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NETEGRITY INC
Form 10-K/A
March 06, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

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

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

OR

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

COMMISSION FILE NUMBER 1-10139
NETEGRITY, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

04-2911320
(I.R.S. Employer
Identification No.)

52 SECOND AVENUE
WALTHAM, MASSACHUSETTS 02451
(Address of principal executive offices, including Zip Code)

(781) 890-1700
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:
NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
COMMON STOCK, PAR VALUE \$.01 PER SHARE
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item
405 of Regulation S-K is not contained herein, and will not be contained, to the
best of the registrant's knowledge, in definitive proxy or information
statements incorporated by reference in Part III of this Form 10-K or any
amendment to this Form 10-K.

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). |X| Yes No | |

The aggregate market value of the voting Common Stock held by non-affiliates of the registrant was \$190,634,555 based on the closing price of the registrant's Common Stock on June 30, 2002 as reported by the NASDAQ National Market (\$6.16 per share). As of February 10, 2003, there were 34,311,460 shares of Common Stock outstanding.

DOCUMENT INCORPORATED BY REFERENCE:

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders for the year ended December 31, 2002, which will be filed with Securities and Exchange Commission within 120 days after the end of the registrant's fiscal year, are incorporated by reference into Part III hereof.

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EXPLANATORY NOTE

THIS AMENDMENT NO. 1 TO ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002 IS BEING FILED TO REFLECT THE INCREASE, FROM 55,000,000 TO 135,000,000, IN THE AUTHORIZED NUMBER OF SHARES OF OUR COMMON STOCK, AS APPROVED BY OUR STOCKHOLDERS ON MAY 30, 2001. THE REVISED NUMBER OF AUTHORIZED SHARES IS INCLUDED IN THE AMENDED AND RESTATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (ITEM 8) FILED HERewith. THERE HAVE BEEN NO OTHER CHANGES TO OUR FINANCIAL STATEMENTS SET FORTH HEREIN.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's consolidated financial statements and the related auditors' reports are presented in the following pages. The consolidated financial statements filed in this Item 8 are as follows:

Reports of Independent Accountants

Consolidated Balance Sheets -- December 31, 2002 and 2001

Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2002, 2001 and 2000

Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000

Notes to Consolidated Financial Statements

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REPORT OF INDEPENDENT ACCOUNTANTS

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

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We have audited the accompanying consolidated balance sheet of Netegrity, Inc. and subsidiaries as of December 31, 2002, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The 2001 consolidated financial statements were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those consolidated financial statements, before the restatement described in Note 1 to the consolidated financial statements, in their report dated January 30, 2002.

We conducted our audit 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 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Netegrity, Inc. and subsidiaries as of December 31, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed above, the consolidated financial statements of Netegrity, Inc. and subsidiaries as of December 31, 2001 and for the year then ended were audited by other auditors who have ceased operations. As described in Note 1, those financial statements have been restated. In our opinion, the adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 consolidated financial statements of Netegrity, Inc. and subsidiaries other than respect to such adjustments and, accordingly, we do not express an opinion or any form of assurance on the 2001 consolidated financial statements taken as a whole.

KPMG LLP

Boston, Massachusetts
January 29, 2003

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THE FOLLOWING REPORT OF ARTHUR ANDERSEN LLP (ANDERSEN) IS A COPY OF THE REPORT PREVIOUSLY ISSUED BY ANDERSEN ON JANUARY 30, 2002. THE REPORT OF ANDERSEN IS INCLUDED IN THIS ANNUAL REPORT ON FORM 10-K PURSUANT TO RULE 2-02(E) OF REGULATION S-X. AFTER REASONABLE EFFORTS THE COMPANY HAS NOT BEEN ABLE TO OBTAIN A REISSUED REPORT FROM ANDERSEN. ANDERSEN HAS NOT CONSENTED TO THE INCLUSION OF ITS REPORT IN THIS ANNUAL REPORT ON FORM 10-K. BECAUSE ANDERSEN HAS NOT CONSENTED TO THE INCLUSION OF ITS REPORT IN THIS ANNUAL REPORT, IT MAY BE DIFFICULT TO SEEK REMEDIES AGAINST ANDERSEN AND THE ABILITY TO SEEK RELIEF AGAINST ANDERSEN MAY BE IMPAIRED.

REPORT OF INDEPENDENT ACCOUNTANTS

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

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We have audited the accompanying consolidated balance sheet of Netegrity, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2001, and the related consolidated statement of operations, stockholders' equity and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Netegrity, Inc. and subsidiaries as of December 31, 2001, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Boston, Massachusetts
January 30, 2002

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REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the consolidated statements of operations, stockholders' equity and cash flows for the year ended December 31, 2000 present fairly, in all material respects, the results of operations and cash flows of Netegrity, Inc. and its subsidiaries for the year ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. 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 audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PRICEWATERHOUSECOOPERS LLP

Boston, Massachusetts
January 25, 2001

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NETEGRITY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

| | DECEMBER 31, | |
|---|---------------------------------------|------------|
| | 2002 | 2001 |
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 25,707 | \$ 29,332 |
| Short-term marketable securities | 48,361 | 73,651 |
| Accounts receivable -- trade, net of allowances of \$922 at December 31, 2002; \$1,579 at December 31, 2001 | 15,046 | 16,122 |
| Prepaid expenses and other current assets | 2,949 | 3,418 |
| Restricted cash | 281 | -- |
| | ----- | ----- |
| Total Current Assets | 92,344 | 122,523 |
| Long-term marketable securities | 12,655 | 6,083 |
| Property and equipment, net | 6,837 | 8,494 |
| Restricted cash | 790 | 631 |
| Goodwill | -- | 57,262 |
| Other intangible assets, net | 5,398 | 10,846 |
| Other assets | 338 | 340 |
| | ----- | ----- |
| Total Assets | \$ 118,362 | \$ 206,179 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable -- trade | \$ 1,906 | \$ 1,707 |
| Accrued compensation and benefits | 4,293 | 5,152 |
| Other accrued expenses | 6,530 | 9,956 |
| Deferred revenue | 14,875 | 13,223 |
| | ----- | ----- |
| Total Current Liabilities | 27,604 | 30,038 |
| | ----- | ----- |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, voting, \$.01 par value; 135,000 shares authorized; 34,346 shares issued and 34,308 shares outstanding at December 31, 2002; 33,866 issued and 33,828 outstanding at December 31, 2001 | 343 | 339 |
| Additional paid-in capital | 197,250 | 196,492 |
| Accumulated other comprehensive income (loss) | 106 | (44) |
| Accumulated deficit | (106,741) | (20,432) |
| Loan to officer | (116) | (130) |
| | ----- | ----- |
| Less -- Treasury Stock, at cost: 38 shares | 90,842 | 176,225 |
| | (84) | (84) |
| | ----- | ----- |
| Total Stockholders' Equity | 90,758 | 176,141 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 118,362 | \$ 206,179 |
| | ===== | ===== |

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

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NETEGRITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

| | YEARS ENDED DECEMBER 31, | | |
|---|---------------------------------------|-----------|-----------|
| | 2002 | 2001 | 2000 |
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | |
| Revenues: | | | |
| Software licenses | \$ 36,072 | \$ 55,314 | \$ 37,688 |
| Services | 30,158 | 29,199 | 13,902 |
| Other | 3,034 | 3,633 | 3,655 |
| Total revenues | 69,264 | 88,146 | 55,245 |
| Cost of revenues: | | | |
| Cost of software licenses | 2,071 | 1,931 | 2,549 |
| Non-cash cost of software licenses | 5,449 | 153 | -- |
| Cost of services | 13,664 | 15,113 | 8,624 |
| Cost of other | 1,827 | 2,221 | 2,169 |
| Total cost of revenues | 23,011 | 19,418 | 13,342 |
| Gross profit | 46,253 | 68,728 | 41,903 |
| Selling, general and administrative expenses .. | 52,755 | 51,989 | 36,094 |
| Research and development costs | 22,701 | 15,791 | 9,103 |
| Impairment charge | 57,374 | -- | -- |
| Acquired in-process research and development .. | -- | 3,000 | -- |
| Restructuring and other non-recurring charges . | 2,080 | 529 | -- |
| Loss from operations | (88,657) | (2,581) | (3,294) |
| Other income, net | 2,418 | 4,831 | 6,103 |
| Income (loss) before provision for income taxes | (86,239) | 2,250 | 2,809 |
| Provision for income taxes | 70 | 607 | 75 |
| Net income (loss) | \$ (86,309) | \$ 1,643 | \$ 2,734 |
| Earnings (loss) per share: | | | |
| Basic | \$ (2.53) | \$ 0.05 | \$ 0.09 |
| Diluted | \$ (2.53) | \$ 0.05 | \$ 0.08 |
| Weighted average shares outstanding: | | | |
| Basic | 34,078 | 31,076 | 29,010 |
| Diluted | 34,078 | 32,936 | 33,407 |

