CONCORD COMMUNICATIONS INC
Form S-3/A
July 23, 2004

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As filed with the Securities and Exchange Commission on July 23, 2004

Registration No. 333-112091

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Amendment No. 2
to
FORM S-3
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

Concord Communications, Inc.
(Exact name of Registrant as specified in its charter)

Massachusetts	**04-2710876**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

600 Nickerson Road
Marlboro, Massachusetts 01752
(508) 460-4646
(Address, including zip code, and telephone number,
including area code, of Registrant s principal executive offices)

John A. Blaeser
President and Chief Executive Officer
Concord Communications, Inc.
600 Nickerson Road
Marlboro, Massachusetts 01752
(508) 460-4646
(Name, address, including zip code, and telephone number,
including area code, of agent for service)

Copies of all communications, including all communications sent to the agent for service, should be sent to:

Douglas A. Batt, Esq.	**Kevin M. Barry, Esq.**
Executive Vice-President,	**Testa, Hurwitz & Thibeault, LLP**
General Counsel and Clerk	**125 High Street**

Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following. o

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CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be Registered	Proposed maximum offering price per security	Proposed maximum aggregate offering price	Amount of registration fee
3.0% Convertible Senior Notes due 2023	$86,250,000	100%(1)	$86,250,000	$6,977.63(2)
Common Stock, par value $0.01 per share	(3)	(3)	(3)	(4)(5)

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457 under the Securities Act of 1933.

(2) The fee is calculated pursuant to Section 6(b) of the Securities Act on the basis of the offering price of the notes.

(3) Includes 3,209,776 shares of common stock issuable upon conversion of the notes at the rate of 37.2148 shares of common stock for each $1,000 principal amount at maturity of the notes. Pursuant to Rule 416 under the Securities Act, such number of shares of common stock registered hereby shall include an indeterminate number of shares of common stock that may be issued in connection with a stock split, stock dividend, recapitalization or similar event.

(4) Pursuant to Rule 457(i), there is no additional filing fee with respect to the shares of common stock issuable upon conversion of the notes because no additional consideration will be received in connection with the exercise of the conversion privilege.

(5) The registration fee was previously paid in connection with the initial filing of the registration statement.

The Registrant hereby undertakes to amend this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.

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SUBJECT TO COMPLETION, DATED July 23, 2004

$86,250,000
(AGGREGATE PRINCIPAL AMOUNT)

3.0% CONVERTIBLE SENIOR NOTES DUE 2023 AND
THE COMMON STOCK ISSUABLE UPON THE CONVERSION OF THE NOTES

We issued the notes in a private placement on December 8, 2003. This prospectus will be used by selling securityholders to resell their notes and the common stock issuable upon conversion of their notes. We will not receive any proceeds from this offering.

The notes are issued only in denominations of $1,000 and integral multiples thereof and mature on December 15, 2023. The notes will be issued only in registered book-entry form. You may convert the notes into shares of our common stock in accordance with the terms and conditions of the notes prior to their maturity or their prior redemption or repurchase by us. The conversion rate is 37.2148 shares of common stock per each $1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately $26.87 per share. The notes are initially convertible, in accordance with their terms, into approximately 3,209 shares of common stock as of the date of this prospectus.

We will pay cash interest on the notes on June 15th and December 15th of each year. The first such payment will be made on June 15, 2004. The notes are general unsecured obligations of Concord, ranking equally in right of payment with all our existing and future unsecured senior indebtedness, and senior in right of payment to any of our future subordinated indebtedness. The notes will be effectively subordinated to any of our existing and future secured indebtedness to the extent of the assets securing such indebtedness and to the claims of all creditors of our subsidiaries.

We may redeem for cash all or a portion of the notes at any time on or after December 15, 2008, upon at least 20 days notice, for a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest (including additional amounts), if any, to but not including the redemption date.

Holders may require us to purchase all or part of their notes for cash at a purchase price of 100% of the principal amount of the notes plus accrued and unpaid interest on December 15, 2008, December 15, 2013 and December 15, 2018 and upon the occurrence of a designated event, as described in the section of this prospectus entitled DESCRIPTION OF NOTES.

The notes are eligible to trade on the Nasdaq s screen-based automated trading system known as the Private Offerings, Resale and Trading through Automated Linkages, or PORTAL . Holders who are not listed in the section of the prospectus entitled SELLING SECURITYHOLDERS may continue to use PORTAL to trade the notes. Our common stock is quoted on the Nasdaq National Market under the symbol CCRD . On July 16, 2004, the last reported closing price of our common stock on the Nasdaq National Market was $9.40 per share.

