KRONOS INC
Form 10-Q
February 10, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended December 28, 2002

OR

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

For the transition period from ------------------- to -------------------------

Commission file number 0-20109

Kronos Incorporated

(Exact name of registrant as specified in its charter)

Massachusetts	04-2640942
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
297 Billerica Road, Chelmsford, MA	01824
(Address of principal executive offices)	(Zip Code)

(978) 250-9800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Yes X No

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

Yes No X

As of January 25, 2003, 19,911,395 shares of the registrant's common stock, $.01 par value, were outstanding.

KRONOS INCORPORATED

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share amounts)
UNAUDITED

	Three Months Ended	
	December 28, 2002	December 29, 2001
Net revenues:		
Product	$ 38,887	$ 35,214
Maintenance	28,985	23,421

Professional services	21,837	17,494
	89,709	76,129
Cost of sales:		
Costs of product	9,427	8,454
Costs of maintenance and professional services	25,873	20,814
	35,300	29,268
Gross profit	54,409	46,861
Operating expenses and other income:		
Sales and marketing	29,053	25,191
Engineering, research and development	8,483	7,936
General and administrative	6,045	4,532
Amortization of intangible assets	719	643
Other income, net	(905)	(975)
	43,395	37,327
Income before income taxes	11,014	9,534
Provision for income taxes	3,965	3,337
Net income	$ 7,049	$ 6,197
Net income per common share:		
Basic	$ 0.36	$ 0.32
Diluted	$ 0.35	$ 0.30
Weighted-average common shares outstanding:		
Basic	19,639,827	19,404,923
Diluted	20,409,753	20,388,203

See accompanying notes to condensed consolidated financial statements.

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

	December 28, 2002
ASSETS	
Current assets:	
Cash and equivalents	$ 49,745
Marketable securities	13,262

Accounts receivable, less allowances of $10,062 at December 28, 2002 and $9,697 at September 30, 2002	78,076
Deferred income taxes	7,394
Other current assets	18,665
Total current assets	167,142
Property, plant and equipment, net	38,294
Marketable securities	24,175
Intangible assets	20,111
Goodwill	57,480
Capitalized software, net	22,296
Other assets	11,136
Total assets	$ 340,634
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	$ 5,992
Accrued compensation	24,936
Accrued expenses and other current liabilities	10,153
Deferred product revenues	6,333
Deferred professional service revenues	33,010
Deferred maintenance revenues	68,809
Total current liabilities	149,233
Deferred maintenance revenues	8,109
Other liabilities	8,866
Shareholders' equity:	
Preferred Stock, par value $1.00 per share: authorized 1,000,000 shares, no shares issued and outstanding	--
Common Stock, par value $.01 per share: authorized 50,000,000 shares, 19,911,952 shares issued at December 28, 2002 and September 30, 2002	199
Additional paid-in capital	30,460
Retained earnings	150,224
Cost of Treasury Stock (139,610 shares and 366,062 shares at December 28, 2002 and September 30, 2002, respectively)	(5,361)
Accumulated other comprehensive loss:	
Foreign currency translation	(1,174)
Net unrealized gain on available-for-sale investments	78
	(1,096)
Total shareholders' equity	174,426
Total liabilities and shareholders' equity	$ 340,634

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
UNAUDITED

	Three Months Ende	
	December 28, 2002	Decemb 20
Operating activities:		
Net income	$ 7,049	$ 6,
Adjustments to reconcile net income to net cash and equivalents provided by operating activities:		
Depreciation	2,610	2,
Amortization of intangible assets	719	
Amortization of capitalized software	2,764	2,
Provision for deferred income taxes	263	(
Changes in certain operating assets and liabilities:		
Accounts receivable, net	6,829	12,
Deferred product revenues	(549)	(1,
Deferred professional service revenues	(559)	(
Deferred maintenance revenues	1,469	(
Accounts payable, accrued compensation and other liabilities	(8,342)	(8,
Taxes payable	(337)	(6,
Other	(547)	
Tax benefit from exercise of stock options	2,413	7,
Net cash and equivalents provided by operating activities	13,782	12,
Investing activities:		
Purchase of property, plant and equipment	(2,238)	(2,
Capitalized internal software development costs	(2,824)	(2,
Decrease (increase) in marketable securities	3,193	(12,
Acquisitions of businesses, net of cash acquired	(1,646)	(23,
Net cash and equivalents used in investing activities ...	(3,515)	(41,
Financing activities:		
Net proceeds from exercise of stock options and employee purchase plans	5,126	10,
Purchase of treasury stock	(2,518)	(2,
Proceeds from (net investment in) call options	2,596	(2,
Net cash and equivalents provided by financing activities	5,204	6,
Effect of exchange rate changes on cash and equivalents	157	
Increase (decrease) in cash and equivalents	15,628	(22,
Cash and equivalents at the beginning of the period	34,117	36,
Cash and equivalents at the end of the period	$ 49,745	$ 13,

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE A - General

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals that management of Kronos Incorporated (the "Company" or "Kronos") considers necessary for a fair presentation of the Company's financial position and results of operations as of and for the interim periods presented pursuant to the rules and regulations of the Securities and Exchange Commission. Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures in these financial statements are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the fiscal year ended September 30, 2002. The results of operations for the three months ended December 28, 2002 are not necessarily indicative of the results for a full fiscal year. Certain reclassifications have been made in the accompanying consolidated financial statements in order to conform to the fiscal 2003 presentation.

NOTE B - Fiscal Quarters

The Company utilizes a system of fiscal quarters. Under this system, the first three quarters of each fiscal year end on a Saturday. However, the fourth quarter of each fiscal year will always end on September 30. Because of this, the number of days in the first quarter (89 days in fiscal 2003 and 90 days in fiscal 2002) and fourth quarter (94 days in fiscal 2003 and 93 days in fiscal 2002) of each fiscal year varies from year to year. The second and third quarters of each fiscal year will be exactly thirteen weeks long. This policy does not have a material effect on the comparability of results of operations between quarters.

NOTE C - Other Current Assets

Other current assets consists of the following (in thousands):

	December 28, 2002	September 30, 2002
Inventory	$7,087	$6,492
Prepaid expenses	11,578	11,343
Total	$18,665	$17,835

NOTE D - Intangible Assets

Acquired intangible assets subject to amortization are presented in the following table (in thousands).

