other acquisition related liabilities and a $2.3 million increase in the fair value of certain acquired assets. In the fourth quarter of 2002, the Company incurred actual costs lower than estimates made in the final allocation and recorded an investment in equity securities of a publicly traded company which was acquired in the PictureTel acquisition but initially valued at zero, as they were held in escrow. These securities were released from escrow in the fourth quarter and appropriately valued. These adjustments resulted in a goodwill decrease of $1.1 million. See Note 5 of Notes to Consolidated Financial Statements regarding the increase to the facility closings liability.

The following table presents details of the Company's total purchased intangible assets as of December 31, 2002 (in thousands):

PURCHASED INTANGIBLE ASSETS	GROSS VALUE	ACCUMULATED AMORTIZATION	OTHER ADJUSTMENTS	NET VALUE
Core and developed technology	$23,978	$ (9,992)	$ —	$13,986
Patents	8,668	(3,472)	—	5,196
Customer and partner relationships	19,625	(7,217)	—	12,408
Acquired workforce	700	(175)	(525)	—
Trade name	1,021	(103)	—	918
Other	500	(181)	—	319
Total	$54,492	$(21,140)	$(525)	$32,827

Upon adoption of SFAS 142, the Company determined that the purchased trade name intangible had an indefinite life as the Company expects to generate cash flows related to this asset indefinitely. Consequently, the trade name is no longer amortized but is reviewed for impairment annually or sooner under certain circumstances.

In June 2002, we completed our transitional goodwill and purchased intangibles impairment tests outlined under SFAS 142 which required the assessment of goodwill and purchased intangibles for impairment as of January 1, 2002 and in October 2002, we completed our annual impairment tests. These tests were conducted by determining and comparing the fair value of our reporting units, as defined in SFAS 142, to the reporting unit's carrying value as of that date. Based on the results of these impairment tests, we determined that our goodwill assets and purchased intangible assets were not impaired as of January 1, 2002 or during 2002. We plan to conduct our annual impairment tests in the fourth quarter of every year, unless impairment indicators exist sooner.

The estimated future amortization expense of purchased intangible assets as of December 31, 2002 is as follows (in thousands):

YEAR ENDING DECEMBER 31,	AMOUNT
2003	$17,590
2004	13,870
2005	449
Total	$31,909

In accordance with the transitional disclosures outlined in SFAS 142, the following tables reconcile and summarize reported results for the years ended December 31, 2002, 2001 and 2000, adjusted to exclude amortization of goodwill, trade name and assembled workforce intangible assets, as if the non-amortization requirements of SFAS 142 had been applied at the beginning of each period presented (in thousands, except per share amounts).

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Reported net income (loss)	$26,760	$(27,700)	$37,463
Add back:			
Goodwill, trade name and acquired workforce amortization	—	2,382	—
Adjusted net income (loss)	$26,760	$(25,318)	$37,463
Reported basic net income (loss) per share	$ 0.27	$ (0.33)	$ 0.50
Add back:			
Goodwill, trade name and acquired workforce amortization	—	0.03	—
Adjusted basic net income (loss) per share	$ 0.27	$ (0.30)	$ 0.50
Reported diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45
Add back:			
Goodwill, trade name and acquired workforce amortization	—	0.03	—
Adjusted diluted net income (loss) per share	$ 0.27	$ (0.30)	$ 0.45

5. Acquisition-Related Costs and Liabilities:

For the year ended December 31, 2002, the Company recorded a charge to operations of $3.7 million for acquisition-related integration costs primarily related to the PictureTel acquisition. These charges include outside financial advisory, legal and accounting services. For the year ended December 31, 2001, the Company recorded a charge to operations of $24.1 million, related to the PictureTel, Accord and Circa acquisitions. For the year ended December 31, 2000, the Company recorded a charge to operations of $4.8 million, for acquisition-related costs related to the acquisition of Accord. These charges include the cost of actions designed to improve the Company's combined competitiveness, productivity and future profitability and primarily relate to the elimination of redundant and excess facilities and workforce in the Company's combined businesses and the elimination of redundant assets.

The following table summarizes the status of the Company's acquisition-related liabilities, restructuring and integration costs (in thousands):

	FACILITY CLOSINGS	SEVERANCE AND RELATED BENEFITS	ASSET IMPAIRMENT	ASSET WRITE-OFF	OTHER EXIT COSTS	INTEGRATION COSTS, MERGER FEES AND EXPENSES
2000 Additions to the reserve	$ —	$ —	$ —	$ —	$ —	$ 4,768
2000 Cash payments and other usage	—	—	—	—	—	(301)
Balance at January 1, 2001	—	—	—	—	—	4,467
2001 Additions to the reserves	1,429	2,311	6,655	771	309	12,602
2001 Liabilities assumed through purchase acquisitions	24,081	14,088	—	—	—	—
2001 Cash payments and other usage	(137)	(5,359)	(6,655)	(771)	(126)	(15,258)
Balance at December 31, 2001	25,373	11,040	—	—	183	1,811
2002 Additions to the reserves	—	—	—	—	—	3,699
2002 Finalization of facilities closing liability	15,042	—	—	—	—	—
2002 Liabilities assumed through purchase acquisitions	31	277	—	—	—	—
2002 Cash payments and other usage	(3,732)	(8,484)	—	—	(183)	(5,510)
Balance at December 31, 2002	$36,714	$2,833	$ —	$ —	$ —	$ —

The Company had approximately $32.0 million and $23.9 million, at December 31, 2002 and December 31, 2001, respectively, of acquisition-related reserves classified as long-term liabilities. Approximately $7.5 million and $14.5 million, at December 31, 2002 and December 31, 2001, respectively, of acquisition-related reserves were classified as current liabilities.

Facility closings

The facility closings liability is primarily related to estimated lease termination costs and the net present value of the minimum lease payments for vacated and redundant facilities that the Company intends to sublease or negotiate a lease termination settlement. The Company has netted estimated sublease cash receipts against its lease obligations to determine the minimum lease payments for the facilities it intends to sublease. The longest lease term for facilities identified for a sublease arrangement extends to 2014. The Company also assumed liabilities related to facility closings totaling $24.1 million from the acquisitions of PictureTel, ASPI and MeetU. During 2002, the Company finalized its purchase price allocation related to the PictureTel acquisition which resulted in an additional accrual to the facility closings liability of approximately $15.0 million. This adjustment resulted from final clarifications related to the terms under which the Company could sublease certain redundant facilities and changes in estimates of operating costs related to these facilities.

Severance and related benefits

The severance and related benefits liability is for workforce reductions that were initiated in 2002 and 2001. Additionally, the Company assumed liabilities related to severance totaling $14.4 million from the acquisitions of PictureTel, ASPI and MeetU. These workforce reductions were substantially complete as of December 31, 2002. Severance payments are being made through the end of 2004.

Asset Impairments and Write-offs, Other Exit Costs and Merger Fees

Asset impairments in the amount of $6.7 million and asset write-offs in the amount of $0.8 million were principally related to the elimination of redundant or excess equipment. Other exit costs in the amount of $0.3 million were related to payment obligations that carried no future benefit to the Company's combined operations and were completed as of December 31, 2002. Merger-related transaction and period expenses for the years ended December 31, 2002, 2001 and 2000 of $3.7 million, $12.6 million and $4.8 million, respectively principally consisted of financial advisory, accounting, legal and consulting fees, and other direct merger-related expenses incurred in the period.

