NETWORKS ASSOCIATES INC/
Form 10-K/A
October 31, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

Amendment No. 2

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the Fiscal Year Ended December 31, 2000

Or

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission file number 0-20558

Networks Associates, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	**77-0316593**
(State of incorporation)	*(I.R.S. Employer Identification No.)*

3965 Freedom Circle

Santa Clara, California 95054
(408) 988-3832
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

EXPLANATORY NOTE:

THIS 10-K/A IS BEING FILED FOR THE PURPOSE OF AMENDING AND RESTATING ITEMS 6, 7, 7A, 8 AND 14 TO REFLECT THE RESTATEMENT OF OUR CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998. WE HAVE MADE NO FURTHER CHANGES TO THE PREVIOUSLY FILED FORM 10-K/A. ALL INFORMATION IN THIS FORM 10-K/A IS AS OF DECEMBER 31, 2000 AND DOES NOT REFLECT ANY SUBSEQUENT INFORMATION OR EVENTS OTHER THAN THE RESTATEMENT. THIS 10-K/A AMENDS OUR PREVIOUSLY FILED FORM 10-K/A WHICH WAS FILED ON JUNE 28, 2002. FOR A DESCRIPTION OF OUR BUSINESS AND THE RISKS RELATED TO OUR BUSINESS, SEE OUR ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2002.

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PART I

Restatement of Consolidated Financial Statements

In the first quarter of 2002, the Securities and Exchange Commission (SEC) commenced a Formal Order of Private Investigation into our accounting practices. In the first quarter of 2003, we became aware that the U.S. Department of Justice (DOJ) had commenced an investigation into our consolidated financial statements for 2000 and years prior.

In April 2002, we announced our intention to file, and in June 2002 we filed with the SEC, Amendment No. 1 to this Annual Report on Form 10-K containing restated consolidated financial statements for 2000, 1999 and 1998, years which precede our current management s tenure. This previous restatement (i) corrected certain inaccuracies found in our accounts for 1998 through 2000 and (ii) gave effect to our adoption of Emerging Issues Task Force (EITF) Issue No. 01-09 *Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products* (EITF 01-09). EITF 01-09 required that our consolidated financial statements prior to 2000, the year of adoption, that are presented for comparative purposes be reclassified to comply with the required income statement display requirement. Many of the previous accounting inaccuracies pertained to amounts that were reclassified from tax liability accounts to our general and liability accounts, which caused our expenses to be understated. Other previous accounting inaccuracies included reclassification of tax liability accounts to the sales return allowance account, reclassification of amounts from a general and administrative liability account to a marketing liability account, and the recording of payments to a distributor in a balance sheet tax liability account instead of reducing net revenue. Our consolidated results of operations for 2001 and the interim periods of 2002 were not impacted by the previous restatement. However, to give effect to accumulated prior-period adjustments and their related tax impacts, we restated our December 31, 2001 and March 31, 2002 consolidated balance sheets.

As a result of information obtained in connection with the SEC and DOJ investigations, in March 2003, we concluded we would restate our consolidated financial statements for 1998 through 2000 to properly reflect sales to our distributors and resellers on the sell-through basis of revenue recognition (which is how we have accounted for these sales since 2001). In the course of reviewing these consolidated financial statements, we identified additional items and errors for which accounting adjustments were necessary.

