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AMDOCS LTD
Form 6-K/A
February 11, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 6-K/A

AMENDMENT NO. 1 TO
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13A-16 OR 15D-16 OF
THE SECURITIES EXCHANGE ACT OF 1934

For the Month of November, 2001

AMDOCS LIMITED

Suite 5, Tower Hill House Le Bordage
St. Peter Port, Island of Guernsey, GY1 3QT Channel Islands

Amdocs, Inc.
1390 Timberlake Manor Parkway, Chesterfield, Missouri 63017

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

FORM 20-F

FORM 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

YES

NO

This Amendment No. 1 to Report on Form 6-K is being filed in order to include:

- the unaudited pro forma condensed combined statements of operations for the twelve months ended September 30, 2001 and for the three months ended December 31, 2001, in each case reflecting the acquisition by Amdocs Limited ("Amdocs") from Nortel Networks Corporation ("Nortel"), on November 28, 2001, of substantially all of the assets of Nortel's Clarify business ("Clarify"); and
- the audited financial statements of Clarify Inc. (the predecessor of Clarify) for the years ended December 31, 1998 and 1999 and the period from January 1, 2000 through March 16, 2000, the audited financial statements of Clarify for the period from March 17, 2000 through December 31, 2000, and the unaudited condensed financial statements of Clarify for the nine months ended September 30, 2001.

The Report on Form 6-K of Amdocs filed on December 12, 2001 is amended by substituting the text below each of the following headers for the text that appeared below each such header in the original report on Form 6-K.

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FINANCIAL STATEMENTS AND PRO FORMA FINANCIAL INFORMATION

(a) Pro Forma Financial Information.

The unaudited pro forma condensed combined statements of operations for the twelve months ended September 30, 2001 and for the three months ended December 31, 2001 are set forth below.

(b) Financial Statements of Business Acquired.

The financial statements of Clarify Inc. (the predecessor of Clarify) for the years ended December 31, 1998 and 1999 and the period from January 1, 2000 through March 16, 2000 and the financial statements of Clarify for the period from March 17, 2000 through December 31, 2000 and for the nine months ended September 30, 2001 are set forth below.

EXHIBITS

| EXHIBIT NO. | DESCRIPTION |
|-------------|---|
| 23.1 | Consent of PricewaterhouseCoopers LLP. |
| 23.2 | Consent of Deloitte & Touche LLP. |
| 99.1* | Amdocs Press Release dated November 28, 2001. |

* Previously filed.

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UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

The unaudited pro forma condensed combined statements of operations for the twelve months ended September 30, 2001 and the three months ended December 31, 2001, gives effect to the acquisition from Nortel of substantially all of the assets of Clarify, which closed on November 28, 2001 (the "Acquisition"), as if it had occurred on October 1, 2000.

The unaudited pro forma condensed combined statements of operations are based upon, and should be read in conjunction with, (i) our historical audited financial statements for the year ended September 30, 2001. (ii) our historical unaudited financial statements for the three months ended December 31, 2001, (iii) the historical audited financial statements of Clarify for the year ended December 31, 2000, and (iv) the historical unaudited financial statements of Clarify for the nine months ended September 30, 2001.

The aggregate purchase price for Clarify was \$203.8 million in cash. The purchase price is subject to final price adjustments that may result in a reduction only. In addition, transaction costs were \$7.2 million. We accounted for the Acquisition as a business combination using the purchase method of accounting, as required by Statements of Financial Accounting Standards No. 141, "Business Combinations." The total purchase price is being allocated to Clarify's tangible assets and liabilities based on their respective estimated fair values, on the date the transaction was consummated. We allocated the excess of the purchase price over the fair value of the net tangible assets acquired to identifiable intangible assets, including customer arrangements,

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core technology, in-process research and development costs, and the remainder to goodwill. In addition, deferred taxes will be recognized for the difference between the book and tax basis of certain intangible assets.

We believe that the fair value of the tangible net assets is not materially different from their historical book value. The allocation of the excess purchase price over net tangible assets has been determined based on a preliminary evaluation available at the date of the preparation of the unaudited pro forma condensed combined financial information. A final determination of purchase accounting adjustments will be made following the completion of the evaluation.

The pro forma financial results are not intended to be a projection of future results and are not necessarily indicative of the results that would have occurred if the business combination had been in effect on the dates presented.

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UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENTS OF OPERATIONS FOR
THE TWELVE MONTHS ENDED SEPTEMBER 30, 2001
(in thousands, except per share data)
(in U.S. dollars)

| | AMDOCS HISTORICAL ----- | CLARIFY HISTORICAL ----- |
|---|-------------------------------|--------------------------------|
| Revenue | \$ 1,533,910 | \$ 242,153 |
| Cost of revenue | 853,242 | 80,971 |
| Research and development | 105,807 | 76,052 |
| Selling, general and administrative | 195,592 | 166,421 |
| Amortization of goodwill and purchased intangible assets | 219,988 | 566,492 |
| Special charges | -- | 932,104 |
| | ----- 1,374,629 | ----- 1,822,040 |
| Operating income (loss) | 159,281 | (1,579,887) |
| Interest income and other, net | 22,286 | 137 |
| | ----- | ----- |
| Income (loss) before income taxes | 181,567 | (1,579,750) |
| Income taxes (tax benefit) | 115,181 | (44,366) |
| | ----- | ----- |
| Net income (loss) | \$ 66,386 ===== | \$ (1,535,384) ===== |
| Basic earnings (loss) per share | \$ 0.30 ===== | |
| Diluted earnings (loss) per share | \$ 0.29 ===== | |
| Basic weighted average number of shares outstanding | 222,002 ===== | |

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| | |
|--|------------------|
| Diluted weighted average number of shares outstanding | 226,832 ===== |
|--|------------------|

See Notes to Unaudited Pro Forma Condensed Combined Financial Information for discussion of adjustments.

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UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENTS OF OPERATIONS FOR THE THREE
MONTHS ENDED DECEMBER 31, 2001
(in thousands, except per share data)
(in U.S. dollars)

| | AMDOCS HISTORICAL ----- | CLARIFY HISTORICAL ----- |
|--|-------------------------------|--------------------------------|
| Revenue | \$ 422,641 | \$ 20,000 |
| Cost of revenue | 231,583 | 9,647 |
| Research and development | 28,557 | 7,134 |
| Selling, general and administrative | 53,779 | 11,293 |
| Amortization of goodwill and purchased intangible assets | 56,782 | 28,225 |
| In-process research and development and nonrecurring charge | 30,711 | -- |
| | ----- | ----- |
| | 401,412 | 56,299 |
| | ----- | ----- |
| Operating income (loss) | 21,229 | (36,299) |
| Interest income (expense) and other, net | 3,327 | (13) |
| | ----- | ----- |
| Income (loss) before income taxes | 24,556 | (36,312) |
| Income taxes | 20,222 | (3,190) |
| | ----- | ----- |
| Net income (loss) | \$ 4,334 | \$ (33,122) |
| | ===== | ===== |
| Basic earnings per share | \$ 0.02 | |
| | ===== | |
| Diluted earnings per share | \$ 0.02 | |
| | ===== | |
| Basic weighted average number of shares outstanding | 222,696 | |
| | ===== | |
| Diluted weighted average number of shares outstanding | 225,090 | |
| | ===== | |

See Notes to Unaudited Pro Forma Condensed Combined Financial Statements for discussion of adjustments.

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NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION
(in thousands, except per share data)
(in U.S. dollars)

Amdocs acquired Clarify on November 28, 2001. Accordingly, Clarify's operations are included in the historical results of Amdocs from that date. The amounts presented on the statement of operations for the three months ended December 31, 2001 represent the historical results of Clarify for the two months ended November 28, 2001.

Set forth below is the preliminary allocation of the preliminary purchase price:

| | |
|-----------------------------|------------|
| Purchase price to Nortel | \$ 203,750 |
| Estimated transaction costs | 7,150 |
| | ----- |
| Total purchase price | \$ 210,900 |
| | ===== |

Allocation of total purchase price:

| | |
|--|------------|
| Tangible assets acquired | \$ 40,237 |
| Liabilities assumed | (52,557) |
| | ----- |
| Net tangible assets | (12,320) |
| | ----- |
| In-process research and development (*) | 17,400 |
| Core technology | 13,400 |
| Customer arrangements | 34,800 |
| Deferred taxes resulting from the difference between the assigned value of certain assets and their respective tax bases | (2,297) |
| | ----- |
| Net identifiable intangible assets | 63,303 |
| | ----- |
| Goodwill(**) | 159,917 |
| | ----- |
| | \$ 210,900 |
| | ===== |

(*) The amount of \$17,400 allocated to in-process research and development was charged to expense immediately upon the completion of the transaction.

(**) Under FAS 142, goodwill in connection with the Acquisition will not be amortized.

(1) Reflects the elimination of Clarify's historical amortization of acquired intangible assets.

(2) Reflects amortization of \$13,400 over 2 years of the core technology

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resulting from the valuation at the time of the Acquisition.

- (3) Reflects amortization of \$34,800 over 3 years of the customer arrangements resulting from the valuation at the time of the Acquisition.

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- (4) Reflects the elimination of Clarify's historical nonrecurring charge related to the write-down of acquired intangible assets.
- (5) Reflects the elimination of interest income earned on the cash used for the Acquisition.
- (6) Reflects the elimination of Clarify's historical tax benefit related to acquired intangible assets and nonrecurring charge.
- (7) Reflects release of deferred taxes resulting from the differences between the values assigned to core technology and customer arrangements and their respective tax bases.
- (8) Reflects elimination of in-process research and development expenses included in Amdocs' historical financial statements as a result of the Acquisition which are nonrecurring and attributable to the Acquisition.

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INDEX TO CLARIFY FINANCIAL STATEMENTS

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| Consolidated Statements of Income for the Years Ended December 31, 1998, 1997 and 1996..... | |
| Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 1998, 1997 and 1996..... | |
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Statements of Cash Flows for the Year Ended December 31, 1999
 (Predecessor Company), the Period from January 1, 2000 through March 16,
 2000 (Predecessor Company) and the Period
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Unaudited Statements of Net Assets as of September 30, 2001 and December 31, 2000.....

Unaudited Statements of Operations for the Nine Months Ended September 30, 2001,
 the Period From January 1, 2000 Through March 16, 2000 (Predecessor
 Company), and the Period From March 17, 2000 Through September 30, 2000.....

Unaudited Statements of Cash Flows for the Nine Months Ended September 30, 2001, the
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 and the Period From March 17, 2000 Through September 30, 2000.....

Notes to Unaudited Financial Statements for the Nine Months Ended September 30, 2001, the
 Period From January 1, 2000 Through March 16, 2000 (Predecessor Company),
 and the Period From March 17, 2000 Through September 30, 2000.....

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CLARIFY INC.
 BALANCE SHEETS
 (in thousands, except per share data)

| | YEARS ENDED DECEMBER 31, | |
|--|-----------------------------|----------|
| | 1997 | 1998 |
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | \$11,956 | \$31,27 |
| Short-term investments | 19,239 | 25,91 |
| Accounts receivable, net of allowances of \$1,310 in 1997 and \$2,757 in 1998 | 32,854 | 45,22 |
| Prepaid expenses and other current assets | 2,463 | 2,60 |
| Deferred tax assets | 4,133 | 4,93 |
| Total current assets | 70,645 | 109,95 |
| Property and equipment, net | 8,611 | 8,43 |
| Long-term investments | 5,167 | 51 |
| Non-current deferred tax assets | 1,559 | 1,86 |
| Other non-current assets | 849 | 1,83 |
| Total assets | \$86,831 | \$122,60 |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,047 | \$ 5,82 |
| Payroll related accruals | 6,833 | 9,58 |
| Other accrued liabilities | 4,269 | 8,80 |
| Income taxes payable | 1,851 | 1,98 |

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| | | |
|---|----------|----------|
| Unearned revenue | 11,734 | 25,08 |
| | ----- | ----- |
| Total current liabilities | 29,734 | 51,28 |
| | ===== | ===== |
| Commitments (Note 6). | | |
| Stockholders' equity: | | |
| Preferred stock, \$.0001 par value, 5,000 shares authorized; none outstanding | | |
| Common stock, \$.0001 par value, 55,000 shares authorized; shares issued and outstanding: 21,335 in 1997 and 22,168 in 1998 | 2 | |
| Additional paid-in-capital | 51,640 | 59,12 |
| Accumulated other comprehensive income | 28 | (60) |
| Deferred compensation | (65) | (1) |
| Retained earnings | 5,492 | 12,81 |
| | ----- | ----- |
| Total stockholders' equity | 57,097 | 71,31 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$86,831 | \$122,60 |
| | ===== | ===== |