6. Restructure Costs:

In 2002, the Company's management approved restructuring actions in response to the continued global economic downturn and to improve the Company's overall cost structure by prioritizing resources in strategic areas of the business and reducing operating expenses. The Company recorded a restructuring charge of $1.7 million in 2002 as a result of these actions. This charge consisted of severance and other employee termination benefits related to a workforce reduction of approximately six percent of the Company's employees worldwide. As of December 31, 2002, the Company had paid approximately $1.2 million of the $1.7 million charge. The remaining amount will be paid in fiscal 2003.

7. Investments:

Investments at December 31, 2002 and 2001 comprise (in thousands):

	FAIR VALUE	COST BASIS
Investments—Short-term:		
US government securities	$ 26,844	$ 26,738
State and local governments	2,000	2,000
Corporate debt securities	9,578	9,560
Corporate equity securities	248	367
	38,670	38,665
Investments—Long-term:		
US government securities	179,849	178,591
State and local governments	906	902
Corporate debt securities	138,205	136,793
Corporate equity securities	187	187
	319,147	316,473
Balances at December 31, 2002	$357,817	$355,138
Investments—Short-term:		
US government securities	$ 5,282	$ 5,317
State and local governments	13,029	13,032
Corporate debt securities	4,479	4,479
Corporate equity securities	558	558
	23,348	23,386
Investments—Long-term:		
US government securities	24,402	24,440
State and local governments	17,073	17,005
Corporate debt securities	18,034	17,477
Corporate equity securities	9,173	9,173
	68,682	68,095
Balances at December 31, 2001	$ 92,030	$ 91,481

All short-term investments as of December 31, 2002 and 2001 mature within one year. Long-term investments, excluding equities, mature within two years. During 2002 and 2001, the Company recorded net realized gains of $43,000 and $391,000, respectively on the disposal of investments. During 2000, there were no realized gains or losses on the disposal of investments. The Company used the specific identification method for determining the cost basis and resulting realized gain or loss on the transactions. Included in investments at December 31, 2002 and 2001 are approximately $0.4 million and $9.7 million, respectively in investments in equity securities of publicly traded companies which have been marked to market from their original $1.6 and $8.6 million investment value, respectively.

8. Inventories:

Inventories consist of the following (in thousands):

	DECEMBER 31,	
	2002	2001
Raw materials	$ 1,111	$15,412
Work in Process	221	1,101
Finished goods	30,976	31,660
	$32,308	$48,173

9. Property and equipment, net:

Property and equipment, net, consist of the following (in thousands):

	DECEMBER 31,	
	2002	2001
Computer equipment and software	$44,403	$35,309
Equipment, furniture and fixtures	13,070	11,185
Tooling equipment	9,054	7,725
Leasehold improvements	6,951	5,597
	73,478	59,816
Less, accumulated depreciation and amortization	45,050	30,871
	$28,428	$28,945

10. Other Accrued Liabilities:

Other accrued liabilities consist of the following (in thousands):

	DECEMBER 31,	
	2002	2001
Accrued expenses	$ 6,586	$22,342
Short-term restructuring reserves	7,975	14,460
Warranty obligations	10,224	9,123
Inventory purchase commitment	3,359	6,419
Sales tax payable	4,597	1,930
Employee stock purchase plan withholding	2,135	1,637
Other accrued liabilities	1,643	8,476
	$36,519	$64,387

The inventory purchase commitment was a PictureTel liability that the Company assumed as part of the acquisition of that entity in October 2001, and represents a commitment to purchase inventory volumes manufactured by a third-party vendor in excess of what the Company estimates it can sell.

11. Business Risks and Credit Concentration:

The Company sells a limited number of products and services which serve the communications equipment market. A substantial majority of the Company's net revenues are derived from sales of the ViewStation, SoundStation, iPower and network systems and related services. Any factor adversely affecting demand or supply for these products or services could materially adversely affect the Company's business and financial performance.

Currently, the Company subcontracts the manufacturing of all of the video and voice products through one subcontractor in Asia. The Company believes that there are a number of alternative contract manufacturers that could produce these products, but in the event of a reduction or interruption of supply, it could take a significant period of time to qualify an alternative subcontractor and commence manufacturing. The effect of such reduction or interruption in supply on results of operations would be material. Certain key components used in our products are currently available from only one source and others are available from only a limited number of sources.

The Company's network systems products are manufactured in Israel which is currently experiencing internal and external conflicts that include terrorist acts and military action. Also, a war with Iraq or other Middle Eastern countries perceived as a threat by the United States government could cause us to experience a manufacturing disruption due to acts associated with these conflicts which could harm our business. In addition, certain technology used in the network system products was developed through grants from the Office of the Chief Scientist in Israel. Under Israeli law, it is prohibited to transfer technology developed pursuant to these grants to any person without the prior written consent of the Office of the Chief Scientist. The grants also contain restrictions on the ability to manufacture products developed with these grants outside of Israel. Approval to manufacture such products outside of Israel, if granted, is generally subject to an increase in the total amount to be repaid to the Office of the Chief Scientist of between 120% to 300% of the amount granted, depending on the extent of the manufacturing to be conducted outside of Israel. These restrictions on the ability to transfer technology to third parties or manufacture products outside Israel may adversely affect the Company's operating results and significantly reduce the value of the technology developed under these grants.

The Company's cash, cash equivalents and investments are maintained with a limited number of international investment management companies and commercial banks and their international affiliates, and are invested in the form of demand deposit accounts, money market accounts, corporate debt securities and government securities. Deposits in these institutions may exceed the amount of insurance provided on such deposits.

The Company markets its products to distributors and end-users throughout the world. Management performs ongoing credit evaluations of the Company's customers and maintains an allowance for potential credit losses. The expansion of Polycom's product offerings may increase the Company's credit risk as customers place larger orders for new products. There can be no assurance that the Company's credit loss experience will remain at or near historic levels. At December 31, 2002 and 2001, no single customer accounted for more than 10% of accounts receivable.

The Company has purchased licenses for technology incorporated in its products. The value of these long-term assets is monitored for any impairment and if it is determined that a write-down is necessary, this charge could have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

12. Commitments and Contingencies:

Litigation:

From time to time, the Company is involved in various legal proceedings arising from the normal course of business activities. In addition, from time to time, third parties assert patent or trademark infringement claims against the Company in the form of letters and other forms of communication. We do not believe that any of these legal proceedings or claims are likely to have a material adverse effect on our consolidated results of operations, financial condition or cash flows.

On September 23, 2002, a suit captioned *Collaboration Properties, Inc. v. Polycom, Inc.* was filed in the United States Court in the Northern District of California. The complaint alleges that Polycom's ViewStation, ViaVideo, iPower, WebOffice and Path Navigator products infringe 4 U.S. Patents owned by plaintiff. The complaint seeks unspecified compensatory and exemplary damages for past and present infringement and to permanently enjoin Polycom from infringing on the patents in the future. On November 14, 2002 the Company filed an answer asserting, among other things, no infringement and that plaintiff's patents are invalid and unenforceable. The Company believes that it has meritorious defenses and counterclaims, and intends to vigorously defend this action.