As more fully described in note 3 to our consolidated financial statements for 1998 through 2000 (contained in this Form 10-K/A) and in note 3 to our consolidated financial statements for 2000 through 2002 (contained in our filing on Form 10-K for year ended December 31, 2002), the revenue restatement adjustments primarily resulted in revenue being deferred and recognized in subsequent periods, although certain adjustments resulted in permanent reductions in revenue. The adjustments include (i) amounts deferred and recognized in subsequent periods as a result of (a) conversion from the sell-in basis to the sell-through basis of accounting for revenue from distributors and resellers to properly report revenue on these sales, and (b) errors previously made in the application of the revenue recognition principles under Statement of Position (SOP) 97-2, *Software Revenue Recognition* (SOP 97-2), and (ii) permanent reductions in revenue as a result of the presence of concurrent investments in customers and errors due to misclassifications between revenue and expense. The net effect of these revenue adjustments is to increase previously announced (2002) or previously reported total revenue by $101.2 million, $259.2 million, $11.6 million and $49.4 million in 2002, 2001, 2000 and 1999, respectively, and to decrease total revenue by $533.9 million in 1998. For the five-year period 1998 through 2002, these adjustments result in a $112.6 million reduction to net revenue. Net revenue for 2003 is also expected to be increased by approximately $5.7 million as a result of these adjustments. We have determined that, excluding the effect of currency related adjustments, the aggregate amount of net revenue was not reduced as a result of (i) our restatement to the sell-through method of accounting for distributor and reseller sales in 1998 through 2000 or (ii) changes related to SOP 97-2 revenue recognition principles. These adjustments had the effect of deferring revenue from earlier periods to be recognized in later periods.

We also made certain deferrals and adjustments to our expenses and other accounts in connection with these revenue adjustments and have made certain other adjustments to our expenses. The net effect of these

expense and other account adjustments is to increase 2002 previously announced expenses by $2.9 million, increase 2001 expenses by $20.7 million, reduce 2000 expenses by $28.7 million, increase 1999 expenses by $16.2 million, and reduce 1998 expenses by $15.7 million. As a result of these adjustments to our revenues and expenses and other accounts, we are also making certain income tax-related adjustments, which decrease (increase) our tax expense by $9.7 million, $(54.6) million, $(24.4) million, $(28.2) million and $166.7 million in 2002, 2001, 2000, 1999 and 1998, respectively.

The consolidated statements of operations impact of all of these adjustments discussed above is to increase previously announced 2002 net income by $38.1 million; restate our previously reported 2001 net loss of $100.6 million to net income of $83.3 million; reduce 2000 net loss by $15.9 million; reduce 1999 net loss by $4.9 million; and restate our previously reported net income of $32.4 million in 1998 to a net loss of $319.1 million.

The foregoing restatement adjustments required an evaluation of a number of complex criteria and significant accounting judgments by us.

SEC Filings

We are filing this Amendment No. 2 to our 2000 Form 10-K containing restated consolidated financial statements for 1998 through 2000. Pending the completion of this restatement, the filings of our 2002 Form 10-K and Form 10-Qs for the first and second quarters of 2003 were delayed. These documents have now been filed with the SEC. We have not amended and do not intend to amend our other previously filed annual reports on Form 10-K or our quarterly reports on Form 10-Q for the periods affected by the restatements or adjustments. For this reason, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon.

Amended Items

We hereby amend the following items, consolidated financial statements, exhibits or other portions of our Annual Report on Form 10-K/A for the year ended December 31, 2000 as set forth herein:

Item 6. ***Selected Financial Data.***

The information set forth under the caption Selected Financial Data is amended to read in its entirety as set forth at pages 3 through 4 herein and is incorporated herein by reference.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

The information set forth under the caption Management s Discussion and Analysis is amended to read in its entirety as set forth at pages 4 through 17 herein and is incorporated herein by reference.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk.***

The information set forth under the caption Quantitative and Qualitative Disclosures About Market Risk is amended to read in its entirety as set forth at pages 16 through 17 herein and is incorporated herein by reference.

Item 8. ***Financial Statements and Supplementary Data***

Our quarterly financial information is amended to read in its entirety as set forth as pages 17 through 20 herein and is incorporated herein by reference.

Our consolidated financial statements and supplementary data and the report of independent auditors thereon are amended to read in their entirety as set forth at pages 22 through 73.

Item 14. ***Exhibits, Financial Statement Schedules and Exhibit Index***

The information set forth in Item 14(a)(1)-(2) is amended to read in its entirety as set forth at page 21 herein and is incorporated herein by reference.