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

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NETEGRITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| | COMMON STOCK | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | ACCUMULATED DEFICIT |
|--|-----------------|----------------------------------|---|------------------------|
| | ----- | ----- | ----- | ----- |
| | | | | (IN THOUSANDS) |
| BALANCE AT DECEMBER 31, | | | | |
| 1999 | 257 | 131,200 | -- | (24,809) |
| Net income | -- | -- | -- | 2,734 |
| Issuance of common stock from warrant exercises (2,251 shares) | 22 | 2,980 | -- | -- |
| Issuance of common stock under stock plans (2,247 shares) | 23 | 5,414 | -- | -- |
| Recognition of compensation expense on warrant | -- | 292 | -- | -- |
| | ----- | ----- | ----- | ----- |
| BALANCE AT DECEMBER 31, | | | | |
| 2000 | 302 | 139,886 | -- | (22,075) |
| Comprehensive income, net of taxes: | | | | |
| Net income | -- | -- | -- | 1,643 |
| Other comprehensive loss -- translation adjustment | -- | -- | (44) | -- |
| Total comprehensive income | -- | -- | -- | -- |
| Issuance of common stock for acquisition (2,500 shares) | 25 | 49,674 | -- | -- |
| Issuance of common stock under stock plans (1,114 shares) | 12 | 6,909 | -- | -- |
| Issuance of warrants | -- | 23 | -- | -- |
| | ----- | ----- | ----- | ----- |
| BALANCE AT DECEMBER 31, | | | | |
| 2001 | \$ 339 | \$ 196,492 | \$ (44) | \$ (20,432) |
| Comprehensive loss, net of taxes: | | | | |
| Net loss | -- | -- | -- | (86,309) |
| Other comprehensive income | -- | -- | 150 | -- |
| Total comprehensive loss | -- | -- | -- | -- |
| Issuance of common stock under stock plans (476 shares) | 4 | 758 | -- | -- |
| Repayment of loan to officer | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- |
| BALANCE AT DECEMBER 31, | | | | |
| 2002 | \$ 343 | \$ 197,250 | \$ 106 | \$ (106,741) |
| | ===== | ===== | ===== | ===== |

The accompanying notes are an integral part of the

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consolidated financial statements.

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NETEGRITY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | YEARS ENDED DECEMBER 31, | | |
|--|--------------------------|-----------|----------|
| | 2002 | 2001 | 2000 |
| | (IN THOUSANDS) | | |
| OPERATING ACTIVITIES: | | | |
| Net income (loss) | \$ (86,309) | \$ 1,643 | \$ 2,000 |
| Adjustments to reconcile net income (loss) to net cash (used for) provided by operating activities: | | | |
| Depreciation, amortization and impairment | 67,531 | 2,906 | 1,000 |
| Provision (recoveries) for doubtful accounts receivable | (132) | 2,573 | 1,000 |
| Acquired in-process research and development | -- | 3,000 | |
| Compensation expense related to warrant | -- | -- | |
| Loss on disposal of property and equipment | -- | -- | |
| Other | 282 | 291 | |
| Changes in operating assets and liabilities, net of effects of acquisition: | | | |
| Accounts receivable -- trade | 1,208 | (2,601) | (12,000) |
| Prepaid expenses and other current assets | 153 | (1,058) | |
| Other assets | 318 | (140) | |
| Accounts payable -- trade | 200 | (820) | |
| Accrued compensation and benefits | (859) | (3,290) | 6,000 |
| Other accrued expenses | (3,539) | 2,337 | 1,000 |
| Deferred revenue | 1,652 | 3,490 | 7,000 |
| Net cash (used for) provided by operating activities | (19,495) | 8,331 | 9,000 |
| INVESTING ACTIVITIES: | | | |
| Proceeds from sales of marketable securities | 60,868 | 30,680 | |
| Proceeds from maturities of marketable securities | 120,619 | 160,610 | |
| Purchases of marketable securities | (162,868) | (271,315) | |
| Purchases of property and equipment | (3,052) | (4,598) | (3,000) |
| Cash used for acquisition, net of cash acquired | -- | (17,518) | |
| Restricted cash | (440) | 311 | |
| Net cash (used for) provided by investing activities | 15,127 | (101,830) | (4,000) |
| FINANCING ACTIVITIES: | | | |
| Net proceeds from issuance of common stock | -- | -- | 3,000 |
| Issuance of common stock under stock plans | 762 | 6,921 | 5,000 |
| Repayment of loan to officer and other principal payments under capital leases | 14 | 172 | |
| Net cash provided by financing activities | 776 | 7,093 | 8,000 |
| Effect of exchange rate changes on cash and cash equivalents | (33) | (9) | |
| Net change in cash and cash equivalents | (18,642) | (86,415) | 12,000 |

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| | | | |
|--|-----------|-----------|---------|
| Cash and cash equivalents at beginning of year | 29,332 | 115,747 | 102, |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of year | \$ 25,707 | \$ 29,332 | \$ 115, |
| | ===== | ===== | ===== |
| SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING | | | |
| ACTIVITIES: | | | |
| Acquisition of DataChannel, Inc.: | | | |
| Fair value of assets acquired | \$ -- | \$ 70,196 | \$ |
| Less: | | | |
| Cash paid | -- | 16,087 | |
| Fair value of stock issued | -- | 49,699 | |
| Accrued acquisition costs | -- | 2,970 | |
| | ----- | ----- | ----- |
| Liabilities assumed | \$ -- | \$ 1,440 | \$ |
| | ===== | ===== | ===== |

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

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NETEGRITY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: NATURE OF THE BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

Netegrity, Inc. and its wholly-owned subsidiaries (Netegrity or the Company) is a leading provider of security software solutions for securing access to corporate assets and for managing and securing the identities of users accessing those assets. Netegrity's flexible, standards-based solutions are designed to enable companies to conduct business securely with customers, partners, suppliers and employees across the Internet, intranets and extranets.

Netegrity's products help customers ensure that only the people or business processes that are entitled to access corporate resources and applications access them. Netegrity's products enable customers to manage the population that needs to access those resources and applications. In addition, Netegrity's products provide a more automated way to grant, modify or revoke account access to applications and resources.

The Company is integrating its core products, SiteMinder, IdentityMinder, and TransactionMinder, with its new provisioning technology into an identity and access management solution to provide Web access control and management, user administration, provisioning and de-provisioning of account access. Netegrity's solution supports a broad range of technology environments, and aims to ensure that companies optimize their existing information technology investments while incorporating new technologies. The Company believes that through these solutions it helps companies to address some of the most critical requirements for conducting business securely.

We also offer various levels of consulting and support services that enable our customers to successfully implement our products in their organizations.

PRINCIPLES OF CONSOLIDATION

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The consolidated financial statements of the Company also include the accounts and operations of its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

REVENUE RECOGNITION

The Company's revenues have been primarily generated from the sale of perpetual licenses for its proprietary SiteMinder and DMS (renamed IdentityMinder in the fourth quarter of 2002) products and services. In the future, the Company anticipates generating its revenue primarily from the sale of perpetual licenses for SiteMinder, IdentityMinder, TransactionMinder and provisioning products and services as well as from new product offerings. The Company generates its services revenue from consulting and training services performed for customers and from maintenance and support. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Management analyzes various factors, including a review of specific transactions, historical experience, credit worthiness of customers and current market and economic conditions. Changes in judgments based upon these factors could impact the timing and amount of revenue and cost recognized.

We generally license our software products on a perpetual basis. We apply the provisions of Statement of Position No. 97-2, "Software Revenue Recognition," as amended by Statement of Position No. 98-9, "Software Revenue Recognition, with Respect to Certain Transactions," to all transactions involving the sale of software products. We recognize revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, the fees are fixed or determinable and collection of the resulting receivable is reasonably assured. This policy is applicable to all sales, including sales to resellers and end users. The Company does not offer a right of return on its products.

For all sales, we use either a binding purchase order or signed license agreement as evidence of an arrangement. For arrangements with multiple obligations (for example, product, undelivered maintenance and support, and training and consulting), we allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. We defer revenue from the arrangement equivalent to the fair value of the undelivered elements. Fair values for the ongoing

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maintenance and support obligations are based upon separate sales of renewals of maintenance contracts. Fair value of services, such as training or consulting, is based upon separate sales of these services to other customers.

At the time of the transaction, we assess whether the fee associated with the transaction is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of the fee is due after our normal payment terms, which are generally 30 to 90 days from invoice date, we account for the fee as not being fixed or determinable. In these cases, we recognize revenue as the fees become due. In addition, we assess whether collection is probable or not based on the credit worthiness of the customer. Initial credit worthiness is assessed through Dun & Bradstreet or similar credit rating agencies. Credit worthiness for follow-on transactions is assessed through a review of the transaction history with the customer. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash.

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Installation by Netegrity is not considered essential to the functionality of our products as these services do not alter the product capabilities, do not require specialized skills and may be performed by the customer or other vendors. Revenues for maintenance and support are recognized ratably over the term of the support period. Revenues from consulting and training services are recognized as the services are performed.

CASH AND CASH EQUIVALENTS AND STATEMENT OF CASH FLOWS SUPPLEMENTAL INFORMATION

Cash and cash equivalents include cash, money market investments and other highly liquid investments with original maturities of three months or less at the date of purchase.