On September 3, 1997, VTEL Corporation, or VTEL, filed a lawsuit in the State District Court in Travis County, Texas against ViaVideo Communications, Inc. and its founders (who were formerly employed by VTEL). On May 27, 1998, following our acquisition of ViaVideo, VTEL amended its suit to add Polycom as a defendant. Nor In the lawsuit, VTEL alleged breach of contract, breach of confidential relationship, disclosure of proprietary information and related allegations. ViaVideo, its founders and Polycom answered the suit, denying in their entirety VTEL's allegations. On March 3, 2000, VTEL voluntarily dismissed the allegations against Polycom and ViaVideo with prejudice for no consideration. As a one-time item in the first quarter of 2000, the excess accrual associated with the expenses the Company estimated to be incurred in connection with this lawsuit totaling $1.8 million was released since no further material expenses will be incurred.

On November 20, 1998, a patent infringement claim was filed against Accord's U.S. subsidiary, Accord Networks, Inc., in the United States District Court, District of Massachusetts, alleging that the U.S. subsidiary had and was willfully and deliberately infringing on one of Ezenial's patents. The complaint was later amended to allege that the U.S. subsidiary also had and was willfully and deliberately infringing on other patents. On June 10, 1999, Accord was added as a defendant in the lawsuit. On June 16, 2000, Accord and its U.S. subsidiary entered into a written settlement agreement, and the Court entered an order dismissing the case. The lawsuit settlement cost of $6.5 million, which final payment was made on December 28, 2000, represents a one-time charge resulting from this settlement and was reported under "Litigation settlement" in the consolidated statement of operations in June 2000.

Standby Letters of Credit:

The Company has several standby letters of credit totaling approximately $791,000 which were issued to guarantee certain of the Company's foreign office lease obligations and other contractual obligations.

License Agreements:

On March 3, 2000, the Company entered into a patent licensing agreement with VTEL Corporation (VTEL). VTEL provided a fully-paid up, royalty-free license to three patents related to various videoconferencing technologies. In exchange for these licenses, the Company paid VTEL approximately $8.3 million and sublicensed to VTEL a royalty-bearing patent for videoconferencing technology. The royalty, if any, under the sublicense was payable to the patent holder not Polycom. Amortization of the license was computed using the straight-line method over the economic life of the license of five years. On October 19, 2001, the Company recorded a charge of $5.5 million related to the impairment of the VTEL license as management determined that the technology used by PictureTel was superior to that obtained by Polycom under the VTEL license and that the PictureTel technology would be used in Polycom's products and research and development and would better protect the Company's intellectual property. This charge is included in "Acquisition-related costs" on the consolidated statement of operations.

The Company also enters into other various license agreements in the normal course of business and the cost of those agreements are amortized over the expected life of the respective agreements. The cost of these agreements and the amounts amortized in the years presented, both combined and individually, are not significant.

Leases:

The Company leases certain office facilities and equipment under noncancelable operating leases expiring between 2003 and 2014. As of December 31, 2002, the following future minimum lease payments, net of sublease income are due under our current lease obligations. The Company has an approximately 152,000 square foot building which is fully subleased to a third party for which the sublease runs concurrent with the Company's lease obligation. As a result the Company is not currently showing a lease obligation related to this facility. In addition to these minimum lease payments, we are contractually obligated under the majority of our operating leases to pay certain operating expenses during the term of the lease such as maintenance, taxes and insurance. This table excludes leases subject to cancellation within twelve months of December 31, 2002 (in thousands):

YEAR ENDING DECEMBER 31,	MINIMUM LEASE PAYMENTS	PROJECTED ANNUAL OPERATING COSTS
2003	$13,392	$ 4,272
2004	13,343	4,644
2005	11,750	4,011
2006	11,578	4,032
2007	8,636	3,249
Thereafter	35,416	13,575
Minimum future lease payments	$94,115	$33,783

The Company is currently headquartered in an approximately 50,000 square foot facility in Pleasanton, California pursuant to a lease which expires in May 2012. This facility accommodates executive and administrative operations. Our former headquarters in Milpitas, California continues to house research and development, manufacturing, marketing, sales and customer support operations for primarily our voice business. This facility is approximately 102,000 square feet and is leased through January 2007.

The majority of the Company's video and service operations are located in approximately 321,000 square feet in Andover, Massachusetts pursuant to a lease that expires in September 2014 and approximately 64,000 square feet in Austin, Texas pursuant to a lease that expires in December 2004. The network systems operations occupy approximately 40,000 square feet in Petach Tikva, Israel and 32,000 square feet in Atlanta, Georgia, which is also shared with our installed voice business. In addition, the Company leased space in Goleta, California through January 2003 for the network access products' engineering, manufacturing and marketing organizations and the Company leases space in North Vancouver, Canada for the VoIP development operation and in Burlington, Massachusetts for our advanced voice development operations.

The Company leases an approximately 55,000 square foot facility in Tracy, California which is used as the North American and Latin American distribution center. Further, the Company utilizes space at a manufacturing contractor in Thailand and the Company's European distribution contractor in the United Kingdom and Netherlands to provide Asian and European distribution and repair centers, respectively.

Included in the noncancelable operating leases are those assumed as part of the acquisition of PictureTel. The Company has identified vacated or redundant PictureTel leased facilities that the company intends to terminate or sublease and has recognized them as a liability assumed in a purchase combination. The liability is valued at the estimated net present value of the lease commitments. The estimated net present value of the cost of terminating these leases net of any estimated sublease rent is $36.5 million of which $4.7 million is classified as a current liability and $31.8 million is classified as a long term liability.

Rent expense for the years ended December 31, 2002, 2001 and 2000 was $14.6 million, $8.3 million and $6.3 million, respectively.

Grants:

In December 2000, Accord repaid all of its outstanding grants from the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade. Accordingly, an amount of approximately $5.5 million was recorded as an expense in the consolidated statement of operations in 2000. Previously, Accord was obligated to pay royalties to the Office of the Chief Scientist on proceeds from sales of systems resulting from three research and development projects which the Office of the Chief Scientist helped fund with grants to Accord, at the following progressive royalty rates: 3% of annual system sales for the first three years of system sales by Accord, 4% for the next three years of system sales, and 5% for any systems sales thereafter, up to 100% of the aggregate amount of grants received by Accord. At the time the funding was received, successful development of the related projects was not assured.

In December 2000, Accord repaid all of its outstanding grants from the Israel-United States Binational Industrial Research and Development foundation (BIRD). Accordingly, an amount of approximately $0.4 million was recorded as an expense in the consolidated statement of operations in 2000. Accord was obligated to pay royalties to BIRD on the proceeds from sale, leasing or other marketing or commercial exploitation of the results of research and development in which BIRD helped fund with grants to Accord. Royalties up to the amount of 150% of the aggregate amount of the grant were to be paid at the rate of 5% of related products sales, up to the aggregate amount of the grant; once the amount of the grant was repaid, royalties would have been payable at the rate of 2.5% of related products sales, until additional royalties in an amount of 16%-50% of the aggregate grant amount were to be paid to BIRD.

Royalty expenses related to the above mentioned commitments for the year ended December 31, 2000 was approximately $1.6 million. There were no royalty expenses in 2002 or 2001.

13. Credit Arrangements:

The Company has available a $25 million revolving line of credit with a bank under an agreement dated November 15, 2001. Borrowings under the line are unsecured and bear interest at the bank's prime rate (4.25% at December 31, 2002) or at the London interbank offered rate (LIBOR) plus 0.65% (approximately 2.06% to 2.07%, depending on the term of the borrowings at December 31, 2002). Borrowings under the line are subject to certain financial covenants and restrictions on liquidity, indebtedness, financial guarantees, business combinations, profitability levels, and other related items. The line of credit expires on December 3, 2003.

