CONCORD COMMUNICATIONS INC
Form 10-Q
May 10, 2005

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended March 31, 2005.**

**OR**

o **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: 0-23067**

**CONCORD COMMUNICATIONS, INC.**

**(Exact name of registrant as specified in its charter)**

| **Massachusetts** | **04-2710876** |
|---|---|
| (State of incorporation) | (IRS Employer Identification Number) |

**600 Nickerson Road**
**Marlborough, Massachusetts 01752**
**(508) 460-4646**
(Address and telephone of principal executive offices)

Indicate by check mark whether 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 þ NO o

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

YES þ NO o

18,854,398 shares of the registrant s common stock were outstanding as of May 5, 2005.

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**FORM 10-Q, March 31, 2005**

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## PART I: FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

### CONCORD COMMUNICATIONS, INC.

### CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
**(In thousands, except per share and share data)**

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 11,137 | $ 15,816 |
| Marketable securities | 57,763 | 143,639 |
| Restricted cash | 591 | 66 |
| Accounts receivable, net of allowance of $1,258 and $423 at March 31, 2005 and December 31, 2004, respectively | 23,333 | 24,183 |
| Deferred tax assets, net | 3,147 | 1,763 |
| Prepaid expenses and other current assets | 8,593 | 8,170 |
| Total current assets | 104,564 | 193,637 |
| Equipment and improvements, net | 10,365 | 6,226 |
| Goodwill | 88,123 | 6,225 |
| Other intangible assets, net | 22,891 | 2,191 |
| Deferred tax assets, net | 11,795 | 12,211 |
| Unamortized debt issuance costs and other long-term assets | 2,803 | 3,001 |
| Total assets | $ 240,541 | $ 223,491 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current Liabilities: | | |
| Accounts payable | $ 4,715 | $ 6,334 |
| Accrued expenses | 19,061 | 12,171 |
| Deferred revenue | 42,187 | 27,207 |
| Total current liabilities | 65,963 | 45,712 |
| Convertible senior notes | 86,250 | 86,250 |
| Other long term liabilities | 560 | |
| Total liabilities | 152,773 | 131,962 |
| Commitments and Contingencies (Note 4) | | |
| Stockholders Equity: | | |
| Common stock, $0.01 par value: | | |
| Authorized - 50,000,000 shares issued and outstanding 18,698,636 and 18,449,964 shares at March 31, 2005 and December 31, 2004, respectively | 187 | 184 |
| Additional paid-in capital | 119,453 | 117,113 |
| Deferred compensation | (1,939) | |

| | | |
|---|---|---|
| Accumulated other comprehensive loss | (802) | (427) |
| Accumulated deficit | (29,131) | (25,341) |
| Total stockholders equity | 87,768 | 91,529 |
| Total liabilities and stockholders equity | $ 240,541 | $ 223,491 |

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

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**CONCORD COMMUNICATIONS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**
**(In thousands, except per share and share data)**

| | Three Months Ended | |
|---|---|---|
| | March 31, 2005 | March 31, 2004 |
| Revenues: | | |
| License revenues | $ 11,570 | $ 10,350 |
| Service revenues | 17,541 | 13,495 |
| Total revenues | 29,111 | 23,845 |
| Costs of Revenues: | | |
| Cost of license revenues | 1,674 | 822 |
| Cost of service revenues | 5,077 | 3,949 |
| Total cost of revenues | 6,751 | 4,771 |
| Gross profit | 22,360 | 19,074 |
| Operating Expenses: | | |
| Research and development | 7,162 | 5,789 |
| Sales and marketing | 14,021 | 11,516 |
| General and administrative | 4,183 | 2,643 |
| Acquisition related charges | 100 | |
| Acquired in-process research and development | 1,400 | |
| Total operating expenses | 26,866 | 19,948 |
| Operating loss | (4,506) | (874) |
| Other Income: | | |
| Interest income | 673 | 1,089 |
| Interest expense | (817) | (823) |
| Other expense | (138) | (169) |
| Total other (loss) income, net | (282) | 97 |
| Loss before income taxes | (4,788) | (777) |
| Benefit for income taxes | (998) | (295) |
| Net loss | $ (3,790) | $ (482) |
| Net loss per common and potential common share: | | |
| Basic | $ (0.21) | $ (0.03) |
| Diluted | $ (0.21) | $ (0.03) |

| | | |
|---|---|---|
| Weighted average common and potential common shares outstanding: | | |
| Basic | 18,473,855 | 18,159,503 |
| Diluted | 18,473,855 | 18,159,503 |

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

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**CONCORD COMMUNICATIONS, INC.**

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

| | Three Months Ended March 31, 2005 | March 31, 2004 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net loss | $ (3,790) | $ (482) |
| Adjustments to reconcile net loss to net cash (used for) provided by operating activities: | | |
| Depreciation and amortization | 2,159 | 1,113 |
| Amortization of debt issuance costs | 171 | 176 |
| Realized investment losses (gains) | 110 | (12) |
| Write-off of in-process research and development | 1,400 | |
| Deferred income taxes provision | (1,127) | (285) |
| Changes in assets and liabilities, excluding effects of acquired business: | | |
| Accounts receivable | 6,000 | 2,574 |
| Prepaid expenses and other current assets | 160 | 210 |
| Other assets | 27 | (13) |
| Accounts payable | (3,784) | (2,678) |
| Accrued expenses | (5,642) | (2,000) |
| Deferred revenue | 3,070 | 2,961 |
| Other liabilities | 560 | |
| Net cash (used for) provided by operating activities | (686) | 1,564 |
| Cash Flows from Investing Activities: | | |
| Purchases of equipment and improvements | (1,241) | (776) |
| Purchases of marketable securities | (78,022) | (57,157) |
| Proceeds from maturities and sale of marketable securities | 163,247 | 17,204 |
| Acquisition of business, net of cash acquired | (88,340) | |
| Release of restricted cash | | 194 |
| Net cash used for investing activities | (4,356) | (40,535) |
| Cash Flows from Financing Activities: | | |
| Proceeds from issuance of common stock | 363 | 597 |
| Net cash provided by financing activities | 363 | 597 |
| Net decrease in cash and cash equivalents | (4,679) | (38,374) |
| Cash and cash equivalents, beginning of period | 15,816 | 69,436 |
| Cash and cash equivalents, end of period | $ 11,137 | $ 31,062 |

Supplemental Disclosure of Cash Flow Information:

| | | | | |
|---|---|---|---|---|
| Cash paid for income taxes | $ | 881 | $ | 206 |
| Supplemental Disclosure of Noncash Investing Transactions: | | | | |
| Unrealized (loss) gain on available-for-sale securities | $ | (605) | $ | 832 |

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

**CONCORD COMMUNICATIONS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***(a) Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared by Concord Communications, Inc. (the Company or Concord ) in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial statements and with the instructions to Form 10-Q and Regulation S-X pertaining to interim financial statements. Accordingly, these interim financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements reflect all adjustments and accruals of a normal recurring nature, which management considers necessary for a fair presentation of the Company s financial position as of March 31, 2005 and December 31, 2004, and the Company s results of operations for the three months ended March 31, 2005 and 2004. The results for the interim periods presented are not necessarily indicative of results to be expected for any future period. The financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s 2004 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC ) on March 16, 2005.

***(b) Financial Instruments, Concentration of Credit Risk and Significant Customers***

The Company maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area. No individual customer accounted for more than 10% of revenues for either the three months ended March 31, 2005 or 2004. No individual customer accounted for more than 10% of the Company s accounts receivable at March 31, 2005 and one North American telecommunications customer accounted for approximately 16% of accounts receivable at December 31, 2004.

***(c) Derivative Financial Instruments***

The Company uses forward contracts to reduce its exposure to foreign currency risk and variability in operating results due to fluctuations in exchange rates underlying the value of accounts receivable denominated in foreign currencies until such receivables are collected. A forward contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates. These foreign currency forward exchange contracts are denominated in the same currency in which the underlying foreign currency receivables are denominated and bear a contract value and maturity date that approximate the value and expected settlement date, respectively, of the underlying transactions. For contracts that are designated and effective as hedges, unrealized gains and losses on open contracts at the end of each accounting period, resulting from changes in the fair value of these contracts, are recognized in earnings in the same period as gains and losses on the underlying foreign denominated receivables are recognized and generally offset. Gains and losses on forward contracts and foreign denominated receivables are included in other income (expense), net. The Company does not enter into or hold derivatives for trading or speculative purposes and only enters into contracts with highly rated financial institutions. At March 31, 2005 the Company did not have any forward contracts outstanding, gains and losses on such contracts were not material for any period presented.