The securities offered hereby involve a high degree of risk.
See Risk Factors beginning on page 5.

Neither the Securities and Exchange Commission (SEC) nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is July , 2004.

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You should rely only on the information contained herein or specifically incorporated by reference in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The selling stockholders are offering to sell, and seeking offers to buy, securities only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of securities.

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SPECIAL CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

- variations in our quarterly operating results;
- integration of acquired products and technologies;
- announcements of technological innovations or new products by us or our competitors;
- introduction of new products or new pricing policies by us or our competitors;
- announcements by us or our competitors of significant customer orders;
- acquisitions or strategic alliances by us or others in our industry;
- changes in global economic and political conditions;
- relationships with strategic partners and other evolving distribution channels;
- the hiring or departure of key personnel;
- our failure to continue to expand into international markets;
- failure to obtain or protect our intellectual property rights;
- changes in the software industry cycle;
- changes in the market for our products and services;
- changes in market valuations of companies within the software industry;
- changes in estimates of our performance or recommendations by financial analysts; and
- the other risks and uncertainties described in this prospectus under Risk Factors.

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

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SUMMARY OF THE OFFERING AND THE COMPANY

As used in this prospectus, references to Concord, we, our or us refer solely to Concord Communications, Inc. and not to any of our current or future subsidiaries, unless the context otherwise requires.

The following summary is qualified in it entirety by the more detailed information appearing elsewhere in this prospectus. You should consider carefully the information set forth in this prospectus under the heading RISK FACTORS.

This prospectus is offering an aggregate principal amount of $86,250,000 of 3.0% Convertible Senior Notes due 2023 and 3,209,776 shares of our common stock issuable on conversion of the notes for sale by certain selling stockholders. The selling stockholders acquired the notes in connection with a private placement on December 8, 2003 and the resultant resale by the initial purchaser of the notes under Rule 144A for the Securities Act.

We are receiving no proceeds from the sale of securities offered for sale hereunder. We have agreed to pay the expenses associated with registering the securities of the selling stockholders. We may suspend the use of this prospectus during certain periods of time described in the section of this prospectus entitled DESCRIPTION OF NOTES if the prospectus would, in our judgment, contain a material misstatement or omission as a result of an event that has occurred and is continuing, and we determine in good faith that the disclosure of this material non-public information would have a material adverse effect on us and our subsidiaries taken as a whole.

Concord is a software company that provides a Business Service Management (BSM) solution to enterprise customers, managed service providers and telecommunication carriers. Our solution, the eHealth® Suite of products, maps information technology (IT) services to business needs, measures the actual end user experience and manages application, system and network infrastructures.

We develop, market and support a family of software products, the eHealth® Suite. Our software solution links IT services to business needs by proactively managing the technology that IT services depend upon and detecting problems before they impact critical business services.

Our software maps IT services to business needs, measures the actual end-user experience, and manages applications, systems, and networks. It does this by collecting data from the underlying infrastructure of network devices, desktop/server systems and applications. This information is stored in a database where it is consolidated and analyzed. Business unit managers and IT personnel use our eHealth® solution to gain a better understanding of the availability or performance of applications and IT services.

High performing applications and technology services are essential for many corporations as these support critical business services. The business dependency on applications and IT services requires corporations to closely measure the impact that IT slowness or downtime has on their applications and ultimately their business, by managing the devices like desktop/server systems, the network infrastructures, as well as the business applications. Our eHealth® Suite helps businesses by providing information that businesses use to keep their applications and IT services highly performing and available. Specific business market segments that we target are enterprises, service providers and telecommunication carriers.

Enterprises use our eHealth® Suite of products to protect their revenue by ensuring that critical applications are available when needed. Our software also allows them to reduce expenses by limiting the need for incremental IT administrators and equipment as their business and IT infrastructures expand. IT personnel can also use our software to plan the future capacity of their IT infrastructure.

Service providers, who provide IT services to enterprises for a fee, use the eHealth® Suite to monitor compliance with service level agreements, maintain the quality of their services and to introduce new services for their business customers.

Telecommunication carriers that provide services like cable, broadband internet and wireless services to residential and commercial businesses rely on the eHealth® Suite to maintain the quality of their services such as network and bandwidth services, web hosting, data center/co-location services or providing internet services.