There were no balances outstanding on the line of credit and the Company was in compliance with all applicable financial covenants and restrictions for the periods presented.

14. Mandatorily Redeemable Convertible Preferred Stock:

On June 28, 2000, Accord converted 3,693,761 mandatorily redeemable convertible preferred shares into common stock.

15. Stockholders' Equity:

Public Stock Offering:

In February 2002, the Company completed a public offering in which it sold 8,050,000 shares of its common stock, including an over-allotment option of 1,050,000 shares exercised by the underwriters, at a price of $31.20 per share for net proceeds to the Company of approximately $237.5 million after underwriting discounts and commissions and expenses. The Company intends to use the net proceeds from this sale primarily for general corporate purposes, including working capital and capital expenditures, as well as for acquisitions of complementary businesses or technologies.

In August 2000, the Company completed the public offering of 5,608,976 shares of common stock at a price of $45.438 per share. Of the shares sold, approximately 3.5 million shares were sold by the Company for net proceeds of approximately $148.3 million, and the balance of shares were sold by a selling stockholder.

In July 2000, Accord completed an initial public offering of 1,762,376 shares of common stock at an offering price of $35.89 per share. Of the shares sold, 1,732,665 were sold by Accord for net proceeds of approximately $54.9 million and 29,731 shares were sold by selling stockholders.

Stock Split:

On August 2, 2000, the Company announced that its Board of Directors approved a two-for-one split of the Company's common stock. The stock split was effected as a stock dividend on August 31, 2000, and payable to all stockholders of record as of August 15, 2000. All references to share and per share amounts for all periods presented have been adjusted to give effect to this stock split.

Common Stock:

As of December 31, 2002 and 2001, 2,861 and zero shares, respectively, of common stock were outstanding but subject to repurchase.

Treasury Stock:

As a result of the acquisition of PictureTel, the Company acquired 363,557 shares of treasury stock with an aggregate value of $11.2 million based on the market value of the Company's common stock on the date of the acquisition. During 2002, these shares were retired and reclassified as authorized and unissued.

Share Repurchase Program:

In June 2002, the Board of Directors approved a plan to repurchase up to 3.5 million shares of the Company's common stock in the open market or privately negotiated transactions. As of December 31, 2002, the Company has repurchased approximately 1,483,000 shares, for cash of $15.9 million, in the open market. During 2002, the Company retired and reclassified these shares of common stock as authorized and unissued.

Stock Option Exchange Program:

On May 21, 2001, the Company commenced a voluntary stock option exchange program to certain eligible employees and consultants of the Company. Under the program, eligible employees and consultants were given the option to cancel each outstanding stock option previously granted to them at an exercise price greater than or equal to $23.55 per share, in exchange for a new option to buy 0.85 shares of the Company's common stock to be granted on December 26, 2001, six months and one day from June 25, 2001, the date the old options were canceled. In total, 1.1 million stock options were canceled as a result of this program and approximately 827,000 stock options were granted. The exchange program did not result in additional compensation charges or variable option plan accounting.

Stock Option Plan:

In 2001, the Board of Directors reserved 750,000 shares of common stock under the 2001 Nonstatutory Stock Option Plan (the Nonstatutory Plan) for issuance of nonqualified stock options to employees of acquired companies and for foreign-based employees ineligible for incentive stock options.

In 1996, the Board of Directors reserved 6,250,000 shares of common stock under its 1996 Stock Option Plan (the Plan) for issuance to employees and directors of the Company. An additional 15,000,000 shares have been reserved and approved by stockholders. The Plan supersedes the 1991 Stock Option Plan (91 Plan).

The ViaVideo Plan was assumed by Polycom on January 2, 1998 pursuant to the Agreement and Plan of Reorganization by and among Polycom, Venice Acquisition Corporation and ViaVideo Communications, Inc. dated June 11, 1997 as amended September 2, 1997. All remaining option shares available for grant and subsequent cancellations of option shares under the ViaVideo Plan expired or will expire as no additional option shares can be granted from the ViaVideo Plan subsequent to the merger.

The Atlas Plan was assumed by Polycom on December 1, 1999 pursuant to the Agreement and Plan of Reorganization by and among Polycom, Periscope Acquisition Corporation and Atlas Communication Engines, Inc. dated November 18, 1999. All remaining option shares available for grant and subsequent cancellations of option shares under the Atlas Plan expired or will expire as no additional option shares can be granted from the Atlas Plan subsequent to the merger.

In 1995, Accord reserved 5,087 shares of common stock under the 1995 Accord Networks Ltd. Stock Ownership and Option Plan dated March 29, 1995 for issuance to employees of Accord Networks Ltd. An additional 1,250,867 shares have been reserved. In the year 2000, the Accord Networks Ltd. 2000 Share Option Plan, the Accord Networks Ltd. Share Ownership and Option Plan (2000), and the Accord Networks, Ltd. 2000 Non-Employee Directors Option Plan were created with initial reserves of 229,875 shares, 229,875 shares and 61,300 shares, respectively. All of the Accord Networks Ltd. Plans were assumed by Polycom on February 28, 2001 pursuant to the Agreement and Plan of Merger and Reorganization dated as of December 5, 2000 as amended. All remaining option shares available for grant and subsequent cancellations of option shares under the Accord Networks Ltd. Plans expired or will expire as no additional option shares can be granted from the any of the Accord Networks Ltd. Plans subsequent to the merger.

In addition, the Company assumed outstanding options upon the acquisitions of Atlanta Signal Processors, Inc. ("ASPI Plan"), PictureTel Corporation ("Acquisition Plan") and Circa Communications Ltd. ("Circa Plan"). During fiscal 2001, a total of approximately 2.0 million shares of the Company's common stock have been reserved for issuance under the assumed plans and the related options are included in the following table. No shares were reserved for issuance under the assumed plans in 2002.

Under the terms of the Plan, the 91 Plan, the Nonstatutory Plan, the ViaVideo Plan, the Atlas Plan, the Accord Plans and the Circa Plan, options may be granted at prices not lower than fair market value at date of grant as determined by the Board of Directors. The options granted under the 91 Plan, the ASPI Plan, the ViaVideo Plan and the Circa Plan are immediately exercisable, expire in ten years from the date of grant, and the unvested shares issued upon exercise of the options are generally subject to a right of repurchase by the Company upon termination of employment with the Company. Options granted under the Plan, the Nonstatutory Plan, the Acquisition Plan, the Atlas Plan, the Accord Plans and the Circa Plan expire ten years from the date of grant and generally are only exercisable upon vesting.

Options granted under the Plan prior to December 1998 and under the 91 Plan normally vest at 20% after completing one year of service to the Company and the remaining amount equally over 48 months until fully vested after five years. Options granted under the ViaVideo Plan normally vest monthly for each month of service to the Company until fully vested after four years. Options granted under the Atlas Plan normally vest at 33% after completing one year of service to the Company and the remaining amount in equal quarterly installments over the next eight quarters until fully vested after three years. Options granted under the Acquisition Plan, the Accord Plans and the Circa Plan normally vest at 25% after completing one year of service to the Company and the remaining amount in equal quarterly installments over the next twelve quarters until fully vested after four years. Options granted under the Nonstatutory Plan vest based on conditions set forth by the plan administrator. For new options granted under the Plan beginning in December 1998, the options normally vest at 25% after completing one year of service to the Company and the remaining amount equally over 36 months until fully vested after four years. In addition, as a special grant to employees, option grants that become fully vested after one year of service to the Company have been made under the Plan and the Atlas Plan. While there are many option grants with vesting schedules different than those described, generally vesting of options is consistent within each of the plans.