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The list of exhibits set forth in, and incorporated by reference from the Exhibit Index, is amended to include the following additional exhibits, filed herewith:

23.1	Consent of PricewaterhouseCoopers LLP, independent accountants.
31.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Item 6. ***Selected Financial Data (Unaudited)***

We are filing Amendment No. 2 to our 2000 Form 10-K containing restated consolidated financial statements for 1998 through 2000 concurrently with the filing of our previously delayed 2002 Form 10-K and Forms 10-Q for the first and second quarters of 2003. You should read the following selected financial data with the consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this Amendment No. 2 to our Form 10-K. You should also read our concurrent filings to fully consider factors affecting future results and subsequent events to the financial information contained in this Form 10-K/A.

	Years Ended December 31,				
	2000	1999	1998	1997 (1)(2)(3)	1996 (1)(2)
	(In thousands, except per share amounts)				
	(As restated)	(As restated)	(As restated)	(As restated)	
Statements of Operations Data:					
Net revenue	$ 709,372	$ 660,337	$ 427,767	$723,450	$514,997
Income (loss) from operations	(127,541)	(136,725)	(402,826)	79,054	57,568
Income (loss) before income taxes and minority interest	(70,924)	(127,776)	(386,211)	100,352	65,419
Net income (loss)	(108,014)	(151,964)	(319,074)	19,760	10,711
Net income (loss) per share, basic	$ (0.78)	$ (1.10)	$ (2.40)	$ 0.16	$ 0.09
Net income (loss) per share, diluted	$ (0.78)	$ (1.10)	$ (2.40)	$ 0.15	$ 0.09
Shares used in per share calculation basic	138,072	138,695	133,075	126,662	115,626
Shares used in per share calculation diluted	138,072	138,695	138,609	132,729	125,502

	December 31,				
	2000	1999	1998	1997	1996
	(As restated)	(As restated)	(As restated)	(As restated)	
Balance Sheet Data:					
Cash and cash equivalents	$ 275,539	$ 329,732	$ 418,899	$157,031	$165,785
Working capital	79,591	64,560	159,856	270,998	307,478
Total assets	1,465,623	1,510,388	1,461,936	824,521	613,867
Deferred revenue and taxes	531,555	446,778	349,590	140,324	91,020
Other Long-Term Debt and liabilities	400,456	382,517	375,234	2,353	
Total equity	$ 222,923	$ 355,938	$ 378,994	$502,279	$425,671

(1) Operating results for 1997 and 1996 reflect the sell-in method for revenue recognition on our sales to distributors and resellers (with the exception of our largest distributor, which beginning in 1997 is on sell-through revenue recognition) and are not necessarily comparable to results for 2000, 1999 and 1998, which reflect revenue recognition for distributors on the sell-through basis of revenue recognition.

(2) Net revenue for 1997 and 1996 has not been reduced for consideration, including sales incentives and rebates, paid by us to our resellers or customers as required by EITF 01-09 because we determined it to be impractical to do so.

(3) Net revenues and net income have been increased (decreased) from previously reported amounts by $(12.2) million and $9.1 million, respectively. Net revenues in 1997 were determined to be overstated as a result of $5.2 million in revenue recorded when collectibility was not reasonably assured, $22.0 million in revenue for conversion of a distributor to sell through basis of accounting, $8.9 million of revenue related to 90-day free upgrade rights that had not expired at the end of 1997, $3.2 million of other errors which had the effect of recognizing revenue in 1997 that should have been deferred to later periods offset by $27.0 million in excess revenue allowances (contra revenue accounts). Expenses in 1997 were determined to be overstated by $29.8 million previously, principally as a result of $15.3 million in excess acquisition related expenses, excess cost of sales of $13.4 million related to the reduction of revenue, and $1.1 million of marketing and other costs. As a result of these adjustments, there was an $8.4 million increase in income tax expense for 1997 and a $9.1 million reduction in net income.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Forward-Looking Statements and Factors That May Affect Future Results

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others things, those risk factors set forth in this section and elsewhere in this report. We identify forward-looking statements by words such as may, will, should, could, expects, plans, anticipates, believes, estimates potential, or continue or similar terms that refer to the future. We cannot guarantee future results, levels of activity, performance or achievements. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Impact of Restatement of Consolidated Financial Statements

The following discussion gives effect to the restatement of our consolidated financial statements for 1998 through 2000 and should be read in conjunction with the consolidated financial statements and related notes, including note 3 describing the restatement. Among others, the more significant categories of restatement adjustments were recorded:

to properly reflect sales to our distributors and resellers on the sell-through basis for 1998 through 2000, which is how we have accounted for these sales since 2001;

to correct errors previously made in the application of the revenue recognition principles under SOP 97-2 in connection with multi-element revenue transactions in 1998 through 2000; and

to adjust revenue from distributors and resellers, where in error we initially recognized revenue at the time of sale but subsequently determined collection was not probable at that time.