***(d) Stock-Based Compensation***

The Company accounts for employee stock-based compensation arrangements under the provisions of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation,* permits the use of either a fair-value based method or the intrinsic value method under APB No. 25

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to account for employee stock-based compensation arrangements. Companies that elect to use the intrinsic value method provided in APB No. 25 are required to disclose the pro forma net income (loss) and net income (loss) per share that would have resulted from the use of the fair value method. The Company has provided, below, the pro forma disclosures of the effect on net income (loss) and net income (loss) per share as if SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment to FASB Statement No. 123,* had been applied in measuring compensation expense for all periods presented.

| | Three Months Ended | |
|---|---|---|
| | March 31, 2005 | March 31, 2004 |
| Net loss: | | |
| As reported | $ (3,790) | $ (482) |
| Add: | | |
| Stock-based employee compensation expense included in reported net loss, net of related taxes | 33 | |
| Less: | | |
| Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects | (1,428) | (1,979) |
| Pro forma net loss | $ (5,185) | $ (2,461) |
| Basic net loss per share: | | |
| As reported | $ (0.21) | $ (0.03) |
| Pro forma | $ (0.28) | $ (0.14) |
| Diluted net loss per share: | | |
| As reported | $ (0.21) | $ (0.03) |
| Pro forma | $ (0.28) | $ (0.14) |

***(e) Restricted Stock***

In February 2005, the Board of Directors approved a stock-based award to certain key employees of Aprisma Holding, Inc., a company acquired by the Company (Note 8). These awards consisted of a grant of restricted stock which vests over four years. The restricted shares are forfeited by the employee upon termination of employment with the Company. Upon the grant of the restricted stock, deferred compensation for the fair market value of the stock on the date granted was recorded as a separate component of stockholders equity and subsequently amortized as compensation expense over the vesting period. Amortization expense for the three months ended March 31, 2005 was $0.04 million.

***(f) Restricted Cash***

Restricted cash totaling $0.6 and $0.07 million at March 31, 2005 and December 31, 2004, respectively, consists of money market funds held in the Company s name with a major financial institution and treasury bills. Such funds are being used as collateral under letter of credit arrangements required by the landlord for leases that terminate in 2007 and 2008.

***(g) Reclassifications***

Certain amounts in the 2004 condensed consolidated financial statements have been reclassified to conform to the 2005 presentation.

**2. GOODWILL AND OTHER INTANGIBLE ASSETS**

The Company s goodwill resulted from the acquisition of netViz Corporation ( netViz ) on July 17, 2003, Vitel Software, Inc. ( Vitel ) on January 5, 2005 (see Note 8) and Aprisma Holdings, Inc. ( Aprisma ) on February 22, 2005 (see Note 8). The changes in the carrying amount of goodwill, by reportable segment (see Note 7), for the three months ended March 31, 2005 and 2004 are as follows (in thousands):

| | Concord | Spectrum | Total |
|---|---|---|---|
| Balance as of December 31, 2004 | 6,225 | | 6,225 |
| Goodwill acquired due to Aprisma acquisition | | 77,947 | 77,947 |
| Goodwill acquired due to Vitel acquisition | 3,951 | | 3,951 |
| Balance as of March 31, 2005 | $ 10,176 | $ 77,947 | $ 88,123 |

There were no changes in the carrying amount of goodwill during the three months ended March 31, 2004.

Goodwill is tested for impairment on June 30th of each year and whenever changes in circumstances indicate goodwill could be impaired. As of June 30, 2004, the Company performed its annual test for impairment on the carrying value of goodwill related to netViz, on its existing reporting units. The Company compared the fair value of each reporting unit to which goodwill has been allocated to its book value and determined that no impairment existed at that date. The carrying value of goodwill resulting from the netViz, Vitel (see Note 9) and Aprisma (see Note 9) acquisitions will be tested for impairment at June 30, 2005.

Other intangible assets as of March 31, 2005 and December 31, 2004 consist of the following (in thousands):

| | March 31, 2005 | | | December 31, 2004 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Completed technology (software) | $ 3,730 | $ (997) | $ 2,733 | $ 2,130 | $ (799) | $ 1,331 |
| Core technology (software) | 7,530 | (173) | 7,357 | | | |
| Reseller relationships | 5,240 | (309) | 4,931 | 570 | (171) | 399 |
| Maintenance relationships | 5,830 | (220) | 5,610 | 340 | (102) | 238 |
| Subscription relationships | 860 | (17) | 843 | | | |
| Non-compete agreements | 210 | (5) | 205 | | | |
| Backlog | 399 | (346) | 53 | | | |
| Contractor agreements | 300 | (131) | 169 | 300 | (112) | 188 |
| Trade name/trademark | 1,050 | (60) | 990 | 70 | (35) | 35 |
| Total | $ 25,149 | $ (2,258) | $ 22,891 | $ 3,410 | $ (1,219) | $ 2,191 |

Aggregate amortization expense for the three months ended March 31, 2005 and 2004 was $1.0 million and $0.2 million, respectively. For the three months ended March 31, 2005, approximately 69% of the aggregate expense was included in costs of revenues and the remainder was included in operating expenses.

### 3. IN-PROCESS RESEARCH AND DEVELOPMENT

On February 22, 2005 the Company acquired Aprisma Holdings Inc, (See Note 8). Based upon the status of ongoing research and development ( R&D ) efforts related to Aprisma and a review of the typical technology development cycle and standards for establishing technological feasibility of products, the Company identified SPECTRUM Version 8.0 as a project which represents development efforts in areas where the technologically feasibility has not yet been established. The SPECTRUM Version 8.0 project is a major release to the existing Aprisma product, which includes various architectural changes, such as removal of the dependency to link product on-site and the addition of Linux support. Since this in-process technology is being developed for highly specific

applications, the Company believes that there is no alternate future use for the in-process technology beyond the stated purpose of the specific R&D project. Given the riskier nature of the cash flows related to the in-process R&D, the level of completion of the project and its perceived risk, a discount rate of 40% was applied to value the in-process R&D. The in-process R&D of $1.4 million was expensed during the three months ended March 31, 2005, since it was determined that it had not reached technological feasibility and had no alternative future use.

Technological feasibility is established when either of two sets of criteria is met:

a) the detail program design has been completed, documented, and traced to product specifications and its high-risk development issues have been resolved; or

b) a working model of the product has been finished and determined to be complete and consistent with the product design.

Upon the acquisition, Aprisma did not have a completed product design or working model for the SPECTRUM Version 8.0.

The detailed program design for the integration of Aprisma s technology into the Concord *e*Health® Suite of products has not been completed as of March 31, 2005; thus, the exact costs and efforts required for completion of this integration have not been determined. Based on management s initial estimates, an integrated product based on Aprisma s technology will be introduced in the next year at an estimated cost to complete of $1.1 million. However, as with any major software development project, the timing of actual introduction may vary. Failure to successfully market and sell the integrated product may adversely impact the Company s business.

## 4. COMMITMENTS AND CONTINGENCIES

*(a) Indemnifications*

As permitted under Massachusetts law, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was serving, at the Company s request in such capacity. The term of the indemnification period is for the officer or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a Director and Officer insurance policy pursuant to which the Company may recover all or a portion of amounts it pays to directors or officers under their indemnification agreements. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal.

The Company warrants that its software products will perform in all material respects in accordance with its standard published specifications in effect at the time of delivery of the licensed products to the customer for a period of 90 days. Additionally, the Company warrants that its maintenance services will be performed consistent with its maintenance policy in effect at the time those services are delivered. The Company believes its maintenance policy is consistent with generally accepted industry standards. If necessary, the Company would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history; however, the Company has never incurred significant expense under product or services warranties. As a result, the Company believes the estimated liability of these warranties is minimal.

The Company enters into standard indemnification agreements in the ordinary course of its business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally its business partners or customers, in connection with any patent, copyright, trademark, trade secret or other intellectual property infringement claim by any third party with respect to the Company s products. The term of these indemnification agreements is generally perpetual. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is often capped at a dollar figure. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated liability of these agreements is minimal.

When, as part of an acquisition, the Company acquires all of the stock or all or a portion of the assets and/or liabilities of a company, it may assume liability for certain events or occurrences that took place prior to the date of acquisition. The maximum potential amount of future payments it could be required to make for such obligations is undeterminable at this time. The Company has no liabilities recorded for these exposures as of March 31, 2005.