We market to our customers through our own sales force, sales agents, value-added resellers, distributors, network service providers, telecommunication carriers, and original equipment manufacturers (OEMs). As of March 31, 2004, we had over 3,000 customer accounts operating in and serving a broad variety of industries. No single customer accounted for more than 10% of our revenues as of March 31, 2004.

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We were organized as a Massachusetts corporation in 1980 under the name Concord Data Systems, Inc., and changed our name to Concord Communications, Inc. in 1986. Our principal executive offices are located at 600 Nickerson Road, Marlboro, Massachusetts 01752. Our telephone number is (508) 460-4646. Our web site is www.concord.com. The contents of our website are not part of this prospectus.

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The Offering

The following summary contains basic information about the notes and is not intended to be complete. It does not contain all the information that will be important to a holder of the notes. For a more complete understanding of the notes, please refer to the section of this document entitled "Description of Notes.

Issuer	Concord Communications, Inc., a Massachusetts corporation.
Notes Offered	$86.25 million aggregate principal amount of 3.0% Convertible Senior Notes due 2023.
Maturity Date	December 15, 2023, unless earlier repurchased, redeemed, or converted.
Ranking	The notes are our general unsecured obligations, ranking equally in right of payment with all our existing and future unsecured senior indebtedness, and senior in right of payment to any of our future subordinated indebtedness. The notes are effectively subordinated to any of our existing and future secured indebtedness to the extent of the assets securing such indebtedness and to the claims of all creditors of our subsidiaries.
Interest	The notes bear interest at an annual rate of 3.0% on the principal amount from December 8, 2003 payable semi-annually in arrears in cash on June 15th and December 15th of each year, beginning June 15, 2004, to the holders of record at 5:00 p.m., New York City time, on the preceding June 1st and December 1st, respectively. Interest will be computed semi-annually on the basis of a 360-day year comprised of twelve 30-day months.
Conversion Rights	Holders may convert the notes into shares of our common stock at an initial conversion rate of 37.2148 shares of common stock per $1,000 principal amount of notes (representing a conversion price of approximately $26.87 per share), subject to adjustment, prior to the close of business on the final maturity date only under the following circumstances:
	(i) during any conversion period, if on each of at least 20 trading days in the period of 30 consecutive trading days ending on the first trading day of the conversion period, the closing sale price of our common stock exceeded 120% of the conversion price in effect on that 30th trading day of such period, a conversion period will be the period from and including the 30th trading day in a fiscal quarter to, but not including, the 30th trading day (or, if that day is not a trading day, then the next trading day) in the immediately following fiscal quarter; or
	(ii) if we have called those notes for redemption; or
	(iii) upon the occurrence of the specified corporate transactions discussed under Description of Notes Conversion Rights Conversion Upon Specified Corporate Transactions.
	In lieu of delivery of shares of our common stock, and pursuant to the procedures described below, we may elect to deliver to holders surrendering notes either cash or a combination of cash and shares of our common stock. If we elect to satisfy the entire conversion obligation in cash, we will deliver to the holders cash in an amount equal to the product of: (a) a number equal to (i) the aggregate principal amount of the notes to be converted divided by 1,000 and multiplied by (ii) the conversion rate, and (b) the arithmetic average of the closing sale prices of our common stock during the specified cash settlement averaging period.
Sinking Fund	None.
Optional Redemption	On or after December 15, 2008, upon at least 20 days notice, we may redeem all or a portion of the notes at any time for a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest (including additional amounts), if any, to but not including the redemption date. See Description of Notes Optional Redemption.

Repurchase at Option of Noteholders	Holders have the right to require us to purchase all or a portion of their notes for cash on December 15, 2008, December 15, 2013 and December 15, 2018 (each, a purchase date). In each case, upon at least two business days prior notice, we will pay a purchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest, (including additional amounts), if any, to but not including the purchase date. See Description of Notes Purchase of Notes at a Holder s Option and Risk Factors We may not have the funds necessary to purchase the notes upon a designated event or other purchase date, as required by the indenture governing the notes.
Designated Event	After the occurrence of a designated event, a holder will have the right to require us to purchase for cash all or any part of the notes at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest (including additional amounts), if any, up to, but not including, the designated event purchase date. See Description of the Notes Purchase of Notes at a Holder s Option Upon a Designated Event and Risk Factors We may not have the funds necessary to purchase the notes upon a designated event or other purchase date, as required by the indenture governing the notes.
Book-Entry Form	The notes were issued in book-entry form and will be represented by permanent global certificates deposited with, or on behalf of, The Depositary Trust Company, or DTC, and registered in the name of a nominee of DTC. Beneficial interests in any of the notes will be shown on, and transfers will be effected only through, records maintained by DTC or its nominee and any such interest may not be exchanged for certificated securities, except in limited circumstances. See Description of Notes Form, Denomination and Registration.
Nasdaq Symbol	The trading symbol for our common stock is CCRD.