As of December 28, 2002:

Weighted

	Average Life in Years	Gross Carrying Value	Accumulated Amortization
Intangible assets:			
Customer related	9.7	$19,328	$ 7,425
Maintenance relationships	11.9	6,381	592
Tax benefits	10.7	2,131	363
Non-compete agreements ..	5.0	1,943	1,292
Total intangible assets		$29,783	$ 9,672

As of September 30, 2002:

	Average Life in Years	Gross Carrying Value	Accumulated Amortization
Intangible assets:			
Customer related	9.5	$19,166	$ 6,851
Maintenance relationships	11.9	6,267	535
Tax benefits	10.7	2,127	309
Non-compete agreements ..	5.1	1,908	1,228
Total intangible assets		$29,468	$ 8,923

The amount of goodwill acquired during the three months ended December 28, 2002 and December 29, 2001 is $1.2 million and $15.0 million, respectively.

For the three months ended December 28, 2002, the Company recorded amortization expense for intangible assets of $0.7 million. The estimated annual amortization expense for intangible assets for the current and next five fiscal years is as follows (in thousands):

Fiscal Year Ending September 30,	Estimated Annual Amortization Expense
2003	$3,024
2004	2,723
2005	2,255
2006	2,190
2007	2,172
2008	2,072

NOTE E - Acquisitions

On November 20, 2002, the Company completed the acquisition of certain assets and the ongoing business operations of Hi-Tek Special Systems, Inc. ("HT"), the former Texas-based Kronos dealer. The aggregate purchase price was not material to the Company's financial position. The results of HT's operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since that date. HT was engaged in the sale and service of employee time and attendance, employee scheduling, data collection and labor management hardware and software systems, including the resale of the Company's products through a dealer relationship. As a result of the acquisition, the Company gained access to existing and prospective customers in the Texas, New Mexico and Mexico area through its direct sales and service organizations, as well as access to the existing maintenance revenue stream from HT customers. The deferred revenue related to the maintenance revenue stream, which was recorded at an amount approximating cost, plus a normal profit margin, was recognized as the Company had assumed a legal performance obligation as described in EITF 01-03.

On December 28, 2001, the Company completed the acquisition of certain assets and the ongoing business operations of the Integrated Software Business of SimplexGrinnell's Workforce Solutions Division ("SimplexGrinnell"). The aggregate purchase price was $22.1 million in cash. The results of SimplexGrinnell's operations have been included in the consolidated financial statements since that date. SimplexGrinnell was engaged in the development, sales and support of integrated workforce management software solutions. As a result of the acquisition, the Company has increased its presence in the mid-market sector, which includes companies with between 100 and 1,000 employees.

The SimplexGrinnell transaction was accounted for under the purchase method of accounting and accordingly, the assets and liabilities acquired were recorded at their estimated fair values at the effective date of the acquisition. The goodwill recognized is deductible for income tax purposes. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition (in thousands).

	At December 28, 2001
Accounts receivable	$6,678
Customer related intangible asset (amortized over 12 years)	1,100
Maintenance relationships intangible asset (amortized over 12 years)	2,500
Goodwill	18,065
Other assets	768
Total assets acquired	29,111
Deferred professional services revenue	(1,564)
Deferred maintenance revenue	(5,157)
Other liabilities	(340)
Total liabilities assumed	(7,061)
Net assets acquired	$22,050

In connection with the acquisition of the assets and liabilities of SimplexGrinnell in December 2001, the Company acquired obligations to provide services associated with maintenance contracts and obligations to provide professional services, primarily installation services. The amounts of deferred revenue ascribed to acquired maintenance obligations and professional services amounts to $5.2 million and $1.6 million, respectively. The deferred revenue, which was recorded at an amount approximating cost, plus a normal profit margin, was recognized as the Company had assumed a legal performance obligation as described in EITF 01-03. The acquired maintenance arrangements required the Company to provide phone support, bug fixes and unspecified upgrades for the remaining contract terms. The acquired professional services obligations required the Company to provide installation services.

Certain agreements contain provisions that require the Company to make a guaranteed payment and/or contingent payments based upon profitability of the business unit or if specified minimum revenue requirements are met. These provisions expire during fiscal 2003 through 2006. Guaranteed payments are accrued at the time of the acquisition and are included in the purchase price allocation. Contingent payments due under the terms of the agreements are recognized when earned and are principally recorded as goodwill. However, under certain circumstances, a portion of the contingent payment may be recorded as compensation expense. During the first quarter of fiscal 2003 and 2002, $0.6 million and $0.2 million, respectively, of contingent payments were earned, all of which was recorded as goodwill. There are several contingent payment arrangements currently outstanding, on which the Company may have future payment obligations, contingent upon the achievement of various financial performance goals. As of December 28, 2002, the Company has the obligation to pay $4.2 million in guaranteed payments. These payments will be made at various dates through fiscal 2006.

NOTE F - Comprehensive Income

For the three months ended December 28, 2002 and December 29, 2001, comprehensive income consisted of the following (in thousands):

	Three Months Ended	
	December 28, 2002	December 29, 2001
Comprehensive income:		
Net income	$7,049	$6,197
Cumulative translation adjustment	198	203
Unrealized gain (loss)on available-for-sale securities	(115)	(151)
Total comprehensive income	$7,132	$6,249

NOTE G - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended	
	December 28, 2002	December 29, 2001
Net income	$7,049	$6,197

Weighted-average shares	19,639,827	19,404,923
Effect of dilutive securities:		
Employee stock options	769,926	983,280
Adjusted weighted-average shares and assumed conversions	20,409,753	20,388,203
Basic earnings per share	$0.36	$0.32
Diluted earnings per share	$0.35	$0.30

NOTE H - New Accounting Pronouncements

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." This statement provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based compensation. The statement amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The Company accounts for stock-based compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and complies with the disclosure provisions of FASB Statement No. 123. The transition provisions are effective for fiscal years ending after December 15, 2002. The disclosure provisions are effective for interim periods beginning after December 15, 2002. The Company will implement the required disclosure provisions in the three month period ending March 29, 2003. The adoption of this statement is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows as the Company does not anticipate making the voluntary change to the fair value method of accounting for stock-based compensation.