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*(b) Legal Proceedings*

On April 30, 2004, the Company received a letter from LMS Technology Distributions SDN BHD ( LMS ) of Malaysia that demands that the Company reimburse LMS for approximately $4.65 million in alleged losses arising out of the Company s purported wrongful termination of a Concord Authorized Reseller Agreement (the CAR Agreement ) with LMS. The Company disputes that the CAR Agreement was wrongfully terminated or that LMS is owed any of the amounts claimed, and the Company intends to defend vigorously against the demand. It is not possible to predict or determine the outcome of these demands or to provide ranges of losses that may arise, if any.

In November 2003, Concord received notice from a former sales employee in France, stating that he was wrongfully dismissed in July 2003. The former employee filed a wrongful termination lawsuit against Concord claiming approximately $0.4 million in damages. In January 2005, the Labor Court of Poissy issued its decision on the former employee s unfair dismissal and failure to pay commissions claims. The Court found that the Company did not fulfill our obligations as required by French law and awarded the former employee approximately $12,000. This payment was made by Concord in the three months ended March 31, 2005.

On December 6, 2002, Aprisma filed a complaint for patent infringement against Micromuse, Inc. in the U. S. District Court for the District of New Hampshire. This case remains pending, with a trial presently unscheduled. This case involves Aprisma s claim that Micromuse s systems management products, including NetcoolÓ products such as Netcool/OMNIbus, Impact and Precision infringe the following U.S. Patents: 5,436,909; 5,504,921; 5,777,549; 5,696,486; 5,768,501; and 6,064,304. Aprisma seeks injunctive relief and damages based on Micromuse s infringement. Micromuse has denied infringement, and has alleged that the asserted patents are invalid and are unenforceable. On January 11, 2005, following a two-day hearing, the Court issued a Memorandum and Order in which it adopted the proposed claim construction of the seven disputed claim terms at issue offered by Aprisma. Based on the Court s claim construction ruling, the parties filed summary judgment motions on the issue of infringement, for which they are awaiting a hearing.

On January 26, 2005, Aprisma was named as a defendant in litigation filed in the Southern District of New York alleging patent infringement of various U.S. patents allegedly owned by Micromuse. This case remains pending, with a trial presently unscheduled. This case involves Micromuse s claim that Aprisma s SNMP support products, the SPECTRUM Assurance Server, the SPECTRUM Alarm Monitor, Gateways and MPLS Manager products infringe the following U.S. Patents: 6,192,034; 6,219,648; 6,330,598; 6,687,335; 6,763,333; 5,936,547; and 6,766,375. Micromuse seeks declaratory, injunctive relief and damages for Aprisma s alleged infringement. On March 8, 2005, Aprisma filed a Motion to Dismiss or Transfer the Complaint to the District of New Hampshire. This Motion remains pending.

Based upon the circumstances in both of the Micromuse legal proceedings, an outcome cannot be reasonably predicted. Concord believes the allegations in the suit against Concord are without merit and intends to vigorously defend against them. Accordingly, no adjustment has been made in purchase accounting for a contingent settlement related to these legal proceedings. See Note 8 for a discussion of future accounting for these items.

**5. NET LOSS PER SHARE**

The Company computes earnings per share following the provisions of SFAS No. 128, *Earnings per Share*. Basic and diluted net loss per share is computed using the weighted-average number of common shares outstanding for a period.

Calculations of the basic and diluted net loss per common share is as follows:

| | Three Months Ended | |
|---|---|---|
| | March 31, 2005 | March 31, 2004 |
| Net loss applicable to common stockholders | $ (3,790) | $ (482) |
| Weighted average common shares outstanding | 18,473,855 | 18,159,503 |
| Basic and diluted net loss per common share | $ (0.21) | $ (0.03) |

For the three months ended March 31, 2005 and 2004, diluted weighted average shares outstanding does not include 2,153,443 and 1,629,989 potential common shares, respectively, as their effect would have been anti-dilutive.

The Emerging Issues Task Force (EITF) has issued a final consensus on Issue 04-08, *Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share,* which requires that convertible securities must be included in the dilutive earnings per share calculation, if dilutive, regardless of whether the market price trigger has been met. The Company s Convertible Senior Notes fall within the scope of EITF 04-08. In the three months ended December 31, 2004, the Company adopted the provisions of EITF 04-08 retroactively for previously reported earnings per share calculations. For the periods ended March 31, 2005 and 2004, common stock reserved for issuance upon conversion of approximately 3,209,776 shares was not included in diluted earnings per share because the effect of their inclusion would have been anti-dilutive.

**6. COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) is defined as the change in net assets of the Company during a period from transactions generated from non-owner sources. The only components of comprehensive income (loss) reported by the Company are net income (loss) and unrealized gains (losses) on available for sale securities.

Comprehensive income (loss) for the three months ended March 31, 2005 and 2004 is as follows:

| | Three Months Ended | |
|---|---|---|
| | March 31, 2005 | March 31, 2004 |
| Net loss | $ (3,790) | $ (482) |
| Unrealized (loss) gain on marketable securities, net of tax | (375) | 543 |
| Comprehensive (loss) income | $ (4,165) | $ 61 |

**7. SEGMENT REPORTING AND INTERNATIONAL INFORMATION**

The Company follows the provisions of SFAS No. 131*, Disclosures about Segments of an Enterprise and Related Information*. SFAS No. 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports

issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate, discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions on how to allocate resources and assess performance. The Company s chief decision-making group, as defined under SFAS No. 131, is the executive management committee, which is comprised of the executive officers of the Company.

The following table presents the approximate revenues by major geographical regions:

| | Three Months Ended March 31, 2005 | March 31, 2004 |
|---|---|---|
| United States | $ 16,672 | $ 14,342 |
| United Kingdom | 3,453 | 1,649 |
| Germany | 1,819 | 2,257 |
| Europe (excluding the U.K. and Germany) | 2,610 | 2,286 |
| Rest of the World | 4,557 | 3,311 |
| Total | $ 29,111 | $ 23,845 |

For the three months ended March 31, 2005, two countries, the United States and United Kingdom, accounted for greater than 10% of total revenues. For the three months ended March 31, 2004, no one country, except the United States, accounted for greater than 10% of total revenues. Substantially all of the Company s assets are located in the United States.

Following the acquisition of Aprisma, since then renamed Spectrum Business Unit, in February 2005, Concord now has two segments: Concord, which includes the revenue generated by Concord s core product, the eHealth Suite of software, which includes Vitel and netViz products, and Spectrum, which includes the revenues of Spectrum products. The Spectrum products manage the availability of IT infrastructures and the business services that rely on them. The operating results for the reportable segments for the three months ended March 31, 2005 were as follows:

| | March 31, 2005 | | | March 31, 2004 | | |
|---|---|---|---|---|---|---|
| | Concord | Spectrum | Total | Concord | Spectrum | Total |
| Revenues: | | | | | | |
| License revenues | $ 9,605 | $ 1,965 | $ 11,570 | $ 10,350 | | $ 10,350 |
| Service revenues | 14,966 | 2,575 | 17,541 | $ 13,495 | | $ 13,495 |
| Total revenues | 24,571 | 4,540 | 29,111 | $ 23,845 | | $ 23,845 |
| Costs of Revenues: | | | | | | |
| Cost of license revenues. | 978 | 696 | 1,674 | $ 822 | | $ 822 |
| Cost of service revenues. | 4,701 | 376 | 5,077 | $ 3,949 | | $ 3,949 |
| Total cost of revenues | 5,679 | 1,072 | 6,751 | $ 4,771 | | $ 4,771 |
| Gross profit | $ 18,892 | $ 3,468 | $ 22,360 | $ 19,074 | | $ 19,074 |

The results for the Spectrum segment for the three months ended March 31, 2005 include the results of operations for the period from the date of acquisition of Aprisma, February 22, 2005, through March 31, 2005. Prior to the acquisition of Aprisma, Concord s reportable segments were determined by customer type, which now makes up the current Concord segment. The accounting policies of the segments are the same as those for the Company on a

consolidated basis. The executive management committee evaluates segment performance based on gross profit. Accordingly, all operating expenses are considered corporate level activities and are not allocated to segments. Also, the executive management committee does not assign assets to these segments.

The Company currently does not provide revenues by product or product family, as it is impractical due to the nature of its single suite of products. Some components of the suite could be included in more than one product family. In addition, categorization and classification of the Company s components into product families is changing in nature; changes in packaging, licensing and product categorization occur on a frequent basis.