Activity under the above plans is as follows (in thousands, except share and per share data):

		OUTSTANDING OPTIONS			
	SHARES AVAILABLE FOR GRANT	NUMBER OF SHARES	EXERCISE PRICE	AGGREGATE PRICE	WEIGHTED AVG EXERCISE PRICE
Balances, December 31, 1999	719,848	10,631,718	$0.04-$31.94	$ 83,189	$ 7.82
Options reserved	3,959,750	—	—	—	—
Options granted	(5,060,392)	5,060,392	$23.46-$67.00	206,899	$ 40.89
Options exercised	—	(3,292,079)	$0.04-$27.84	(12,569)	$ 3.82
Options canceled	912,420	(912,420)	$0.04-$65.19	(14,411)	$ 15.79
Options expired	(67,000)	—	—	—	—
Balances, December 31, 2000	464,626	11,487,611	$0.04-$67.00	$ 263,108	$ 22.90
Options reserved	3,250,000	—	—	—	—
Options related to acquisitions	1,994,521	—	—	—	—
Options granted	(6,283,707)	6,283,707	$0.01-$37.29	164,990	$ 26.22
Options exercised	—	(2,399,381)	$0.01-$33.50	(13,442)	$ 5.88
Options canceled	2,232,760	(2,232,760)	$0.01-$67.00	(90,655)	$ 41.06
Options expired	(625,321)	—	—	—	—
Balances, December 31, 2001	1,032,879	13,139,177	$0.01-$67.00	$ 324,001	$ 24.66
Options reserved	4,000,000	—	—	—	—
Options granted	(4,226,020)	4,226,020	$6.83-$36.17	53,630	$ 12.69
Options exercised	—	(604,810)	$0.08-$33.50	(2,690)	$ 4.45
Options canceled	1,427,489	(1,427,489)	$3.03-$64.88	(40,278)	$ 28.09
Options expired	(194,683)	—	—	—	—
Balances, December 31, 2002	2,039,665	15,332,898	$0.01-$66.31	$334,663	$ 21.85

As of December 31, 2002, 2001 and 2000, 6,626,657, 4,224,324 and 2,725,647 outstanding options were exercisable at an aggregate average exercise price of $23.39, $21.32 and $8.07, respectively. Of these options that were exercisable, zero, zero and 109,083 as of December 31, 2002, 2001 and 2000, respectively, were unvested and, the shares received on exercise would be subject to repurchase.

The options outstanding and currently exercisable by exercise price at December 31, 2002 are as follows:

	OPTIONS OUTSTANDING			OPTIONS CURRENTLY EXERCISABLE	
RANGE OF EXERCISE PRICE	NUMBER OUTSTANDING	WEIGHTED AVG REMAINING CONTRACTUAL LIFE (YRS)	WEIGHTED AVG EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVG EXERCISE PRICE
$0.01-$10.00	1,754,270	5.12	$ 5.41	1,083,751	$3.211
$10.10-$10.10	2,359,868	6.52	$10.10	0	$ 0.00
$10.21-$17.47	2,135,498	6.42	$15.19	1,449,506	$16.01
$17.88-$23.06	1,315,465	5.85	$21.13	291,556	$21.51
$23.25-$23.50	2,614,583	5.46	$23.50	1,044,289	$23.49
$23.62-$32.01	2,179,453	7.78	$30.60	940,308	$30.01
$32.06-$35.71	2,005,461	7.25	$34.30	1,228,498	$34.29
$35.89-$65.00	964,600	7.61	$46.01	586,746	$46.13
$65.19-$66.31	3,700	7.75	$65.22	2,003	$65.22
	15,332,898	6.45	$21.85	6,626,657	$23.39

The weighted average fair value of options granted pursuant to the Plans were $7.52, $14.44 and $23.36 in 2002, 2001 and 2000, respectively. The fair value of each option grant is estimated on the date of grant using the multiple options approach with the Black-Scholes option pricing model with the following weighted average assumptions:

	2002	2001	2000
Risk-free interest rate	3.27%	4.31%	6.00%-6.24%
Expected life (yrs)	1.0	0.5	0.5
Expected dividends	—	—	—
Expected volatility	0.9	0.9	0.5-0.9

The Company has also estimated the fair value of purchase rights issued under the Employee Stock Purchase Plan. Rights under this plan were also evaluated using the Black-Scholes option-pricing model. Purchase periods occur twice yearly and each effectively contains a 6-month option.

The weighted average fair value of purchase rights granted pursuant to the Employee Stock Purchase Plan in 2002, 2001 and 2000 was $14.73, $17.47 and $5.73, respectively. The fair value of each purchase right is estimated with the Black-Scholes option pricing model with the following weighted average assumptions:

	2002	2001	2000
Risk-free interest rate	3.27%	4.31%	6.02%
Expected life (yrs)	0.5	0.5	0.5
Expected dividends	—	—	—
Expected volatility	0.9	0.9	0.9

Unearned Stock-based Compensation:

In connection with the acquisitions of Circa and ASPI, the Company recorded unearned stock-based compensation costs for unvested stock options assumed by the Company totaling $1.5 million which is being recognized over the vesting period of the options. In connection with certain stock option grants during 1999, the Company recorded unearned stock-based compensation cost totaling $2.4 million which is being recognized over the vesting period of the related options of three years. Amortization expense associated with unearned stock compensation totaled $544,000, $557,000 and $845,000 in 2002, 2001 and 2000, respectively.

Approximately $127,000, $343,000 and $498,000 of unearned stock based compensation was reversed in 2002, 2001 and 2000, respectively, upon cancellation of unvested stock option grants resulting from termination of certain employees.

Warrants:

In March 1996 and 1998, Accord issued warrants to purchase 178,906 and 369,402 shares of series B preferred stock, respectively, for total consideration of $5,000, to several shareholders at an exercise price of $7.31 per share. Accord issued 18,130 and 160,776 shares of series B preferred stock in December 1999 and January 2000, respectively, upon the exercise of warrants. In the third quarter of 2000, Accord issued 294,175 shares of common stock upon the cashless exercise of a warrant.

On April 28, 1999, Accord granted a warrant to a bank in connection with a two-year credit line. The warrant is exercisable for a period of three years to purchase 42,009 shares of common stock at an exercise price of $11.91 per share. In December 2000 the bank exercised the warrant for 30,658 shares of common stock. As of December 31, 2001, the Company had no significant warrants outstanding.

Preferred Share Rights Purchase Plan:

In July 1998, the Board of Directors approved a Preferred Shares Rights Agreement, which the Board amended in March 2001 (the "Rights Agreement"). The Rights Agreement is intended to protect stockholders' rights in the event of an unsolicited takeover attempt. It will not interfere with a transaction approved by the Board of Directors. Upon becoming exercisable, each right entitles stockholders to buy 1/1000 of a share of Series A Preferred Stock of the Company at an exercise price of $400.00, subject to adjustment. The rights will be exercisable only if a person or a group (an "Acquiring Person") acquires or announces a tender or exchange offer to acquire 20% or more of the Company's common stock.