Net cash used for operating activities reflect cash payments for income taxes of approximately \$57,000, \$125,000 and \$25,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

RESTRICTED CASH

Restricted cash represents time deposits held at financial institutions in connection with the Company's lease of office space. As of December 31, 2002, restricted cash is security for outstanding letters of credit expiring in February 2003 and April 2003. The letter of credit expiring in April 2003 has an automatic renewal clause.

MARKETABLE SECURITIES

Investments, which primarily consist of debt securities, are accounted for under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities" issued by the Financial Accounting Standards Board (FASB). Pursuant to the provisions of SFAS No. 115, the Company has classified its investment portfolio as "trading", "available-for-sale" or "held to maturity". "Trading" securities are bought and held principally for the purpose of selling them in the near term and are recorded at fair value. Fair value is based upon quoted market prices. Unrealized gains and losses on trading securities are included in the determination of net earnings. "Available-for-sale" securities include debt securities that are being held for an unspecified period of time and may be used for liquidity or other corporate purposes and are recorded at fair value. Unrealized gains and losses on available-for-sale securities are reported as a separate component of comprehensive income (loss) in stockholders' equity. "Held to maturity" securities are debt securities that the Company intends to hold to maturity and are recorded at amortized cost. See Note 4 for further information on the Company's marketable securities.

OFF-BALANCE-SHEET AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, marketable securities and accounts receivable -- trade. The Company has no significant off-balance-sheet risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements. Cash and cash equivalents are held with high quality financial institutions. Marketable securities are primarily held in high quality corporate debt instruments and government obligations. Concentration of credit risk with respect to accounts receivable -- trade is limited due to a large customer base. The Company periodically performs credit evaluations of its customers and maintains reserves for potential losses. One customer accounted for approximately 24% of accounts receivable as of December 31, 2002. No other customer accounted for more than 10% of accounts receivable as of December 31, 2002 and no one customer accounted for more than 10% of accounts receivable as of December 31, 2001. No one customer accounted for more than 10% of revenue for each of the three years ended December 31, 2002.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments consist principally of cash equivalents, restricted cash, marketable securities, accounts receivable -- trade, accounts payable, accrued expenses and letters of credit. The estimated fair value of these financial instruments approximates their carrying value.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization is provided using the straight-line method, based upon the following asset lives:

| | |
|--|--------------------------------------|
| Computer equipment and purchased software..... | 3-5 years |
| Furniture and office equipment..... | 5-7 years |
| Leasehold improvements..... | Shorter of lease term or useful life |

Maintenance and repairs are charged to operations as incurred. Renewals and betterments which materially extend the life of assets are capitalized and depreciated. Upon disposal, the asset cost and related accumulated depreciation are removed from their respective accounts and any resulting gain or loss is reflected in earnings.

ACCOUNTING FOR IMPAIRMENT OF LONG-LIVED ASSETS

The Company uses the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

OTHER INTANGIBLE ASSETS, NET

The Company accounts for purchased technology and software development costs in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed". Under SFAS No. 86, the Company is required to test for recoverability of its capitalized software costs as of each balance sheet date or an interim period if events and circumstances indicate that the carrying amount may not be recoverable. Impairment is recorded as the excess of the unamortized cost over the expected future net realizable value of the products.

Software development costs subsequent to the establishment of technological feasibility are capitalized and amortized to non-cash cost of software. Based on the Company's product development process, technological feasibility is established upon completion of all planning, designing, coding and testing activities. Such costs are amortized over the estimated life of the product. During 2002, 2001 and 2000, costs incurred by the Company between

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completion of all planning, designing, coding and testing activities and the point at which the product is ready for general release were insignificant and therefore, no such costs have been capitalized during this time period.

OTHER ACCRUED EXPENSES

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

| | DECEMBER 31, | |
|--|--------------|---------|
| | 2002 | 2001 |
| Acquisition related lease obligations .. | \$1,053 | \$1,834 |
| Accrued acquisition costs | -- | 1,585 |
| Accrued income taxes | 353 | 607 |
| Accrued sales taxes | 1,486 | 1,500 |
| Other | 3,638 | 4,430 |
| | ----- | ----- |
| | \$6,530 | \$9,956 |
| | ===== | ===== |

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COMPREHENSIVE INCOME

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, including foreign currency translation adjustments and unrealized gains and losses on marketable securities held as "available-for-sale". For the year ended December 31, 2002, the difference of approximately \$150,000 between the comprehensive loss of (\$86.2) million and the net loss is due to the effect of an unrealized gain on marketable securities of approximately \$177,000, partially offset by an unfavorable cumulative translation adjustment of approximately (\$27,000). For the year ended December 31, 2001, the difference of approximately \$44,000 between the comprehensive income of \$1.6 million and net income is due to the effect of an unfavorable cumulative translation adjustment. For the year ended December 31, 2000, there was no difference between comprehensive income and net income.

RESEARCH AND DEVELOPMENT

Research and development expenditures are charged to operations as incurred.

INCOME TAXES

The Company accounts for income taxes using the asset and liability method in accordance with SFAS No. 109, "Accounting for Income Taxes", pursuant to which deferred income taxes are recognized based on temporary differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the temporary differences are expected to reverse. Valuation allowances are provided if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

EARNINGS (LOSS) PER SHARE

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Basic earnings (loss) per share (EPS) are calculated by dividing net income (loss) by the weighted average number of shares outstanding during the period. Diluted EPS is calculated by dividing net income by the weighted average number of shares outstanding plus the dilutive effect, if any, of outstanding stock options and warrants using the "treasury stock" method. During periods of net loss, diluted net loss per share does not differ from basic net loss per share since potential common shares from stock options and warrants are anti-dilutive and therefore are excluded from the calculation. The following table presents the calculation for both basic and diluted EPS (in thousands, except per share data):

| | YEAR ENDED | | |
|---|-------------|----------|----------|
| | 2002 | 2001 | 2000 |
| Net income (loss) | \$ (86,309) | \$ 1,643 | \$ 2,734 |
| Basic weighted average shares outstanding ... | 34,078 | 31,076 | 29,010 |
| Dilutive effect of stock options and warrants | -- | 1,860 | 4,397 |
| Diluted shares outstanding | 34,078 | 32,936 | 33,407 |
| Basic EPS | \$ (2.53) | \$ 0.05 | \$ 0.09 |
| Diluted EPS | \$ (2.53) | \$ 0.05 | \$ 0.08 |

Options to purchase a total of 771,714, 1,347,000 and 285,000 shares for the years ended December 31, 2002, 2001 and 2000, respectively, were excluded from the computation of diluted EPS because the impact was anti-dilutive.

STOCK-BASED COMPENSATION

The Company accounts for its stock option plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based compensation cost is reflected in net income for these plans, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock Based Compensation, to stock based compensation.

| | YEAR ENDED DECEMBER 31, | | |
|--|-------------------------|-------------|------------|
| | 2002 | 2001 | 2000 |
| Net income (loss), as reported | \$ (86,309) | \$ 1,643 | \$ 2,734 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | (86,431) | (95,688) | (2,734) |
| Pro-forma net (loss) | \$ (172,740) | \$ (94,045) | \$ (2,734) |
| Earnings (loss) per share: | | | |

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| | | | | | |
|------------------------------|----|--------|----|--------|-------|
| Basic -- as reported | \$ | (2.53) | \$ | 0.05 | \$ |
| Basic -- pro-forma | \$ | (5.07) | \$ | (3.03) | \$ |
| | | ===== | | ===== | ===== |
| Diluted -- as reported | \$ | (2.53) | \$ | 0.05 | \$ |
| Diluted -- pro-forma | \$ | (5.07) | \$ | (3.03) | \$ |
| | | ===== | | ===== | ===== |

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

| | DECEMBER 31 | | | | |
|--|------------------|---------|------------------|---------|----------|
| | 2002 | | 2001 | | |
| | STOCK OPTIONS | ESPP | STOCK OPTIONS | ESPP1 | ESPP 2 |
| Risk-free interest rate | 2.95% | 1.65% | 5.39% | 2.71% | 4.44% |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Expected volatility | 140% | 106% | 126% | 131% | 143% |
| Expected life (years) | 5.0 | 0.4 | 4.0 | 0.6 | 0.6 |
| Weighted average fair value of options granted during the year | \$ 11.51 | \$ 0.65 | \$ 25.22 | \$ 3.80 | \$ 11.70 |

The pro-forma net loss for the years ended December 31, 2002 and 2001 includes the effects of options that were canceled by the Company in connection with the tender offers described in Note 10 to the consolidated financial statements. The remaining unamortized pro-forma compensation expense at the date of cancellation for these options in the amount of approximately \$51.9 million and \$63.0 million, respectively, is reflected as an expense in these pro-forma amounts.

FOREIGN CURRENCY

The functional currencies of the Company's wholly-owned subsidiaries are the local currencies. The financial statements of the subsidiaries are translated to U.S. dollars using period-end exchange rates for assets and liabilities and average exchange rates during the corresponding period for revenues, cost of revenues and expenses. Translation gains and losses (amounting to a loss of approximately \$27,000 as of December 31, 2002) are deferred and accumulated as a separate component of stockholders' equity (accumulated other comprehensive income (loss)). Net gains and losses resulting from foreign exchange transactions, amounting to a gain of approximately \$16,000 and \$325,000 for the years ended December 31, 2002 and 2001, are included in other income, net in the accompanying consolidated statements of operations and was not material for the year ended December 31, 2000.