**8. ACQUISITIONS**

***(a) Acquisition of Vitel Software, Incorporated***

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On January 5, 2005, Concord acquired 100% of the common stock of privately-held Vitel Software, Incorporated ( Vitel ), a provider of voice network performance management solutions. Vitel technology enables enterprises and service providers to manage the performance of next-generation IP and legacy voice networks and messaging systems, including voice mail, from multiple vendors. The purchase of Vitel will position Concord to deliver innovative solutions to customers before, during, and after their migration to an IP-based voice network. This strategic acquisition will enable Concord to proactively manage voice network performance across multiple vendors, applications, and technologies.

Consideration for the acquisition totaled $4.0 million of cash purchase price and transaction costs of $0.1 million. The acquisition was accounted for using the purchase method of accounting and the results of operations of the acquired business since the date of acquisition were included in the financial statements of the Company for the three month period ended March 31, 2005. The total purchase consideration was allocated to the assets and liabilities assumed at their estimated fair values on the date of acquisition, as determined by management, and with respect to identifiable intangible assets by management with the assistance of an appraisal provided by a third-party valuation firm. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed has been recorded as goodwill. In accordance with current accounting standards, the goodwill will not be amortized and will be tested for impairment annually as required by SFAS 142.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

| | | **(In thousands)** |
|---|---|---|
| Total consideration: | | |
| Cash | $ | 4,000 |
| Transaction costs | | 125 |
| Total purchase consideration | $ | 4,125 |
| Allocation of the purchase consideration | | |
| Current assets, including cash of $35 | $ | 148 |
| Fixed assets | | 7 |
| Net deferred tax asset | | 79 |
| Identifiable intangible assets | | 790 |
| Goodwill | | 3,951 |
| Total assets acquired | | 4,975 |
| Less: fair value of liabilities assumed | | 850 |
| | $ | 4,125 |

The following are identified intangible assets acquired and the respective estimated periods over which the assets will be amortized:

| | **Amount** | **Amortization Period** |
|---|---|---|

| | (In thousands) | (In years) |
|---|---|---|
| Completed technology (software) | $ 320 | 5 |
| Maintenance relationships | 400 | 6 |
| Reseller relationships | 70 | 5 |
| Total | $ 790 | |

The completed technology (software), reseller relationships and maintenance relationships are being amortized at the greater of (a) the ratio that current revenues bear to the total of current and anticipated future revenues or (b) the straight-line method over their respective remaining useful lives. For the three months ended March 31, 2005, the identifiable intangible assets have been amortized using the straight-line method over their respective remaining useful lives. The values of the completed technology (software), reseller relationships, and maintenance relationships were determined using the income approach. The income approach requires a projection of revenues and expenses specifically attributed to the intangible assets. The discounted cash flow ( DCF ) method is then applied to the potential income streams after making necessary adjustments with respect to such factors as the wasting nature of the identifiable intangible assets and the allowance of a fair return on the net tangible assets and

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other intangible assets employed. There are several variations on the income approach, including the relief-from-royalty method, the avoided cost method, and the lost profits method.

The relief-from-royalty method was used to value the completed technology. The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the completed technology are as follows: royalty rate 5%, discount rate 18.5%, tax rate 40% and estimated average economic life of 5 years.

The maintenance relationships were valued using the income approach without variation. The key assumptions used in valuing the maintenance relationships are as follows: discount rate 18.5%, tax rate 40% and estimated average economic life of 6 years.

The avoided cost method was used to value the reseller relationship. The avoided cost method considers the concept of avoided cost as an indicator of value. The avoided cost method is appropriate for estimating the fair value of an asset where reliable data for sales of comparable property are not available and where the property does not directly produce an income stream. The key assumptions used in valuing the reseller relationships are as follows: tax rate 40% and estimated average economic life of 5 years.

***(b) Acquisition of Aprisma Holdings, Inc.***

On February 22, 2005, the Company acquired privately held Aprisma Holdings Inc. ( Aprisma ). Aprisma s software provides business service intelligence and manages the availability of IT infrastructures and business services that rely upon them. Strategically combining the two companies complementary technologies will enable Concord to expand its ability to deliver a new generation of intelligent software that maps IT services to business processes, measures the actual end-user experience and manages the entire IT infrastructure. With its acquisition of Aprisma, Concord expects to significantly extend its ability to address this market by augmenting its product suite with proven fault management and sophisticated service modeling technologies.

Consideration for the acquisition totaled $82.4 million of cash purchase price, transaction costs of $2.2 million and payments of $2.8 million under Aprisma s Equity Participation Plan ( EPP ). The acquisition was accounted for using the purchase method of accounting and the results of operations of the acquired business since the date of acquisition were included in the financial statements of the Company for the three month period ended March 31, 2005. The total purchase consideration was allocated to the assets and liabilities assumed at their estimated fair values on the date of acquisition, as determined by management and, with respect to identifiable intangible assets, an appraisal provided by a third party valuation firm. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed has been recorded as goodwill. In accordance with current accounting standards, the goodwill will not be amortized and will be tested for impairment annually as required by SFAS 142.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

| | | **(In thousands)** |
|---|---|---|
| Purchase Price: | | |
| Cash | $ | 82,350 |

| | | |
|---|---|---|
| Equity Participation Plan payments | | 2,846 |
| Transaction costs paid | | 1,941 |
| Transaction costs accrued | | 269 |
| Total purchase price | $ | 87,406 |
| Allocation of purchase price | | |
| Fair value of tangible assets acquired, excluding fixed assets | $ | 6,549 |

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| | | (In thousands) |
|---|---|---|
| Fixed assets at fair value | | 3,970 |
| Identifiable intangible assets | | 20,949 |
| In-process research and development (Note 3) | | 1,400 |
| Goodwill | | 77,947 |
| Total assets acquired | | 110,815 |
| Less: Fair value of liabilities assumed, including deferred revenue of $11,592 | | 23,409 |
| | $ | 87,406 |

The following are identified intangible assets acquired and the respective estimated periods over which the assets will be amortized:

| | | Amount (In thousands) | Amortization Period (In years) |
|---|---|---|---|
| Core Technology | $ | 7,530 | 5 |
| Completed Technology | | 1,280 | 3 |
| Direct Maintenance Customer Relationships | | 5,090 | 7 |
| Direct Subscription Customer Relationships | | 860 | 6 |
| Reseller Agreements | | 4,600 | 5 |
| Product Name/Trademark | | 980 | 6 |
| Non-Competition Agreements | | 210 | 5 |
| Backlog | | 399 | |
| Total | $ | 20,949 | |

The core technology, completed technology (software), maintenance and subscription relationships, and reseller relationships will be amortized at the greater of (a) the ratio that current revenues bear to the total of current and anticipated future revenues or (b) the straight-line method over their respective remaining useful lives. For the three months ended March 31, 2005, the identifiable intangible assets have been amortized using the straight-line method over their respective remaining lives. The product name/trademarks and the non compete agreements will be amortized on a straight line basis over their respective remaining useful lives.

The values of the core technology, completed technology (software), maintenance and subscription relationships, reseller relationships, product name/trademark and non-compete agreements were determined using the income approach.

The relief-from-royalty method was used to value the product name/trademark. The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the product trade name/trademark are as

follows: royalty rate 1%, discount rate 18.5%, tax rate 40% and estimated average economic life of 6 years.

The core technology, completed technology and subscription and maintenance relationships were valued using the income approach without variation. The key assumptions used in valuing the core technology, completed technology and subscription and maintenance relationships are as follows: discount rate 18.5%, tax rate 40% and estimated average economic life of 5, 3, 7 and 6 years for core technology, completed technology, subscription relationships and maintenance relationships, respectively.

The avoided cost method was used to value the reseller relationship. The avoided cost method considers the concept of avoided cost as an indicator of value. The avoided cost method is appropriate for estimating the fair value of an asset where reliable data for sales of comparable property are not available and where the property does not

directly produce an income stream. The key assumptions used in valuing the reseller relationships are as follows: tax rate 40% and estimated average economic life of 5 years.

The lost profits method was used to value the non-compete agreements of four employees valued as a group. The lost profits method recognizes that the current value of an asset may be premised upon the expected receipt of future economic benefits protected by clauses within an agreement. These benefits are generally considered to be higher income resulting from the avoidance of a loss in revenue that would likely occur without an agreement. The key assumptions used in valuing the non-compete agreements are as follows: discount rate 18.5%, tax rate 40% and estimated average economic life of 5 years.