NOTE I - Call Option Arrangements

The Company periodically enters into call option arrangements, which are classified as an equity instrument in accordance with the provisions of EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." During the quarter, a call option arrangement matured in December 2002. At maturity, the Company's stock price exceeded the strike price of $25.00 per share and the Company received a return of its cash investment and a premium totaling approximately $2.6 million, which is credited to additional paid-in-capital. If at maturity the Company's stock price was less than the strike price, the Company would use its cash investment to purchase Company shares at a predetermined price. A call option arrangement provides the Company an opportunity to lock in a repurchase price for shares under the Company's stock repurchase program. There are no dividend and liquidation preferences, participation rights, sinking-fund requirements, unusual voting rights or any other significant terms pertaining to these call option arrangements. As of the balance sheet date, the Company did not have any call option arrangements outstanding.

NOTE J - Additional Stock Option Program Information

Option Program Description: The Company intends that its stock option program be its primary vehicle for offering long-term incentives and rewarding its executives and key employees. Stock options are granted to key employees based upon, among other things, prior performance of the executive or key employee, the importance of retaining their services for the Company and the potential for their performance to help the Company attain its long-term goals. There is no set formula for the award of options to individual executives or employees.

Stock options are generally granted annually in conjunction with the Compensation Committee's formal review of the individual performance of its key executives, including its Chief Executive Officer, and their contributions to the Company. In the three month period ended December 28, 2002, 75% of the options granted went to employees other than the top five officers ("Named Executive Officers"). The Named Executive Officers for the first quarter of fiscal 2003, for purposes of this footnote, are the same Named Executive Officers for fiscal 2002, which are identified in the Company's definitive proxy statement for the 2003 Annual Meeting of Stockholders. The Named Executive Officers for fiscal 2001 are the officers which are identified in the Company's definitive proxy statement for the 2002 Annual Meeting of Stockholders. All the options awarded are granted from the same plan. Options, which are granted at the fair market value on the date of grant, typically vest annually over a four-year period beginning one year from the date of grant and have a contractual life of four years and six months.

Distribution and Dilutive Effect of Options:

Employee and Executive Option Grants:

	For the Three Month Period Ended December 28, 2002	For the Fiscal Year Ended September 30, 2002
Net grants during period as % of outstanding ... shares	4.0%	4.7%
Grants to Named Executive Officers during period as % of options granted	25.2%	25.3%
Grants to Named Executive Officers .... during period as % of shares outstanding	1.0%	1.2%

General Option Information:

Summary of Option Activity
(in thousands, except per share data)

	Shares Available for Options	Number of Option Shares Outstanding
Outstanding at September 30, 2002	1,624	2,641

Grants	(794)	794
Exercises	--	(291)
Cancellations	--	(16)
Additional shares reserved	--	--
Outstanding at December 28, 2002	830	3,128

In-the-Money and Out-of-the-Money Option Information as of December 28, 2002
(in thousands, except per share data)

	Exercisable		Unexercisable		T
	Shares	Weighted-Average Exercise Price per Share	Shares	Weighted-Average Exercise Price per Share	Shares
In-the-Money	936	$ 21.59	2,090	$ 24.35	3,026
Out-of-the-Money (1)	9	$ 43.33	93	$ 43.02	102
Total Options Outstanding	945	$ 21.80	2,183	$ 25.14	3,128

(1) Out-of-the-Money options are those options with an exercise price equal to or above the closing price of $38.179 at the end of the current quarter.

Executive Options: The following tables summarize option grants and exercises during the three month period ended December 28, 2002 to the Company's Named Executive Officers and the value of the options held by such persons at December 28, 2002.

Options Granted to Named Executive Officers

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Name	Individual Grants: Number of Securities Underlying Options Granted (1)	Percent of Total Options Granted to Employees in Three Month Period Ended December 28, 2002 (2)	Exercise or Base Price per Share (3)	Expiration Date	O 5%
Mark S. Ain .... CEO and Chairman	60,000	7.6%	$24.86	04/07/07	$366,7
Paul A. Lacy .... Exec. V.P. and Chief Financial & Administrative Officer	40,000	5.0%	24.86	04/07/07	244,5
Aron J. Ain .... Exec. V.P. and Chief Operating Officer	40,000	5.0%	24.86	04/07/07	244,5
Peter C. George .... V.P., Engineering & Chief Technology Officer	30,000	3.8%	24.86	04/07/07	183,3
James Kizielewicz .... V.P., Marketing and Corporate Strategy	30,000	3.8%	24.86	04/07/07	183,3

(1) Each option vests in four equal annual installments commencing one year from the date of grant.

(2) Based on an aggregate of 793,900 shares subject to options granted to employees of the Company in the three month period ended December 28, 2002.

(3) The exercise price of each option was equal to the fair market value of the Company's common stock on the date of grant as reported by The NASDAQ National Market(R).

(4) Amounts represent hypothetical gains that could be achieved for the respective options if exercised at the end of the option term. These gains are based on assumed rates of stock appreciation of 5% and 10% compounded annually from the date the respective options were granted to their expiration date (and are shown net of the option exercise price, but do not include deductions for taxes or other expenses associated with the exercise of the options or the sale of the underlying shares.) Actual gains, if any, on stock option exercises will depend on the future performance of the common stock, the optionholder's continued employment with the Company through the option vesting period and the date on which the options are exercised.

Option Exercises and Remaining Holdings of Named Executive Officers (for the three month period ended December 28, 2002)

Name	Shares Acquired on Exercise	Value Realized (1)	Number of Securities Underlying Unexercised Options at December 28, 2002 Exercisable/ Unexercisable
Mark S. Ain	--	$ --	161,250/155,250
Paul A. Lacy	20,000	563,400	57,625/100,375
Aron J. Ain	27,000	783,720	50,625/100,375
Peter C. George	--	--	46,125/80,625
James Kizielewicz	13,500	398,620	25,500/76,500

(1) Represents the difference between the exercise price and the fair market value of the common stock on the date of exercise.