EXPORT SALES

The Company generates revenues from international business. Export sales amounted to approximately \$13.1 million, or 19%, \$16.1 million, or 18%, and \$10.0 million, or 18%, of total revenue for the years ended December 31, 2002, 2001 and 2000, respectively.

401(K) PLAN

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The Company maintains a 401(k) Plan for its employees, which is intended to be a retirement and tax deferred savings vehicle. The Company may make discretionary contributions to the plan. The Company has made no contributions to date.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

RESTATEMENT ADJUSTMENTS

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The Company has recorded certain restatement adjustments to its previously issued 2001 and 2000 consolidated financial statements. The Company adopted EITF 01-14 effective January 1, 2002, and as a result, reclassified approximately \$1.6 million and \$1.2 million into revenues from reduction of cost of revenues for the years ended December 31, 2001 and 2000, respectively, to comply with this guidance. Additionally, the Company has restated the previously reported 2001 and 2000 pro-forma impact of the fair value recognition provisions of SFAS No. 123 to properly reflect pro-forma expense associated with its employee stock purchase plans. The adjustment reflects additional pro-forma expense of approximately \$364,000 and \$300,000 in 2001 and 2000, respectively, and results in a pro-forma basic and diluted loss per share of (\$3.03) and (\$0.72) in 2001 and 2000, respectively. The Company has also reclassified \$3.0 million from short-term marketable securities to cash and cash equivalents at December 31, 2001.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. SFAS No. 142 discusses how intangible assets that are acquired should be accounted for in financial statements upon their acquisition. In addition, under SFAS No. 142, goodwill and other indefinite lived intangible assets are no longer amortized but are reviewed at least annually for impairment (or more frequently if impairment indicators arise). Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives.

The acquisition discussed in Note 3 was accounted for in accordance with the transition provisions of SFAS No. 141 and No. 142. In connection with the adoption of SFAS No. 142, goodwill is to be tested at least annually and on an interim basis if an event or circumstance indicates that it is more likely than not that an impairment loss has been incurred. We currently operate as a single reporting unit and all of our goodwill was associated with the entire company. A transitional impairment test was performed on January 1, 2002. See Note 3 regarding the impairment of goodwill recorded during the quarter ended September 30, 2002.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which is effective for the Company on January 1, 2002. SFAS No. 144 addresses accounting and reporting of certain

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long-lived assets, except goodwill, that are either held and used or disposed of through sale or other means.

The Company adopted SFAS No's. 141, 142 and No. 144 during the first quarter of 2002 without a material impact on its financial position or results of operations. If the Company had accounted for goodwill and other intangibles in accordance with SFAS 142 during the years ended December 31, 2001 and 2000, the results of operations would not be materially different from those previously reported.

In November 2001, the Emerging Issues Task Force issued Topic No. D-103 (Topic D-103), subsequently recharacterized as EITF 01-14, relating to the accounting for reimbursements received from customers for the Company's out-of-pocket expenses for the delivery of services. In accordance with EITF 01-14, reimbursements received for out-of-pocket expenses incurred should be characterized as revenue in the statement of operations. The Company has historically accounted for reimbursements received for out-of-pocket expenses incurred as a reduction to the cost of service revenues in the statement of operations to offset the costs incurred. The Company adopted EITF 01-14 effective January 1, 2002 and reclassified approximately \$1.6 million and \$1.2 million into revenues from cost of revenues for the years ended December 31, 2001 and 2000, respectively, to comply with this guidance.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement is effective for fiscal years beginning after December 31, 2002. We do not believe that the impact of adopting SFAS No. 146 will have a material impact on the consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and the recognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. The application of the requirements of FIN 45 did not have a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure". SFAS No. 148 amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of

SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. As the Company did not make a voluntary change to the fair value based method of accounting for stock-based employee compensation in 2002, the adoption of SFAS No. 148 did not have a material impact on the Company's financial position and results of operations.

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NOTE 2: RESTRUCTURING AND OTHER NON-RECURRING CHARGES

The Company recorded restructuring and other non-recurring expenses of \$2.1 million and \$529,000 for the years ended December 31, 2002 and 2001, respectively. These expenses are associated with the Company's restructuring plans and other non-recurring expenses.

During 2002, the Company, as a result of changing market dynamics and economic factors, reduced its workforce through restructurings by approximately 32%. The reductions in workforce were primarily in the development group as well as in the sales and services departments, both domestically and internationally. The majority of the reductions in the development group were concurrent with the Company's decision to stop developing, marketing or selling its portal product on a stand-alone basis. As a result of the 2002 restructurings, the Company recorded restructuring charges, which related primarily to severance payments and the closing of several sales offices, of approximately \$2.1 million during the year ended December 31, 2002. Approximately \$1.3 million was paid as of December 31, 2002. The remainder is expected to be paid prior to March 31, 2003.

During 2001, the Company reduced its workforce by approximately 8% in order to reduce expenses and realign its cost structure. The reduction in workforce was primarily in the sales, development and general and administrative groups. The Company recorded a charge of \$303,000 during the year ended December 31, 2001, for severance payments (\$278,000) and the consolidation of excess facilities (\$25,000). Approximately \$275,000 was paid as of December 31, 2001 and the remainder was paid during 2002.

Additionally, the Company recorded non-recurring charges of \$226,000 during the year ended December 31, 2001 primarily attributable to a contribution to the James Hayden Memorial Fund, established in the memory of the Company's former Chief Financial Officer, and the acceleration of 15,300 of his options that would have vested by December 31, 2001.

NOTE 3: ACQUISITION

On December 14, 2001, the Company acquired all of the outstanding stock of DataChannel, Inc., a Washington corporation (DataChannel) and a provider of enterprise portal solutions. DataChannel became a wholly-owned subsidiary of the Company. The aggregate consideration included approximately \$17.5 million in cash (including assumed debt of approximately \$1.4 million), \$3.0 million in acquisition costs and 2,499,968 shares of the Company's common stock valued at approximately \$49.7 million. The acquisition was accounted for using the purchase method of accounting. Accordingly, the excess of the purchase price over the fair value of the assumed tangible net liabilities of approximately \$71.4 million was allocated to acquired technology, in-process research and development, and goodwill in the amounts of approximately \$11.0 million, \$3.0 million and \$57.4 million, respectively. The results of operations of DataChannel from the acquisition date are included in the Company's consolidated results of operations.

In connection with the acquisition, the Company initiated an overall integration plan that included the elimination of redundant headcount and facilities. The Company accrued approximately \$2.2 million of cost related to the integration plan consisting of approximately \$1.8 million of facilities costs and \$0.4 million for planned workforce reductions consisting primarily of duplicative general and administrative functions. Approximately \$1.2 million and \$0 of these costs were paid during the years ended December 31, 2002 and 2001, respectively. The remainder is expected to be paid by June 2005.

The Company initially amortized the acquired existing technology of approximately \$11.0 million over an estimated remaining useful life of three

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years. This technology was embedded in the initial version of one of our products that was released in the fourth quarter of 2002. During the fourth quarter of 2002, the Company made the decision to remove the acquired technology from its products. It is expected that the first version of our products that do not include the portal technology will be released in August 2003 and will be the only version sold in the third quarter of 2003. As a result of this decision, we determined that there has been a change in the estimated useful life of the acquired technology and therefore it is appropriate to amortize the associated expense over a nine month period starting at the beginning of the fourth quarter of 2002 (the period during which the change in estimated life was identified) through June 30, 2003. Amortization expense related to the purchased technology was \$5.4 million and \$153,000 for the

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years ended December 31, 2002 and 2001, respectively, and has been classified as non-cash cost of software licenses in the accompanying consolidated statements of operations. Amortization expense for the purchased technology is estimated to be approximately \$5.4 million for the year ended December 31, 2003

The total goodwill of approximately \$57.4 million related to the acquisition was not amortized in accordance with SFAS No. 142. In lieu of being amortized, goodwill is required to be tested for impairment annually or on an interim basis if an event or circumstance indicates that it is more likely than not that an impairment loss has been incurred. During the first quarter of 2002, the Company performed a transitional impairment test on goodwill and concluded that there was no impairment as of January 1, 2002. During the third quarter of 2002, the Company determined that a significant decline in its stock price as a result of underperformance relative to recent and expected operating results and the overall adverse change in the business climate had resulted in a triggering event that warranted an impairment review in accordance with SFAS No. 142. As a result, the Company tested for impairment based on a two-step approach. The first step was to test for indicators of impairment of goodwill by comparing the fair value of the Company with its carrying value. Since the Company operates as an enterprise-wide reporting unit, it was determined that the market value of the Company represents an approximation of its fair value as of September 30, 2002. Furthermore, it was determined that the fair value of the Company as of September 30, 2002 was less than its carrying value and therefore, an indication of impairment existed. The second step was to measure the amount of the impairment of goodwill. As a result of the second step, we determined that the implied fair value of the goodwill determined using the market capitalization of the Company on September 30, 2002 was lower than its carrying value and therefore, goodwill had been impaired. The Company recorded a charge of \$57.4 million in the third quarter of 2002, classified as impairment charge in the accompanying consolidated statements of operations, to write down goodwill to its implied fair value of zero.