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

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CLARIFY INC.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

| | YEARS ENDED DECEMBER 31, | | |
|------------------------|--------------------------|----------|----------|
| | 1996 | 1997 | 1998 |
| | ----- | ----- | ----- |
| Revenues: | | | |
| License fees | \$39,139 | \$59,214 | \$84,874 |
| Services | 17,183 | 29,003 | 45,636 |
| | ----- | ----- | ----- |
| Total revenues | 56,322 | 88,217 | 130,510 |
| | ----- | ----- | ----- |
| Cost of revenues: | | | |
| License fees | 1,409 | 2,400 | 2,424 |
| Services | 10,711 | 18,149 | 26,165 |
| | ----- | ----- | ----- |
| Total cost of revenues | 12,120 | 20,549 | 28,589 |
| | ----- | ----- | ----- |
| Gross margin | 44,202 | 67,668 | 101,921 |

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| | | | |
|--|----------|----------|----------|
| Operating expenses: | | | |
| Product development and engineering | 10,384 | 16,777 | 20,329 |
| Sales and marketing | 20,351 | 38,054 | 61,389 |
| General and administrative | 4,920 | 7,903 | 10,094 |
| Merger costs | 1,061 | - | - |
| | ----- | | |
| Total operating expenses | 36,716 | 62,734 | 91,812 |
| | ----- | | |
| Operating income | 7,486 | 4,934 | 10,109 |
| Interest income | 1,653 | 1,437 | 1,536 |
| Interest expense | (9) | (6) | (31) |
| Other income (expense), net | - | (127) | 2 |
| | ----- | | |
| Income before income taxes | 9,130 | 6,238 | 11,616 |
| Provision for income taxes | 940 | 2,308 | 4,298 |
| | ----- | | |
| Net income | \$ 8,190 | \$ 3,930 | \$ 7,318 |
| | ===== | | |
| Basic net income per share | \$ 0.41 | \$ 0.19 | \$ 0.34 |
| | ===== | | |
| Shares used in per share computation-basic | 20,143 | 20,909 | 21,683 |
| | ===== | | |
| Diluted net income per share | \$ 0.38 | \$ 0.18 | \$ 0.32 |
| | ===== | | |
| Shares used in per share computation-diluted | 21,768 | 22,164 | 22,592 |
| | ===== | | |

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

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CLARIFY INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

| | COMMON STOCK | | ADDITIONAL | ACCUMULATED | DEFERRED |
|--|--------------|--------|------------|---------------|--------------|
| | ----- | | PAID-IN | OTHER | STOCK |
| | SHARES | AMOUNT | CAPITAL | COMPREHENSIVE | COMPENSATION |
| | | | | INCOME | |
| | ----- | | | | |
| Balances, January 1, 1996 | 19,869 | \$2 | \$39,316 | \$ (5) | \$ (159) |
| Net income | | | | | |
| Other comprehensive income, net of tax | | | | | |
| Translation adjustment | | | | (61) | |
| Total comprehensive income | | | | | |
| Exercise of stock options | 442 | | 224 | | |
| Employee stock purchases | 289 | | 1,845 | | |
| Amortization of deferred stock option compensation | | | | | 47 |
| Forgiveness of notes payable to stockholders | | | | | |
| Tax benefit from exercise of nonqualified stock options | | | 4,171 | | |

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| | | | | | |
|---|--------|-----|----------|----------|---------|
| Balances, December 31, 1996 | 20,600 | 2 | 45,556 | (66) | (112) |
| Net income | | | | | |
| Other comprehensive income, net of tax | | | | | |
| Translation adjustment | | | | 72 | |
| Change in unrealized gain on investment | | | | 22 | |
| Total comprehensive income | | | | | |
| Exercise of stock options | 305 | | 436 | | |
| Employee stock purchases | 463 | | 3,370 | | |
| Amortization of deferred stock option compensation | | | | | 47 |
| Common stock repurchased for cash | (33) | | (23) | | |
| Tax benefit from exercise of nonqualified stock options | | | 2,301 | | |
| Cumulative translation adjustment | | | | | |
| Balances, December 31, 1997 | 21,335 | 2 | 51,640 | 28 | (65) |
| Net income | | | | | |
| Other comprehensive income, net of tax | | | | | |
| Translation adjustment | | | | (618) | |
| Change in unrealized gain on investment | | | | (12) | |
| Total comprehensive income | | | | | |
| Exercise of stock options | 369 | | 1,383 | | |
| Employee stock purchases | 447 | | 4,348 | | |
| Amortization of deferred stock option compensation | | | | | 47 |
| Common stock repurchased for cash | (13) | | (3) | | |
| Tax benefit from exercise of nonqualified stock options | | | 1,621 | | |
| Fair value of options for services | | | 138 | | |
| Balances, December 31, 1998 | 22,168 | \$2 | \$59,127 | \$ (602) | \$ (18) |

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

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CLARIFY INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

| | YEARS ENDED DECEMBER 31, | | |
|--|--------------------------|----------|---------|
| | 1996 | 1997 | 1998 |
| Cash flows from operating activities: | | | |
| Net income | \$ 8,190 | \$ 3,930 | \$ 7,31 |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities: | | | |

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| | | | |
|---|-----------|-----------|----------|
| Depreciation and amortization | 1,750 | 4,666 | 5,68 |
| Provision for doubtful accounts | 596 | 874 | 2,28 |
| Deferred income taxes | (801) | (1,909) | (1,10 |
| Loss on disposal of assets | 133 | 271 | - |
| Other | (61) | 67 | 9 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (11,441) | (15,913) | (13,57 |
| Prepaid and other current assets | (663) | (707) | (2 |
| Accounts payable | 2,811 | 1,157 | 76 |
| Payroll related accruals | 2,777 | 2,085 | 2,69 |
| Other accrued liabilities | 2,419 | 3,702 | 4,53 |
| Unearned revenue | 7,462 | (955) | 12,48 |
| Net cash provided by (used for) operating activities | 13,172 | (2,732) | 21,16 |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (8,048) | (5,092) | (5,52 |
| Purchase of investments | (5,470) | (31,483) | (21,82 |
| Sale and maturities of investments | 1,995 | 10,519 | 19,69 |
| Increase in other assets | (758) | (9) | (97 |
| Net cash used for investing activities | (21,281) | (26,065) | (8,62 |
| Cash flows from financing activities: | | | |
| Payments of capital lease obligations | (81) | -- | - |
| Proceeds from issuance of common stock, net | 2,069 | 6,084 | 7,48 |
| Borrowings under (payments of) notes payable | (215) | -- | - |
| Net cash provided by financing activities | 1,773 | 6,084 | 7,48 |
| Net increase in cash and cash equivalents | 2,664 | (22,713) | 20,02 |
| Effect of foreign exchange rate changes on cash | -- | 192 | (71 |
| Cash and cash equivalents, beginning of year | 31,813 | 34,477 | 11,95 |
| Cash and cash equivalents, end of year | \$ 34,477 | \$ 11,956 | \$ 31,27 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year for interest | \$ 9 | \$ 6 | \$ 3 |
| Cash paid during the year for taxes | \$ 464 | \$ 233 | \$ 3,81 |
| Supplemental disclosure of noncash investing and financing activities: | | | |
| Change in unrealized holding gains on investments | | \$ 22 | \$ (1 |
| Tax benefit from exercise of nonqualified stock options | \$ 4,171 | \$ 2,301 | \$ 1,62 |
| Forgiveness of notes payable to stockholders | \$ 1,047 | | |

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

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CLARIFY INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS OF THE COMPANY

Clarify, Inc. (the "Company"), a Delaware corporation, was founded in August 1990 to develop, market, and support adaptable client/server application software designed to address the external and internal service, support, and product quality needs of today's global enterprises. The Company markets its software and services primarily through its direct sales organization.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPALS OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The functional currency for the majority of the Company's foreign operations is the applicable local currency. The translation from the applicable foreign currency to U.S. dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using the weighted average exchange rate during the period. Adjustments resulting from such translation are reflected in accumulated other comprehensive income. Gains or losses resulting from foreign currency transactions are included in the results of operations.

USE OF ESTIMATES

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

FINANCIAL INSTRUMENTS

The Company considers cash and all highly liquid investments purchased with an original or remaining maturity of less than three months at the date of purchase to be cash equivalents. Short-term and long-term investments are classified as available-for-sale and are carried at fair market value. Unrealized holding gains and losses on such investments are reported, net of related taxes, as a part of accumulated other comprehensive income in a separate component of stockholders' equity. Realized gains and losses on sales of such investments are reported in earnings and computed using the specific identification cost method.

The amounts reported for cash equivalents, accounts receivables and other financial instruments are considered to approximate fair values based upon comparable market information available at the respective balance sheet dates.

The financial instruments that potentially subject the Company to concentrations of credit risk comprise principally cash, investments and trade accounts receivable. Cash and cash equivalents and investments are, for the most part, custodied with three major financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. These deposits may generally be redeemed upon demand and, therefore, bear minimal risk. The Company's customer base is dispersed across many different geographic areas throughout the United States, Europe, and Asia and consists principally of companies in the networking equipment, high-end software, telecommunications,

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and computer systems industries. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses. Collateral, such as letters of credit and bank guarantees, is generally not required.

In the normal course of business, the Company has exposures to foreign currency fluctuations arising from foreign currency sales and purchases and intercompany transactions, among other things. The Company uses foreign exchange forward contracts to limit its exposure to foreign exchange losses arising from foreign currency payables and receivables. The Company evaluates its net exposure therefrom and enters into forward contracts to hedge the net exposure over a specified amount. These contracts are executed with credit-worthy financial institutions and are denominated in currencies of major industrial nations. Gains and losses on these contracts serve as hedges in that they offset fluctuations that would otherwise impact the Company's financial results. Costs associated with entering into such contracts are generally amortized over the life of the instruments and are not material to the Company's financial results.

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At December 31, 1998, the Company had foreign currency forward contracts outstanding to hedge foreign currency intercompany accounts receivable and accounts payable. These contracts typically have 30-day maturities and are intended to reduce exposure to foreign currency exchange risk. The total aggregate fair value of and the net unrealized loss on foreign exchange contracts were \$10.3 million and \$0.2 million, respectively.

REVENUE RECOGNITION

The Company's revenue is derived from primarily two sources, across many industries: (i) product license revenue, derived primarily from product sales to customers, including large scale enterprises; and (ii) service and support revenue, derived primarily from providing software updates, support, training, and consulting services to customers.

The Company adopted the provisions of Statement of Position (SOP) 97-2 "Software Revenue Recognition", as amended by SOP 98-4 "Deferral of the Effective Date of Certain Provisions of SOP 97-2", effective January 1, 1998. SOP 97-2 supersedes SOP 91-1 "Software Revenue Recognition", and delineates the accounting for software product and maintenance revenue. Under SOP 97-2, the Company recognizes product revenue upon shipment if a signed contract exists, the fee is fixed and determinable and collection of resulting receivables is probable. In 1997 and 1996, the Company's revenue recognition policy was the same as set forth above.

For contracts with multiple obligations (e.g. deliverable and undeliverable products, maintenance, and other services), the Company allocates revenue to each component of the contract based on objective evidence of its fair value, which is specific to the Company, or for products not being sold separately, the price established by management. The Company recognizes revenue allocated to undelivered products when the criteria for product revenue set forth above are met. The Company recognizes revenue allocated to maintenance fees for ongoing customer support and product updates ratably over the period of the maintenance contract. Payments for maintenance fees are generally made in advance and are non-refundable. For revenue allocated to training and consulting services, the Company recognizes revenue as the related services are performed.

COMPREHENSIVE INCOME

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In accordance with Statement of Financial Accounting Standards (SFAS) No. 130 "Reporting Comprehensive Income", the Company has elected to display the total nonowner changes in equity as "Accumulated Other Comprehensive Income" on the Consolidated Balance Sheets and in the Consolidated Statements of Stockholders' Equity. Comprehensive income is the change in equity of a business enterprise resulting from transactions from nonowner sources. The components of accumulated other comprehensive income for the two years ended December 31, 1998 are as follows (in thousands):

| | 1997 | 1998 |
|--|-------|----------|
| | ----- | ----- |
| Unrealized net holding gain on investments | \$ 22 | \$ 10 |
| Cumulative translation adjustment | 6 | (612) |
| | ----- | ----- |
| Accumulated other comprehensive income | \$ 28 | \$ (602) |
| | ===== | ===== |

EARNINGS PER SHARE

The Company calculates earnings per share in accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share". Basic earnings per share is computed based on the weighted average number of shares outstanding during the period. Diluted earnings per share is computed based on the weighted average number of shares outstanding during the period increased by the effect of dilutive stock options and stock purchase contracts, using the treasury stock method.