Our restatement adjustments required an evaluation of a number of complex criteria and significant accounting judgments by us.

Restatement to Sell-through Basis of Revenue Recognition

We sell certain of our products through retail distribution channels and other resellers. Through December 2000, revenue transactions with our distributors and resellers generally required payment within a

customary collection period and included limited return rights under specific circumstances and revenue was recognized on a sell-in basis, net of allowances for estimated returns. Under the provisions of Statement of Financial Accounting Standard (SFAS) No. 48, *Revenue Recognition When Right-of-Return Exists,* (SFAS 48), specific criteria must be met for revenue to be recognized upon shipment when the buyer has the explicit or implicit right to return the product. In error, we previously concluded that these criteria had been satisfied. We subsequently determined that in 1998, 1999 and 2000 we did not meet the criteria requiring that the vendor s obligation to the buyer be complete and the fees be fixed or determinable at the time of product shipment. We provided concessions, including return rights and stock rotation rights, outside the contractual terms, and in some instances facilitated the resale of our products by our distributors. In addition, in some cases, distributors and resellers were not obligated to pay for delivered inventory until they had sold the inventory to a third party. Accordingly, we adjusted revenue on our distributor and reseller transactions prior to 2001 to reflect the sell-through basis of revenue recognition.

Restatement adjustments required under our change to a sell-through revenue recognition policy with respect to sales to our distributors and resellers had the effect of deferring recognition of revenue to periods later than originally recorded. We have concluded, except for the effect of foreign currency adjustments, no revenue was lost as a result of this change. The total correcting adjustments required under our change to a sell-through revenue recognition policy resulted in previously announced (2002) or reported net revenue increasing by $25.2 million, $82.4 million, $49.4 million and $137.0 million in 2002, 2001, 2000 and 1999, respectively, and net revenue decreasing in 1998 by $303.0 million.

Allocation of Revenue in Multiple-element Arrangements

The accounting treatment with respect to certain revenue arrangements in 1998 through 2000 with multiple elements was adjusted to correct certain errors. Our software license arrangements typically include the licensing of software and maintenance and support services or post contract support (PCS). SOP 97-2, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions,* provides that for arrangements with multiple elements, such as the sale of software licenses with undelivered PCS, revenue is allocated to each element of the arrangement based on evidence of fair value of the undelivered elements. Where evidence of fair value of the undelivered element is determinable and the fair value of the delivered element (e.g. the license) is not determinable, we defer revenue from the arrangement equivalent to the fair value of the undelivered elements (e.g. PCS) and recognize revenue on the delivered element under the residual value method. If the evidence of fair value of undelivered PCS is not determinable, then the entire arrangement fee is recognized ratably over the period that PCS is provided or until evidence of fair value is established. When evidence of fair value is established at a later date, the fair value of the undelivered elements is deferred and the residual portion of the delivered element is recognized as license revenue. As more fully described below and in note 3 to our consolidated financial statements, we recorded correcting adjustments to comply with the applicable accounting guidance.