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RISK FACTORS

An investment in the notes involves significant risks. You should carefully consider the following risk factors in conjunction with the other information contained and incorporated by reference in this prospectus before purchasing the notes.

Risks Related to Our Business

Our future operating results are uncertain.

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

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

Our future operating results must be considered in light of these factors.

Failure to successfully integrate acquisitions may adversely impact our business.

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

- failure to successfully integrate the acquired products;
- failure to successfully integrate personnel and management structures;
- failure to retain key customers;
- loss of key employees;
- failure to effectively control costs associated with the integration;

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- failure to meet expected timelines for product development and commercialization; and
- exposure to liabilities of the acquired company that were not known or accurately evaluated by us prior to consummating the acquisition.

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

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

During the third fiscal quarter of 2003, we completed the acquisition of netViz and entered into a license agreement with Tavve, Inc. (Tavve) to acquire Tavve s technology relating to root cause analysis and discovery of layers 2 and 3 of the network topology. We plan to integrate the netViz technology, the eHealth® Suite technology, and the Tavve technology to enable customers to employ data-driven icons to visualize and take action on the critical relationships between business processes, application services, and network and system infrastructures.

During the fourth fiscal quarter of 2003, we launched an enhanced VoIP solution which is designed to enable customers to manage the voice traffic carried on their IP network. While we believe the incorporation of these technologies into our products will increase our products and services revenue, the markets for these integrated products are at an early stage of development and are evolving, thereby making it difficult to assess:

- the size of the market;
- the competitive landscape;
- the appropriate features and prices for products to address this market;
- the optimal distribution and marketing strategy; and
- the market that will develop and the impact of large competitors within the market.

Failure to successfully market and sell our integrated product may adversely impact our business.

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

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

In an effort to achieve profitability and adequately fund research and development, we continue to work to reduce or maintain our operating expenses as a percentage of total revenues while maintaining necessary funding for company operations. However, competition in the marketplace may require us to increase our operating expenses in the future in order to:

- fund higher levels of research and development;
- increase our sales and marketing efforts;
- develop new distribution channels;
- broaden our customer support capabilities; and

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respond to unforeseeable economic or business circumstances.

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

Our operating results may fluctuate.

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

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

the timing, composition, and size of orders from our customers, including the tendency for significant bookings to occur in the final two weeks of each fiscal quarter (including the fiscal year end);

difficulties penetrating new markets for our products;

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

our customers spending patterns and budgetary resources for our products;

geopolitical conditions in the world;

the success of our new customer generation activities;

introductions or enhancements of products, or delays in the introductions or enhancements of products, by us or our competitors;

changes in our pricing policies or those of our competitors;

changes in the distribution channels through which our products are sold;

our success in anticipating and effectively adapting to developing markets and rapidly changing technologies;

our success in attracting, retaining, and motivating qualified personnel;

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

changes in general economic conditions; and

changes in accounting rules.

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

Due to all of the foregoing factors, we believe that our quarterly operating results are likely to vary significantly in the future. Therefore, in some future quarter our results of operations may fall below the expectations of securities analysts and investors. In such event, the trading price of our common stock will likely suffer.

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

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

Our debt service obligations may adversely affect our cash flow.

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

The level of our indebtedness among other things, could:

- make it difficult for us to make payments on the notes;
- make it difficult for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete; and
- make us more vulnerable in the event of a downturn in our business.

Our success is dependent upon sales to telecommunication carriers, service providers, and enterprise customers.

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

The market for business service management software is emerging.

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

- the size of the business service management market;
- the appropriate features and prices for products to address this market;
- the optimal distribution strategy; and
- the market that will develop and the impact of large competitors within the market.

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

Increased royalty costs could adversely impact our business.

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

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

The market for our application availability and performance products is in an early stage of development. Although the rapid expansion and increasing complexity of computer applications, systems, and networks in recent years have increased the demand for availability (i.e., fault) and performance management software products, the awareness of, and the demand for, an integrated fault and performance solution is a recent development, and therefore it is difficult to assess:

- the size of this market;
- the appropriate features and prices for products to address this market;
- the optimal distribution strategy; and
- the market that will develop and the impact of large competitors within the market.