The following unaudited pro-forma financial information presents the combined results of operations of the Company and DataChannel as if the acquisition of DataChannel occurred on January 1, 2000, after giving effect to certain adjustments, including amortization expense. Due to the non-recurring nature of the in-process research and development charge, the amount has not been included in the unaudited pro-forma financial information. The unaudited pro-forma financial information does not necessarily reflect the results of operations that would have occurred had the acquisition been completed as of the dates indicated or of the results that may be obtained in the future (in thousands except per share data).

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| | YEAR ENDED DECEMBER 31, | |
|---|-------------------------|------------|
| | 2001 | 2000 |
| Revenues | \$ 95,965 | \$ 63,466 |
| Net loss | \$(23,654) | \$(30,692) |
| Net loss per basic and fully diluted common share | \$ (0.70) | \$ (0.98) |

NOTE 4: MARKETABLE SECURITIES

As of December 31, 2002 and 2001, based on management's intentions, all marketable securities have been classified as "available-for-sale" and consist of the following (in thousands):

| | DECEMBER 31, | |
|--|--------------|----------|
| | 2002 | 2001 |
| Municipal securities | \$25,191 | \$18,065 |
| Corporate bonds and notes | 25,342 | 19,889 |
| Asset backed corporate debt securities | 10,483 | 12,733 |
| Commercial paper | -- | 17,037 |
| U.S. Government-agency securities | -- | 12,010 |
| | ----- | ----- |
| | \$61,016 | \$79,734 |
| | ===== | ===== |

The total carrying value of all marketable securities as of December 31, 2002 and 2001 includes approximately \$12.7 million and \$6.1 million that mature during 2004 and 2003, respectively, and are therefore classified as long-term. Net gains (losses) from the sales and maturities of marketable securities amounting to approximately (\$3,000) and \$291,000 are included in other income, net in the consolidated statements of operations for the years ended December 31, 2002 and 2001. The net unrealized holding gain of approximately \$177,000 and \$0 has been included in "Accumulated other comprehensive income (loss)" on the consolidated financial statements at December 31, 2002 and 2001, respectively.

NOTE 5: PROPERTY AND EQUIPMENT

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Property and equipment are stated at acquisition cost and consist of the following (in thousands):

| | DECEMBER 31, | |
|---|--------------|-----------|
| | 2002 | 2001 |
| Computer equipment and purchased software | \$ 12,875 | \$ 10,771 |
| Leasehold improvements | 1,504 | 654 |
| Furniture and office equipment | 1,677 | 1,578 |

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| | | |
|-------------------------------------|----------|----------|
| | ----- | ----- |
| | 16,056 | 13,003 |
| Less accumulated depreciation | (9,219) | (4,509) |
| | ----- | ----- |
| | \$ 6,837 | \$ 8,494 |
| | ===== | ===== |

Depreciation expense for the years ended December 31, 2002, 2001 and 2000 was \$4,708,000, \$2,753,000 and \$1,124,000, respectively.

NOTE 6: COMMITMENTS AND CONTINGENCIES

The Company has commitments that expire at various times through 2010. Operating leases shown below are primarily for facility costs for the Company's corporate headquarters and world-wide sales offices. Other contractual obligations primarily consist of minimum royalty fees payable by the Company in connection with a software license and distribution agreement which the Company entered into in January 2003.

| YEARS ENDING DECEMBER 31, | OPERATING LEASES | OTHER CONTRACTUAL OBLIGATIONS |
|---------------------------|------------------|----------------------------------|
| ----- | ----- | ----- |
| 2003..... | \$ 4,626 | \$ 1,000 |
| 2004..... | 2,380 | 1,400 |
| 2005..... | 1,788 | 1,600 |
| 2006..... | 1,734 | -- |
| 2006..... | 1,734 | -- |
| Thereafter..... | 632 | -- |
| | ----- | ----- |
| | \$ 12,894 | \$ 4,000 |
| | ===== | ===== |

Included in the operating lease commitments above is approximately \$1.1 million related to excess facilities which have been accrued in purchase accounting.

The Company incurred total operating lease expense, primarily related to certain facilities and equipment under non-cancelable operating leases, of approximately \$4.9 million, \$3.7 million and \$2.2 million for the years ended December 31, 2002, 2001 and 2000, respectively.

In April 2002, the Company entered into an agreement with a system integrator to assist the Company in the development and launch of one of its products. Under the terms of the agreement, for consideration of the system integrator's time in assisting with the development of the product, the Company agreed to promote the system integrator as an integrator of the developed product. The Company's obligation under the agreement will be considered satisfied once the system integrator receives consulting revenues totaling approximately \$3.9 million from the Company's customers, or by April 2004, whichever occurs first. In the event that the Company recommends a competitor of the system integrator to do the integration work for a customer, the Company could potentially owe a royalty to the system integrator based on the net license fee. As of December 31, 2002, no royalties were due to the system integrator.

In August 2002, the Company entered into a five year non-cancelable operating lease for an office building for its Corporate headquarters. The

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Company anticipates moving to the new facility in March 2003. In connection with the lease agreement, the Company delivered an irrevocable, unconditional, negotiable letter of credit in the amount of \$760,000 as a security deposit. The Company anticipates that it will spend approximately \$1.0 million in leasehold improvements to build out the new facility. As of December 31, 2002, approximately \$725,000 had been spent.

In January 2003, the Company entered into a software license and distribution agreement under which Netegrity was granted the right to sublicense the use of a provisioning application software program. In addition, Netegrity was granted certain rights to integrate or combine the software into its existing products. In exchange for these rights, Netegrity has agreed to pay a quarterly royalty fee based on a percentage of the net license fees charged by Netegrity for the software. The minimum royalty fees due in the first, second and third years of the agreement are approximately \$1.0 million, \$1.4 million and \$1.6 million. The initial term of this agreement is

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three years.

The Company has entered into indemnification agreements with the non-employee members of its Board of Directors. Additionally, the Company has entered into employment and executive retention agreements with certain employees and executive officers which, among other things, include certain severance and change of control provisions.

Under the terms of the Company's standard software license contracts, the Company indemnifies its customers for the potential liability associated with the infringement of other parties' technology based upon the Company's software product. There is a possibility that the Company may be liable to its customers in the event that there is infringement occurring. The Company is not aware of any infringement related to the Company's technology, and therefore has not accrued any amounts for the replacement or refund of any software products sold through December 31, 2002.

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. The Company is not presently a party to any legal proceedings, the adverse outcome of which, in management's opinion, would have a material adverse effect on the Company's results of operations or financial position.

NOTE 7: RELATED PARTY TRANSACTIONS

LOAN TO OFFICER

The consolidated balance sheets as of December 31, 2002 and 2001 include \$116,000 and \$130,000, respectively, in loans to an officer of the Company issued in connection with the exercise of stock options in 1996. The loan is reflected as a reduction of stockholders' equity in the accompanying consolidated balance sheets statements. The loan is payable upon demand and bears interest at 7% per annum. The loan was originally represented by a secured note however, in May 2002, the note was amended such that it became a full recourse note. During the fourth quarter of 2002, the officer repaid approximately \$14,000 of the loan balance and repaid an advance made during 2002 of approximately \$17,000.

MARKETING SERVICES

During the years ended December 31, 2002, 2001 and 2000, the Company paid

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approximately \$125,000, \$68,000 and \$15,000, respectively, to a company for marketing services. The principal shareholder of such company, is the son-in-law of one of the members of our Board of Directors. The Company has similar arrangements with other marketing services firms and believes the arrangement was entered into on substantially the same terms and conditions as its arrangements with such other firms.

ACQUISITION TRANSACTIONS

On August 2, 2001, the Company entered into an agreement with Broadview International LLC ("Broadview"), which called for Broadview to assist the Company in negotiating and structuring acquisitions of a defined set of companies with portal service products. The Chairman and Chief Executive Officer of Broadview is a member of the Company's Board of Directors. Under the agreement, Broadview was entitled to a transaction fee equal to \$750,000 in connection with the Company's acquisition of DataChannel. The Company had a substantially similar agreement with an investment bank that was not related to the Company and thus believes the agreement with Broadview was entered into on the same terms and conditions as would have been granted on an arm's-length basis.

The accompanying consolidated balance sheet as of December 31, 2001 includes \$750,000 payable to Broadview in connection with the acquisition of DataChannel discussed in Note 3. This amount was paid in 2002. The Company does not expect to complete any additional acquisitions subject to this agreement.