The portion of the purchase price allocated to in-process research and development in the Aprisma acquisition was $1.4 million. At the date of acquisition, Aprisma s in-process research and development project SPECTRUM Version 8.0 had not reached technological feasibility and had no alternative use (see Note 3).

Backlog represents an Aprisma customization project for which the work had not commenced at the date of acquisition. During the period from the date of acquisition to March 31, 2005 the work was completed, product revenue was recognized and all of the intangible related to product revenue was amortized in cost of revenue. The remaining balance of the backlog intangible at March 31, 2005 of $53,000 will be amortized ratably as the related maintenance revenue is recognized.

Aprisma s Equity Participation Plan ( EPP ) was an incentive compensation plan set up for certain directors, officers and employees; under the plan, participants receive cash compensation if Aprisma is sold. Three equal payments are to be made to the participants: at the acquisition date, six months after the acquisition date and one year after the acquisition date. The $2.8 million reflects the portion immediately due and is without regard to future employment; accordingly, such amount is reflected as a component of the acquisition purchase price. The second and third payments, amounting to $6.1 million, are payable to the participants if they remain employed with the acquirer at each anniversary date or if they are terminated without cause by the acquirer prior to the anniversary dates. If the participants terminate their employment with the acquirer or are terminated with cause prior to the anniversary dates, then the payments are made to the original owners of Aprisma. With regard to the second and third payments, one person was identified by Concord for termination at the time of the acquisition. This person s second and third payments, totaling $0.6 million, have been recorded as a liability at the acquisition date. The remaining payments, amounting to $5.5 million, will be recorded as compensation expense over the service period by Concord, assuming the employment conditions, as described above, are met. If the participants terminate their employment or Concord terminates them with cause, such that the payments are made to the original owners of Aprisma, then, these payments will be recorded as additional purchase consideration for which goodwill would be increased. It is assumed that the majority of the transaction costs will not be deductible for tax purposes. However, the EPP will be deductible for tax purposes, with the exception of compensation for an Aprisma officer which will exceed the Section 162 (m) limitation of $1.0 million.

Prior to the acquisition of Aprisma by Concord, Aprisma filed a complaint for patent infringement against Micromuse, Inc. On the date of acquisition this case was pending. This case involves Aprisma s claim that Micromuse s systems management products, infringe upon certain of their patents. Micromuse has denied infringement, and has alleged that the asserted Aprisma patents are invalid and are unenforceable. Prior to the acquisition of Aprisma by Concord, Aprisma was named as a defendant in litigation alleging patent infringement of various U.S. patents allegedly owned by Micromuse. This case was pending at the date of acquisition. This case involves Micromuse s claim that certain Aprisma products infringe on certain of their patents. Concord believes the allegations in this suit are without merit and will vigorously defend against them. Based upon the circumstances in both of these legal proceedings, an outcome cannot be reasonably predicted. Concord believes the allegations in the suit against Concord are without merit and intends to vigorously defend against them. Accordingly, no adjustment has been made in

purchase accounting for a contingent settlement related to these legal proceedings. If these legal proceedings are resolved and settled before February 22, 2006, the settlement will be recorded as an adjustment to goodwill. Should the legal proceedings be resolved and settled after February 22, 2006 the settlement will be included in the determination of net income or loss in the period in which the settlement is determined.

The following table reflects unaudited pro forma results of operations of the Company for the three months ended March 31, 2005 and March 31, 2004 assuming that the Aprisma acquisition had occurred on January 1, 2005 and January 1, 2004, respectively (in thousands, except per share data):

| | Three Months Ended | |
|---|---|---|
| | March 31, 2005 | March 31, 2004 |
| Revenues | $ 34,871 | $ 34,105 |
| Net loss | (2,847) | (1,286) |
| Net loss per diluted share | $ (0.15) | $ (0.07) |

## 9. ACCRUED SEVERANCE AND LEASE RESTRUCTURING CHARGES

Upon the purchase of Aprisma (see Note 8), the Company assumed certain liabilities at the fair value for abandoned facilities in South Wales, Australia; Herndon, Virginia; and Portsmouth, New Hampshire. The present value of the remaining lease obligations for these locations, less estimated sublease income totaled $2.7 million at March 31, 2005 and were for leases that expire at various dates through 2012. In the period from February 22, 2005, the date of acquisition, through March 31, 2005 rent and related expense payments and sublease income received were charged against the lease restructuring accrual.

The Company may record additional adjustments or charges in the future due to changes in estimates and the volatility of the real estate markets in which the Company s facilities are located. As of March 31, 2005 the Company does not expect future charges related to lease obligations and restoration costs, excluding estimated sublease income, to exceed approximately $4.9 million, the maximum undiscounted remaining unaccrued obligation under existing contractual lease terms.

As a result of restructuring actions taken in connection with the Aprisma acquisition, $1.1 million of merger related costs associated with the severance of approximately 11 Aprisma employees was accrued in purchase accounting. The Company expects that all of the severance and related costs will be paid out by March 31, 2006. For the period from February 22, 2005, the date of acquisition, through March 31, 2005 approximately $0.4 million in payments were charged against the severance accrual.

## 10. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued a revision to SFAS No. 123, SFAS 123R *Share-Based Payment.* SFAS No. 123R requires all companies to measure compensation costs for all share-based payments, including stock options, at fair value and expense such payments over the service period. SFAS No. 123R specifies that companies must use an option-pricing model to estimate fair value, although it does not specifically require the use of a particular model. The FASB announced that it would permit registrants additional

time to implement the requirements of SFAS No. 123R. The FASB will permit companies to implement SFAS 123R for fiscal years beginning after June 15, 2005, and therefore, will be effective for the Company beginning with the first quarter of 2006. Under the provisions of FAS 123R, companies can select from three transition methods for the implementation of this standard. The modified prospective method would require all new awards that are granted after the effective date to use the provisions of FAS 123R. Under this method, for vested awards that are outstanding on the effective date of FAS 123R, a company would not have to record any additional compensation expense. For unvested awards that are outstanding on the effective date of FAS 123R and were previously included as part of pro forma net income and earnings per share under the provisions of FAS 123 would be charged to expense over the remaining vesting period, without any changes in measurement. The second alternative is a variation of the modified prospective method, which would allow companies to restate earlier interim periods in the year that FAS 123R is adopted using the applicable FAS 123 pro forma amounts. Under the third alternative, the modified retrospective method, companies would apply the modified prospective method and also restate their prior financial statements to include the amounts that were previously recognized in their pro forma disclosures under the original provisions of FAS 123. Currently, the Company discloses the estimated effect on net income of these share-based payments in the footnotes to the financial statements and the estimated fair value of the share-based payments has historically been determined using the Black-Scholes pricing model. The Company has not determined which option-pricing model or transition method to use upon implementation of this standard and has not yet completed its evaluation of the impact of SFAS No. 123R, but expects the adoption to have a material effect on its consolidated financial statements.

The FASB has issued two FASB Staff Positions (FSP) that provide accounting guidance on how companies should account for the effects of the American Jobs Creation Act of 2004 that was signed into law on October 22, 2004. The American Jobs Creation Act of 2004 allows for temporary dividend deductions equal to 85% of cash dividends received during the tax year from controlled foreign corporations and invested in the United States. The result of this legislation could affect how companies report their deferred income tax balances. The first FSP is FSP SFAS 109-1 and concludes that the tax relief from this legislation should be accounted for as a special deduction instead of a tax rate reduction. The second FSP is FSP SFAS 109-2 and gives a company additional time to evaluate the effects of the legislation on any plan for reinvestment or repatriation of foreign earning for purposes of applying FASB Statement No. 109, Accounting for Income Taxes. The Company has not yet completed its evaluation of the provisions of the American Jobs Creation Act of 2004. The repatriation of foreign earnings would not have a material effect on the Company s consolidated financial statements. The Company does not anticipate the repatriation of foreign earnings to the United States in the future.

**11. SUBSEQUENT EVENT**

On April 7, 2005, the Company announced that Computer Associates International, Inc. ( Computer Associates ), Minuteman Acquisition Corp., a wholly owned subsidiary of Computer Associates ( Merger Sub ) and Concord entered into an Agreement and Plan of Merger (the Merger Agreement ) under which Merger Sub will merge with and into Concord, with Concord as the surviving corporation (the Merger ). As a result of the Merger, Concord will become a wholly owned subsidiary of Computer Associates.

Pursuant to the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of common stock of Concord will be converted into the right to receive $17.00 in cash, without interest. Additionally, at the effective time of the Merger, each outstanding option to purchase common stock of Concord, whether vested or unvested, will be assumed by Computer Associates and become an option to acquire shares of common stock of Computer Associates, on the terms and conditions set forth in the Merger Agreement.