(2) Based on the fair market value of the common stock on December 28, 2002 ($38.179), the last day of the first quarter of the Company's 2003 fiscal year, less the option exercise price.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This discussion includes certain forward-looking statements about Kronos' business and its expectations, including statements relating to revenues, product and service revenues and revenue growth rates, deferred maintenance revenue, gross profit, future acquisitions and available cash, investments and operating cash flow, Kronos' ability to obtain third-party financing, and the future effects of accounting pronouncements. Any such statements are subject to risk that could cause the actual results to vary materially from expectations. For a further discussion of the various risks that may affect Kronos' business and expectations, see "Certain Factors That May Affect Future Operating Results" at the end of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Critical Accounting Policies

Management's discussion and analysis of financial condition and results of operations are based upon Kronos' consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires Kronos to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. Kronos bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions.

Kronos has identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of consolidated financial statements. This listing is not a comprehensive list of all of Kronos' accounting policies. Please refer to Note A in the Notes to Consolidated Financial Statements in Item 15 of Kronos' Annual Report on Form 10-K for the fiscal year ended September 30, 2002 for further information.

Revenue Recognition - The Company licenses software and sells data collection hardware and related ancillary products to end-user customers through its direct sales force as well as indirect channel customers, Automatic Data Processing, Inc. ("ADP") and its independent resellers. Substantially all of the Company's software license revenue is earned from perpetual licenses of off-the-shelf software requiring no modification or customization. The software license, data collection hardware and related ancillary product revenues from the Company's end-user customers and indirect channel customers are generally recognized using the residual method when:

- persuasive evidence of an arrangement exists, which is typically when a non-cancelable sales and software license agreement has been signed;

- delivery, which is typically FOB shipping point, is complete for the software (either physically or electronically), data collection hardware and related ancillary products;

- the customer's fee is deemed to be fixed or determinable and free of contingencies or significant uncertainties;

- collectibility is probable; and

- vendor specific objective evidence of fair value exists for all undelivered elements, typically maintenance and professional services.

Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue, assuming all other conditions for revenue recognition have been satisfied. Substantially all of the Company's product revenue is recognized in this manner. If the Company cannot determine the fair value of any undelivered element included in an arrangement, the Company will defer revenue until all elements are delivered, services are performed or until fair value can be objectively determined.

As part of an arrangement, end-user customers typically purchase maintenance contracts as well as professional services from the Company. Maintenance services include telephone and Web-based support as well as rights to unspecified upgrades and enhancements, when and if the Company makes them generally available. Professional services are deemed to be non-essential and typically are for implementation planning, loading of software, installation of the data collection hardware, training, building simple interfaces, running test data, and assisting in the development and documentation of pay rules and best practices consulting.

Revenues from maintenance services are recognized ratably over the term of the maintenance contract period based on vendor specific objective evidence of fair value. Vendor specific objective evidence of fair value is based upon the amount charged when purchased separately, which is typically the contract's renewal rate. Maintenance services are typically stated separately in an arrangement. The Company has classified the allocated fair value of revenues pertaining to the contractual maintenance obligations that exist for the 12-month period subsequent to the balance sheet date as a current liability, and the contractual obligations with a term beyond 12 months as a non-current liability. Revenues from time and material maintenance services are recognized as the services are delivered.

Revenues from professional services are generally recognized based on vendor specific objective evidence of fair value when: (1) a non-cancelable agreement for the services has been signed or a customer's purchase order has been received; and (2) the professional services have been delivered. Vendor specific objective evidence of fair value is based upon the price charged when these services are sold separately and are typically an hourly rate for professional services and a per class rate for training. Based upon the Company's experience in completing product implementations, it has determined that these services are typically delivered within a 12-month period subsequent to the contract signing and therefore classifies deferred professional services as a current liability.

The Company's arrangements with its end-user customers and indirect channel customers do not include any rights of return or price protection, nor do arrangements with indirect channel customers include any acceptance provisions. Generally, the Company's arrangements with end-user customers also do not include any acceptance provisions. However, if an arrangement does include acceptance provisions, they typically are based on the Company's standard acceptance provision. The Company's standard acceptance provision provides the end-user customer with a right to a refund if the arrangement is terminated because the product did not meet Kronos' published specifications. Generally, the Company determines that these acceptance provisions are not substantive and therefore should be accounted for as a warranty in accordance with SFAS No. 5.

At the time the Company enters into an arrangement, the Company assesses the probability of collection of the fee and the terms granted to the customer. For end-user customers, the Company's typical payment terms include a deposit and subsequent payments, based on specific due dates, such that all payments for the software license, data collection hardware and related ancillary products, as well as services included in the original arrangement are ordinarily due within one year of contract signing. The Company's payment terms for its indirect channel customers are less than 90 days and typically due within 30 days of invoice date.

If the payment terms for the arrangement are considered extended or if the arrangement includes a substantive acceptance provision, the Company defers revenue not meeting the criterion for recognition under SOP 97-2 and classifies this revenue as deferred revenue, including deferred product revenue. This revenue is recognized, assuming all other conditions for revenue recognition have been satisfied, when the payment of the arrangement fee becomes due and/or when the uncertainty regarding acceptance is resolved as generally evidenced by written acceptance or payment of the arrangement fee. The Company reports the allocated fair value of revenues related to the product element of arrangements as a current liability because of the expectation that these revenues will be recognized within 12 months of the balance sheet date.

Since fiscal 1996, the Company has had a standard practice of providing creditworthy end-user customers the option of financing arrangements beyond one year. These arrangements, which encompass separate fees for software license, data collection hardware and ancillary products, maintenance and support contracts and professional services, are evidenced by distinct standard sales, license and maintenance agreements and typically require equal monthly payments.

The term of these arrangements typically range between 18 and 36 months. At the time the Company enters into an arrangement, the Company assesses the probability of collection and whether the arrangement fee is fixed or determinable. The Company considers its history of collection without concessions as well as whether each new transaction involves similar customers, products and arrangement economics to ensure that the history developed under previous arrangements remains relevant to current arrangements. If the fee is not determined to be collectible, fixed or determinable, the Company will initially defer the revenue and recognize when collection becomes probable, which typically is when payment is due assuming all other conditions for revenue recognition have been satisfied.

Allowance for Doubtful Accounts and Sales Returns Allowance - Kronos maintains an allowance for doubtful accounts to reflect estimated losses resulting from the inability of customers to make required payments. This allowance is based on estimates made by Kronos after consideration of factors such as the composition of the accounts receivable aging and bad debt history. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances and bad debt expense may be required. In addition, Kronos maintains a sales returns allowance to reflect estimated losses for sales returns and adjustments. Sales returns and adjustments are generally due to incorrect ordering of product, general customer satisfaction issues or incorrect billing. This allowance is established by Kronos using estimates based on historical experience. If Kronos experiences an increase in sales returns and adjustments, additional allowances and charges against revenue may be required.