NOTE 8: INCOME TAXES

The components of income tax expense are as follows (in thousands):

| | YEAR ENDED DECEMBER 31, | | |
|--------------------------|----------------------------|--------|-------|
| | 2002 | 2001 | 2000 |
| | ----- | ----- | ----- |
| Current: | | | |
| Federal | \$(135) | \$ 223 | \$ 75 |
| State | 21 | 168 | -- |
| Foreign | 184 | 216 | -- |
| | ----- | ----- | ----- |
| | \$ 70 | \$ 607 | \$ 75 |
| | ----- | ----- | ----- |
| Deferred: | | | |
| Federal | \$ -- | \$ -- | \$ -- |
| State | -- | -- | -- |
| Foreign | -- | -- | -- |
| | ----- | ----- | ----- |
| | -- | -- | -- |
| | ----- | ----- | ----- |
| Total income tax expense | \$ 70 | \$ 607 | \$ 75 |
| | ===== | ===== | ===== |

The provision for income taxes differs from the federal statutory rate of 34% as follows (in thousands):

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| | YEAR ENDED DECEMBER 31, | | |
|--|----------------------------|---------|--------|
| | 2002 | 2001 | 2000 |
| Expected federal tax provision (benefit) | \$ (29,321) | \$ 765 | \$ 955 |
| State provision | 14 | 288 | -- |
| Non-deductible in-process research and development | -- | 1,020 | -- |
| Other | (113) | 282 | 81 |
| Goodwill impairment | 19,507 | -- | -- |
| Change in valuation allowance | 9,983 | (1,748) | (961) |
| | ----- | ----- | ----- |
| | \$ 70 | \$ 607 | \$ 75 |
| | ===== | ===== | ===== |

Significant components of the deferred tax assets and liabilities are as follows (in thousands):

| | DECEMBER 31, | |
|--------------------------------------|--------------|-----------|
| | 2002 | 2001 |
| Net operating loss carryforward | \$ 70,837 | \$ 63,407 |
| Loss on investment | 908 | 908 |
| Accruals and reserves | 2,274 | 1,487 |
| Research and development tax credits | 3,806 | 3,343 |
| Intangible assets | (2,159) | (4,400) |
| Other | 236 | 1,103 |
| Valuation allowance | (75,902) | (65,848) |
| | ----- | ----- |
| | \$ -- | \$ -- |
| | ===== | ===== |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred taxes assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the net operating losses are allowed to be carried forward or temporary differences become deductible. Due to the uncertainty of the Company's ability to realize the benefit of the deferred tax assets, the deferred tax assets are fully offset by a valuation allowance. The net change in the valuation allowance during 2002 and 2001 was an increase of approximately \$10.1 million and \$29.3 million (primarily due to the DataChannel acquisition), respectively. The Company re-evaluates the positive and negative evidence on a quarterly basis.

At December 31, 2002, the Company has available for federal income tax purposes net operating loss carryforwards of approximately \$177.0 million expiring at various dates through fiscal 2022. The net operating loss carryforward includes approximately \$98.2 million of tax deductions relating to stock options that will be credited to additional paid-in capital when realized. Additionally, approximately \$53.5 million of the net operating loss carryforward at December 31, 2002 is attributable to the DataChannel acquisition that when realized, will first reduce any remaining non-current intangible assets and the

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remaining will be recorded to reduce income tax expense. The acquired loss carryforwards are subject to an annual limitation under Internal Revenue Code Section 382 of approximately \$3.1 million. Under the Tax Reform Act of 1986, the utilization of a corporation's net operating loss carryforward is limited following a greater than 50% change in ownership over a three-year period. As of December 31, 2002, no change in ownership has occurred, although such a change can occur in a future period. If a change occurs, it could substantially limit the utilization of the loss carryforward of the Company in the future.

NOTE 9: CAPITAL STOCK AND CAPITAL STOCK WARRANTS

AUTHORIZED CAPITAL STOCK

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In May 2001, stockholders of Netegrity approved an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of capital stock from 55.0 million to 135.0 million. As of December 31, 2002, the authorized capital stock of the Company was comprised of 135.0 million shares of common stock (approximately 34.3 million shares issued), and 5.0 million shares of preferred stock, \$0.01 par value (see Preferred Stock Issuances, below).

PREFERRED STOCK ISSUANCES

The 5.0 million shares of preferred stock were designated as Series D. Between January 6, 1998 and June 30, 1998, the Company sold 3.3 million shares of Series D Preferred Stock to an institutional investor under a Preferred Stock and Warrant Purchase Agreement, as amended. When issued, each share of Series D Preferred Stock in 1998 was convertible into one share of common stock, which represented a discount from the fair value of common stock on the date of issuance. The value attributable to this conversion feature represented a beneficial conversion feature which was recognized as a return to preferred stockholders. The Series D Preferred Stock converted one for one to common stock in September 1999 and such shares cannot be reissued by the Company. The remaining authorized shares of Series D Preferred Stock of approximately 1.7 million shares have not been issued by the Company.

In conjunction with the agreement as described above, warrants to purchase a total of 2,251,000 shares of common stock exercisable at \$1.33 were issued to an institutional investor expiring on January 7, 2003. As part of the Agreement with the institutional investor described above, James McNiel joined the Board of Directors of the Company, as designee of the Pequot Entities and the Company granted Mr. McNiel a warrant for the purchase of 150,000 shares of common stock exercisable at \$1.00 expiring on January 7, 2003 for his services as a director. Due to certain terms of the warrant, the warrant was accounted for as a variable award. As a result, a non-cash compensation charge was recorded for the increase in the fair market value of the Company's common stock compared to the exercise price since the warrant was issued. The expense was recognized over the two year vesting period of the warrant and through the date of exercise. During the year ended December 31, 2000 compensation expense of \$292,000 was recorded related to this warrant. As of December 31, 2000, all of these warrants had been exercised.

WARRANTS

Outstanding warrants as of December 31, 2002 consisted of the following:

| DATE GRANTED | NUMBER OF WARRANTS | EXERCISE PRICE | EXPIRATION DATE |
|--------------|--------------------|----------------|-----------------|
|--------------|--------------------|----------------|-----------------|

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| Grant Date | Number of Shares | Exercise Price | Expiration Date |
|------------------------|------------------|----------------|-------------------|
| August 2, 1999..... | 37,500 | \$ 14.00 | August 2, 2001 |
| December 15, 2000..... | 4,004 | \$ 62.50 | December 15, 2002 |
| June 29, 2001..... | 6,965 | \$ 24.77 | June 29, 2003 |
| | ----- | | |
| | 48,469 | | |
| | ===== | | |

The outstanding warrants were granted to customers and accordingly revenue was reduced on the grant date based on the value of the warrant using the Black-Scholes option-pricing model.

NOTE 10: STOCK PLANS

STOCK OPTION PLANS

The Company has several stock option plans, as described hereunder, that provide for the issuance of an aggregate of 12,647,000 shares of the Company's common stock. All options issued under the plans are granted at fair market value at the date of grant, become exercisable at varying rates, generally over three or four years, as determined by the Board of Directors, and generally expire seven to ten years from the date of grant.

Stock Option Plans for Outside Directors: The Company maintains stock option plans intended only for members of the Company's Board of Directors who are neither employees nor officers of the Company (the Directors' Plans). The Directors' Plans provide for the grant of options to purchase up to 277,500 shares of Company common stock. The timing, amounts, recipients and other terms of the option grants are determined by the provisions of or formulas in the Directors' Plans. As of December 31, 2002, options for 71,562 shares were available for future grant.

Stock Option Plans for Employees and Others: The Company maintains stock option plans intended for employees, consultants and officers and, in the case of one of the plans, directors, providing for the granting of options to purchase up to 12,369,500 shares of

Company common stock as an inducement to obtain and retain the services of qualified persons. Incentive stock options may be granted to officers and employees, and non-qualified stock options may be granted to directors, officers, employees or consultants. As of December 31, 2002, aggregate options for 6,883,771 shares were available for future grant to employees and officers of and consultants to the Company.

TENDER OFFERS

On August 9, 2001 and as subsequently amended, the Company filed a tender offer statement with the Securities and Exchange Commission in connection with certain stock options issued after December 1, 1999 (the Option Offer). Under the Option Offer, the Company offered to exchange certain employee options to purchase shares of the Company's common stock for new options to purchase shares of its common stock. The Option Offer, which excluded executive officers, directors and non-employees of the Company and which expired on September 7, 2001, provided for the grant of new options on March 11, 2002 to eligible employees who were actively employed on the grant date. The number of shares underlying the new options was equal to the number of shares underlying the

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cancelled eligible options. The exercise price of the new options was equal to the fair market value of one share of common stock on the date of grant of the new options as determined in accordance with the applicable option plans. Each new option will vest in accordance with a vesting schedule that is equivalent to what would have been in place had the cancelled option remained in effect.

On March 11, 2002, the Company granted options to purchase an aggregate of 2,103,406 shares of its common stock at fair market value in connection with the Option Offer. In accordance with FASB Interpretation No. 44, since the replacement options were granted more than six months after cancellation of the old options, the new options were considered a fixed award and therefore did not result in any compensation expense.