For our enterprise multi-element products, we unbundle and defer revenue from the undelivered PCS element and recognize revenue with respect to the delivered license element. For one-year and two-year term enterprise software licenses in 1998 through 2000, amounts were allocated based on the list prices of the license and the PCS element. In other instances, we allocated revenue to the PCS element based on the amount invoiced to the customer in 1998 through 2000. Further, when we offered our customers a discount on the list price of bundled licenses and PCS in 1998 through 2000, the discount was allocated proportionately based on list price to the license and PCS. We have determined that these discounts should have been allocated entirely to the delivered license elements. In addition, we reevaluated whether our methods for allocating revenues to the PCS element were supported by sufficient evidence of the fair value of the PCS based on prices for which PCS was sold separately in 1998 through 2000. For some products, we determined that sufficient evidence of fair value did not exist. For other products, evidence of fair value existed, but the amount of deferred revenue should have been greater. These correcting adjustments cumulatively will result in the recognition of additional services and support revenue of $139.5 million, $46.0 million, and $0 in 2001, 2002 and 2003, respectively.

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Upon review of maintenance and support agreements included with the sale of retail licenses in 1998 through 2000, we also determined we had inappropriately established the fair value for the PCS element (i.e., updates to virus definition files) of these arrangements. As we did not sell the PCS separately until late 2000, all license and PCS revenue under the arrangement should have been deferred and recognized over the three-year estimated life of the retail license or until evidence of fair value of the PCS was established. In the fourth quarter of 2000, we established the VSOE of fair value for PCS based on an annual renewal rate for the PCS element included with our retail licenses.

Overall correcting adjustments to multi-element revenue arrangements in 1998 through 2000, including those described above, resulted in the same amount of revenue recognized in total, excluding foreign currency adjustments. However, there was a significant increase in deferred revenue for PCS offset by a commensurate decrease in product revenue in 1998 through 2000. This deferred PCS revenue will be recognized in later periods as service and support revenue. The total restatement adjustments regarding allocation of revenue in multiple-element arrangements in 1998 through 2000 resulted in net revenue decreasing by $161.7 million, $77.9 million and $9.0 million in 1998, 1999 and 2000, respectively, and increasing in 2001 and 2002 by $157.5 million and $71.2 million, respectively.

Collection Not Reasonably Assured

Several of our distributors were undergoing financial difficulty during 1998, 1999 and 2000; however, in error, we continued to recognize revenue on these distributors upon shipment of product to the distributor. Revenue from these distributors should have been recognized upon receipt of cash as one of the criteria for revenue recognition under SOP 97-2 is that collectibility is reasonably assured. In addition, upon review of transactions recorded into the provision for doubtful accounts in 1998 through 2000, we identified excess allowances for doubtful accounts transferred to our revenue allowances account (a contra revenue account reflecting, among other things anticipated product returns, estimates for price adjustments and product incentives). Correcting adjustments were recorded in 1998 through 2000 to reduce revenue for the amounts misclassified in error with an offsetting decrease in the provision for doubtful accounts.

Overall adjustments to revenue resulting from arrangements where collection was not reasonably assured resulted in permanent decreases in net revenue with net revenue decreasing in 1998 and 2000 by $46.9 million and $2.7 million, respectively, and net revenue increasing in 1999 and 2001 by $40.8 million, and $3.0 million, respectively.

Additional Adjustments and Information

Additional information regarding the restatement adjustments described above and our other restatement adjustments is included in note 3 of our consolidated financial statements set forth elsewhere in this Form 10-K/A.

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Results of Operations

Fiscal Years Ended December 31, 2000, 1999, and 1998

The following table, which reflects restated amounts, describes for the periods indicated the percentage of net revenue represented by certain items in our consolidated statements of operations:

	Years Ended December 31,		
	2000	1999	1998
		(As restated)	
Net revenue:			
Product	62%	66%	56%
Services and support	38	34	44
Total net revenue	100	100	100
Cost of net revenue:			
Product	17	14	28
Services and support	6	6	9
Total cost of net revenue	23	20	37
Operating costs:			
Research and development	23	23	32
Marketing and sales	51	50	64
General and administrative	15	24	23
Amortization of intangibles	8	8	10
Provision for (recovery of) bad debt	(2)	(4)	1
Acquisition and other related costs			27
Total operating costs	95	101	157
Loss from operations	(19)	(21)	(94)
Interest and other income	6	5	7
Interest and other expense	(3)	(3)	(3)
Gain (loss) on investments, net	4	(1)	
Loss before provision for (benefit from) income taxes and minority interest	(12)	(20)	(90)
Provision for (benefit from) income taxes	6	4	(16)
Loss before minority interest	(18)	(24)	(74)
Minority interest in loss of consolidated subsidiaries	1		
Net loss	(17)%	(24)%	(74)%

Net Revenue. Net revenue increased 7% to $709.4 million in 2000 from $660.3 million in 1999. Net revenue increased 54% to $660.3 million in 1999 from $427.8 million in 1998.