In the event that an Acquiring Person acquires 20% or more of the Company's Common Stock (a "Triggering Event"), each right not held by the Acquiring Person will entitle the holder to purchase for the exercise price that number of shares of Common Stock having a market value equal to two times the exercise price. In addition, in the event that, following a Triggering Event, the Company is acquired in a merger or sells 50% or more of its assets, each right not held by an Acquiring Person will entitle the holder to purchase for the exercise price that number of shares of common stock of the acquiring company having a market value equal to two times the exercise price. The rights are redeemable, at the Company's option, at a price of $0.005 per right. The Company may also exchange the rights for shares of Common Stock under certain circumstances. The rights will expire on the earlier of July 15, 2008 or the date of their redemption or exchange.

16. Employee Benefits Plans:

401(k) Plans:

The Company has a 401(k) Plan (the Polycom 401(k) Plan), which covers the majority of employees in the United States. Each eligible employee may elect to contribute to the Polycom 401(k) Plan, through payroll deductions, up to 20% of their compensation, subject to current statutory limitations. The Company does not offer its own stock as an investment option in the Polycom 401(k) Plan. The Company, at the discretion of the Board of Directors, may make matching contributions to the Polycom 401(k) Plan. Beginning with fiscal year 2000 the Company matched in cash 50% of the first 3% of compensation employees contribute to the Polycom 401(k) Plan, up to a maximum of $500 per participating employee per year. For fiscal year 2001 and 2002, the maximum Company cash match has been increased to $1,000 and $1,500, respectively, per participating employee per year.

The Company also had a 401(k) Plan which arose from the acquisition of Accord (the Accord 401(k) Plan), which covers substantially all Accord employees in the United States. Each eligible employee may elect to contribute to the Accord 401(k) Plan, through payroll deductions, up to 15% of their compensation, subject to current statutory limitations. The Company, at the discretion of the Board of Directors, may make match-

ing contributions to the Accord 401(k) Plan but had not done so through 2000. In connection with the acquisition of Accord, the Accord 401(k) Plan terminated in 2001. Beginning April 2, 2001, all eligible former Accord employees may elect to participate in the Polycom 401(k) Plan.

The Company also had a defined contribution profit sharing plan incorporating features under Section 401(k) of the Internal Revenue Code, which arose from the acquisition of PictureTel (the PictureTel Plan), which covered substantially all PictureTel employees. In connection with the acquisition of PictureTel, the PictureTel Plan terminated in 2001. Beginning January 1, 2002 all eligible former PictureTel employees may elect to participate in the Polycom 401(k) Plan.

The Company's contributions to the Polycom 401(k) Plan and the Accord 401(k) Plan totaled approximately $956,000, $433,000 and $183,000 in fiscal 2002, 2001 and 2000, respectively.

Employee Stock Purchase Plan:

Under the Employee Stock Purchase Plan, the Company can grant stock purchase rights to all eligible employees during offering periods of up to a maximum of 24 months with purchase dates approximately every six months (each January and July). The Company has reserved 2,500,000 shares of common stock for issuance under the plan. Shares are purchased through employees' payroll deductions, up to a maximum of 15% of employees' compensation, at purchase prices equal to 85% of the lesser of the fair market value of the Company's common stock at either the date of the employee's entrance to the offering period or the purchase date. No participant may purchase more than 3,000 shares or $25,000 worth of common stock in any one calendar year. During 2002, 2001 and 2000, 283,858, 170,250 and 223,094 shares were purchased at average per share prices of $14.31, $22.74 and $10.90, respectively. At December 31, 2002 there were 1,203,086 shares available to be granted under this plan.

Other Benefit Plans:

Under Israeli labor laws and agreements the Company is required to pay severance pay upon dismissal of an employee of the Company's Israeli subsidiaries or upon termination of employment in specified circumstances. The Company's severance pay for its employees in Israel, based upon length of service and the latest monthly salary (one month's salary for each year worked), is mainly covered by purchased managerial insurance policies. The value of these policies is recorded as an asset in the consolidated balance sheets. The net amount of severance pay charged against income totaled approximately $1,124,000, $977,000 and $739,000 in 2002, 2001 and 2000, respectively. At December 31, 2002 and 2001 severance pay funded included in other assets was approximately $1,743,000 and $1,183,000, respectively, and accrued severance pay included in long-term liabilities was approximately $3,078,000 and $2,035,000, respectively.

The Company is also contributing funds on behalf of its Israeli employees to an individual insurance policy. This policy provides a combination of savings plan, insurance and severance pay benefits to the insured employee. It provides for payments to the employee upon retirement or death and secures a substantial portion of the severance pay, if any, to which the employee is legally entitled upon termination of employment. Each participating employee contributes an amount equal to 5.0% of the employee's base salary, and the employer contributes between 13.3% and 15.8% of the employee's base salary. All of the Company's full-time Israeli employees participate in this benefit package. The net amount of insurance expense charged against income totaled approximately $383,000, $361,000 and $297,000 in 2002, 2001 and 2000, respectively. The Company also provides some employees with an education fund, to which each participating employee contributes an amount equal to 2.5% of the employee's base salary, and the employer contributes an amount equal to 7.5% of the employee's base salary. Education fund expenses charged against income totaled approximately $439,000, $402,000, and $312,000 in 2002, 2001 and 2000, respectively.

17. Income Taxes:

Income tax expense consists of the following (in thousands):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Current			
U. S. Federal	$ 7,445	$13,353	$24,955
Foreign	3,696	1,641	855
State and local	929	2,500	4,212
Total current	12,070	17,494	30,022
Deferred			
U. S. Federal	(1,166)	(2,196)	(5,423)
Foreign	(252)	(34)	(15)
State and local	(502)	(524)	(337)
Total deferred	(1,920)	(2,754)	(5,775)
Income tax expense	$10,150	$14,740	$24,247

The sources of income (loss) before the provision for income taxes are as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
United States	$ (4,600)	$(21,960)	$60,498
Foreign	41,510	9,000	1,212
Income (loss) before provision for income taxes	$ 36,910	$(12,960)	$61,710

The Company's tax provision differs from the provision computed using statutory tax rates as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Federal tax at statutory rate	$12,919	$ (4,536)	$21,590
State taxes, net of federal benefit	977	(492)	2,401
Nondeductible expenses	671	3,451	729
In-process research and development and goodwill amortization	—	21,633	—
Tax exempt interest	(130)	(1,260)	(1,242)
Foreign income at tax rates different than U.S. rates	(3,666)	(2,660	—
Research and development tax credit	(1,447)	(1,650)	(1,162)
Other	826	254	1,931
Tax provision	$10,150	$14,740	$24,247

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The tax effects of temporary differences that give rise to the deferred tax assets are presented below (in thousands):

	2002	2001
Property and equipment, net, principally due to differences in depreciation	$ 6,612	$ 5,323
Inventory	7,992	10,781
Restructuring reserves	13,402	11,541
Other reserves	20,199	28,445
Net operating and capital loss carryforwards	22,394	3,181
Tax credit carryforwards	13,084	9,894
Investments	4,285	3,883
Deferred tax asset	87,968	73,048
Acquired intangibles	(4,735)	(7,923)
Net deferred tax asset	$83,233	$65,125

As of December 31, 2002, the Company has tax net operating loss carryforwards, tax credit carryovers and capital loss carryovers of approximately $61.0 million, $13.1 million and $3.8 million, respectively. These net operating loss carryforwards, tax credit carryforwards and capital loss carryforwards begin to expire in 2013, 2007 and 2007, respectively. A portion of the future utilization of the Company's carryforwards are subject to certain limitations due to a change in ownership that occurred in 1998 and 2001. Deferred tax assets of approximately $26.1 million as of December 31, 2002 pertain to certain net operating loss carryforwards and credit carryforwards resulting from the exercise of employee stock options.