The Merger Agreement has been approved by Concord s Board of Directors, and the transactions contemplated by the Merger Agreement are subject to, among other things, adoptions of the Merger Agreement by Concord s shareholders, the termination or expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements

Act of 1976, as amended, and other customary closing conditions. The Merger is anticipated to be consummated in the second or third quarter of 2005.

A contingent termination fee of $11.5 million plus reimbursement of up to $0.5 million of Computer Associates expenses related to the transaction is payable by the Company to Computer Associates in the event that the Merger Agreement is terminated as a result of certain events as detailed in the Merger Agreement.

**CONCORD COMMUNICATIONS, INC.**
**FORM 10-Q, March 31, 2005**

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

## OVERVIEW

We are a software company that provides a solution to enterprise customers, managed service providers and telecommunication carriers. We serve the Business Service Management ( BSM ) market with our suite of solutions. The *e*Health® Suite of products, which maps IT services to business needs, measures the actual end user experience and manages application, system and network infrastructure by simplifying the management of the underlying technology and infrastructure required to deliver business services. Our SPECTRUM® software manages the availability of IT infrastructures and the business services that rely on them. Our *Vitel IVIZE*® solution enables enterprises and service providers to manage the performance of next-generation IP and legacy voice networks and messaging systems, including voice mail, from multiple vendors. Our n***etViz***® solution enables users to visualize business processes and allows them to map relationships within the supporting technology infrastructure through data-driven icons.

We sell our products worldwide through a direct sales force, channel partners, and other resellers. We have sales employees in nineteen countries, including the United States and we have customers in 63 countries.

Our products are generally sold on a perpetual license basis. On an initial purchase, customers will usually buy a license to our *e*Health® Console and a certain number of software elements, which is dependent on the number of components of the IT services to be managed. As a customer s IT services management requirements expands, they will order additional modules and elements. We believe that our significant installed base provides an opportunity to sell additional software elements and other products to our existing customer accounts. Most of our customers purchase maintenance upon the initial licensing of our software. In addition, the majority of these customers renew their maintenance agreements annually. For an annual maintenance fee, a customer receives telephone, email and web-based support, as well as updated product releases. In addition to on-going technical support, we also offer professional and educational services to our customers.

Our total revenues are generated from license revenues and service revenues. License revenues are usually generated by the purchase of a license to our product. Concord s service revenues consist of fees for maintenance, training and professional services. For the three months ending March 31, 2005, our total revenues increased year over year: total revenues were $29.1 million, up 22.1% from $23.8 million mostly due to the acquisition of Aprisma Holdings. For the three months ending March 31, 2005 eHealth revenue fell short of our expectations. The lower revenue did not offset our increased level of expenses and resulted in a decrease in profitability year over year. In addition, expenses related to the acquisition of Aprisma, such as in-process research and development expenses and the compensation expenses related to the Aprisma equity participation plan also affected our profitability. This plan provides payment to a certain number of Aprisma employees following the sale of Aprisma Holdings provided certain employment conditions are met (see Note 8). Our diluted earnings per share decreased to $(0.21) per share for the three-month period ending March 31, 2005 compared to $(0.03) per share for the corresponding prior year period. We used $0.7 million in operating cash during the three-month period ending March 31, 2005 and finished the quarter with $69.5 million of cash, cash equivalents, marketable securities and restricted cash.

On January 5, 2005, we completed the acquisition of privately held Vitel Software, Incorporated. Vitel s software enables enterprises and service providers to manage the performance of voice networks and messaging systems that

are either internet protocol-based, time division multiplexing-based, or include a hybrid of both. The *Vitel IVIZE®* product, now renamed Concord s eHealth for Voice, provides a unified view into the performance of voice networks built on equipment from multiple vendors such as market leaders Avaya, Cisco, and Nortel Networks. The purchase price was $4.1 million, including $0.1 million in direct costs of acquisition and was paid in

cash during the three months ending March 31, 2005. The acquisition has been accounted for under the purchase method of accounting (see Note 8).

On February 22, 2005, we completed the acquisition of Aprisma Holdings, Inc, which has been renamed internally by Concord s management, Spectrum Business Unit. Prior to its acquisition by Concord, Aprisma Holdings, Inc. was a privately held software company owned by Gores Technology Group and its operating subsidiary, Aprisma Management Technologies, Inc. ( Aprisma ). Concord s cash payment to acquire Aprisma on February 22, 2005 was approximately $82.4 million. The acquisition has been accounted for under the purchase method of accounting (see Note 8).

Aprisma s SPECTRUM® software manages the availability of IT infrastructures and the business services that rely on them. Concord believes that strategically combining the two companies complementary technologies will enable Concord to expand its ability to deliver a new generation of intelligent BSM software that maps IT services to business processes, measures the actual end-user experience, and manages the entire IT infrastructure. Aprisma, which profitably generated approximately $43.9 million in 2004 revenues, will operate as a business unit within Concord.

On April 7, 2005, Concord announced that it had signed a definitive agreement to be acquired by Computer Associates International, Inc. If this transaction is consummated, Concord expects to become a wholly owned subsidiary of Computer Associates.

Pursuant to the merger agreement, each issued and outstanding share of common stock of Concord will be converted into the right to receive $17.00 in cash, without interest. Additionally, at the effective time of the merger, each outstanding option to purchase common stock of Concord, whether vested or unvested, will be assumed by Computer Associates and become an option to acquire shares of common stock of Computer Associates, on the terms and conditions set forth in the Merger Agreement.

The merger agreement has been approved by Concord s Board of Directors, and the transactions contemplated by the merger agreement are subject to, among other things, adoption of the Merger Agreement by Concord s shareholders, the termination or expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and other customary closing conditions. The Merger is anticipated to be consummated in the second or third quarter of 2005.

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### Critical Accounting Policies, Significant Estimates and Judgments

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. U.S. GAAP requires us to make estimates and judgments in several areas. If actual results differ significantly from management s estimates and projections, there could be a material effect on our financial statements. See our audited consolidated financial statements and notes thereto in our Annual Report on Form 10-K and which contain accounting policies and other disclosures required by U.S. GAAP.

We believe that the policies, significant estimates and judgments discussed below are the most critical to our financial statements and the understanding of our financial condition and results of operations because their application places the most significant demands on management s judgment.

***(a) Revenue Recognition***

Our revenues consist of software license revenues and service revenues. Software license revenues are recognized in accordance with the American Institute of Certified Public Accountants Statement of Position ( SOP ) 97-2, *Software Revenue Recognition, as modified by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with respect to Certain Transactions.* Software license revenues are recognized when persuasive evidence of an arrangement exists and delivery of the software has occurred, provided that the license fee is fixed or determinable, collection is considered reasonably assured and no customer acceptance clauses exist. If an arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period. If an arrangement includes a right of return for the possibility that the software does not meet published specifications during the warranty period, which is typically 90 days, revenue is recognized upon shipment if all other criteria are met as our product is mature and we have not experienced returns of our products. If the fee is determined not to be fixed or determinable, revenue is recognized when the fees become due. If collection is not considered reasonably assured, revenue is recognized upon the receipt of cash. Revenues under multiple-element arrangements, which typically include software products, services, maintenance and sometimes undelivered specified software upgrades sold together, are allocated to each element using the residual method in accordance with SOP 98-9. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized when these elements are delivered; the remainder of the arrangement consideration is allocated to the software. We have established sufficient vendor specific objective evidence for professional services, training, maintenance, customer support services and specified software upgrades based on the price charged when these elements are sold separately. Accordingly, software license revenues are recognized under the residual method in arrangements in which software is licensed with professional services, training, maintenance, customer support services and specified software upgrades. The Company recognizes revenue from term license arrangements ratably over the term of the contract on a straight-line basis if we do not have VSOE on the undelivered maintenance; this will generally occur when the term of the maintenance agreement is the same as the license agreement.

Service revenues include professional services, training, and maintenance and customer support fees. Professional services are not essential to the functionality of the other elements in an arrangement and are accounted for separately. Service revenues are recognized as the services are performed, provided evidence of an arrangement exists, fees are fixed or determinable, and collection is considered reasonably assured.

Maintenance revenues, a component of service revenues, are derived from customer support agreements generally entered into in connection with initial license sales and subsequent renewals. Maintenance fees include the right to unspecified upgrades on a when-and-if-available basis and ongoing technical support. Maintenance revenues are recognized ratably over the term of the maintenance period. Payments for maintenance fees are generally made in advance and are included in deferred revenue.