Valuation of Intangible Assets and Goodwill - In assessing the recoverability of goodwill and other intangible assets, Kronos must make assumptions regarding the estimated future cash flows and other factors to determine the fair value of these assets. If these estimates or their related assumptions change in the future, Kronos may be required to record impairment charges against these assets in the reporting period in which the impairment is determined. For intangible assets, this evaluation includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over their estimated useful lives, Kronos will record an impairment charge in the amount by which the carrying value of the assets exceeds their fair value. For goodwill, the impairment evaluation includes a comparison of the carrying value of the reporting unit which houses goodwill to that reporting unit's fair value. Kronos has only one reporting unit. The fair value of the reporting unit is based upon the net present value of future cash flows, including a terminal value calculation. If the reporting unit's estimated fair value exceeds the reporting unit's carrying value, no impairment of goodwill exists. If the fair value of the reporting unit does not exceed its carrying value, then further analysis would be required to determine the amount of the impairment, if any.

Capitalization of Software Development Costs - Costs incurred in the research, design and development of software for sale to others are charged to expense until technological feasibility is established. Thereafter, software development costs are capitalized and amortized to product cost of sales on a straight-line basis over the lesser of three years or the estimated economic lives of the respective products, beginning when the products are offered for sale. Costs incurred in the development of software for internal use are charged to expense until it becomes probable that future economic benefits will be realized. Thereafter, certain costs are capitalized and amortized to operating expense on a straight-line basis over the lesser of three years or the estimated economic life of the software.

Results of Operations

Revenues. Revenues for the first quarter of fiscal 2003 were $89.7 million as compared to $76.1 million for the first quarter of the prior year. Revenue growth, as compared to the same period in the prior year, was 18% in the first quarter of fiscal 2003, as compared to 17% in the first quarter of fiscal 2002. Revenues from core business (business generated from customers that have not been part of an acquired business transaction over the last four quarters) grew 11% in the first quarter of fiscal 2003 and 2002, and revenues attributable to acquisitions of businesses over the last four quarters contributed 7% and 6% of revenue growth in the first quarter of fiscal 2003 and 2002, respectively. Management presently anticipates that revenue growth for the second quarter and for the entire fiscal 2003, including revenues from customers obtained in the acquisition of businesses, will range between 16% - 20% and 11% - 13%, respectively.

Product revenues for the first quarter of fiscal 2003 were $38.9 million as compared to $35.2 million for the first quarter of fiscal 2002. Product revenue growth, as compared to the same period in the prior year, was 10% in the first quarter of fiscal 2003, as compared to 4% in first quarter of fiscal 2002. One factor driving the product revenue growth experienced in the first quarter of fiscal 2003 was revenues related to the conversion to Kronos products by, and add-on sales to, customers acquired from other providers of labor management solutions. Product revenue derived from acquired customers accounted for 6% of the growth in the first quarter of fiscal 2003, or $2.1 million in revenue. Other less significant factors include increased customer demand for Kronos products, as well as platform and capacity upgrades and upgrades to the newest badge terminals from existing customers. Although product revenues increased during the quarter, management believes that the continued economic downturn may result in many customers deferring or reducing their technology purchases in the future. While management believes the impact on technology purchasing may be temporary, the effect may continue to cause delays or reductions in customer purchases of Kronos products and services in the future. The product growth in the first quarter of fiscal 2002 was attributable to customer demand for platform and capacity upgrades from existing customers and demand for Kronos' new products, as well as, revenues from customers obtained from acquisitions of businesses.

Maintenance revenues for the first quarter of fiscal 2003 were $29.0 million as compared to $23.4 million in the first quarter of fiscal 2002. Maintenance revenues, as compared to the same period in the prior year, increased 24% in the first quarter of fiscal 2003, as compared to 25% in the first quarter of fiscal 2002. The increase in maintenance revenues in both periods is a result of expansion of the installed base, an increase in the value of maintenance contracts and incremental maintenance revenues attributable to customers obtained from the acquisition of businesses. The increase in the value of the maintenance contracts was principally attributable to the platform upgrade of existing customers to Kronos' new products. Platform and capacity upgrade sales generally result in an increased value of maintenance contracts. Excluding the effect of incremental maintenance revenues from acquisitions of businesses in the preceding four quarters, maintenance revenues would have increased 14% in the first quarter of fiscal 2003 and 2002.

Professional services revenues for the first quarter of fiscal 2003 were $21.8 million as compared to $17.5 million in the first quarter of fiscal 2002.

Professional service revenues, as compared to the same period in the prior year, increased 25% in the first quarter of fiscal 2003 as compared to 40% in the first quarter of fiscal 2002. The growth in professional services is primarily due to an increase in the level of professional services accompanying new and platform upgrade sales, an increase in demand for Kronos' services, and to a lesser extent, incremental revenues from acquisition of businesses. Excluding the effect of incremental professional service revenues from acquisitions of businesses in the preceding four quarters, professional service revenues would have increased 19% and 31% in the first quarter of fiscal 2003 and 2002, respectively. The growth in professional service revenues for the first quarter of fiscal 2002 reflects an increase in the level of professional services accompanying new and upgrade sales, an increase in the level of services sold to the installed base, an increase in delivery of professional services resulting from improving the efficiency of Kronos services organization, as well as incremental revenues from acquisitions of businesses.

Deferred maintenance revenues increased 2% from September 30, 2002. Current deferred maintenance revenues increased 3% and long-term deferred maintenance revenues decreased 6% from September 30, 2002. Although maintenance revenue increased 24% in the first quarter of fiscal 2003, as compared to the same period of last year, the deferred maintenance revenue increased 2% from September 30, 2002 primarily due to the positive impact on the maintenance revenues of the acquisitions completed during the past fiscal year, primarily the December 28, 2001 acquisition of the Integrated Software Business of SimplexGrinnell's Workforce Solutions Division, as well as the effect of the timing of the expiration of multi-year maintenance contracts sold in previous years. The decrease in the long-term portion was due to Kronos' decision in fiscal 2000 to curtail the practice of selling multi-year maintenance contracts. Kronos management does not anticipate significant reductions in the growth rate of deferred maintenance in the foreseeable future. Deferred professional services revenues decreased 2% from September 30, 2002. The decrease in deferred professional services revenue is the result of an increase in volume of the delivery of professional services which accompanied product sales during the fourth quarter of fiscal 2002. As the volume of sales in the fourth quarter typically result in a larger deferred professional services revenue balance, the combination of the delivery of these services during the first quarter, as well as typically lower sales in the first quarter as compared to the fourth quarter, will typically result in a similar or lower deferred professional service revenue balance at the end of the first quarter of the fiscal year.