The Company provides for U.S. income taxes on the earnings of foreign subsidiaries unless they are considered permanently invested outside of the U.S. At December 31, 2002, the cumulative amount of earnings upon which U.S. income tax has not been provided is approximately $67.4 million.

Tax benefits of $1.8 million in 2002 and $12.5 million in 2001 associated with the exercise of employee stock plans were added to stockholders equity.

The Company has been granted a beneficial tax status by the Israeli tax authorities for income earned in Israel. Under the terms, the Company is eligible for significant tax rate reductions for several years following the first year in which the Company has Israeli taxable income after consideration of tax losses carried forward. The Company to date has realized tax savings of approximately $3.7 million. The reduced tax rates, as well as other tax benefits, are conditional upon the Company fulfilling the terms stipulated under the Israeli law for the Encouragement of Capital Investments of 1959. Failure to comply with these conditions may result in cancellation of the benefits in whole or in part.

18. Business Segment Information:

Polycom is a leading global provider of a line of high-quality, easy-to-use communications equipment that enables enterprise users to more effectively conduct video, voice, data and web communications. Polycom's offerings are organized along five product lines; Video Communications, Voice Communications, Network Systems, Network Access Products and Services. For reporting purposes the Company aggregates Video Communications and Voice Communications into one segment named Communications and reports Network Systems and Network Access as separate segments. Services is allocated amongst Communications and Network Systems as it does not meet the disclosure thresholds for separate segment reporting. The segments were determined in accordance with how management views and evaluates Polycom's business and based on the aggregation criteria as outlined in SFAS131. Segment financial data for the years ended December 31, 2001 and 2000 have been adjusted to reflect these segments. A description of the types of products and services provided by each reportable segment is as follows:

Communications Segment

Communications products include videoconferencing collaboration products and network management software that facilitate high-quality video communications, desktop, conference, analog, digital and IP voice communications products that enhance business communication and a wide range of service and support offerings to our resellers and directly to some end-user customers. Our communication service offerings include: integration services consisting of consulting, education, design and project management services; consulting services consisting of planning and needs analysis for end-users; design services, such as room design and custom solutions, providing customized videoconferencing solutions to meet each end-user's unique requirements; and project management, installation and training which provide end-users with effective implementation of videoconferencing systems.

Network Systems Segment

Network Systems products provide a broad range of video, voice and data conferencing and collaboration capabilities to businesses, telecommunications service providers, and governmental and educational institutions. Our recently introduced MGC-25 and our existing MGC-50 and MGC-100 media servers provide seamless network connectivity across packet-based broadband networks and traditional circuit-switched networks for both video and voice multipoint conferencing. The advanced transcoding capabilities of our MGC systems enable reliable and optimal communication among end-points with different video, voice and data parameters and bandwidth capabilities. In addition, the MGC products combine fully featured voice conferencing and fully featured video conferencing on the same platform supported by a common management system.

Our GW-25 and GW-45 gateways move and translate traffic effectively and securely from one network type to another and also include a Checkmark registered firewall capability for secure video communications across IP networks.

Our line of network systems products also includes the PathNavigator call processing server and WebOffice, a web-conferencing software application. PathNavigator offers powerful network management capabilities that simplify the use of enterprise video throughout a converged network, ensures reliability and security and effectively manages network bandwidth. WebOffice provides a web-based virtual office, enabling users to conduct online meetings, or share documents, applications or desktops in a secure, interactive environment on an ad-hoc or scheduled basis. WebOffice users can also conduct Instant Message sessions with colleagues and launch voice and video conferencing from their WebOffice browser.

To assist our end-user customers in implementing and managing their network systems products, we offer a portfolio of additional professional and maintenance services. For the on-going support of our end-user customers' network systems, we provide premium warranty plans and maintenance services, including telephone support, parts exchange, on-site assistance and direct access to our support engineers for real-time troubleshooting of our products. Our services are sold both directly to end-user customers and through our resellers.

Network Access Segment

Network access products that consisted of our NetEngine family of integrated access devices ("IADs") and routers that enabled enterprise customers to access broadband and VoB services. The Company sold this segment to Verilink Corporation in January 2003. See Note 20 to Notes to Consolidated Financial Statements.

The three reportable segments disclosed in these consolidated financial statements are based on Polycom's organization structure and the aggregation criteria as defined in SFAS 131. Future changes to this organizational structure or the business may result in changes to the reportable segments disclosed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Segment Revenue and Profit

The accounting policies used to derive reportable segments are the same as those described in Note 1 to the Consolidated Financial Statements. A significant portion of each segment's expenses arise from shared services and infrastructure that Polycom has historically allocated to the segments in order to realize economies of scale and to use resources efficiently. These expenses include, sales and marketing, information technology services, facilities and other infrastructure costs.

Segment Data

The results of the reportable segments are derived directly from Polycom's management reporting system. The results are based on Polycom's method of internal reporting and are not necessarily in conformity with accounting principles generally accepted in the United States. Management measures the performance of each segment based on several metrics, including contribution margin.

Asset data, with the exception of inventory, is not reviewed by management at the segment level. All of the products and services within the respective segments are generally considered similar in nature, and therefore a separate disclosure of similar classes of products and services below the segment level is not presented.

Financial information for each reportable segment was as follows as of and for the fiscal years ended December 31, 2002, 2001 and 2000 (in thousands):

	COMMUNICATIONS	NETWORK SYSTEMS	NETWORK ACCESS	TOTAL
2002:				
Net revenue	$365,582	$86,559	$13,818	$465,959
Contribution margin	69,503	30,324	(9,655)	90,172
Inventory	26,942	3,182	2,184	32,308
2001:				
Net revenue	$283,783	$83,049	$16,357	$383,189
Contribution margin	79,029	30,492	(18,847)	90,674
Inventory	32,243	4,527	11,403	48,173
2000:				
Net revenue	$301,374	$42,252	$29,928	$373,554
Contribution margin	101,568	7,709	(5,066)	104,211
Inventory	29,246	7,206	13,519	49,971

Segment contribution margin includes all product line segment revenues less the related cost of sales, direct marketing and direct engineering expenses. Management allocates corporate manufacturing costs, sales and marketing expenses and some infrastructure costs such as facilities and IT costs. Contribution margin is used, in part, to evaluate the performance of, and allocate resources to, each of the segments. Certain operating expenses, which are separately managed at the corporate level, are not allocated to segments. These unallocated costs include general and administrative costs, such as legal and accounting, acquisition-related costs, charges for in-process research and development, amortization of purchased intangible assets and goodwill, restructure costs, grant repayments, litigation settlement, litigation reserve release, interest income, net, loss on strategic investments, other income (expense), net and provision for income taxes.