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

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maintenance of direct and indirect sales channels. The integration of availability and performance management functionality into the applications, systems, and networks of telecommunication carriers, managed services providers, and enterprise customers and the presence of larger competitors in this market may impact our ability to retain or increase our market share.

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

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

- application performance software vendors;
- fault management software vendors;
- IT visualization software vendors;
- report toolset niche vendors;
- enterprise management software, framework and platform providers;
- software vendors providing service assurance for the wireless market;
- large, well-established management framework companies that have developed network or application management platforms;
- developers of network element management solutions;
- probe vendors;
- telecommunications vendors;
- system agent vendors; and
- vendors that provide, as a service, some of the functionality of our products.

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

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

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

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

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

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

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

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

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

the availability and price of competitive products and services;

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

the demand for data-driven visualization software; and

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

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

We may need future capital funding.

We plan to continue to expend substantial funds on the continued development, marketing, and sale of the eHealth® Suite family of products. We had approximately $164.3 million in short term investments (cash, cash equivalents and marketable securities) as of March 31, 2004. Notwithstanding the foregoing, we cannot ensure that our existing capital resources and any funds that may be generated from future operations together will be sufficient to finance our future operations or that other sources of funding will be available on terms acceptable to us, if at all. In addition, future sales of substantial amounts of our securities in the public market could adversely affect prevailing market prices and could impair our future ability to raise capital through the sale of our securities.

We must introduce product enhancements and new products on a timely basis.

Because of rapid technological change in the software industry, potential changes in the architecture of the IT infrastructure, changes in the software markets in which our product and services are sold, and changes in industry standards, the market acceptance of updated versions of our eHealth® Suite is difficult to estimate. We cannot ensure that:

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we will successfully develop and market enhancements to our eHealth® Suite or successfully develop new products that respond to technological changes, evolving industry standards, or customer requirements;

we will not experience difficulties that could delay or prevent the successful development, introduction, and sale of enhancements or new products; or

enhancements or new products will adequately address the requirements of the marketplace and achieve market acceptance.

The need for our products may decrease if manufacturers incorporate our product features into their product offerings.

Our products manage the performance of computer applications, systems, and networks. Presently, manufacturers of both hardware and software have not implemented these management functions into their products in any significant manner. These products typically include operating systems, workstations, network devices, and software. If manufacturers begin to incorporate these management functions into their products, this may decrease the value of our products and have a substantial adverse impact on our business.

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

International tensions, exacerbated by the war in Iraq and the war against global terrorism, contribute to an uncertain political and economic climate, both in the United States and globally, which may affect our ability to generate revenue on a predictable basis. As we sell products both in the United States and internationally, the threat of future terrorist attacks may adversely affect our business. In addition, as a result of the United States role in the war against global terrorism, products produced by U.S. companies may experience boycott or backlash, which may adversely affect our business.

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

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

Our common stock price could experience significant volatility.

The market price of our common stock may be highly volatile and could be subject to wide fluctuations in response to:

variations in our quarterly operating results;

announcements of technological innovations or new products by us or our competitors;

changes in financial estimates by securities analysts;

announcements of results of operations by other companies;

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

announcements relating to financial improprieties by public companies; or other events or factors.

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In addition, the financial markets have experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many high technology companies and that often have been unrelated to the operating performance of such companies or have resulted from the failure of the operating results of such companies to meet market expectations in a particular quarter. Broad market fluctuations or any failure of our operating results in a particular quarter to meet market expectations may adversely affect the market price of our common stock, leading to an increased risk of securities class action litigation. Such litigation could result in substantial costs and a diversion of our attention and resources.

Our industry is subject to rapid technological change. Our success depends upon maintenance of standard protocols.

The software industry is characterized by:

- rapid technological change;
- frequent introductions of new products;
- changes in customer demands; and
- evolving industry standards.

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

We rely on strategic partners and other evolving distribution channels.

Our distribution strategy is to develop multiple distribution channels, including sales through:

- strategic marketing partners;
- value added resellers;
- system integrators;
- telecommunication carriers;
- original equipment manufacturers; and
- independent software vendors and international distributors.