Gross Profit. Gross profit as a percentage of revenues was 61% in first quarter of fiscal 2003, compared to 62% in the same period in the prior year. The reduction in gross profit is primarily attributable to a higher proportion of service revenue, which generally carries a lower gross profit than product revenue. Product gross profit as a percentage of product revenues was 76% in the first quarter of fiscal 2003 and 2002. Service gross profit as a percentage of service revenues was 49% in the first quarter of fiscal 2003 and 2002. Management anticipates overall gross profit to decline in fiscal 2003 as more revenue derives from newer products including its Kronos 4500 terminal and Human Resources Management System (HRMS) products, which carry higher royalty and production costs, and as Kronos increases its investment in infrastructure to support the introduction of its HRMS products. In addition, if service revenues continue to grow proportionately faster than product revenues, gross margins may decrease as service revenues have a lower gross profit.

Net Operating Expenses. Net operating expenses as a percentage of revenues were 48% and 49% in the first quarter of fiscal 2003 and 2002, respectively. The reduction in net operating expenses as a percentage of revenues is attributable to a corporate-wide effort to contain costs, as well as leveraging existing investments in infrastructure to generate higher sales volumes. Although management intends to decrease operating expenses as a percentage of revenues during the remainder of fiscal 2003, principally through continued productivity improvements, uncertainty related to the current economic climate and its impact on the timing of customers' purchases, as well as increased investment in infrastructure to support the introduction of the new HRMS products may prevent decreases in operating expenses as a percentage of revenues from being realized.

Sales and marketing expenses as a percentage of revenues were 32% and 33% in the first quarter of fiscal 2003 and 2002, respectively. The increase in sales and marketing expenses is attributable to Kronos' investments in sales personnel and related support costs to maximize the penetration of existing accounts and to add new customers as well as initiatives to expand market awareness of Kronos products and services. The decrease in sales and marketing expense as a percentage of revenue in the first quarter of fiscal 2003 was primarily due to leveraging our investment in infrastructure to generate higher sales volumes.

Engineering, research and development expenses as a percentage of revenues were 9% and 10% in the first quarter of 2003 and 2002, respectively. The decrease as a percentage of revenues for the first quarter of fiscal 2003 as compared to the same quarter in fiscal 2002 is primarily due to a reduction in costs associated with engineering consultants, coupled with higher sales volume in fiscal 2003. Engineering, research and development expenses of $8.5 million and $7.9 million in the first quarter of fiscal 2003 and 2002, respectively, are net of capitalized software development costs of $2.8 million and $2.6 million, respectively. The increase in expenses in the first quarter of fiscal 2003 as compared to the same period of the prior year is principally attributable to an increase in salary-related expenses for additional engineering personnel. The significant project development efforts in the first quarter of fiscal 2003 principally related to further development and enhancement of the Workforce Central(R) suite, Workforce HR(TM), Workforce Payroll(TM), Kronos 4500(TM) terminal and, to a lesser extent, the eForce(R) software acquired from SimplexGrinnell on December 28, 2001.

General and administrative expenses as a percentage of revenues were 7% and 6% in the first quarter of fiscal 2003 and 2002, respectively. General and administrative expenses primarily consist of personnel and overhead related expenses for administrative, information technology, finance, legal and human resources support functions. The increase in general and administrative expenses in fiscal 2003 is primarily due to Kronos' investment in personnel and other infrastructure to support the growth of operations.

Amortization of intangible assets as a percentage of revenues were 1% in the first quarter of fiscal 2003 and 2002. Other income, net as a percentage of revenues were 1% in the first quarter of fiscal 2003 and 2002. Other income, net is principally interest income earned from Kronos' cash as well as investments in its marketable securities and financing arrangements.

Income Taxes. The provision for income taxes as a percentage of pretax income was 36% and 35% in the first quarter of fiscal year 2003 and 2002, respectively. Kronos' effective income tax rate may fluctuate between periods as a result of various factors, including income tax credits, amortization of goodwill for tax purposes, foreign tax rate differentials and state income taxes.

Newly Issued Accounting Standards. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." This statement provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based compensation. The statement amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The Company accounts for stock-based compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and complies with the disclosure provisions of FASB Statement No. 123. The transition provisions are effective for fiscal years ending after December 15, 2002. The disclosure provisions are effective for interim periods beginning after December 15, 2002. The adoption of this statement is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows as the Company does not anticipate making the voluntary change to the fair value method of accounting for stock-based compensation. The Company expects to implement the required disclosure provisions in the three month period ending March 29, 2003.

Liquidity and Capital Resources

Kronos funds its business through cash generated by operations. If near-term demand for Kronos' products weakens or if significant anticipated sales in any quarter do not close when expected, the availability of such funds may be adversely impacted. If the need arose, Kronos believes that based on its current debt-free balance sheet and its financial position, it would be successful in securing financing from the capital markets.

Cash, cash equivalents and marketable securities (which includes both short and long term securities) at December 28, 2002 increased to $87.2 million from $74.7 million at September 30, 2002. This increase in cash, cash equivalents and marketable securities is due to cash generated from operations. Working capital as of December 28, 2002 amounted to $17.9 million as compared with $2.4 million at September 30, 2002. This increase in working capital is primarily due to an increase in cash resulting from cash provided by operations.

Cash provided by operations amounted to $13.8 million in the first quarter of fiscal 2003 as compared to $12.1 million for the same period in the prior year. The increase in operating cash flows in fiscal 2003 is principally attributable to an increase in deferred revenues, particularly maintenance revenues to be recognized over the next twelve months, and increased net income as well as increased non-cash charges related to deprecation and amortization that are added back in the calculation of cash flow from operations. These increases were offset by a lower rate of accounts receivable collections from customer financing arrangements. In addition, although the tax benefit from exercise of stock options contributed less to cash flow from operations in the first quarter of fiscal 2003, as compared to the same period last year, the resulting increase in taxes payable offsets this effect.