The following table presents information necessary to calculate basic and diluted earnings per common and common equivalent share (in thousands):

| | 1996 | 1997 | 1998 |
|---|----------|----------|----------|
| | ----- | ----- | ----- |
| Weighted average shares outstanding-Basic | 20,143 | 20,909 | 21,683 |
| Dilutive common stock equivalents | 1,625 | 1,255 | 909 |
| | ----- | ----- | ----- |
| Weighted average shares and equivalents-Diluted | 21,768 | 22,164 | 22,592 |
| | ===== | ===== | ===== |
| Net income for basic and diluted earnings per share computation | \$ 8,190 | \$ 3,930 | \$ 7,318 |
| | ===== | ===== | ===== |

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets (generally three to five years). Assets under capital leases and leasehold improvements are amortized over the lesser of their useful lives or the term of the lease. Upon disposal, the assets and related accumulated depreciation are removed from the Company's accounts, and the resulting gains or losses are reflected in the statement of income.

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INCOME TAXES

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company is required to adjust its deferred tax liabilities in the period when tax rates or the provisions of the income tax laws change. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

PRODUCT DEVELOPMENT AND ENGINEERING EXPENDITURES

Costs related to research, design and development of products are charged to product development and engineering expenses as incurred. Software development costs are capitalized beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. Generally, the Company's products are released soon after technological feasibility has been established. As a result, costs subsequent to achieving technological feasibility have not been significant and all software development cost have therefore been expensed.

ADVERTISING COSTS

Advertising costs are expensed as incurred and totaled \$258,000, \$690,000, and \$972,000 during the years ended December 31, 1996, 1997, and 1998, respectively.

STOCK SPLIT

On September 18, 1996, the Company's Board of Directors authorized a two-for-one stock split payable in the form of a dividend of one additional share of the Company's common stock for each share owned by stockholders of record on September 30, 1996. All share and per share information in the accompanying financial statements has been restated to give retroactive recognition to the stock split for all periods presented.

STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards No. 123 (SFAS 123) "Accounting for Stock-Based Compensation," encourages but does not require companies to record compensation cost for stock-based compensation plans at fair value. The Company has chosen to continue to account for employee stock options using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Management has not yet evaluated the effects of this change on its operations. SFAS No. 133 will be effective for the Company's fiscal year 2000. Management believes that this statement will not have a significant impact on the Company.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no impact on net income or

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stockholders' equity for any year presented.

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3. BUSINESS COMBINATION

In April 1996, the Company acquired Metropolis Software, inc. (Metropolis), a sales force automation software provider. The Company issued approximately 663,000 shares of its common stock in exchange for substantially all of the outstanding capital stock of Metropolis. The Company also assumed stock options that converted into options to purchase approximately 77,000 shares of the Company's common stock. The business combination was accounted for as a pooling of interests and the consolidated financial statements have been restated as if Metropolis had been combined for all periods presented.

Revenues and net income (loss) of the separate and combined companies are as follows (in thousands):

Three months ended March 31, 1996

Revenues:

| | |
|-------------|----------|
| The Company | \$ 7,784 |
| Metropolis | 1,170 |
| | ----- |
| Combined | \$ 8,954 |
| | ===== |

Net Income (loss)

| | |
|-------------|--------|
| The Company | \$ 959 |
| Metropolis | (91) |
| | ----- |
| Combined | \$ 868 |
| | ===== |

4. INVESTMENTS

Investments at December 31, 1997 and 1998 are summarized below (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| | | | | |
| December 31, 1997: | | | | |
| State and municipal securities | \$ 19,346 | \$ 20 | \$ - | \$ 19,366 |
| US Gov't. Agency securities | 4,038 | 2 | - | 4,040 |
| Corporate debt securities | 1,000 | - | - | 1,000 |
| | ----- | ---- | ---- | ----- |
| | \$ 24,384 | \$ 22 | \$ - | \$ 24,406 |

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| | ===== | ===== | ===== | ===== |
|--------------------------------|-----------|-------|--------|-----------|
| December 31, 1998: | | | | |
| State and municipal securities | \$ 22,160 | \$ 10 | \$ (2) | \$ 22,168 |
| US Gov't. Agency securities | 2,063 | 2 | - | 2,065 |
| Corporate debt securities | 2,200 | - | - | 2,200 |
| | ----- | ----- | ----- | ----- |
| | \$ 26,423 | \$ 12 | \$ (2) | \$ 26,433 |
| | ===== | ===== | ===== | ===== |

At December 31, 1998, investments with maturity dates of 90 days or less totaled \$20.5 million, investments with maturity dates ranging from 91 days to one year totaled \$5.4 million, and investments with maturity dates ranging from one to three years totaled \$0.5 million.

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5. PROPERTY AND EQUIPMENT

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

| Years Ended December 31. | 1997 | 1998 |
|-------------------------------|----------|----------|
| | ----- | ----- |
| Leasehold improvements | \$ 2,242 | \$ 2,395 |
| Equipment | 9,710 | 13,077 |
| Furniture and fixtures | 2,750 | 3,278 |
| Purchased software | 967 | 2,203 |
| | ----- | ----- |
| | 15,669 | 20,953 |
| Less accumulated depreciation | (7,058) | (12,516) |
| Property and equipment, net | \$ 8,611 | \$ 8,437 |
| | ===== | ===== |

6. COMMITMENTS

The Company leases its principal operating facility and off-site sales offices under operating leases expiring no later than 2006. Future minimum lease payments under these leases, as of December 31, 1998, are as follows (in thousands):

| | |
|------|----------|
| 1999 | \$ 5,753 |
| 2000 | 7,533 |
| 2001 | 7,436 |

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| | |
|------------|-----------|
| 2002 | 7,134 |
| 2003 | 7,224 |
| Thereafter | 18,905 |
| | ----- |
| | \$ 53,985 |
| | ===== |

Rent expense was approximately \$1,773,000, \$4,150,000 and \$4,790,000 in 1996, 1997 and 1998, respectively.

7. STOCKHOLDERS' EQUITY

STOCKHOLDER RIGHTS PLAN

In June 1997, the Company's Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan") in which preferred stock purchase rights were distributed as a dividend at the rate of one Right for each share of common stock held as of the close of business on June 30, 1997. The Company adopted the plan to guard against partial tender offers and other abusive tactics that might be used in an attempt to gain control of the Company without paying all stockholders a fair price for their shares. The Rights Plan, which expires on June 13, 2007, will not prevent takeovers, but is designed to deter coercive takeover tactics and to encourage anyone attempting to acquire the Company to first negotiate with the Board.

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Each Right will entitle each stockholder to buy one-one thousandth of a newly issued share of Series A Junior Participating Preferred Stock of the Company at an exercise price of \$95.00. The Rights will be exercisable only if a person or group, other than an exempted person, makes a tender offer for, or acquires beneficial ownership of 15% or more of the Company's then-outstanding common stock.

If any person other than an exempted person becomes the beneficial owner of 15% or more of the Company's outstanding common stock, then each Right not owned by such person or certain related parties will entitle its holders to purchase, at the Right's then-current exercise price, shares of the Company's common stock (or, in certain circumstances, cash, property or other securities of the Company) having a market value equal to twice the then-current exercise price. In addition, if, after a person becomes the beneficial owner of 15% or more of the Company's outstanding common stock, the Company is acquired in a merger or other business combination transaction, or sells 50% or more of its assets or earning power to another person, each Right will entitle its holder to purchase, at the Right's then-current exercise price, shares of common stock of such other person having a market value equal to twice the then-current exercise price.

The Company's Board of Directors will generally be entitled to redeem the Rights at \$.01 per Right at any time prior to a person or group acquiring 15% or more of the Company's common stock.

EMPLOYEE STOCK-BASED COMPENSATION PLANS

1995 Stock Option/Stock Issuance Plan

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At December 31, 1998, approximately 5,315,300 shares of common stock were authorized for issuance under the Company's 1995 Stock Option/Stock Issuance Plan (the "1995 Plan"), which serves as the successor equity incentive program to the Company's 1991 Stock Option/Stock Issuance Plan (the "1991 Plan"). The 1995 Plan will terminate on September 13, 2005, unless sooner terminated by the Board of Directors.

The 1995 Plan is divided into three separate components: (i) the Discretionary Option Grant Program under which eligible individuals may, at the discretion of the Plan Administrator, be granted incentive or non-statutory stock options to purchase shares of common stock at an exercise price not less than 100% or 85%, respectively, of their fair market value on the grant date; (ii) the Stock Issuance Program under which individuals may, at the Plan Administrator's discretion, be issued shares of common stock directly either by the purchase of such shares at a price not less than 85% of their fair market value at the time of issuance or in consideration of the past performance of services; and (iii) the Automatic Option Grant program under which non-statutory stock option grants will be automatically made at periodic intervals to eligible non-employee Board members to purchase shares of common stock at an exercise price equal to 100% of their fair market value on the grant date. Options are exercisable at times and in increments as specified by the Plan Administrator and generally expire ten years after grant.

On May 9, 1997, the Compensation Committee of the Board of Directors approved the repricing of certain outstanding stock options under the Company's 1995 Plan with exercise prices in excess of the fair market value on May 9, 1997. Each employee or officer who elected prior to May 9, 1997 to participate in the repricing program received a new option with an exercise price of \$13.50 per share (the fair market value on May 9, 1997). Each repriced option retained its original vesting schedule except that no portion of the option could be exercised prior to December 9, 1997 and no vesting accrued between May 9, 1997 and December 9, 1997. Certain options granted within 12 months of May 9, 1997 were subject to a longer vesting schedule. Approximately 1,008,000 shares subject to stock options were repriced pursuant to this program.

1999 NON-EMPLOYEE DIRECTORS' OPTION PLAN

In October 1998, the Board of Directors approved the new Non-Employee Director's Option Plan (subject to stockholder approval) to include an initial pool of 300,000 shares available for issuance under the plan. This plan will replace the automatic grant program of the 1995 Stock Option/Stock Issuance Plan. Options are exercisable at times and increments as specified by the Plan Administrator and generally expire ten years after grant date. The new plan has a term of ten years.

There were no repricings of outstanding stock options during the year ended December 31, 1998.

The share reserve for the 1995 Plan automatically increases on the first trading day in each of the 1996 (1,048,200 shares reserved), 1997 (1,158,600 shares reserved), 1998 (1,226,200 shares reserved), and 1999 (1,351,400 shares reserved) and calendar years by the number of shares equal to five percent of the total number of shares of the Company's common and common stock equivalents outstanding on December 31 of the immediately preceding calendar year.

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Option activity for all plans is summarized as follows:

| | Options Outstanding | |
|---|---------------------|-------------------------------|
| | Number of Shares | Weighted A Exercise per |
| Outstanding, January 1, 1996 | | |
| (1,744,700 exercisable at a weighted average price of \$1.35) | 1,833,400 | \$ |
| Options granted | 1,365,800 | |
| Options exercised | (442,100) | |
| Options cancelled | (188,100) | |
| | | |
| Outstanding, December 31, 1996 | | |
| (1,296,100 exercisable at a weighted average price of \$2.06) | 2,569,000 | |
| Options granted | 2,276,700 | |
| Options exercised | (305,000) | |
| Options cancelled | (1,351,800) | |
| | | |
| Outstanding, December 31, 1997 | | |
| (1,120,500 exercisable at a weighted average price of \$4.02) | 3,188,900 | |
| Options granted | 2,635,300 | |
| Options exercised | (369,100) | |
| Options cancelled | (597,500) | |
| | | |
| Outstanding, December 31, 1998 | | |
| (1,343,100 exercisable at a weighted average price of \$8.30) | 4,857,600 | \$ |
| | ===== | = |

The weighted average fair value of options granted for 1996, 1997 and 1998 was \$12.82, \$5.88 and \$7.75, respectively.

At December 31, 1998, approximately 10,000 shares of common stock issued under the 1991 Plan were subject to repurchase. At December 31, 1998, an aggregate of approximately 455,100 shares were available for future grant under the 1991 and 1995 plans.