Net revenue in 1998 was adversely impacted by a $161.7 million reduction in product revenue in connection with revenue arrangements with multiple elements, with a related increase in PCS deferred revenue recognized ratably as services and support revenue over the estimated

life of the product. Net revenue in 1998 also reflects a reduction of approximately $46.9 million in connection with sales to distributors where collection was not reasonably assured and revenue should have been recognized on the related sales based on actual cash receipts. For example, in 1999, CHS, our largest European distributor, filed for insolvency. Finally, as a result of adoption of the sell-through method of accounting in 1998, we did not recognize revenue on approximately $12.1 million of inventory held at the beginning of 1998 by those distributors and resellers where we had previously recognized revenue under the sell-in method.

Net revenue in 1999 reflects the benefit of (i) a full

year of ratable PCS revenue being recognized for arrangements that beginning in 1998 were subject to three-year ratable revenue recognition versus only a partial year of revenue for 1998 on those arrangements and (ii) a full year of operating results from our purchases of Magic Solutions and CyberMedia, acquired in April 1998 and September 1998, respectively. Offsetting this was (i) a $77.9 million overall reduction in product revenue in connection with revenue arrangements from 1999 with multiple elements and (ii) beginning in the first quarter of 1999, a lessening of distributor and reseller demand, with a corresponding lengthening of their sales cycle, due to among other factors, Year 2000 concerns.

Net revenue in 2000 includes $20.0 million of revenue recognized in connection with our establishing evidence of fair value for the PCS element of various multi-element retail arrangements which allowed us to recognize the remaining related deferred license revenue using the residual method. Net revenue also reflects improved sales through by our distributors and resellers.

Product revenue includes revenue from product licenses and hardware. Product revenue increased 0% to $438.5 million in 2000 from $438.3 million in 1999. Product revenue increased 84% to $438.3 million in 1999 from $238.4 million in 1998. These increases in product revenue are due to the same factors discussed above.

Services and support revenues include revenues from software support and maintenance contracts, education and consulting services, which are deferred and recognized over the related service period. Service revenues increased 22% to $270.9 million in 2000 from $222.1 million in 1999. Service revenue increased 17% to $222.1 million in 1999 from $189.3 million in 1998. In 1999, $32.8 million more of services and support revenue was recognized as compared to 2000 due to the deferral of services and support revenue from 1998 with respect to multi-element revenue contracts. Also, after establishing evidence of fair value for PCS for various multi-element retail arrangements late in 2000, a smaller portion of the total license fee was allocated to service and support. The general increase in services and support revenues resulted from growth in all categories of service revenues, principally due to the growth of our installed customer base and the resulting renewal of support and maintenance contracts. In addition, services and support revenues increased from sales of software licenses that include PCS where we do not have evidence of fair value for the PCS and, consequently, must recognize the entire amount of the arrangement over the PCS term as services and support revenue.

International revenue accounted for approximately 34%, 34%, and 51% of net revenue for 2000, 1999, and 1998, respectively. The decrease in international net revenue as a percentage of net revenue from 1998 to 1999 was due to under performance in sales operations, changes in sales management, the insolvency of our major European distributor, a slow down due to softening market conditions and continued weakness of the Euro. To minimize the impact of foreign currency fluctuations, we use non-leveraged forward currency contracts. However, our future results of operations may be adversely affected by currency fluctuations or by costs associated with currency risk management strategies. Other risks inherent in international revenue include the impact of longer payment cycles, greater difficulty in accounts receivable collection, unexpected changes in regulatory requirements, seasonality due to the slowdown in European business activity during the third quarter, tariffs and other trade barriers, uncertainties relative to regional economic circumstance, political instability in emerging markets and difficulties staffing and managing foreign operations. These factors may have a material adverse effect on our future international license revenue. Further, in countries with a high incidence of software piracy, we may experience a higher rate of piracy of our products.