Cash used for property, plant and equipment was $2.2 million in the first quarter of fiscal 2003 compared to $2.2 million for the same period in the prior year. Kronos' use of cash for property, plant and equipment in both periods presented includes investments in information system and infrastructure to improve and support expanding operations. Kronos' use of cash for the acquisition of businesses in the first quarter of fiscal 2003 and 2002 was principally related to the acquisitions of specified assets and/or businesses of Kronos' dealers and/or other providers of labor management solutions. Kronos is assessing several acquisition opportunities that may be completed over the next twelve months, although there can be no assurance that these acquisitions will be completed. Excess cash reserves not required for operations, investments in property, plant and equipment or acquisitions are invested in marketable securities. Net investments in marketable securities decreased by $3.2 million in the first quarter of fiscal 2003 compared to an increase of $12.5 million in the first quarter of fiscal 2002.

Under Kronos' stock repurchase program, Kronos repurchased 65,000 shares of common stock during the first quarter of fiscal 2003 at an aggregate cost of $2.5 million compared to 22,500 common shares at a cost of $0.6 million in the first quarter of fiscal 2002. The common shares repurchased under the program are used for Kronos' employee stock option plans and employee stock purchase plan. During the first quarter of fiscal 2003, Kronos received $2.6 million upon the maturity of a call option arrangement. As of December 28, 2002, Kronos did not have any outstanding call option arrangements. Please refer to Note I in the Notes to Condensed Consolidated Financial Statements for further details regarding call option arrangements. Cash provided by operations was sufficient to fund investments in capitalized software development costs, property, plant and equipment and stock repurchases.

Kronos leases certain office space, manufacturing facilities and equipment under long-term operating lease agreements. Future minimum rental commitments under operating leases with noncancellable terms of one year or more are as follows (in thousands):

Fiscal Year	Operating Lease Commitments
2003 (remaining 9 months)	$ 7,043
2004	8,926
2005	8,075
2006	6,086
2007	4,230
Thereafter	4,238
	$38,598

Certain acquisition agreements contain provisions that require Kronos to make a guaranteed payment and/or contingent payments based upon profitability of the business unit or if specified minimum revenue requirements are met. Please refer to Note E in the Notes to Condensed Consolidated Financial Statements for further details regarding guaranteed and/or contingent payments.

Kronos believes that with cash generated from ongoing operations it has adequate cash and investments and operating cash flow to fund its investments in property, plant and equipment, software development costs, cash requirements under operating leases, cash payments related to acquisitions, if any, and any additional stock repurchases for the foreseeable future.

During the first quarter of fiscal 2003, Kronos did not engage in:

- material off-balance sheet activities, including the use of structured finance or special purpose entities,
- material trading activities in non-exchange traded commodity contracts, or
- transactions with persons or entities that benefit from their non-independent relationship with Kronos.

Certain Factors That May Affect Future Operating Results

Except for historical matters, the matters discussed in this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). Kronos desires to take advantage of the safe harbor provisions of the Act and is including this statement for the express purpose of availing itself of the protection of the safe harbor with respect to all forward-looking statements that involve risks and uncertainties.

Kronos' actual operating results may differ from those indicated by forward-looking statements made in this Quarterly Report on Form 10-Q and presented elsewhere by management from time to time because of a number of factors including the potential fluctuations in quarterly results, timing and acceptance of new product introductions by Kronos and its competitors, the dependence on Kronos' time and attendance product line, the ability to attract and retain sufficient technical personnel, the protection of Kronos' intellectual property and the potential infringement on Kronos' intellectual property rights, competitive pricing pressure, and the dependence on alternate distribution channels and on key vendors, as further described below and in Kronos' Annual Report on Form 10-K for the fiscal year ended September 30, 2002, which are specifically incorporated by reference herein.

Potential Fluctuations in Results. Kronos' operating results, including revenue growth, sources of revenue, effective tax rate and liquidity, may fluctuate as a result of a variety of factors, including the purchasing patterns of its customers, mix of products and services sold, the ability of Kronos to effectively integrate acquired businesses into Kronos' operations, the timing of the introduction of new products and product enhancements by Kronos and its competitors, the strategy employed by Kronos to enter the Human Resources Management System ("HRMS") market, market acceptance of new products, competitive pricing pressure and general economic conditions. Kronos historically has realized a relatively larger percentage of its annual revenues and profits in the third and fourth quarters and a relatively smaller percentage in the first and second quarters of each fiscal year, although there can be no assurance that this pattern will continue. In addition, substantially all of Kronos' product revenue and profits in each quarter result from orders received in that quarter. If near-term demand for Kronos' products weakens or if significant anticipated sales in any quarter do not close when expected, Kronos' revenues for that quarter will be adversely affected. Kronos believes that its operating results for any one period are not necessarily indicative of results for any future period.

Dependence on Labor Management Product Line. To date, more than 90% of Kronos' revenues have been attributable to sales of labor management systems and related services. Although Kronos has introduced its products for the licensed HRMS market during fiscal 2002, Kronos expects that its dependence on the labor management product line for revenues will continue for the foreseeable future. Competitive pressures or other factors could cause Kronos' labor management products to lose market acceptance or experience significant price erosion, adversely affecting the results of Kronos' operations.

Product Development and Technological Change. Continual change and improvement in computer software and hardware technology characterize the markets for labor management systems. Kronos' future success will depend largely on its ability to enhance the capabilities and increase the performance of its existing products and to develop new products and interfaces to third-party products on a timely basis to meet the increasingly sophisticated needs of its customers. Although Kronos is continually seeking to further enhance its labor management, HR and payroll product offerings (including products for the HRMS market) and to develop new products and interfaces, there can be no assurance that these efforts will succeed, or that, if successful, such product enhancements or new products will achieve widespread market acceptance, or that Kronos' competitors will not develop and market products which are superior to Kronos' products or achieve greater market acceptance.