The following information applies to options outstanding at December 31, 1998:

| Options Outstanding | | | |
|-----------------------------|-----------------------|---|---------------------------------------|
| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price |
| \$ 0.11 - 3.56 | 510,700 | 6.23 | \$ 1.67 |
| 4.00 - 8.69 | 563,100 | 8.81 | 7.77 |
| 9.22 - 11.25 | 510,100 | 8.84 | 10.87 |
| 11.31 - 12.15 | 623,600 | 9.07 | 11.87 |
| 12.31 - 13.44 | 651,400 | 9.21 | 13.05 |
| 13.50 - 13.50 | 695,900 | 8.28 | 13.50 |

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| | | | |
|-----------------|-----------|-------|----------|
| 13.56 - 14.81 | 556,300 | 9.15 | 14.17 |
| 14.88 - 16.88 | 508,900 | 8.96 | 15.00 |
| 17.00 - 24.13 | 236,600 | 8.75 | 19.73 |
| 34.50 - 34.50 | 1,000 | 8.07 | 34.50 |
| ----- | ----- | ---- | ----- |
| \$ 0.11 - 34.50 | 4,857,600 | 8.60 | \$ 11.59 |
| ===== | ===== | ===== | ===== |

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EMPLOYEE STOCK PURCHASE PLAN

At December 31, 1998, the Company had a total of approximately 642,000 shares of common stock reserved for future issuance under its Employee Stock Purchase Plan (the ESPP). The purpose of the ESPP is to provide eligible employees of the Company with a means of acquiring common stock of the Company through payroll deductions. The plan consists of four six-month purchase periods in each two year offering period. Employees purchase stock at 85% of the market value at either the beginning of the offering period or at the end of the purchase period, whichever price is lower. No participant may purchase more than \$25,000 worth of common stock in any calendar year. Employees may end their participation in the offering at any time during the offering period, and participation ends automatically on termination of employment with the Company. During 1996, 1997 and 1998, approximately 289,000, 463,000 and 477,000 shares, respectively, were sold through the ESPP.

STOCK-BASED COMPENSATION

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation." If compensation cost for the 1995 Plan and the ESPP had been determined based on the fair value on the grant dates for awards in 1996 and 1995 consistent with the provisions of SFAS No. 123, the Company's net income (loss) and diluted net income (loss) per share would have been reduced to the pro forma amounts indicated below (in thousands except per share data):

| | 1996 | 1997 | 1998 |
|---|----------|-----------|--------|
| | ----- | ----- | ----- |
| Pro forma net income (loss) | \$ 6,398 | \$ (849) | \$ 434 |
| Pro forma basic net income (loss) per share | \$ 0.32 | \$ (0.04) | \$0.02 |
| Pro forma diluted net income (loss) per share | \$ 0.29 | \$ (0.04) | \$0.02 |
| | ----- | ----- | ----- |

Pro forma net income (loss) reflects only options granted since January 1, 1995. Therefore, the full impact of calculating compensation cost under SFAS 123 is not reflected in the pro forma amounts presented above because compensation cost is reflected over the options' vesting period of generally four or five years and compensation cost for options granted prior to January 1, 1995 is not considered.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used:

| | 1996 | 1997 | 1998 |
|-------------------------|-------|-------|-------|
| Risk free interest rate | 6.00% | 5.74% | 5.15% |
| Expected life (years) | 4 | 4 | 4 |
| Volatility | 0.55 | 0.55 | 0.77 |
| Dividends yield | 0.00 | 0.00 | 0.00 |

The fair value of employees' stock purchase rights under the ESPP was estimated using the Black-Scholes model with the following assumptions:

| | 1996 | 1997 | 1998 |
|-------------------------|----------|----------|-------|
| Risk free interest rate | 6.00% | 5.74% | 5.50% |
| Expect life (months) | 6 and 12 | 6 and 12 | 6 |
| Volatility | 0.55 | 0.55 | 0.77 |
| Dividends yield | 0.00 | 0.00 | 0.00 |

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8. INCOME TAXES

The components of the provision for income taxes are as follows (in thousands):

| | 1996 | 1997 | 1998 |
|--------------------------|---------|----------|----------|
| Federal-current payable | \$ 152 | \$ 3,185 | \$ 5,284 |
| Federal-deferred | 3,172 | (802) | (735) |
| State-current payable | 5 | 452 | 686 |
| State deferred | 612 | (142) | 61 |
| Foreign-deferred | - | (961) | (1,385) |
| Valuation allowance | (3,001) | 576 | 387 |
| Provision for income tax | \$ 940 | \$ 2,308 | \$ 4,298 |
| | ===== | | |

The reconciliation of the statutory federal income tax to the effective rate is as follows (as a percent of pretax income):

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| | 1996 | 1997 | 1998 |
|---------------------------------------|------|------|------|
| Federal statutory tax rate | 34% | 34% | 35% |
| State tax, net of federal tax benefit | 6 | 5 | 4 |
| Permanent differences | 3 | (3) | 1 |
| Tax credits utilized | (4) | (4) | (5) |
| Utilization of net operating losses | (19) | 0 | 0 |
| Change in valuation allowance | (14) | 9 | 3 |
| Other | 4 | (4) | (1) |
| Provision for income tax | 10% | 37% | 37% |

The significant components of deferred tax assets are as follows (in thousands):

| | 1997 | 1998 |
|---------------------------------|----------|----------|
| Foreign loss carryforward | \$ 961 | \$ 2,124 |
| Tax credit carryforwards | 1,360 | 600 |
| Reserves | 862 | 1,525 |
| Accrued expenses | 1,798 | 1,367 |
| Deferred revenue | 788 | 2,232 |
| Other | 499 | (91) |
| Valuation allowance | (576) | (963) |
| Net deferred tax assets | \$ 5,692 | \$ 6,794 |
| Current deferred tax assets | \$ 4,133 | \$ 4,934 |
| Non-current deferred tax assets | 1,559 | 1,860 |
| Net deferred tax assets | \$ 5,692 | \$ 6,794 |

The Company has not recorded a valuation allowance for those deferred tax assets that management believes are more likely than not to be realized through taxable income in the carryback period or through future taxable income. However, at December 31, 1998, a valuation allowance of approximately \$963,000 has been recorded. This valuation allowance is provided because of the uncertainty regarding realization of certain foreign tax net operating losses as a result of the limited profitable operating history in certain foreign tax jurisdictions.

At December 31, 1998, the Company had a foreign loss carryforward of \$6,069,000 and state tax credit carryforwards totalling \$923,000. The carryforwards will expire between 2001 and 2008.

9. SEGMENT INFORMATION AND MAJOR CUSTOMERS

In accordance with Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information," the

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Company is required to disclose information about its products, services, the geographic area in which it operates and major customers. The Company operates in a single industry segment encompassing the design, development, marketing and technical support for front-office automation software.

The following are revenues and long-lived assets by geographic area as of and for the years ended December 31 (in thousands):

| | Revenues | | | Long-Lived Assets | |
|---------------------|----------|----------|-----------|-------------------|---------|
| | 1996 | 1997 | 1998 | 1997 | 1998 |
| U.S. | \$48,620 | \$79,121 | \$ 97,928 | \$7,639 | \$7,257 |
| International | 7,702 | 9,096 | 32,582 | 972 | 1,180 |
| Total | \$56,322 | \$88,217 | \$130,510 | \$8,611 | \$8,437 |

No one customer accounted for more than 10% of total revenues in 1996, 1997 and 1998.

10. RETIREMENT PLAN

Effective August 1991, the Company began a voluntary 401(k) plan covering substantially all employees. The plan provides for discretionary employer contributions. No employer contributions were made or authorized in 1996, 1997 or 1998.

11. SUBSEQUENT EVENT

On March 12, 1999, the Board of Directors approved an amendment to the current ESPP. The Company anticipates that the shares available for future purchase under the current plan will be depleted on or before April 30, 2000. The Board approved the following amendment to include one final six-month offering period commencing May 1, 1999 and ending October 31, 1999. All other terms for participation by employees will remain the same. The current plan will terminate after this final purchase period. Additionally, the Board approved the new 1999 Employee Stock Purchase Plan (subject to stockholder approval) to include an initial pool of 1,000,000 shares available for purchase under the Plan plus an annual increase to the shares reserved under the Plan on the first day of each fiscal year in 2000, 2001, 2002, 2003 and 2004 equal to the lesser of (i) 500,000, (ii) 5% of the Company's common stock outstanding on the last day of the preceding fiscal year, or (iii) a lesser number of shares as determined by the Board, for stock purchases. The new Plan has a term of 20 years.

CLARIFY INC.
REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF CLARIFY, INC.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Clarify,

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Inc. and its subsidiaries at December 31, 1997 and 1998, and the results of their operations and their cash flows in each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ Pricewaterhouse Coopers LLP

San Jose, California, January 19, 1999
except for Note 11 for which the date is March 12, 1999

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Nortel Networks Corporation
Brampton, Ontario (Canada)

We have audited the accompanying combined balance sheet of the Clarify business ("Clarify") of Nortel Networks Corporation ("Nortel Networks") as of December 31, 2000, and the related combined statements of operations, net investment and cash flows for the period from March 17, 2000 (acquisition date) to December 31, 2000. We have also audited the accompanying consolidated balance sheet of the predecessor of the Clarify business, Clarify Inc., as of December 31, 1999 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended, and for the period from January 1, 2000 to March 16, 2000. These financial statements are the responsibility of Nortel Networks' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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As discussed in Note 1 to the financial statements, the balance sheet of the Clarify business of Nortel Networks as of December 31, 2000 includes the net assets acquired by Nortel Networks in its purchase of Clarify on March 16, 2000, after giving effect to the allocation of Nortel Networks' purchase price to Clarify's net assets and to the changes in the net assets of Clarify subsequent to the acquisition; the related combined statements of operations, net investment and cash flows reflect the results of operations and the cash flows of Clarify subsequent to such acquisition after giving effect to the allocation of Nortel Networks' purchase price to Clarify's net assets.

In our opinion, such combined financial statements present fairly, in all material respects, the financial position of the Clarify business of Nortel Networks as of December 31, 2000, and the results of its operations and its cash flows for the period from March 17, 2000 to December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the above-mentioned consolidated financial statements of the predecessor of Clarify present fairly, in all material respects, its financial position as of December 31, 1999 and its results of operations and its cash flows for the year ended December 31, 1999, and for the period from January 1, 2000 to March 16, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

January 7, 2002

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CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)

BALANCE SHEETS
(In thousands, except par value amounts)

| ASSETS | Predecessor Company December 1999 ----- |
|---|---|
| Current assets: | |
| Cash and cash equivalents | \$ 37,49 |
| Short-term investments | 21,21 |
| Accounts receivable, net of allowance for doubtful accounts and returns of \$5,894 in 1999 and \$876 in 2000 | 76,24 |
| Prepaid expenses and other current assets..... | 7,69 |
| Deferred tax assets | 7,51 |
| Receivable from Nortel Networks Corporation | - |
| Total current assets | ----- 150,15 |
| Property and equipment, net | 16,98 |
| Long-term investments | 19,58 |
| Noncurrent deferred tax assets | 3,26 |
| Other noncurrent assets | 1,14 |
| Acquired intangibles, net | 14,95 |

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| | |
|--------------------|-----------|
| Total assets | \$ 206,10 |
|--------------------|-----------|

LIABILITIES AND STOCKHOLDERS' EQUITY / NET INVESTMENT

| | |
|-------------------------------------|-----------|
| Current liabilities: | |
| Accounts payable | \$ 17,80 |
| Payroll-related accruals | 14,38 |
| Other accrued liabilities | 10,01 |
| Income taxes payable | 20 |
| Unearned revenue | 36,50 |
| Total current liabilities | 78,90 |

Commitments (Note 5)

| | |
|--|--------|
| Stockholders' equity/net investment: | |
| Nortel Networks Corporation net investment | - |
| Preferred stock, \$.0001 par value, 5,000 shares authorized; none outstanding . | - |
| Common stock, \$.0001 par value, 55,000 shares authorized; 24,060 shares issued and outstanding in 1999 | 100,50 |
| Additional paid-in-capital | (80) |
| Accumulated other comprehensive loss | 27,48 |
| Retained earnings | - |

| | |
|---|--------|
| Total stockholders' equity/net investment | 127,19 |
|---|--------|

| | |
|---|-----------|
| Total liabilities and stockholders' equity/net investment | \$ 206,10 |
|---|-----------|

See notes to financial statements.

CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)

STATEMENTS OF OPERATIONS
(In thousands)

| | Predecessor Company | | |
|--------------------------|------------------------------------|---|--|
| | Year Ended December 31, 1999 | Period from January 1, 2000 to March 16, 2000 | Period Fro March 17, 2000 to December 3 2000 |
| Revenues: | | | |
| License fees | \$ 134,687 | \$ 4,330 | \$ 159,647 |
| Services | 96,010 | 22,293 | 118,292 |
| Total revenues | 230,697 | 26,623 | 277,939 |

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| | | | |
|--|-----------|-------------|--------------|
| Cost of revenues: | | | |
| License fees | 3,764 | 1,252 | 5,522 |
| Services | 50,935 | 13,397 | 59,865 |
| | ----- | ----- | ----- |
| Total cost of revenues | 54,699 | 14,649 | 65,387 |
| | ----- | ----- | ----- |
| Gross margin | 175,998 | 11,974 | 212,552 |
| Operating expenses: | | | |
| Product development and engineering | 29,837 | 9,395 | 56,237 |
| Sales and marketing | 101,706 | 31,186 | 118,784 |
| General and administrative | 14,803 | 3,946 | 15,648 |
| In-process research and development | 2,348 | -- | 63,939 |
| Merger-related expenses | 2,464 | -- | -- |
| Amortization of acquired intangibles | 978 | 810 | 557,223 |
| | ----- | ----- | ----- |
| Total operating expenses .. | 152,136 | 45,337 | 811,831 |
| | ----- | ----- | ----- |
| Operating income (loss) | 23,862 | (33,363) | (599,279) |
| Interest income | 2,225 | 599 | 829 |
| Interest expense | (41) | (4) | (1) |
| Other income (expense), net | 539 | 214 | (1,678) |
| | ----- | ----- | ----- |
| Income (loss) before income taxes | 26,585 | (32,554) | (600,129) |
| Provision (benefit) for income taxes . | 11,908 | (14,773) | (28,194) |
| | ----- | ----- | ----- |
| Net income (loss) | \$ 14,677 | \$ (17,781) | \$ (571,935) |
| | ===== | ===== | ===== |

See notes to financial statements.