We license our software to end-users and resellers. Decisions regarding revenue recognition are centralized at our corporate headquarters, located in the United States. Our arrangements with customers do not generally include provisions involving acceptance of our products by our customers. However, if a customer arrangement includes an acceptance provision, revenue recognition occurs upon the earlier of receipt of a written customer acceptance or expiration of the acceptance period. With respect to revenues from our channel partners and other resellers, we recognize revenue upon delivery of our software to the channel partner or reseller. We do not offer any right of return, price protection or similar rights to our channel partners and other resellers.

For all sales, in the absence of a signed license agreement, we use either a purchase order or purchase order equivalent as evidence of an arrangement. If a signed license agreement is obtained, we use either the license agreement or the license agreement and a purchase order as evidence of an arrangement. Sales to resellers are usually evidenced by a master agreement governing the relationship together with purchase orders on a transaction-by-transaction basis.

Delivery generally occurs when product is delivered to a common carrier and the delivery terms are FOB Concord. The costs of shipping and handling related to the delivery of the product are included in revenue. In the case of arrangements with resellers, revenue is recognized upon delivery to the reseller. Most of these arrangements involve a sell-through by the reseller to an end user. For a reseller, evidence usually comes in the form of a purchase order typically identifying the end-user.

At the time of the transaction, we assess whether the fee associated with our revenue transaction is fixed or determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of a fee is due after our normal payment terms, which are usually 30 to 60 days from invoice date, depending upon the region, we account for the fee as not being fixed or determinable. In these cases, we recognize revenue when the fees become due.

We assess collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue upon receipt of cash. Concord s channel partners and other resellers are responsible to Concord upon delivery.

For arrangements with multiple elements (for example, undelivered maintenance and support or undelivered specified software upgrades), we allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. This means that we defer revenue from the fee arrangement equivalent to the fair value of the undelivered elements. We determine fair values for ongoing maintenance and support obligations using our internal pricing policies for maintenance and by referencing the prices at which we have sold separate maintenance contract renewals to our customers. We determine fair value of services, such as training or consulting, by referencing the prices at which we have separately sold comparable services to our customers. For specified undelivered software upgrades, we determine fair value of these upgrades by referencing the prices at which we sell upgrades separately to our customers.

The Company recognizes revenue from term license arrangements ratably over the term of the contract on a straight-line basis if we do not have VSOE on the undelivered maintenance; this will generally occur when the term of the maintenance agreement is the same as the license agreement.

The majority of our sales transactions are completed using standard terms and conditions; however, there are agreements that contain non-standard terms and conditions. As a result, significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a

multiple obligations arrangement should be treated as separate units of accounting for revenue recognition purposes, and if so, how the price should be allocated among the deliverable elements and when to recognize the revenue for each element. Changes in the allocation of the sales price between deliverable elements might impact the timing of revenue recognition, but would not change the total revenue recognized for the transaction.

***(b) Accounts Receivable***

We record our trade accounts receivable at the invoiced amount; these accounts do not bear interest. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer s current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based on our historical experience and any specific customer collection issues that we have identified. We review our allowance for doubtful accounts on a quarterly basis. We review all past due balances over 60 days individually for collectibility. We charge account balances against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance-sheet credit exposure to our customers.

While credit losses have historically been within our expectations and appropriate reserves have been established, we cannot guarantee that we will continue to experience the same credit loss rates that we have experienced in the past. Thus, if the financial condition of our customers were to deteriorate, our actual losses may exceed our estimates, and additional allowances would be required.

***(c) Accounting for Income Taxes***

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. To do this, we estimate our actual current tax liabilities, while also assessing temporary differences resulting from differing treatment of items, such as deferred revenue and expense accruals, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. To the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations. To the extent we reverse any portion of the valuation allowance, we must recognize a benefit within the tax provision in the statement of operations or to additional paid-in capital for the benefit of deductions for stock option exercises.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have not placed any reserve on our deferred tax assets by recording a valuation allowance. The resulting net deferred tax asset of $14.9 million at March 31, 2005 is based on our estimate that future taxable income we expect to generate will be sufficient to realize the net deferred asset. In the event the actual results differ from the estimates or we adjust these estimates in future periods, we may need to establish another valuation allowance. Establishing new or additional valuation allowances could materially adversely impact our financial position and results of operations.

***(d) Accounting for Acquisitions and Acquired In-process Research and Development***

The purchase price of businesses acquired accounted for as purchase business combinations, is allocated to the tangible and intangible assets acquired based on their estimated fair values with any amount in excess of such allocations designated as goodwill, in accordance with SFAS No. 141, *Business Combinations.* Our accounting for acquisitions involves significant judgments and estimates regarding primarily, but not limited to: the fair value of acquired intangible assets, which are based on projections of future revenues and cash flows, assumptions regarding

discount factors, royalty rates, tax rates, amortization methodologies and related useful lives, as well as the fair value of other acquired assets and assumed liabilities, including potential contingencies and deferred income taxes. The valuation of purchased intangibles is based upon estimates of the future performance and cash flows from the acquired business. If different assumptions are used, it could materially impact the purchase price allocations and

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our financial position and results of operations. Our identifiable assets are generally amortized at the greater of (a) the ratio that current revenues bear to the total of current and anticipated future revenues or (b) the straight-line method over their respective remaining useful lives.

We completed our acquisitions of Vitel Software Incorporated ( Vitel ) and Aprisma Holdings, Inc. ( Aprisma ) on January 5, 2005 and on February 22, 2005, respectively. Both acquisitions were accounted for under the purchase method of accounting and resulted in recording significant goodwill and other intangible asset balances. The purchase prices of Vitel and Aprisma have been allocated to the assets acquired and liabilities assumed at their estimated fair values on the date of acquisition, as determined by management and, with respect to the identifiable intangible assets, an appraisal.

The values of certain identifiable assets of Vitel and Aprisma were determined using the income approach. The income approach requires a projection of revenues and expenses specifically attributed to the intangible assets. The discounted cash flow ( DCF ) method is then applied to the potential income streams after making necessary adjustments with respect to such factors as the wasting nature of the identifiable intangible assets and the allowance of a fair return on the net tangible assets and other intangible assets employed. There are several variations on the income approach, including the relief-from-royalty method, the avoided cost method, and the lost profits method.

The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is then applied to estimate the royalty savings.

The avoided cost method considers the concept of avoided cost as an indicator of value. The avoided cost method is appropriate for estimating the fair value of an asset where reliable data for sales of comparable property are not available and where the property does not directly produce an income stream.

We completed our acquisition of Vitel on January 5, 2005. The values of the completed technology (software), reseller relationships, and maintenance relationships for Vitel were determined using the income approach.

The relief-from-royalty method was used to value the completed technology. The key assumptions used in valuing the completed technology of Vitel are as follows: royalty rate 5%, discount rate 18.5%, tax rate 40% and estimated average economic life of 5 years.

The maintenance relationships of Vitel were valued using the income approach without variation. The key assumptions used in valuing the maintenance relationships of Vitel are as follows: discount rate 18.5%, tax rate 40% and estimated average economic life of 6 years.

The avoided cost method was used to value the reseller relationship of Vitel. The key assumptions used in valuing the reseller relationships of Vitel are as follows: tax rate 40% and estimated average economic life of 5 years.

We completed our acquisition of Aprisma on February 22, 2005. The value of the core technology, completed technology, maintenance and subscription relationships, reseller relationships, product trade-name and non compete agreements were valued using the income approach.

The relief-from-royalty method was used to value the product trade name/trademark. The key assumptions used in valuing the product trade name/trademark are as follows: royalty rate 1%, discount rate 18.5%, tax rate 40% and estimated average economic life of 6 years.

The core technology, completed technology and subscription and maintenance relationships were valued using the income approach without variation. The key assumptions used in valuing the core technology, completed technology and subscription and maintenance relationships are as follows: discount rate 18.5%, tax rate 40% and

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estimated average economic life of 5, 3, 7 and 6 years for core technology, completed technology, subscription relationships and maintenance relationships, respectively.

The avoided cost method was used to value the reseller relationship. The key assumptions used in valuing the reseller relationships are as follows: tax rate 40% and estimated average economic life of 5 years.

The lost profits method was used to value the non-compete agreements of four employees valued as a group. The key assumptions used in valuing the non-compete agreements are as follows: discount rate 18.5%, tax rate 40% and estimated average economic life of 5 years.