The reconciliation of segment information to Polycom consolidated totals was as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Segment contribution margin	$ 90,172	$ 90,674	$104,211
Corporate and unallocated costs	(32,682)	(29,865)	(29,773)
Acquisition related-costs	(3,699)	(24,077)	(4,768)
Purchased in-process research and development charges	(900)	(52,642)	—
Amortization of purchased intangibles	(17,135)	(3,905)	—
Amortization of goodwill	—	(2,114)	—
Restructure costs	(1,657)	—	—
Grant repayment	—	—	(5,876)
Litigation settlement	257	—	(6,500)
Litigation reserve release	—	—	1,843
Interest income, net	9,492	12,755	8,419
Loss on strategic investments	(7,465)	(3,178)	(5,854)
Other income (expense), net	527	(608)	8
Provision for taxes	(10,150)	(14,740)	(24,247)
Total net income (loss)	$ 26,760	$ (27,700)	$ 37,463

The Company's net revenues are substantially denominated in U.S. dollars and are summarized as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
United States	$261,921	$242,055	$245,373
Canada	6,239	2,812	7,054
Total North America	268,160	244,867	252,427
Europe, Middle East and Africa	101,963	72,887	70,602
Asia	84,111	58,394	42,120
Caribbean and Latin America	11,725	7,041	8,405
Total international	197,799	138,322	121,127
Total net revenue	$465,959	$383,189	$373,554

The percentage of total net revenues for the Video Communications, Voice Communications, Network Systems, Network Access Products and iPower-related Service were as follows:

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Video Communications	56%	53%	58%
Voice Communications	16%	19%	23%
Network Systems	19%	22%	11%
Network Access Products	3%	4%	8%
iPower-related Service	6%	2%	—
Total net revenue	100%	100%	100%

No customer accounted for more than 10% of the Company's net revenues in 2002, 2001 or 2000.

The Company's fixed assets, net of accumulated depreciation, are located in the following geographical areas (in thousands):

	DECEMBER 31,	
	2002	2001
North America	$23,888	$23,758
Israel	2,716	2,976
Europe, Middle East and Africa	1,177	1,609
Other	647	602
Total	$28,428	$28,945

19. Net Income (Loss) Per Share Disclosures:

In accordance with the disclosure requirements of SFAS 128, a reconciliation of the numerator and denominator of basic and diluted EPS is provided as follows (in thousands, except per share amounts):

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Numerator—basic and diluted net income (loss) per share			
Net income (loss)	$ 26,760	$(27,700)	$37,463
Denominator—basic net income (loss) per share			
Weighted average common stock outstanding	100,121	85,213	75,807
Treasury shares	(794)	(73)	—
Shares subject to repurchase	(3)	(17)	(543)
Total shares used in calculation of basic net income (loss) per share	99,324	85,123	75,264
Basic net income (loss) per share	$ 0.27	$ (0.33)	$ 0.50
Denominator—diluted net income (loss) per share			
Denominator—basic net income (loss) per share	99,324	85,123	75,264
Effect of dilutive securities:			
Common stock options	1,369	—	6,035
Shares subject to repurchase	3	—	543
Convertible warrants and preferred stock	—	—	1,986
Total shares used in calculation of diluted net income (loss) per share	100,696	85,123	83,828
Diluted net income (loss) per share	$ 0.27	$ (0.33)	$ 0.45

In 2001, options to purchase 2,998,580 shares of common stock on a weighted average basis have not been included in the computation of diluted net loss per share as their effect would have been anti-dilutive.

In 2002, 2001 and 2000, 10,949,063, 4,635,424 and 864,887 options, respectively, on a weighted average basis were excluded from the computation of earnings per share, since the option exercise price was greater than the average market price of the common shares for the period.

20. Subsequent Event (Unaudited):

In January 2003, the Company sold to Verilink Corporation ("Verilink"), certain fixed assets and intellectual property rights relating to Polycom's network access product line, including Polycom's line of NetEngine integrated devices, for a total of up to $3.0 million in cash, of which (i) $1.0 million was paid to Polycom at closing, (ii) $0.25 million will be paid to Polycom on the first anniversary of the closing, and (iii) up to $1.75 million will be paid to Polycom quarterly based on ten percent of Verilink's revenues related to the sale of NetEngine products. Concurrent with the closing, certain of our employees joined Verilink. Verilink has also agreed to purchase Polycom's existing NetEngine-related inventories, with a book value of approximately $1.9 million as of the closing date, on an as needed basis. Additionally, in connection with the sale, Polycom entered into a license agreement with Verilink pursuant to which Verilink granted to Polycom a license to use and further develop the network access technology related to the NetEngine product line. The Company has agreed not to compete with Verilink in the network access market for a period of three years.

Supplementary Financial Data (Unaudited)

(in thousands, except per share amounts)	2001 FIRST QUARTER	2001 SECOND QUARTER	2001 THIRD QUARTER	2001 FOURTH QUARTER	2002 FIRST QUARTER	2002 SECOND QUARTER	2002 THIRD QUARTER	2002 FOURTH QUARTER
Net revenue	$96,217	$84,470	$82,454	$120,048	$134,511	$124,954	$106,033	$100,461
Gross profit	$55,313	$48,105	$47,118	$ 65,906	$ 75,474	$ 70,057	$ 59,491	$ 58,225
Net income (loss)	$ 6,445	$ 6,335	$ 9,875	$ (50,355)	$ 14,508	$ 5,633	$ 3,484	$ 3,135
Basic net income (loss) per share	$ 0.08	$ 0.08	$ 0.12	$ (0.56)	$ 0.15	$ 0.06	$ 0.03	$ 0.03
Diluted net income (loss) per share	$ 0.08	$ 0.07	$ 0.11	$ (0.56)	$ 0.14	$ 0.06	$ 0.03	$ 0.03

All historical financial information has been restated to reflect the acquisitions that were accounted for as a pooling of interests.

Price Range of Common Stock

The following table presents the high and low sale prices per share for our common stock as reported by the Nasdaq National Market, under the symbol PLCM, for the periods indicated.

	HIGH	LOW
Year Ended December 31, 2001:		
First Quarter	$37.81	$10.75
Second Quarter	29.88	10.88
Third Quarter	30.00	17.91
Fourth Quarter	42.59	23.88
Year Ended December 31, 2002:		
First Quarter	$39.09	$21.23
Second Quarter	26.50	11.37
Third Quarter	12.80	6.44
Fourth Quarter	12.04	6.84
Year Ending December 31, 2003:		
First Quarter (through February 28, 2003)	$11.95	$ 9.18

On February 28, 2003, the last reported sale price of our common stock as reported on the Nasdaq National Market was $10.03 per share. As of December 31, 2002, there were approximately 1,954 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Corporate Directory

BOARD MEMBERS

Betsy S. Atkins [2][3]
CEO, Baja LLC
Co-Founder,
Ascend Communications
Member, Board of Directors,
UT Starcom and McData

John Seely Brown [2][3]
Chief Scientist,
Xerox Corporation
Former Director,
Xerox PARC
Member, Board of Directors,
Varian Medical Systems, Inc.
Corning Incorporated

Robert C. Hagerty
Chairman of the Board,
President and CEO,
Polycom, Inc.

Durk I. Jager [1]
Former Chairman, President and CEO,
The Procter & Gamble Company
Member, Board of Directors,
Eastman Kodak Company,
Royal KPN N.V.

John A. Kelley [1][3]
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Captaris, Inc.,

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Former Vice Chairman,
Joint Chiefs of Staff

Thomas G. Stemberg [2]
Founder and Chairman of the Board,
Staples, Inc.
Member, Board of Directors,
The Nasdaq Stock Market, Inc.,
PETsMART, Inc.

(1) Member on the audit committee
(2) Member of the compensation committee
(3) Member of the governance and nomination committee

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Cynthia L. Pevehouse
General Counsel

CORPORATE AND INVESTOR INFORMATION

Polycom, Inc.'s Form 10-K, filed with the Securities and Exchange Commission, will be sent without charge upon written request. Please write:

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STOCK MARKET INFORMATION

Polycom, Inc. stock is quoted daily on the NASDAQ stock market under the symbol PLCM.

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