On August 23, 2002 and as subsequently amended, the Company filed a tender offer statement with the Securities and Exchange Commission in connection with certain stock options outstanding under non-director stock plans (the Offer to Exchange). Under the Offer to Exchange, the Company offered to exchange certain employee options to purchase shares of the Company's common stock for new options to purchase shares of its common stock. The Offer to Exchange, which excluded directors and non-employees of the Company and which expired on September 23, 2002, provided for the grant of new options on two different dates. The Company expects to grant 50% of the new options on or about March 25, 2003 and the remaining 50% on or about April 25, 2003 to employees that are continuously and actively employed from the date the employee tendered eligible options for exchange to the date of the grant of the new options. The number of shares underlying the new options will be equal to the number of shares underlying the cancelled eligible options, except that certain options granted to certain executive officers will be exchanged at a rate of one share underlying a new option for each two shares underlying the tendered options. The exercise price of the new options will be equal to the fair market value of one share of common stock on the date of grant of the new options as determined in accordance with the applicable option plans. Each new option will vest in accordance with a schedule tied to the length of time of an individual's employment with the Company.

SUMMARY OF OPTION ACTIVITY

Stock option activity for the years ended December 31 is as follows (in thousands, except average life and price data):

| | FOR THE YEARS ENDED DECEMBER 31, | | | | | |
|---|----------------------------------|---------------------------------|---------|---------------------------------|---------|---------------------------------|
| | 2002 | | 2001 | | 2000 | |
| | SHARES | WEIGHTED AVERAGE EXERCISE PRICE | SHARES | WEIGHTED AVERAGE EXERCISE PRICE | SHARES | WEIGHTED AVERAGE EXERCISE PRICE |
| Options outstanding at beginning of year..... | 4,114 | \$ 20.11 | 6,500 | \$ 24.58 | 6,530 | \$ |
| Option activity during the year: | | | | | | |
| Granted..... | 5,025 | 13.06 | 1,898 | 34.38 | 2,427 | |
| Exercised..... | (364) | 1.62 | (1,073) | 5.57 | (2,215) | |
| Forfeited..... | (899) | 19.80 | (1,031) | 31.48 | (242) | |
| Option Offer..... | (5,745) | 20.02 | (2,180) | 45.62 | -- | |
| Options outstanding at end of | | | | | | |

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| | | | | | | |
|--------------------------|-------|---------|-------|----------|-------|-------|
| year..... | 2,131 | \$ 7.63 | 4,114 | \$ 20.11 | 6,500 | \$ |
| | ===== | ===== | ===== | ===== | ===== | ===== |
| Options exercisable..... | 1,030 | | 1,896 | | 1,831 | |
| | ===== | | ===== | | ===== | |

Stock options outstanding at December 31, 2002 are as follows (in thousands, except price data):

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| RANGE OF EXERCISE PRICES | SHARES OUTSTANDING | OPTIONS OUTSTANDING | | SHARES | WEIG AVE EXER PR |
|--------------------------|-----------------------|---------------------------------|---------------------------------------|--------|---------------------------|
| | | WEIGHTED AVERAGE LIFE (A) | WEIGHTED AVERAGE EXERCISE PRICE | | |
| \$.83-\$1.42..... | 474 | 3.6 | \$ 0.95 | 474 | \$ 0 |
| \$1.46-\$2.05..... | 300 | 6.8 | 1.99 | 11 | 1 |
| \$2.06-\$2.46..... | 321 | 6.5 | 2.27 | 173 | 2 |
| \$2.67-\$2.99..... | 410 | 6.8 | 2.72 | 73 | 2 |
| \$3.25-\$15.25..... | 201 | 6.7 | 7.05 | 76 | 8 |
| \$15.37-\$17.34..... | 156 | 7.4 | 16.14 | 16 | 17 |
| \$17.70-\$78.00..... | 269 | 8.5 | 35.12 | 207 | 35 |
| | ----- | | | ----- | |
| \$.83-\$78.00..... | 2,131 | 6.3 | \$ 7.63 | 1,030 | \$ 8 |
| | ===== | === | ===== | ===== | ===== |

(a) Average contractual life remaining in years.

EMPLOYEE STOCK PURCHASE PLAN

During May 2002, the Company established the 2002 Employee Stock Purchase Plan ("2002 Stock Purchase Plan") under which eligible employees could purchase shares of the Company's common stock, subject to certain limitations, at 85% of the market value. Purchases were limited to 10% of an employee's eligible compensation, up to a maximum of 1,000 shares per purchase period. The 2002 Stock Purchase Plan originally authorized the issuance of 700,000 shares of common stock (subject to adjustment for capital changes) pursuant to the exercise of nontransferable options granted to participating employees and the maximum number of shares which are available in any single purchase period is 112,500. Prior to establishing the 2002 Stock Purchase Plan, the Company maintained the 1990 Employee Stock Purchase Plan ("1990 Stock Purchase Plan") under which eligible employees could purchase shares of the Company's common stock, subject to certain limitations, at 85% of the market value. Purchases were limited to 10% of an employee's eligible compensation, up to a maximum of 500 shares per purchase period. The 1990 Stock Purchase Plan originally authorized the issuance of 150,000 shares of common stock (subject to adjustment for capital changes) pursuant to the exercise of nontransferable options granted to participating employees. During the year ended December 31, 2002, 112,000 shares of the Company's common stock were issued under the 2002 Stock Purchase Plan and during the years ended December 31, 2001 and 2000, 41,000 and 32,000 shares of the Company's common stock were issued under the 1990 Stock Purchase Plan, respectively. As of October 1, 2001, all authorized shares had been issued under the 1990 Stock Purchase Plan and the plan was terminated.

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STOCK AWARD

During November 2001, the Company issued an aggregate of 5,291 shares of common stock to certain employees as a stock award. This award resulted in compensation expense of approximately \$52,000 which is included in the accompanying consolidated statement of operations for the year ended December 31, 2001.

NOTE 11: OPERATING SEGMENTS AND GEOGRAPHICAL INFORMATION

Based on the information provided to the Company's chief operating decision maker for purposes of making decisions about allocating resources and assessing performance, the Company's continuing operations have been classified into a single segment. The Company operates primarily in three geographic regions: North America, Europe and Asia Pacific. Revenues (based on the location of the customer) and long-lived assets by geographic region are as follows (in thousands):

| | 2002 | 2001 | 2000 |
|---------------------------|----------|----------|----------|
| | ----- | ----- | ----- |
| Revenues: | | | |
| North America .. | \$56,155 | \$72,022 | \$45,278 |
| Europe | 10,145 | 11,293 | 8,114 |
| Asia Pacific ... | 2,964 | 4,831 | 1,853 |
| | ----- | ----- | ----- |
| Total | \$69,264 | \$88,146 | \$55,245 |
| | ===== | ===== | ===== |
| Long-Lived Assets: | | | |
| North America .. | \$19,852 | \$14,822 | |
| Europe | 389 | 170 | |
| Asia Pacific ... | 379 | 556 | |
| | ----- | ----- | |
| Total | \$20,620 | \$15,548 | |
| | ===== | ===== | |

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NOTE 12: SUMMARIZED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following financial information reflects all normal recurring adjustments that are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for fiscal 2002 and 2001 is as follows (in thousands, except per share data):

| | 1ST QUARTER | 2ND QUARTER | 3RD QUARTER |
|------------------------------|-------------|-------------|-------------|
| | ----- | ----- | ----- |
| 2002 | | | |
| Revenues | \$ 21,971 | \$ 15,808 | \$ 15,179 |
| Gross profit | 16,180 | 10,528 | 9,758 |
| Operating loss | (3,370) | (10,677) | (66,673) |
| Net loss | (2,754) | (9,953) | (66,153) |
| Basic loss per share | (0.08) | (0.29) | (1.94) |
| Diluted loss per share | (0.08) | (0.29) | (1.94) |

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| | | | |
|-----------------------------------|-----------|-----------|-----------|
| 2001 | | | |
| Revenues | \$ 26,286 | \$ 25,346 | \$ 17,185 |
| Gross profit | 20,568 | 20,064 | 13,019 |
| Operating income (loss) | 2,164 | 2,118 | (3,715) |
| Net income (loss) | 3,348 | 3,101 | (2,392) |
| Basic earnings (loss) per share . | 0.11 | 0.10 | (0.08) |
| Diluted earnings (loss) per share | 0.10 | 0.09 | (0.07) |

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

A. THE FOLLOWING DOCUMENTS ARE FILED AS PART OF THIS REPORT:

1. Financial Statements

The following financial statements are included in Item 8:

- a. Reports of Independent Accountants
- b. Consolidated Balance Sheets -- December 31, 2002 and 2001
- c. Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000
- d. Consolidated Statements of Stockholders' Equity for the years ended December 31, 2002, 2001 and 2000
- e. Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000
- f. Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-10139) filed with the Securities and Exchange Commission on February 13, 2003.

3. List of Exhibits

The following exhibits, required by Item 601 of Regulation S-K, are filed as part of this Annual Report on Form 10-K/A. Exhibit numbers, where applicable, in the left column correspond to those of Item 601 of Regulation S-K.

| EXHIBIT ITEM NO. ----- | ITEM AND REFERENCE ----- |
|------------------------------|-----------------------------|
|------------------------------|-----------------------------|

| | |
|------|--|
| 2.01 | Agreement and Plan of Merger, dated as of October 24, 2001, by and among Netegrity, Inc., LKN Acquisition Corp., and DataChannel, Inc., as amended by the First Amendment to the Agreement and Plan of Merger dated as of December 3, 2001 and by the Second Amendment to the Agreement and Plan of Merger, dated as of December 7, 2001 |
|------|--|

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(filed as Exhibit 2.1 to Current Report on Form 8-K dated December 24, 2001 and incorporated by reference).