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CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)
STATEMENTS OF STOCKHOLDERS' EQUITY / NET INVESTMENT
(In thousands)

| | NORTEL NETWORKS CORPORATION NET INVESTMENT | COMMON STOCK SHARES | AMOUNT | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED OTHER COMPRE- HENSIVE INCOME | DEFERRED STOCK COMPEN- SATION |
|---------------------------------|--|------------------------|-----------|----------------------------------|--|--|
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Predecessor company: | | | | | | |
| Balances, January 1, 1999 | 22,168 | \$ 2 | \$ 59,127 | \$ (602) | \$ (18) | |

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| | | | | | |
|--|--|--|--|-------|------|
| Net income | | | | | |
| Other comprehensive loss, net of tax: | | | | | |
| Translation adjustment | | | | (116) | |
| Change in unrealized gain on investment | | | | | (85) |
| Total comprehensive income | | | | | |

| | | | | | |
|---|-------|-------|--------|-------|-------|
| Exercise of stock options | 1,217 | | 11,896 | | |
| Employee stock purchases | 414 | | 5,486 | | |
| Common stock issued for Newtonian Acquisition | 261 | | 11,162 | | |
| Amortization of deferred stock option compensation | | | | | 18 |
| Tax benefit from exercise of nonqualified stock options | | | 12,837 | | |
| | ----- | ----- | ----- | ----- | ----- |

| | | | | | |
|---------------------------------|--------|------|---------|-------|----|
| Balances, December 31, 1999 ... | 24,060 | \$ 2 | 100,508 | (803) | -- |
|---------------------------------|--------|------|---------|-------|----|

| | | | | | |
|--|--|--|--|-----|---|
| Net loss | | | | | |
| Other comprehensive income, net of tax: | | | | | |
| Translation adjustment | | | | 291 | |
| Change in unrealized gain on investment | | | | | 6 |
| Total comprehensive loss | | | | | |

| | | | | | |
|---|--------|-------|-----------|----------|-------|
| Exercise of stock options | 267 | | 3,552 | | |
| Employee stock purchases | 54 | | 3,730 | | |
| Tax benefit from exercise of nonqualified stock options | | | 4,740 | | |
| | ----- | ----- | ----- | ----- | ----- |
| Balances, March 16, 2000 | 24,381 | \$ 2 | \$112,530 | \$ (506) | \$ -- |
| | ===== | ===== | ===== | ===== | ===== |

=====

Balance, March 17, 2000 \$2,042,441

| | |
|---|-----------|
| Net loss | (571,935) |
| Other comprehensive income, net of tax-translation adjustment | 1,445 |

 Total comprehensive
 loss

Contribution of Introspect
Systems, Inc. 6,174

Tax benefit from exercise
of nonqualified stock
options 47,122

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Balance, December 31, 2000 \$1,525,247
 =====

See notes to financial statements.

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CLARIFY
 (A BUSINESS OF NORTEL NETWORKS CORPORATION)

STATEMENTS OF CASH FLOWS
 (In thousands)

| | Predecessor |
|--|------------------------------------|
| | Year Ended December 31, 1999 |
| | ----- |
| Cash flows from (used in) operating activities: | |
| Net income (loss) | \$ 14,677 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effects of acquisitions: | |
| Depreciation and amortization | 6,829 |
| Provision for doubtful accounts and returns | 2,773 |
| Deferred income taxes | (3,243) |
| Gain on disposal of assets | (434) |
| Write-off of acquired in-process research and development | 2,348 |
| Tax benefit from exercise of nonqualified stock options | 12,837 |
| Changes in assets and liabilities: | |
| Accounts receivable | (33,392) |
| Prepaid and other assets | (4,365) |
| Accounts payable | 11,835 |
| Payroll-related accruals | 4,741 |
| Other accrued liabilities | (1,106) |
| Unearned revenue | 11,175 |
| | ----- |
| Net cash provided by (used in) operating activities | 24,675 |
| | ----- |
| Cash flows from (used in) investing activities: | |
| Purchase of property and equipment | (14,545) |
| Purchase of investments | (158,582) |
| Sale and maturities of investments | 144,133 |
| Acquisition of business, net of cash received | (6,727) |
| | ----- |
| Net cash provided by (used in) investing activities | (35,721) |
| | ----- |
| Cash flows from financing activities: | |
| Proceeds from issuance of common stock, net | 17,382 |
| Receivable from Nortel Networks Corporation | -- |
| | ----- |
| Net cash provided by (used in) financing activities | 17,382 |
| | ----- |

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| | |
|--|-----------|
| Net increase (decrease) in cash and cash equivalents | 6,336 |
| | ----- |
| Effect of foreign exchange rate changes on cash | (116) |
| Cash and cash equivalents, beginning of period | 31,271 |
| | ----- |
| Cash and cash equivalents, end of period | \$ 37,491 |
| | ===== |
| Supplemental disclosure of cash flow information: | |
| Cash paid during the year for interest | \$ 36 |
| | ===== |
| Cash paid during the year for taxes | \$ 7,123 |
| | ===== |
| Supplemental disclosure of noncash investing and financing activities: | |
| Change in unrealized holding gains on investments | \$ (85) |
| | ===== |
| Common stock issued for business acquisition | \$ 11,162 |
| | ===== |
| Contribution of Introspect Systems, Inc | \$ -- |
| | ===== |

See notes to financial statements.

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CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 1999 (PREDECESSOR COMPANY), PERIOD FROM
JANUARY 1, 2000 THROUGH MARCH 16, 2000 (PREDECESSOR COMPANY)
AND PERIOD FROM MARCH 17, 2000
THROUGH DECEMBER 31, 2000

1. BUSINESS OF THE COMPANY

On March 16 2000, Nortel Networks Limited (then known as Nortel Networks Corporation), currently the principal operating subsidiary of Nortel Networks Corporation ("Nortel Networks"), acquired all of the issued and outstanding shares of Clarify Inc. ("Clarify"), a Delaware corporation, in a transaction ("the Acquisition") that was accounted for using the purchase method (the on-going business is also referred to as "Clarify"). Clarify was founded in August 1990 to develop, market and support adaptable client/server application software designed to address the external and internal service, support, and product quality needs of today's global enterprises. Clarify markets its software and services through its direct sales organization and other Nortel Networks sales organizations.

As a result of the ownership change, the accompanying financial statements reflect the effect of the purchase accounting adjustments that relate to Clarify in accordance with Staff Accounting Bulletin No. 54 of the United States Securities and Exchange Commission. The financial statements of Clarify for the period prior to the March 16, 2000 acquisition date are referred to herein as the Predecessor Company financial statements. The aggregate purchase price allocated to Clarify as of March 16, 2000 was

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\$2,083 million. The allocation of the purchase price, based on the estimated fair value of the net assets, was to net tangible assets of \$18 million, in-process research and development ("IPR&D") of \$64 million, acquired technology of \$210 million, and goodwill of \$1,791 million. The goodwill is being amortized over three years, and the acquired technology is being amortized over two years. On August 24, 2000, a division of Nortel Networks acquired specified assets and assumed specified liabilities of Introspect Systems, Inc. ("ISI"), a privately held Clarify implementation and training consultancy. This acquisition was contributed to Clarify. The aggregate purchase price was approximately \$7 million of which Nortel Networks paid \$6.2 million on behalf of Clarify and other acquisition costs of \$0.8 million were paid by Clarify. The allocation of the purchase price was to goodwill of \$6.7 million and net intangible assets of \$0.3 million. The goodwill is being amortized over three years.

Effective December 31, 2000, Nortel Networks merged Clarify into another Nortel Networks' legal entity and Clarify ceased to exist as a separate legal entity. The accompanying financial statements reflect the carved-out operations and financial position of Clarify as if it had been a stand-alone entity for the period from March 17, 2000 to December 31, 2000. The financial statements therefore include revenue and cost of sales of Clarify's product, as well as personnel, facilities and other expenses which were directly attributable to Clarify's general and administrative, research and development, and sales and marketing activities.

Subsequent to the acquisition, certain functions and processes (including, but not limited to, cash management, processing of receivables and certain payables, legal services, and payroll ("centralized services")) were transitioned during the period from March 17, 2000 to December 31, 2000 to be performed centrally by Nortel Networks for Clarify. Costs for these services are billed to Clarify based on actual usage and are included in Clarify's statement of operations. These costs totaled \$167.4 million for the period from March 17, 2000 to December 31, 2000. Although management is unable to determine the actual costs that would have been incurred if the services performed by Nortel Networks had been purchased from independent third parties, management considers the allocation methodology

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described to be reasonable. The financial position, results of operations and cash flows of Clarify may differ from those that would have been achieved had Clarify operated independent of Nortel Networks for the period after March 16, 2000.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statements - The accompanying combined financial statements of the Clarify business of Nortel Networks include the net assets acquired by Nortel Networks in its purchase of Clarify on March 16, 2000, and the results of Clarify's operations and its cash flows for the period from March 17, 2000 to December 31, 2000, after giving effect to the allocation of Nortel Networks' purchase price to Clarify's net assets, to the changes in net assets of Clarify subsequent to the acquisition and to allocations of certain operating costs provided by Nortel Networks (see Note 1). Accordingly, such financial statements do not purport to be those of Clarify as a separate corporate entity prepared on a historical cost basis of accounting. The accompanying financial statements of Clarify for periods presented prior to March 17, 2000 represent the stand-alone consolidated financial statements of Clarify. All significant intercompany balances and transactions have been eliminated. The functional currency for the majority of Clarify's foreign operations is the applicable local currency. The translation from the applicable foreign currency to U.S.

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dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using the weighted average exchange rate during the period. Adjustments resulting from such translation are reflected in accumulated other comprehensive income. Gains or losses resulting from foreign currency transactions are included in the results of operations.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include allowance for doubtful accounts, valuation of IPR&D and estimated useful life of tangible and intangible assets.

Financial Instruments - Clarify considers cash and all highly liquid investments purchased with a remaining maturity of less than three months at the date of purchase to be cash equivalents. Short-term and long-term investments are classified as available-for-sale and are carried at fair market value. Unrealized holding gains and losses on such investments are reported, net of related taxes, as a part of accumulated other comprehensive income. Realized gains and losses on sales of such investments are reported in earnings and computed using the specific identification cost method.

The amounts reported for cash equivalents, accounts receivables and other financial instruments are considered to approximate fair value based upon comparable market information available at the respective balance sheet dates.

The financial instruments that potentially subject Clarify to concentrations of credit risk comprise principally cash and cash equivalents, investments and trade accounts receivable. Cash and cash equivalents and investments are, for the most part, held by three major financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. These deposits may

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generally be redeemed upon demand and, therefore, bear minimal risk. Clarify's customer base is dispersed across many different geographic areas throughout the United States, Europe and Asia and consists principally of companies in the networking equipment, high-end software, telecommunications and computer systems industries. Clarify performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses. Collateral, such as letters of credit and bank guarantees, is generally not required.

In the normal course of business, Clarify has exposures to foreign currency fluctuations arising from foreign currency sales and purchases and intercompany transactions, among other things. Prior to its acquisition by Nortel Networks, Clarify used foreign exchange forward contracts to limit its exposure to foreign exchange losses arising from foreign currency payables and receivables. Clarify evaluated its net exposure therefrom and entered into forward contracts to hedge the net exposure over a specified amount. Gains and losses on these contracts served as hedges in that they offset fluctuations that would otherwise impact Clarify's financial results. Costs associated with entering into

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such contracts were generally amortized over the life of the instruments and are not material to Clarify's consolidated financial results. After its acquisition by Nortel Networks, Clarify no longer engaged in foreign currency hedging activities to offset its net foreign currency exposure.

At December 31, 1999, Clarify had foreign currency forward contracts outstanding to hedge foreign currency intercompany accounts receivable and accounts payable. The total aggregate fair value and the net unrealized loss on foreign exchange contracts for the year ended December 31, 1999 were \$15.0 million and \$88,000, respectively.