Based upon the status of ongoing research and development ( R&D ) efforts related to Aprisma and a review of the typical technology development cycle and standards for establishing technological feasibility of products, the Company identified SPECTRUM Version 8.0 as a project which represents development efforts in areas where the technologically feasibility has not yet been established. The SPECTRUM Version 8.0 project is a major release to the existing Aprisma product, which includes various architectural changes, such as removal of the dependency to link product on-site and the addition of Linux support. Since this in-process technology is being developed for highly specific applications, the Company believes that there is no alternate future use for the in-process technology beyond the stated purpose of the specific R&D project. Given the riskier nature of the cash flows related to the in-process R&D, the level of completion of the project and its perceived risk, a discount rate of 40% was applied to value the in-process R&D. The in-process R&D of $1.4 million was expensed during the three months ended March 31, 2005, since it was determined that it had not reached technological feasibility and had no alternative future use.

Technological feasibility is established when either of two sets of criteria is met:

a) the detail program design has been completed, documented, and traced to product specifications and its high-risk development issues have been resolved; or

b) a working model of the product has been finished and determined to be complete and consistent with the product design.

***(e) Valuation of Long-Lived Tangible and Intangible Assets and Goodwill***

We have significant long-lived tangible and intangible assets and goodwill, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The long-lived tangible assets are fixed assets, which are depreciated over their estimated useful lives. The long-lived intangible assets are core technology, completed technology (software), reseller relationships, maintenance and subscription relationships, which are amortized at the greater of (a) the ratio that current revenues bear to the total of current and anticipated future revenues or (b) the straight line method over their respective remaining useful lives; and contractor agreements, product name/trademark and non-compete agreements which are being amortized using the straight-line method over their useful lives. Goodwill is not amortized.

At each quarter-end, the carrying value of the completed technology (software) is compared to its net realizable value ( NRV ). NRV is the estimated future gross revenues from products that incorporate the software reduced by the estimated future costs of disposal. If NRV is less than the carrying value, the excess is written-off and the then current NRV becomes the new carrying value of the software. We assess the potential impairment of other identifiable intangible assets and fixed assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important, which could trigger an impairment of such assets, include the following:

significant underperformance relative to historical or projected future operating results;

significant changes in the manner of or use of the acquired assets or the strategy for our overall business;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

a decline in our market capitalization below net book value.

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would impact future results of operations and financial position in the reporting period identified.

Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets,* or SFAS 142 requires goodwill acquired as a result of a purchase method business combination to be tested for impairment using a two-step process. The first step compares the fair value of the reporting unit with the unit s carrying value, including goodwill. When the carrying value of the reporting unit is greater than fair value, the unit s goodwill may be impaired, and the second step must be completed to measure the amount of the goodwill impairment charge, if any. In the second step, the implied fair value of the reporting unit s goodwill is compared with the carrying amount of the unit s goodwill. If the carrying amount is greater than the implied fair value, the carrying value of the goodwill must be written down to its implied fair value. Goodwill is required to be tested for impairment at least annually, or more frequently when events and circumstances occur indicating that the recorded goodwill might be impaired. We perform the annual assessment at June 30 of each fiscal year.

As of June 30, 2004, we performed our annual test for impairment on the carrying value of goodwill relative to netViz, on our reporting units. We compared the fair value of each reporting unit to which goodwill has been allocated to its book value and determined that no impairment existed at that date. The carrying value of goodwill resulting from the netViz, Vitel and Aprisma acquisitions will be tested for impairment at June 30, 2005.

Factors we consider important, which could trigger an impairment of goodwill, include the following:

significant underperformance relative to historical or projected future operating results;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

a decline in our market capitalization below net book value.

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would impact future results of operations and financial position in the reporting period identified.

Significant judgments and estimates are involved in determining the useful lives of our intangible assets, determining what reporting units exist and assessing when events or circumstances would require an interim impairment analysis of goodwill or other long-lived assets to be performed. Changes in events or circumstances, including but not limited to technological advances or competition which could result in shorter useful lives, additional reporting units which may require alternative methods of estimating fair value, or economic or market conditions which may affect previous assumptions and estimates, could have a significant impact on our results of operations or financial position through accelerated amortization expense or impairment charges.

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**RESULTS OF OPERATIONS**

The following table sets forth, for the periods indicated, certain financial data as percentages of the Company s total revenues:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2005** | **March 31, 2004** |
| Revenues: | | |
| License revenues | 39.7% | 43.4% |
| Service revenues | 60.3 | 56.6 |
| Total revenues | 100.0 | 100.0 |
| Cost of Revenues: | | |
| Cost of license revenues | 5.8 | 3.4 |
| Cost of service revenues | 17.4 | 16.6 |
| Total cost of revenues | 23.2 | 20.0 |
| Gross profit | 76.8 | 80.0 |
| Operating Expenses: | | |
| Research and development | 24.6 | 24.3 |
| Sales and marketing | 48.2 | 48.3 |
| General and administrative | 14.3 | 11.1 |
| Acquisition related charges | 0.3 | |
| Acquired in-process research & development | 4.8 | |
| Total operating expenses | 92.2 | 83.7 |
| Operating loss | (15.4) | (3.7) |
| Other Income: | | |
| Interest income | 2.3 | 4.6 |
| Interest expense | (2.8) | (3.4) |
| Other expense | (0.5) | (0.7) |
| Total other (loss) income, net. | (1.0) | 0.5 |
| Loss before income taxes | (16.4) | (3.2) |
| Benefit for income taxes | (3.4) | (1.2) |
| Net loss | (13.0)% | (2.0)% |

**Total Revenues**

Concord s total revenues are generated from license revenues and service revenues.

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, | | March 31, |
| **(in thousands)** | **2005** | **Percent Change** | **2004** |
| License Revenues | $ 11,570 | 11.8% | $ 10,350 |
| Service Revenues | 17,541 | 30.0% | 13,495 |
| Total Revenues | $ 29,111 | 22.1% | $ 23,845 |
| ***Percent of Total Revenues*** | | | |
| License Revenues | 39.7% | | 43.4% |
| Service Revenues | 60.3% | | 56.6% |

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**License Revenues**

Concord s license revenues are derived from the licensing of software products.

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, | | March 31, |
| **(in thousands)** | **2005** | **Percent Change** | **2004** |
| License Revenues | $ 11,570 | 11.8% | $ 10,350 |
| ***Percent of Total Revenues*** | | | |
| License Revenues | 39.7% | | 43.4% |

***First Quarter 2005 Compared to First Quarter 2004:***

The increase in license revenues was driven by the revenue generated by Spectrum which was offset by lower sales of Concord s core products, the eHealth Suite. After the close of this transaction on February 22, Spectrum contributed $2.0 million in license revenues. This was partially offset by a decrease in Concord license revenues due to lower sales by our indirect channel in Europe and Asia.

The continuing decrease of license revenues as a percent of total revenues was the result of a significant increase in service revenues combined with a decrease of the license revenues. As we continue to service our existing customers and continue to add to our customer base, we would expect service revenues as a percent of total revenue to stabilize.

There were no material price increases for products during the first three months of 2005 and inflation did not have a significant impact on our revenues or income during the first three months of 2005.

**New *e*Health and Spectrum customer accounts**

License revenues are partially dependent on our ability to sell to new *e*Health and Spectrum customer accounts. New *e*Health customer accounts represent the number of new customer accounts that purchase software from the Concord *e*Health® Suite of products. New Spectrum customer accounts represent new customers that purchase Spectrum products. NetViz new customer accounts are excluded from this count as these products are not considered key drivers of our primary business. Due to the nature of netViz® products, customers that purchase netViz® products do not generate significant revenue for the initial or subsequent purchase.

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, | | March 31, |
| **(in thousands)** | **2005** | **Percent Change** | **2004** |
| New *e*Health Customer Accounts | 16 | -27.3% | 22 |
| New Spectrum Customer Accounts | 3 | N/A | |
| ***Percent of Total Revenues*** | | | |
| New *e*Health Customer Accounts | 9.5% | | 11.7% |
| New Spectrum Customer Accounts | 8.0% | | |

***First Quarter 2005 Compared to First Quarter 2004:***

The number of sales to new *e*Health customer accounts decreased due to continued focus on existing customers by our salesforce. Internal initiatives, implemented in the third quarter of 2004, such as targeted marketing programs and specific sales incentives, which were successful in the second half of 2004, did not have a demonstrable impact on the number of new eHealth customers in the quarter ending March 31, 2005.

**Transactions over $100,000**

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License revenues can also be dependent on the number of transactions over $100,000 that we are able to close during the period.

**Three Months Ended**