We have developed a number of these relationships and intend to continue to develop new channel partner relationships. We have focused on identifying and developing our key distribution partners worldwide to maximize the success of our indirect sales. As part of this process, we have decreased the total number of distributors selling our products and services, but have sought to increase the quality and focus of our most valuable distributors through improved training and development programs. Our success will depend in large part on our development of these more focused distribution relationships and on the performance and success of other third parties that distribute our products and services, particularly telecommunication carriers and other network service providers. We sell our products and services in the United States through both direct sales to customers and indirect sales to customers through our channel partners. Outside the United States, we sell our products and services primarily through indirect sales via our channel partners. Our international channel partners are located in Europe, the Middle East, Africa, Asia, and North and South America and are subject to local laws, regulations, and customs that may make it difficult to assess accurately the potential revenues that can be generated from a particular market. Our success depends upon our ability to attract and retain valuable channel partners and to accurately assess the size and vitality of the markets in which our products and services are sold. While we have implemented policies and procedures to achieve this, we cannot predict the extent to which we are able to attract and retain financially stable, motivated channel partners. Additionally, our channel partners may not be successful in marketing and selling our products and services. We may:

- fail to attract important and effective channel partners;
- fail to penetrate our targeted market segments through the use of channel partners; or
- lose any of our channel partners, as a result of competitive products and services offered by other companies, products and services developed internally by these channel partners, their financial insolvency or otherwise.

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

We have experienced employee turnover in our sales and operations personnel, our products and services have become increasingly complex, and our distribution channels are being developed and expanded. The rapid evolution of our markets and the increasing complexity of our products and services have placed, and is likely to continue to place, significant strains on our administrative, operational, and financial resources and increase demands on our internal systems, procedures, and controls that may impact our ability to grow our business.

Our success depends on our retention of key personnel.

Our performance depends substantially on the performance of our key technical, senior management, and sales and marketing personnel. We may lose the services of any of such persons. Despite current economic conditions, we experience intense competition for such personnel and are constantly exploring new avenues for attracting and retaining key personnel. However, we cannot ensure that we will successfully attract, assimilate, or retain highly qualified technical, managerial or sales and marketing personnel in the future.

Our failure to continue to expand into international markets could harm our business.

We intend to continue to expand our operations outside of the United States and enter additional international markets, primarily through the establishment of channel partner arrangements. As mentioned above, we have concentrated recently on developing more focused relationships with fewer key distributors. We expect to commit additional time and development resources to customizing our

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products and services for selected international markets and to developing international sales and support channels. We cannot ensure that such efforts will be successful.

We face certain difficulties and risks inherent in doing business internationally, including, but not limited to:

- costs of customizing products and services for international markets;
- dependence on independent resellers;
- multiple and conflicting regulations;
- exchange controls;
- longer payment cycles;
- unexpected changes in regulatory requirements;
- import and export restrictions and tariffs;
- difficulties in staffing and managing international operations;
- greater difficulty or delay in accounts receivable collections;
- potentially adverse tax consequences;
- compliance with a variety of laws outside the United States;
- the impact of possible recessionary environments in economies outside the United States;
- political and economic instability; and
- exposure to foreign currency fluctuations.

Our successful expansion into certain countries will require additional modification of our products and services, particularly national language support. Currently, the majority of our current export sales are denominated in U.S. dollars. To the extent that international sales continue to be denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to other currencies could make our products and services more expensive and, therefore, potentially less competitive in international markets. In certain European Union countries, however, we have introduced pricing in Euros. While we do maintain a foreign currency hedging program on accounts receivable, to the extent that future international sales are denominated in foreign currency, our operating results will be subject to risks associated with foreign currency fluctuation. Additionally, as we increase our international sales, seasonal fluctuations in revenue generation resulting from lower sales that typically occur during the summer months in Europe and other parts of the world may affect our total revenues.

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

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

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We cannot ensure that patents will issue from our pending applications or from any future applications or that, if issued, any claims allowed will be sufficiently broad to protect our technology. In addition, we cannot ensure that any patents that have been or may be issued will not be challenged, invalidated or circumvented, or that any rights granted by those patents would protect our proprietary rights. Failure of any patents to protect our technology may make it easier for our competitors to offer equivalent or superior technology.

We have sought also to protect our intellectual property through the use of copyright, trademark, and trade secret laws. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or services, or to obtain and use information that we regard as proprietary. Third parties may also independently develop similar technology without breach of our proprietary rights.

In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the United States. Furthermore, some of our products are licensed under end user license agreements (also known as shrinkwrap licenses) that are not signed by