Revenue Recognition - Clarify's revenue is derived from primarily two sources, across many industries: (i) product license revenue, derived primarily from product sales to customers, including large-scale enterprises; and (ii) service and support revenue, derived primarily from providing software updates, support, training and consulting services to customers.

Clarify applies the provisions of Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended, and recognizes product revenue upon delivery if a signed contract and customer purchase order exists, the fee is fixed and determinable and collection of resulting receivables is probable.

For contracts with multiple obligations (e.g., deliverable and undeliverable products, maintenance and other services), Clarify allocates revenue to each component of the contract based on objective evidence of its fair value, which is specific to Clarify, or for products not being sold separately, the price established by management ("VSOE"). If VSOE cannot be determined, the entire transaction is deferred until such time as VSOE exists for the undelivered product. Clarify recognizes revenue allocated to maintenance fees for ongoing customer support and product updates ratably over the period of the maintenance contract. Payments for maintenance fees are generally made in advance and are nonrefundable. For revenue allocated to training and consulting services, Clarify recognizes revenue as the related services are performed. Contracts that have extended payment terms are recognized as the amounts become due (if the terms are greater than 90 days).

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Property and Equipment - Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets (generally three to five years). Leasehold improvements are amortized over the lesser of their useful lives or the term of the lease. Upon disposal, the assets and related accumulated depreciation are removed from Clarify's accounts, and the resulting gains or losses are reflected in the statement of operations.

When events and circumstances warrant a review, Clarify evaluates the carrying values of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of. An impairment review is performed whenever events or circumstances indicate that the carrying value may not be recoverable. Certain factors that Clarify considers important which could trigger an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets

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or the strategy for Clarify's overall business, and significant negative industry or economic trends.

The carrying values of long-lived assets, certain identifiable intangibles, and goodwill related to those assets are considered impaired when the anticipated undiscounted cash flow from such assets is less than their carrying values. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value. Fair value is determined using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of are determined in a similar manner, except that fair values are reduced by the cost to dispose of such assets.

Income Taxes - Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Clarify is required to adjust its deferred tax liabilities in the period when tax rates or the provisions of the income tax laws change. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Product Development and Engineering Expenditures - Costs related to research, design and development of products are charged to product development and engineering expenses as incurred. Software development costs are capitalized beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. Generally, Clarify's products are released soon after technological feasibility has been established. As a result, costs subsequent to achieving technological feasibility have not been significant and all software development costs have, therefore, been expensed.

Advertising Costs - Advertising costs are expensed as incurred and totaled \$2,617,000 for the year ended December 31, 1999, \$980,000 for the period January 1 to March 16, 2000 and \$689,000 for the period March 17 to December 31, 2000.

Stock-Based Compensation - SFAS No. 123, Accounting for Stock-Based Compensation, encourages but does not require companies to record compensation cost for stock-based compensation plans at fair value. Clarify has chosen to continue to account for employee stock options using the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock

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Issued to Employees. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of Clarify's stock at the date of the grant over the amount an employee must pay to acquire the stock.

Reclassifications - Certain reclassifications have been made to the 1999 financial statements to conform with the 2000 financial statement presentation. The reclassifications had no impact on net loss or stockholders' equity.

Recently Issued Accounting Standards - In August 2001, the Financial

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Accounting Standards Board (the "FASB") issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS No. 121, and the accounting and reporting provisions of APB 30, for the disposal of a segment of a business. The provisions of SFAS No. 144 are required to be adopted by Clarify effective January 1, 2002. Clarify has not yet determined the effect that the adoption of SFAS No. 144 will have on its business, results of operations, and financial condition.

In June 2001, the FASB issued SFAS No. 141, Business Combinations, effective for business combinations initiated after June 30, 2001, and SFAS No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. SFAS No. 141 transitional rules require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. As a result, the pooling-of-interests method is now prohibited. SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Thus, amortization of goodwill, including goodwill recorded in past business combinations, and intangibles with an indefinite life, will cease upon adoption of this Statement, which for Clarify will be January 1, 2002. However, for any acquisitions completed after June 30, 2001, goodwill and intangible assets with an indefinite life will not be amortized. The adoption of SFAS No. 141 will not have an impact on the business, results of operations, and financial condition of Clarify. The first of the required SFAS No. 142 impairment tests will be performed during 2002 and Clarify has not yet determined the effect that the adoption of SFAS No. 142 will have on its business, results of operations, and financial condition.

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. SFAS No. 133 will be effective for Clarify's fiscal year 2001. Management has determined that this statement will not have a significant impact on Clarify.

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3. PROPERTY AND EQUIPMENT

Property and equipment at December 31 consists of the following (in thousands):

| | 1999 | 2000 |
|---|----------|----------|
| | ----- | ----- |
| Leasehold improvements | \$ 4,305 | \$ 7,531 |
| Equipment | 9,446 | 3,335 |
| Furniture and fixtures | 8,543 | 5,825 |
| Purchased software | 4,947 | 4,200 |
| | ----- | ----- |
| | 27,241 | 20,891 |
| Accumulated depreciation and amortization | (10,257) | (5,156) |
| | ----- | ----- |

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| | | |
|-----------------------------------|-----------|-----------|
| Property and equipment, net | \$ 16,984 | \$ 15,735 |
| | ===== | ===== |

4. ACQUIRED INTANGIBLES

Acquired intangibles at December 31 consist of the following (in thousands):

| | 1999 | 2000 |
|---------------------------|-----------------|------------------------|
| | ----- | ----- |
| Acquired technology | \$ 5,280 | \$ 210,147 |
| Goodwill | 10,657 | 1,797,671 |
| | ----- | ----- |
| Accumulated amortization | 15,937 (978) | 2,007,818 (557,223) |
| | ----- | ----- |
| Acquired intangibles, net | \$ 14,959 | \$ 1,450,595 |
| | ===== | ===== |

5. COMMITMENTS

Clarify leases its principal operating facility and off-site sales offices under operating leases expiring no later than 2007. Future minimum lease payments under these leases, as of December 31, 2000, are as follows (in thousands):

| | |
|------------------|----------|
| 2001 | \$ 8,823 |
| 2002 | 8,985 |
| 2003 | 9,154 |
| 2004 | 8,883 |
| 2005 | 8,376 |
| Thereafter | 12,031 |
| | ----- |
| | \$56,252 |
| | ===== |

Rent expense was approximately \$7,274,000 in 1999, \$2,457,000 for the period from January 1, 2000 through March 16, 2000, and \$10,729,000 for the period from March 17, 2000 through December 31, 2000.

6. EMPLOYEE STOCK PLANS

Employee Stock-Based Compensation Plans

As a result of the acquisition of Clarify by Nortel Networks, all stock

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option plans were assumed by Nortel Networks; however, no Clarify options were granted subsequent to the acquisition. Canadian regulatory requirements do not allow further options to be granted without stockholder approval.

1995 Stock Option/Stock Issuance Plan - Clarify's 1995 Stock Option/Stock Issuance Plan (the "1995 Plan"), which serves as the successor equity incentive program to Clarify's 1991 Stock Option/Stock Issuance Plan (the "1991 Plan"), is divided into three separate components: (i) the Discretionary Option Grant Program under which eligible individuals may, at the discretion of the Plan Administrator, be granted incentive or nonstatutory stock options to purchase shares of common stock at an exercise price not less than 100% or 85%, respectively, of their fair market value on the grant date; (ii) the Stock Issuance Program under which individuals may, at the Plan Administrator's discretion, be issued shares of common stock directly either by the purchase of such shares at a price not less than 85% of their fair market value at the time of issuance or in consideration of the past performance of services; and (iii) the Automatic Option Grant program under which nonstatutory stock option grants will be automatically made at periodic intervals to eligible nonemployee Board members to purchase shares of common stock at an exercise price equal to 100% of their fair market value on the grant date. Options are exercisable at times and in increments as specified by the Plan Administrator and generally expire ten years after grant.

On May 9, 1997, the Compensation Committee of the Board of Directors approved the repricing of certain outstanding stock options under Clarify's 1995 Plan with exercise prices in excess of the fair market value on May 9, 1997. Each employee or officer who elected prior to May 9, 1997 to participate in the repricing program received a new option with an exercise price of \$13.50 per share (the fair market value on May 9, 1997). Each repriced option retained its original vesting schedule except that no portion of the option could be exercised prior to December 9, 1997 and no vesting accrued between May 9, 1997 and December 9, 1997. Certain options granted within 12 months of May 9, 1997 were subject to a longer vesting schedule. Approximately 1,008,000 shares of Clarify common stock subject to stock options were repriced pursuant to this program.

1999 NonEmployee Directors' Option Plan - In October 1998, the Board of Directors approved the new NonEmployee Directors' Option Plan to include an initial pool of 300,000 shares of Clarify common stock available for issuance under the plan. This plan replaced the automatic grant program of the 1995 Stock Option/Stock Issuance Plan. Options are exercisable at times and in increments as specified by the Plan Administrator and generally expire ten years after grant date.

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Option activity for all plans is summarized as follows:

| Outstanding Options | |
|---------------------|--|
| Number of Shares | Weighted Average Exercise Price per Share |
| | |

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| | | |
|--|-------------|----------|
| Outstanding, January 1, 1999 (1,343,100 exercisable at a weighted average price of \$8.30) | 4,857,600 | \$ 11.59 |
| Options granted | 3,800,100 | 37.70 |
| Options exercised | (1,216,500) | 9.62 |
| Options cancelled | (649,000) | 18.13 |
| | ----- | ----- |
| Outstanding, December 31, 1999 (1,543,700 exercisable at a weighted average price of \$12.75) | 6,792,200 | 25.93 |
| Options granted | 394,705 | 133.31 |
| Options exercised | (266,876) | 13.30 |
| Options cancelled | (151,128) | 18.13 |
| | ----- | ----- |
| Outstanding, March 16, 2000 (1,560,912 exercisable at a weighted average price of \$10.09) | 6,768,901 | \$ 32.86 |
| | ===== | ===== |

The weighted average fair values of options granted during 1999 and between January 1, 2000 and March 16, 2000 was \$24.48 and \$84.13, respectively.

Nortel Networks Stock Option Plans

After the acquisition of Clarify by Nortel Networks in March 2000, certain employees of Clarify received grants of nonqualifying stock options under Nortel Networks stock option plans. The stock options were granted at the market price on the date of grant and expire on the tenth anniversary date. The stock options granted generally vest over three years.

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Additional information with respect to stock options under the Nortel Networks' plans is as follows:

| | Outstanding O |
|--|---------------------|
| | ----- |
| | Number of Shares |
| | ----- |
| Outstanding, March 17, 2000 (2) | 17,563,412 |
| Options held by Nortel Networks employees transferred to Clarify | 33,500 |
| Options granted | 580,055 |
| Options exercised | (4,929,163) |
| Options cancelled (employee terminations and transfers) | (1,091,890) |
| | ----- |
| Outstanding December 31, 2000 (5,907,361 exercisable at a weighted average price of \$9.38) | 12,155,914 |
| | ===== |

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- (1) On May 5, 2000, Nortel Networks implemented a two-for-one stock split with respect to its common shares and, as a result, the stock option information has been restated to reflect the stock split.
- (2) Pursuant to the terms of the Acquisition, Nortel Networks assumed outstanding options to purchase 17,563,412 shares of common stock of Nortel Networks under the Clarify stock option plans at March 16, 2000.

The following information applies to options outstanding at December 31, 2000:

| Range of Exercise Prices | Options Outstanding | | | Number Exercisable |
|--------------------------|---------------------|---|---------------------------------|--------------------|
| | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | |
| \$ 0.01 - \$ 4.99 | 2,288,606 | 6.56 | \$ 3.31 | 1,703,632 |
| 5.00 - 7.99 | 2,178,986 | 7.10 | 5.87 | 1,550,422 |
| 8.00 - 9.99 | 1,698,317 | 7.91 | 8.86 | 1,045,883 |
| 10.00 - 14.99 | 1,706,279 | 8.33 | 12.81 | 634,239 |
| 15.00 - 19.99 | 1,528,483 | 8.66 | 17.63 | 600,877 |
| 20.00 - 39.99 | 1,175,362 | 8.96 | 30.24 | 310,559 |
| 40.00 - 59.99 | 1,032,946 | 9.09 | 48.47 | 61,749 |
| 60.00 - 80.69 | 546,935 | 9.31 | 65.34 | -- |
| \$ 0.01 - \$80.69 | 12,155,914 | 7.72 | \$ 16.97 | 5,907,361 |

Employee Stock Purchase Plan ("ESPP") - The purpose of the ESPP is to provide eligible employees of Clarify with a means of acquiring common stock of Clarify through payroll deductions. The plan consists of four six-month purchase periods in each two-year offering period. Employees purchase stock at 85% of the market value at either the beginning of the offering period or at the end of the purchase period, whichever price is lower. No participant may purchase more than \$25,000 worth of common stock in any calendar year. Employees may end their participation in the offering at any time during the offering period, and participation ends automatically on termination of employment with Clarify.