- 3.01 Restated Certificate of Incorporation, as amended, of the Registrant (filed as Exhibit 3.1 to Registration Statement on Form S-3 filed February 12, 2002 and incorporated by reference).
- 3.02 Amended and Restated By-Laws of the Registrant (filed as Exhibit 3.03 to the Registrant's annual report on Form 10-K for the year ended December 31, 1998, and incorporated by reference).
- 4.01 Specimen certificate for shares of Common Stock of the Registrant (filed as Exhibit 4.01 to the Registrant's Registration Statement on Form S-18, No. 33-24446-B, and incorporated by reference).
- 10.01(1) 1991 Director Stock Plan (filed as Exhibit 10.10 to Annual Report on Form 10-K for the fiscal year ended March 31, 1991, and incorporated by reference).
- 10.02 Form of Non-Qualified Stock Option Agreement for the Registrant's 1993 Non-Employee Director Stock Option Plan (filed as Exhibit 10.12 to Annual Report on Form 10-K for the fiscal year ended March 31, 1993, and incorporated by reference).
- 10.03(1) 1994 Stock Plan (filed as Exhibit 4 to Registration Statement on Form S-8, filed on January 26, 1998, and incorporated by reference).

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- 10.04(1) 1997 Stock Option Plan (filed with the Definitive Proxy Statement filed on March 19, 1999 and incorporated by reference).
- 10.05(1) 1997 Non-Employee Director Stock Option Plan (filed as Exhibit 10.16 to Annual Report on Form 10-K for the fiscal year ended December 1997, and incorporated by reference).
- 10.06(1) 2001 Interim General Stock Incentive Plan (filed as Exhibit 4.1 on Form S-8, filed on October 31, 2002, and incorporated by reference).
- 10.07(1) 2002 Employee Retention General Incentive Plan (filed as Exhibit 4.1 on Form S-8, filed on October 31, 2002, and incorporated by reference).
- 10.08(1) 2002 General Stock Incentive Plan (filed as Exhibit 4.1 on Form S-8, filed on October 31, 2002, and incorporated by reference).
- 10.09(1) 2002 Employee Stock Purchase Plan (filed as Exhibit 4.1 on Form S-8, filed on October 31, 2002, and incorporated by reference).
- +10.10 Commercial Lease dated as of March 31, 2000 between the Registrant and Renaissance Worldwide, Inc. (filed as Exhibit 10.09 on Form 10-K for the year ended December 31, 2001 and incorporated by reference).
- 10.11 Preferred Stock and Warrant Purchase Agreement among the Company, Pequot Private Equity Fund L.P. and Pequot Offshore Private Equity Fund, Inc. (filed as Exhibit 4 to Report on Form 8-K filed on January 15, 1998, and incorporated by reference).

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- 10.12(1) Employment Agreement between Netegrity, Inc. and Barry Bycoff dated as of May 31, 1996 (filed as Exhibit 10.1 to Annual Report on Form 10-K/A for the year ended December 31, 1998, and incorporated by reference).
- 10.13(1) Netegrity Inc. 2000 Stock Incentive Plan as amended (filed as Exhibit 10.12 to Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference).
- 10.14 Lease Agreement by and between Netegrity, Inc., and Stonybrook Associates, LLC dated August 2002 (filed as Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.15(1) Offer letter from Netegrity, Inc., to Thomas Thimot, dated September 6, 2002 (filed as Exhibit 10.2 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.16(1) Indemnification Agreement by and between Netegrity, Inc., a Delaware corporation, and Eric Giler, a director of the Corporation (filed as Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.17(1) Indemnification Agreement by and between Netegrity, Inc., a Delaware corporation, and Lawrence D. Lenihan, Jr., a director of the Corporation (filed as Exhibit 10.4 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.18(1) Indemnification Agreement by and between Netegrity, Inc., a Delaware corporation, and Michael L. Mark, a director of the Corporation (filed as Exhibit 10.5 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.19(1) Indemnification Agreement by and between Netegrity, Inc., a Delaware corporation, and Ralph B. Wagner, a director of the Corporation (filed as Exhibit 10.6 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.20(1) Consulting Agreement by and between Netegrity, Inc. and Thomas Palka (filed as Exhibit 10.7 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.21(1) Transition Agreement by and between Netegrity, Inc. and Thomas Palka (filed as Exhibit 10.8 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).

- 10.22(1) Executive Retention Agreement by and between Netegrity, Inc., and Barry Bycoff (filed as Exhibit 10.9 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.23(1) Executive Retention Agreement by and between Netegrity, Inc., and

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Regina O. Sommer (filed as Exhibit 10.10 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).

- 10.24(1) Executive Retention Agreement by and between Netegrity, Inc., and Deepak Taneja (filed as Exhibit 10.11 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.25(1) Executive Retention Agreement by and between Netegrity, Inc., and James Rosen (filed as Exhibit 10.12 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.26(1) Executive Retention Agreement by and between Netegrity, Inc., and William Bartow (filed as Exhibit 10.13 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.27(1) Executive Retention Agreement by and between Netegrity, Inc., and Thomas Thimot (filed as Exhibit 10.14 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.28(1) Executive Retention Agreement by and between Netegrity, Inc., and Scott Sullivan (filed as Exhibit 10.15 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.29(1) Executive Retention Agreement by and between Netegrity, Inc., and Carmen Parisi (filed as Exhibit 10.16 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.30(1) Executive Retention Agreement by and between Netegrity, Inc., and Bradley Nelson (filed as Exhibit 10.17 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.31(1) Executive Retention Agreement by and between Netegrity, Inc., and Mary Jefts (filed as Exhibit 10.18 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.32(1) Executive Retention Agreement by and between Netegrity, Inc., and Vadim Lander (filed as Exhibit 10.19 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.33(1) Executive Retention Agreement by and between Netegrity, Inc., and Amit Jasuja (filed as Exhibit 10.20 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.34(1) Executive Retention Agreement by and between Netegrity, Inc., and Thomas Locke (filed as Exhibit 10.21 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.35(1) Executive Retention Agreement by and between Netegrity, Inc., and Mary Colette Cooke (filed as Exhibit 10.22 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated

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by reference).

- 10.36(1) Executive Retention Agreement by and between Netegrity, Inc., and Geoffrey Charron (filed as Exhibit 10.23 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.37(1) Executive Retention Agreement by and between Netegrity, Inc., and Michael Hyman (filed as Exhibit 10.24 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.38(1) Executive Retention Agreement by and between Netegrity, Inc., and Jill Maunder (filed as Exhibit 10.25 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, and incorporated by reference).
- 10.39(1) Offer letter from Netegrity, Inc., to Stephanie Feraday, dated October 30, 2002 (filed as Exhibit 10.39 to Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated by reference).
- 10.40(1) Executive Retention Agreement by and between Netegrity, Inc., and Stephanie Feraday, dated November 4, 2002, (filed as Exhibit 10.40 to Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated by reference).

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- 21.01 Subsidiaries of the Registrant (filed as Exhibit 21.01 to Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated by reference).
- 23.01 Consent of PricewaterhouseCoopers LLP (filed as Exhibit 23.01 to Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated by reference).
- 23.03 Consent of KPMG LLP (filed herewith).

- + Confidential treatment has been reported as to certain provisions, which have been omitted and filed separately with the Commission.
- (1) Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

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NETEGRITY, INC.

By: /s/ BARRY N. BYCOFF

Barry N. Bycoff
President and Chief Executive Officer

March 5, 2003

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CERTIFICATIONS

I, Barry N. Bycoff, President and Chief Executive Officer, certify that

1. I have reviewed this annual report on Form 10-K/A of Netegrity, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal

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controls; and

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

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

By: /s/ BARRY N. BYCOFF

Barry N. Bycoff
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 5, 2003

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CERTIFICATIONS

I, Regina O. Sommer, Chief Financial Officer and Treasurer, certify that:

1. I have reviewed this annual report on Form 10-K/A of Netegrity, Inc.;

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

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

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

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

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

c) Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our

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evaluation as of the Evaluation Date;

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

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

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

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

By: /s/ REGINA O. SOMMER

Regina O. Sommer
Chief Financial Officer and Treasurer
(Principal Financial Officer and Principal
Accounting Officer)

Date: March 5, 2003

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NETEGRITY, INC.

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

In connection with the Annual Report of Netegrity, Inc. (the "Company") on Form 10-K/A for the year ended December 31, 2002 as filed with the Securities and Exchange Commission (the "Report"), I, Barry N. Bycoff, President and Chief Executive Officer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that this Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in this Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ BARRY N. BYCOFF

Barry N. Bycoff
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 5, 2003

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NETEGRITY, INC.

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

In connection with the Annual Report of Netegrity, Inc. (the "Company") on Form 10-K/A for the year ended December 31, 2002 as filed with the Securities and Exchange Commission (the "Report"), I, Regina O. Sommer, Chief Financial Officer and Treasurer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that this Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in this Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ REGINA O. SOMMER

Regina O. Sommer
Chief Financial Officer (Principal Financial
Officer and Principal Accounting Officer)

Date: March 5, 2003