Dependence on Alternate Distribution Channels. Kronos markets and sells its products through its direct sales organization, independent resellers and ADP under an OEM agreement. In the first quarter of fiscal 2003, approximately 10% of Kronos' revenue was generated through sales to resellers and ADP. Management does not anticipate that its entrance into the HRMS market will have a negative impact on its relationship with ADP. However, a reduction in the sales efforts of either Kronos' major resellers or ADP, or termination or changes in their relationships with Kronos, could have a material adverse effect on the results of Kronos' operations.

Competition. The labor management industry is highly competitive. Technological changes such as those allowing for increased use of the Internet have resulted in new entrants into the market. Although Kronos believes it has core competencies that position it strongly in the marketplace, maintaining Kronos' technological and other advantages over competitors will require continued investment by Kronos in research and development and marketing and sales programs. There can be no assurance that Kronos will have sufficient resources to make such investments or be able to achieve the technological advances necessary to maintain its competitive advantages. Increased competition could adversely affect Kronos' operating results through price reductions and/or loss of market share. With Kronos' efforts to expand its labor management offering with the recent introduction of its HRMS product suite, Kronos will continue to meet strong competition. Many of these competitors may be able to adapt more quickly to new or emerging technologies or to devote greater resources to the promotion and sale of their HRMS products. Many of Kronos' HRMS competitors have significantly greater financial, technical and sales and marketing resources than Kronos, as well as more experience in delivering HRMS solutions. There can be no assurance that Kronos will be able to compete successfully in the HRMS marketplace, and its failure to do so could have a material adverse impact upon its business, prospects, financial condition and operating results.

Attracting and Retaining Sufficient Technical Personnel for Product Development, Support and Sales. Kronos has encountered intense competition for experienced technical personnel for product development, technical support and sales and expects such competition to continue in the future. Any inability to attract and retain a sufficient number of qualified technical personnel could adversely affect Kronos' ability to produce, support and sell products in a timely manner.

Protection of Intellectual Property. Kronos has developed, and through its acquisitions of businesses and software, acquired proprietary technology and intellectual property rights. Kronos' success is dependent upon its ability to further develop and protect its proprietary technology and intellectual property rights. Kronos seeks to protect products, software, documentation and other written materials primarily through a combination of trade secret, patent, trademark and copyright laws, confidentiality procedures and contractual provisions. While Kronos has attempted to safeguard and maintain its proprietary rights, it is unknown whether Kronos has been or will be successful in doing so.

Despite Kronos' efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of its products or obtain and use information that is regarded as proprietary. Policing unauthorized use of Kronos' products is difficult. While Kronos is unable to determine the extent to which piracy of its software products exists, software piracy can be expected to be a persistent problem, particularly in foreign countries where the laws may not protect proprietary rights as fully as in the United States. Kronos can offer no assurance that it can adequately protect its proprietary rights or that its competitors will not reverse engineer or independently develop similar technology.

Infringement of Intellectual Property Rights. Kronos cannot provide assurance that others will not claim that Kronos developed or acquired intellectual property rights are infringing on their intellectual property rights or that Kronos does not in fact infringe on those intellectual property rights.

Any litigation regarding intellectual property rights could be costly and time-consuming and divert the attention of Kronos' management and key personnel from business operations. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement might also require Kronos to enter into costly royalty or license agreements, and in this event, Kronos may not be able to obtain royalty or license agreements on acceptable terms, if at all. Kronos may also be subject to significant damages or an injunction against the use of its products. A successful claim of patent or other intellectual property infringement against Kronos could cause immediate and substantial damage to its business and financial condition.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Kronos is exposed to a variety of market risks, including changes in interest rates affecting the return on its investments, foreign currency fluctuations and decreases in its common stock price affecting capped call options. Refer to Note A "Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements in the Annual Report on Form 10-K for the year ended September 30, 2002 for further discussion regarding marketable securities, foreign currency forward exchange contracts and capped call option arrangements. Kronos' marketable securities that expose it to market rate risks are comprised of debt securities. A decrease in interest rates would not adversely impact interest income or related cash flows pertaining to securities held at December 28, 2002, as all of these securities have fixed rates of interest. A 100 basis point increase in interest rates would not adversely impact the fair value of these securities by a material amount due to the size and average duration of the portfolio. Kronos' exposure to market risk for fluctuations in foreign currency relate primarily to the amounts due from subsidiaries. Exchange gains and losses related to amounts due from subsidiaries have not been material. For foreign currency exposures existing at December 28, 2002, a 10% unfavorable movement in the foreign exchange rates for each subsidiary location would not expose the Company to material losses in earnings or cash flows. The calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar.

Kronos has periodically entered into short term capped call options in conjunction with its stock repurchase initiatives. As of December 28, 2002, there were no capped call option arrangements outstanding.

Item 4. Evaluation of Disclosure Controls and Procedures

1. Evaluation of disclosure controls and procedures. Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) as of a date within 90 days of the filing of this quarterly report on Form 10-Q, the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the

SEC's rules and forms and are operating in an effective manner.

2. Changes in internal controls. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

99.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the fiscal quarter ended December 28, 2002.

SIGNATURES

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

KRONOS INCORPORATED

By /s/ Paul A. Lacy

Paul A. Lacy
Executive Vice President,
Chief Financial and Administrative Officer
(Duly Authorized Officer and
Principal Financial Officer)

February 10, 2003

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Mark S. Ain, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kronos Incorporated;

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

statements were made, not misleading with respect to the period covered by this quarterly report;

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

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

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

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

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

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

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

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

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

Date: February 10, 2003

/s/ Mark S. Ain

Mark S. Ain
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Paul A. Lacy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kronos Incorporated;

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

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

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

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

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

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

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

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

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

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

Date: February 10, 2003

/s/ Paul A. Lacy

Paul A. Lacy

Chief Financial Officer

KRONOS INCORPORATED

EXHIBIT INDEX

Exhibit Number	Description
99.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

EXHIBIT 99.1

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

In connection with the Quarterly Report on Form 10-Q of Kronos Incorporated (the "Company") for the period ended December 28, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Mark S. Ain, Chief Executive Officer of the Company, and Paul A. Lacy, Executive Vice President, Chief Financial and Administrative Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

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

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

/s/ Mark S. Ain

Dated: February 10, 2003 Mark S. Ain
Chief Executive Officer

/s/ Paul A. Lacy

Dated: February 10, 2003 Paul A. Lacy
Executive Vice President, Chief Financial and Administrative Officer