During 1999, approximately 414,000 shares of Clarify common stock were sold through the ESPP. During the period January 1, 2000 to March 16, 2000 approximately 54,000 shares of Clarify common stock were sold through the ESPP. Pursuant to the terms of the Acquisition, the ESPP was cancelled immediately prior to the closing of the Acquisition.

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Stock-Based Compensation - Clarify has adopted the disclosure provisions of SFAS No. 123. If compensation cost for the 1995 Plan and the ESPP had been determined based on the fair value on the grant dates for all awards since January 1, 1995 consistent with the provisions of SFAS No. 123, Clarify's net income (loss) would have been reduced (increased) to the pro forma amounts indicated below (in thousands):

| | YEAR ENDED DECEMBER 31, 1999 | JANUARY 1 TO TO MARCH 16, 2000 |
|-----------------------------------|------------------------------------|--------------------------------------|
| Pro forma net income (loss) | \$2,139 ===== | \$(35,487) ===== |

Pro forma net income (loss) reflects only options granted since January 1, 1995. Therefore, the full impact of calculating compensation cost under SFAS 123 is not reflected in the pro forma amounts presented above because compensation cost is reflected over the options' vesting period of generally four or five years and compensation cost for options granted prior to January 1, 1995 is not considered. Pro forma net income (loss) disclosure for the period after March 16, 2000 reflecting the fair value on the grant dates of options to purchase Nortel Networks common stock granted to Clarify employees, or held by Nortel Networks employees transferred to the Clarify business, is not considered meaningful.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used:

| | 1999 ---- | JANUARY 1, TO MARCH 16, 2000 ---- |
|-------------------------------|--------------|---|
| Risk free interest rate | 5.50% | 5.50% |
| Expected life (years) | 4 | 4 |
| Volatility | 0.82 | 0.82 |
| Dividend yield | -- | -- |

The fair value of employees' stock purchase rights under the ESPP in 1999 was estimated using the Black-Scholes model with the following assumptions. The plan was cancelled in 2000:

| | |
|-------------------------|-------|
| Risk free interest rate | 5.50% |
| Expected life (months) | 6.00 |
| Volatility | 0.82 |
| Dividend yield | -- |

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7. INCOME TAXES

The components of the provision for income taxes are as follows (in thousands):

| | PREDECESSOR COMPANY ----- | | |
|--|------------------------------------|--|---|
| | YEAR ENDED DECEMBER 31, 1999 | PERIOD FROM JANUARY 1 2000 TO MARCH 16, 2000 | PERIOD FROM MARCH 17, 2000 TO DECEMBER 31, 2000 |
| Federal - current payable | \$ 1,506 | \$ (333) | \$ -- |
| Federal - deferred | (2,545) | (17,837) | (68,315) |
| State - current payable | 177 | (4) | -- |
| State - deferred | (521) | (2,500) | (8,692) |
| Foreign - current payable | 454 | -- | 1,691 |
| Valuation allowance | -- | 1,161 | -- |
| Charge in lieu of taxes attributable to employer's stock option plans | 12,837 | 4,740 | 47,122 |
| | ----- | ----- | ----- |
| Provision (benefit) for income tax | \$ 11,908 | \$ (14,773) | \$ (28,194) |
| | ===== | ===== | ===== |

The reconciliation of the statutory federal income tax rate to the effective rate is as follows (as a percent of pretax income):

| | PREDECESSOR COMPANY ----- | | |
|---|------------------------------------|--|---|
| | YEAR ENDED DECEMBER 31, 1999 | PERIOD FROM JANUARY 1 2000 TO MARCH 16, 2000 | PERIOD FROM MARCH 17, 2000 TO DECEMBER 31, 2000 |
| Federal statutory tax rate | 35% | 35% | 35% |
| State tax, net of federal tax benefit | 5 | 6 | 1 |
| Tax credits earned | (4) | 5 | -- |
| In-process R&D | 4 | -- | (4) |
| Nondeductible merger costs and goodwill amortization | 4 | (1) | (27) |
| Valuation allowance | -- | (3) | -- |
| Other | 1 | 4 | -- |
| | ----- | ----- | ----- |
| Effective income tax rate | 45% | 45% | 5% |
| | ===== | ===== | ===== |

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The significant components of the deferred tax assets and liabilities as of December 31 are as follows (in thousands):

| | 1999 | 2000 |
|--------------------------|-----------|-----------|
| Loss carryforwards | \$ 4,101 | \$ 66,602 |
| Tax credit carryforwards | 862 | 9,003 |
| Reserves | 2,247 | 450 |
| Accrued expenses | 2,721 | 471 |
| Deferred revenue | 2,283 | 2,835 |
| Purchased technology | (1,936) | (49,516) |
| Other | 1,470 | 4,891 |
| Valuation allowance | (963) | (2,124) |
| | ----- | ----- |
| Net deferred tax assets | \$ 10,785 | \$ 32,612 |
| | ===== | ===== |

Clarify has not recorded a valuation allowance for those deferred tax assets that management believes will more likely than not be realized through taxable income in the carryback period or through future taxable income. However, at December 31, 2000, a valuation allowance of approximately \$2,124,000 has been recorded because of the uncertainty regarding the realization of certain foreign net operating losses due to the limited profitable operating history in certain foreign jurisdictions. The valuation allowance increased by \$1,161,000 during the period from January 1, 2000 to March 16, 2000, due to uncertainty with respect to realizing tax benefits from current period foreign net operating losses.

Clarify has net operating loss carryforwards available to offset future federal and state taxable income of \$166,000,000 and \$138,000,000, respectively, expiring through 2020. Clarify has tax credit carryforwards available to offset future federal and California state income taxes of \$6,000,000 and \$4,600,000 and such federal credits expire through 2020. Such net operating losses and tax credits are available to offset taxable income and income taxes, respectively, of other Nortel Networks entities in Nortel Networks' consolidated tax returns.

8. RELATED PARTY TRANSACTIONS - NORTEL NETWORKS

The following table presents intercompany transactions and the balance between Clarify and Nortel Networks and its affiliates for the period from March 17, 2000 through December 31, 2000 (in thousands):

| | | |
|--|----|----------|
| Balance at beginning of period | \$ | -- |
| Net cash transfer to Nortel Networks | | 151,496 |
| Investment transfer to Nortel Networks | | 20,969 |
| Fringe and other benefits processed by Nortel Networks | | (89,385) |
| Purchases/payments processed by Nortel Networks | | (77,991) |
| Tax transfer to Nortel Networks | | 4,337 |
| | | ----- |
| Balance due from Nortel Networks at end of period | \$ | 9,426 |

=====

Clarify has deployed its customer relationship management software to other Nortel Networks operating units between 1999 and 2000. Clarify recognized revenues from such Nortel Networks operating units of \$5,072,000 and \$258,000 for the year ended December 31, 1999 and for the period from January 1, 2000 through March 16, 2000, respectively. No revenues from Nortel Networks or its affiliates have been recognized subsequent to the Acquisition. The cost of sales associated with the software was not significant.

9. SEGMENT INFORMATION AND MAJOR CUSTOMERS

In accordance with Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company is required to disclose information about its products, services, the geographic area in which it operates and major customers. The Company operates in a single industry segment encompassing the design, development, marketing and technical support for front-office automation software.

The following are revenues by geographic area (in thousands):

| | PREDECESSOR COMPANY | | |
|--------------------------|------------------------------------|--|---|
| | YEAR ENDED DECEMBER 31, 1999 | PERIOD FROM JANUARY 1 2000 TO MARCH 16, 2000 | PERIOD FROM MARCH 17, 2000 TO DECEMBER 31, 2000 |
| United States..... | 178,590 | 20,660 | 183,977 |
| United Kingdom..... | 23,854 | 2,850 | 41,909 |
| Other International..... | 28,253 | 3,113 | 52,053 |
| Total..... | 230,697 | 26,623 | 277,939 |
| | ===== | ===== | ===== |

Long-lived assets outside of the United States are immaterial. No one customer accounted for more than 10% of total revenues for any of the above periods.

10. RETIREMENT PLAN

Effective August 1991, Clarify began a voluntary 401(k) plan covering substantially all employees. The plan provides for discretionary employer contributions. No employer contributions were made or authorized in 1999 and 2000. This plan was discontinued at the time of the Nortel Networks' acquisition.

11. SUBSEQUENT EVENTS

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On November 28, 2001, Nortel Networks sold substantially all assets used in its Clarify business, including patents, intellectual property, and trademarks, for approximately \$200 million in cash to Amdocs Limited ("Amdocs"). Under the agreement, Amdocs assumed existing customer contracts, as well as certain leased office space.

Clarify, as part of its review of financial results for the three months ended June 30, 2001, also performed an assessment of the remaining carrying values of intangible assets. The assessment was performed in light of the significant negative industry and economic trends impacting both Clarify's current operations and expected future growth rates. The conclusion of that assessment was that the decline in market conditions within Clarify's industry was significant and other than temporary. As a result, Clarify recorded an approximately \$905 million write down of intangible assets in the three months ended June 30, 2001, based on the amount by which the carrying amount of these assets exceeded the fair value.

* * * * *

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CLARIFY (A BUSINESS OF NORTEL NETWORKS CORPORATION)

STATEMENTS OF NET ASSETS (UNAUDITED) (IN THOUSANDS)

| | DECEMBER 31, 2000 ---- | SEPTEMBER 30, 2001 ---- |
|---|------------------------------|-------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 13,459 | \$ 21,678 |
| Accounts receivable, net of allowance for doubtful accounts and returns of \$876 in 2000 and \$3,195 in 2001 | 94,058 | 44,053 |
| Prepaid expenses and other current assets | 8,868 | 3,330 |
| Deferred tax assets | 12,208 | 37,791 |
| Receivable from Nortel Networks Corporation | 9,426 | -- |
| | ----- | ----- |
| Total current assets | 138,019 | 106,852 |
| Property and equipment, net | 15,735 | 6,445 |
| Noncurrent deferred tax assets | 20,404 | 27,755 |
| Other noncurrent assets | 1,187 | -- |
| Acquired intangibles, net | 1,450,595 | 155,557 |
| | ----- | ----- |
| Total assets | \$1,625,940 | \$ 296,609 |
| | ----- | ----- |

LIABILITIES

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| | | |
|--|-------------|------------|
| Current liabilities: | | |
| Accounts payable | \$ 15,065 | \$ 1,499 |
| Payable to Nortel Networks Corporation | -- | 63,403 |
| Payroll-related accruals | 12,146 | 3,903 |
| Other accrued liabilities | 13,036 | 20,308 |
| Income taxes payable | 4,216 | -- |
| Unearned revenue | 56,230 | 37,978 |
| | ----- | ----- |
| Total current liabilities | \$ 100,693 | \$ 127,091 |
| | ----- | ----- |
| Net assets | \$1,525,247 | \$ 169,518 |
| | ===== | ===== |

See notes to financial statements.

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CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)

STATEMENTS OF OPERATIONS (UNAUDITED)
(IN THOUSANDS)

| | PREDECESSOR COMPANY ----- | PERIOD FROM JANUARY 1, 2000 TO MARCH 16, 2000 ---- | PERIOD FROM MARCH 17, 2000 TO SEPTEMBER 30, 2000 ---- | NINE MONTHS ENDED SEPTEMBER 30, 2001 ---- |
|------------------------|---------------------------------|---|--|---|
| Revenues: | | | | |
| License fees | \$ 4,330 | \$ 116,538 | \$ 48,792 | |
| Services | 22,293 | 78,983 | 110,943 | |
| | ----- | ----- | ----- | |
| Total revenues | 26,623 | 195,521 | 159,735 | |
| | ----- | ----- | ----- | |
| Cost of revenues: | | | | |
| License fees | 1,252 | 3,907 | 2,800 | |
| Services | 13,397 | 37,065 | 53,756 | |
| | ----- | ----- | ----- | |
| Total cost of revenues | 14,649 | 40,972 | 56,556 | |
| | ----- | ----- | ----- | |
| Gross margin | 11,974 | 154,549 | 103,179 | |
| | ----- | ----- | ----- | |
| Operating expenses: | | | | |

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| | | | |
|--------------------------------------|-------------|--------------|----------------|
| Product development and engineering | 9,395 | 30,429 | 50,244 |
| Sales and marketing | 31,186 | 82,774 | 92,304 |
| General and administrative | 3,946 | 8,290 | 30,749 |
| In-process research and development | -- | 63,939 | -- |
| Amortization of acquired intangibles | 810 | 380,315 | 389,584 |
| Special charges | -- | -- | 932,104 |
| | ----- | ----- | ----- |
| Total operating expenses | 45,337 | 565,747 | 1,494,985 |
| | ----- | ----- | ----- |
| Operating loss | (33,363) | (411,198) | (1,391,806) |
| Interest income | 599 | 670 | 195 |
| Interest expense | (4) | (1) | -- |
| Other income (expense), net | 214 | (1,461) | -- |
| | ----- | ----- | ----- |
| Loss before income taxes | (32,554) | (411,990) | (1,391,611) |
| Benefit from income taxes | (14,773) | (22,108) | (38,280) |
| | ----- | ----- | ----- |
| Net loss | \$ (17,781) | \$ (389,882) | \$ (1,353,331) |
| | ===== | ===== | ===== |

See notes to financial statements.

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CLARIFY
(A BUSINESS OF NORTEL NETWORKS CORPORATION)

STATEMENTS OF CASH FLOWS (UNAUDITED)
(IN THOUSANDS)

| | PREDECESSOR COMPANY ----- | PERIOD FROM JANUARY 1, 2000 TO MARCH 16, 2000 ----- | PER M SEP |
|---|---------------------------------|--|-----------------|
| Cash flows from (used in) operating activities: | | | |
| Net loss | \$ | (17,781) | \$ |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities, net of the effects of acquisitions: | | | |
| Depreciation and amortization | | 2,275 | |
| Special Charges | | -- | |
| Provision for doubtful accounts and returns | | 83 | |
| Deferred income taxes . | | (19,176) | |
| Write-off of acquired in-process research and development | | -- | |
| Tax benefit from exercise of nonqualified stock options | | 4,740 | |
| Changes in assets and liabilities: | | | |

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| | | |
|--|-----------|-------|
| Accounts receivable | 26,350 | |
| Prepaid and other assets | (27,630) | |
| Accounts payable | 702 | |
| Payroll-related accruals | (4,718) | |
| Other accrued liabilities | 655 | |
| Unearned revenue | 5,828 | |
| | ----- | ----- |
| Net cash provided by (used in) operating activities | (28,672) | |
| | ----- | ----- |
| Cash flows from (used in) investing activities: | | |
| Purchase of property and equipment | (1,902) | |
| Sale and maturities of investments | 15,517 | |
| | ----- | ----- |
| Net cash provided by (used for) investing activities | 13,615 | |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock, net | 7,282 | |
| Receivable/payable to Nortel Networks Corporation | -- | |
| | ----- | ----- |
| Net cash provided by (used in) financing activities | 7,282 | |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | (7,775) | |
| | ----- | ----- |
| Effect of foreign exchange rate changes on cash | 320 | |
| Cash and cash equivalents, beginning of period | 37,491 | |
| | ----- | ----- |
| Cash and cash equivalents, end of period | \$ 30,036 | \$ |
| | ===== | ===== |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the period for interest | \$ -- | \$ |
| | ===== | ===== |
| Cash paid during the period for taxes | \$ 28 | \$ |
| | ===== | ===== |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Change in unrealized holding gains on investments | \$ 6 | |
| | ===== | ===== |
| Contribution of Introspect Systems, Inc | \$ -- | \$ |
| | ===== | ===== |

See notes to financial statements.

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16, 2000 (PREDECESSOR COMPANY) AND PERIOD FROM MARCH 17, 2000 THROUGH SEPTEMBER 30, 2000 (THOUSANDS OF DOLLARS UNLESS OTHERWISE STATED) (CONTINUED)

1. BUSINESS OF THE COMPANY

On March 16, 2000, Nortel Networks Limited (then known as Nortel Networks Corporation), currently the principal operating subsidiary of Nortel Networks Corporation ("Nortel Networks") acquired all of the issued and outstanding shares of Clarify Inc. ("Clarify"), a Delaware corporation, in a transaction (the "Acquisition") that was accounted for using the purchase method (the on-going business is also referred to as "Clarify"). Clarify was founded in August 1990 to develop, market and support adaptable client/server application software designed to address the external and internal service, support, and product quality needs of today's global enterprises. Clarify markets its software and services through its direct sales organization and other Nortel Networks sales organizations.

As a result of the ownership change, the accompanying financial statements reflect the effect of the purchase accounting adjustments that relate to Clarify in accordance with Staff Accounting Bulletin No. 54 of the United States Securities and Exchange Commission. The financial statements of Clarify for the period prior to the March 16, 2000 acquisition date are referred to herein as the Predecessor Company financial statements. The aggregate purchase price allocated to Clarify as of March 16, 2000 was \$2,083 million. The allocation of the purchase price, based on the estimated fair value of the net assets was to net tangible assets of \$18 million, in-process research and development ("IPR&D") of \$64 million, acquired technology of \$210 million, and goodwill of \$1,791 million. The goodwill is being amortized over 3 years and the acquired technology is being amortized over 2 years. On August 24, 2000, a division of Nortel Networks acquired specified assets and assumed specified liabilities of Introspect Systems, Inc. ("ISI"), a privately held Clarify implementation and training consultancy. This acquisition was made on behalf of Clarify. The aggregate purchase price was approximately \$7.0 million of which Nortel Networks paid \$6.2 million on behalf of Clarify and other acquisition costs of \$0.8 million were paid by Clarify. The allocation of the purchase price was to goodwill of \$6.7 million and net tangible assets of \$0.3 million. The goodwill is being amortized over 3 years.

Effective December 31, 2000, Nortel Networks merged Clarify into another Nortel Networks' legal entity and Clarify ceased to exist as a separate legal entity. The accompanying financial statements reflect the carved-out operations and financial position of Clarify as if it had been a stand alone entity for all periods presented. The financial statements therefore include revenue and cost of sales of Clarify's product, as well as personnel, facilities and other expenses which were directly attributable to Clarify's general and administrative, research and development, and sales and marketing activities.

Subsequent to the acquisition, certain functions and processes (including, but not limited to; cash management, processing of receivables and certain payables, legal services, and payroll ("centralized services")) were transitioned during the period from March 17, 2000 to December 31, 2000 to be performed centrally by Nortel Networks for Clarify. Costs for these services are billed to Clarify based on actual usage and are included in Clarify's statement of operations. Although management is unable to determine the actual cost that would have been incurred if the services performed by Nortel Networks had been purchased from independent third parties, management considers the allocation methodology described to be reasonable. The

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financial position, results of operations and cash flows of Clarify may

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differ from those that would have been achieved had Clarify operated independent of Nortel Networks for the periods after March 16, 2000.

2. SPECIAL CHARGES

Special charges were as follows:

| | NINE MONTHS ENDED SEPTEMBER 30, | CUMULATIVE DRAWDOWNS | | PROVISION BALANCE AS AT SEPTEMBER 30, |
|--|---------------------------------------|----------------------|-------------------|---|
| | 2001 ---- | CASH ---- | NON-CASH ----- | 2001 ---- |
| Restructuring activities: | | | | |
| Workforce reduction | \$ 6,668 | \$ 4,243 | \$ -- | \$ 2,425 |
| Contract settlement and lease costs | 14,632 | -- | -- | 14,632 |
| Plant and equipment writedowns | 5,804 | -- | 5,804 | -- |
| | ----- | ----- | ----- | ----- |
| | 27,104 | 4,243 | 5,804 | 17,057 |
| Intangible assets write down | 905,000 | -- | 905,000 | -- |
| | ----- | ----- | ----- | ----- |
| Special charges | \$ 932,104 | \$ 4,243 | \$ 910,804 | \$ 17,057 |
| | ===== | ===== | ===== | ===== |

In light of the continued significant downturn in both the industry and economic environment, there has been a continual augmentation of the work plan for Clarify during the first nine months of 2001 to optimize results and drive efficiencies in its business.

Restructuring activities

For the nine months ended September 30, 2001, Clarify recorded restructuring charges of \$27,104.

Workforce reduction charges of \$6,668 for the nine months ended September 30, 2001 were related to the cost of severance and benefits associated with approximately 139 employees notified of termination. The workforce reduction was primarily in North America. As at September 30, 2001, the workforce reduction provision balance has been drawn down by cash payments of \$4,243, resulting in an ending provision balance of \$2,425. The remaining provision is expected to be substantially drawn down by the end of the first quarter of 2002.

In conjunction with the above noted workforce reduction, Clarify identified a number of leased facilities comprised of office and warehouse and manufacturing space, as well as leased manufacturing equipment, that were no longer required. As a result, Clarify recorded net lease costs of approximately \$14,632 for the nine months ended September 30, 2001. The costs primarily related to Clarify's future

contractual obligations under operating leases. Partially offsetting the total lease charge is approximately \$11,754 in expected sublease revenue on leases that Clarify cannot terminate. As at September 30, 2001, the provision balance has not yet been drawn down. The provision is expected to be substantially drawn down by the end of the fourth quarter of 2002.

Plant and equipment write downs of \$5,804 for the nine months ended September 30, 2001 consisted of the writedown of leasehold improvements and certain information technology equipment associated with the exiting of the above noted leased facilities.

Intangible assets write down

For the nine months ended September 30, 2001, Clarify recorded an intangible assets write down of approximately \$905,000.

Clarify, as part of its review of financial results during the three months ended June 30, 2001, performed an assessment of the carrying values of intangible assets recorded in connection with acquisitions. The assessment during that period was performed in light of the significant negative industry and economic trends impacting both the current operations and expected future growth rates, and the adjustment of technology valuations. The conclusion of that assessment was that the decline in market conditions within the industry was significant and other than temporary. As a result, Clarify recorded a write down of intangible assets of approximately \$905,000 in the three months ended June 30, 2001, based on the amount by which the carrying amount of these assets exceeded the fair value.

Fair value was determined based on discounted future cash flows. The cash flow period used was five years, the discount rate used was 20 percent, and the terminal value was estimated based upon a terminal growth rate of 5 percent. The assumptions supporting the estimated future cash flows, including the discount rate and estimated terminal value, reflect management's best estimates. The discount rate was based upon the weighted average cost of capital as adjusted for the risks associated with the operations.

Clarify has determined that the remaining intangible asset balances will continue to be amortized on a straight-line basis over the remaining useful lives established at the time of the related acquisition as the remaining useful life of these intangible assets has not changed.

The conclusion of the assessment performed during the three months ended September 30, 2001 was that no additional write down of intangible assets was required.

3. COMPREHENSIVE LOSS

The components of comprehensive loss, net of tax, were as follows:

PREDECESSOR

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| | COMPANY | | |
|---|---|---|--------------------------------------|
| | JANUARY 1 2000 TO MARCH 16, 2000 | MARCH 17, 2000 TO SEPTEMBER 30, 2000 | NINE M END SEPTEM 20 --- |
| Net loss | \$ (17,781) | \$ (389,882) | \$ (1,35 |
| Other comprehensive income (loss): | | | |
| Change in foreign currency translation adjustment | 291 | 725 | (|
| Unrealized gain (loss) on investments - net | 6 | -- | |
| Comprehensive loss | \$ (17,484) | \$ (389,157) | \$ (1,35 |

4. RECENT PRONOUNCEMENTS

In August 2001, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS 121, and the accounting and reporting provisions of APB 30, for the disposal of a segment of a business. The provisions of SFAS 144 are required to be adopted by Clarify effective January 1, 2002. Clarify has not yet determined the effect that the adoption of SFAS 144 will have on its business, results of operations, and financial condition.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS 141"), effective for business combinations initiated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") effective for fiscal years beginning after December 15, 2001. SFAS 141 transitional rules require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. As a result, the pooling-of-interests method is now prohibited. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Thus, amortization of goodwill, including goodwill recorded in past business combinations, and intangibles with an indefinite life, will cease upon adoption of this Statement, which for Clarify will be January 1, 2002. However, for any acquisitions completed after June 30, 2001, goodwill and intangible assets with an indefinite life will not be amortized.

The adoption of SFAS 141 will not have an impact on the business, results of operations, and financial condition of Clarify. The first of the required SFAS 142 impairment tests will be performed during 2002

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and Clarify has not yet determined the effect that the adoption of SFAS 142 will have on its business, results of operations, and financial condition.

5. SUBSEQUENT EVENT

On November 28, 2001, Nortel Networks sold substantially all assets used in its Clarify business, including patents, intellectual property, and trademarks, for approximately \$200 million in cash to Amdocs

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Limited ("Amdocs"). Under the agreement, Amdocs assumed existing customer contracts, as well as certain leased office space.

* * * * *

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SIGNATURES

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

AMDOCS LIMITED

/s/ THOMAS G. O'BRIEN

Thomas G. O'Brien
Treasurer and Secretary
Authorized U.S. Representative

Date: February 11, 2002

EXHIBIT INDEX

| EXHIBIT NO. | DESCRIPTION |
|-------------|---|
| 23.1 | Consent of PricewaterhouseCoopers LLP. |
| 23.2 | Consent of Deloitte & Touche LLP. |
| 99.1* | Amdocs Press Release dated November 28, 2001. |

* Previously filed.