Cost of Net Revenue. Cost of net revenue increased 21% to $160.1 million in 2000 from $132.7 million in 1999. From 1998 to 1999, cost of net revenue decreased 17% from $160.6 million in 1998 to $132.7 million in 1999.

Our cost of product revenue consists primarily of the cost of media, manuals and packaging for products distributed through traditional channels, royalties and, with respect to hardware-based products, computer platforms and other hardware components. Cost of product revenues increased 30% to $117.8 million in 2000 from $90.6 million in 1999. From 1998 to 1999, cost of product revenues decreased 25% from $120.9 million in 1998 to $90.6 million in 1999. As a percentage of net product revenue, cost of product revenue was 27% in 2000, 28% in 1999, and 52% in 1998. Cost of product revenue as a percentage of net product revenue in 1999

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and 2000 reflects the favorable impact of services and support revenue deferred from earlier periods, primarily 1998, and recognized in those periods.

The increase in cost of product revenues from 1999 to 2000 was due to a $27.0 million increase in materials cost attributable to computer platform and other hardware product costs resulting from an increase in hardware product revenues, offset by a decrease in costs associated with government contracts. The decrease in cost of products revenues from 1998 to 1999 was partly due to the shift in the mix of higher margin volume priced software licenses versus hardware-based sales. In addition, in 1998 additional cost of product revenues was incurred in connection with sales to distributors, such as CHS which filed for insolvency in 1999, where no related revenue was recognized in 1998 as collection was not reasonably assured.

Cost of services and support revenue consists principally of salaries and benefits related to employees providing customer support and consulting services. In 2000, the cost of services and support revenue remained relatively flat at $42.3 million from $42.1 million in 1999. From 1998 to 1999, cost of services and support revenue increased 6% to $42.1 million in 1999 from $39.7 million in 1998. Cost of services and support revenue as a percentage of net services and support revenue was 16% in 2000, 12% in 1999, and 21% in 1998.

Expenses. Set forth below for the indicated periods are our operating costs, including and excluding stock-based compensation (in thousands). Our management believes that a presentation of operating costs excluding stock-based compensation provides investors a meaningful basis of evaluating our underlying cost and expense levels. The size and amount of our stock-based charges has varied, and in the future will vary, from period to period based on movements in our stock price, making period to period comparisons difficult and, in some cases, not meaningful. See Stock-Based Compensation below.

Operating Costs Including Stock-Based Compensation (in thousands):

	Years Ended December 31,		
	2000	1999	1998
	(As restated)	(As restated)	(As restated)
Research and development	$164,218	$152,728	$135,475
Marketing and sales	358,295	327,508	273,696
General and administrative	91,277	114,521	97,851
Amortization of intangibles	58,236	50,354	40,969
Provision for (recovery of) doubtful accounts	4,785	19,246	4,828
Acquisition and other related costs			117,170
Total operating costs, including the effects of stock-based compensation	$676,811	$664,357	$669,989

Operating Costs Excluding Stock-Based Compensation (in thousands):

	Years Ended December 31,		
	2000	1999	1998
	(As restated)	(As restated)	(As restated)
Research and development(1)	$162,324	$148,213	$134,807
Marketing and sales(2)	353,725	320,346	273,696
General and administrative(3)	87,625	105,495	97,851
Amortization of intangibles	58,236	50,354	40,969
Provision for (recovery of) doubtful accounts	4,785	19,246	4,828
Acquisition and other related costs			117,170

Total operating costs, excluding the effects of stock-based compensation	$666,695	$643,654	$669,321

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(1) Excludes stock-based compensation charge of $1,894, $4,515, and $668 for 2000, 1999, and 1998, respectively.

(2) Excludes stock-based compensation charge of $4,570, $7,162, and none for 2000, 1999, and 1998, respectively.

(3) Excludes stock-based compensation charge of $3,652, $9,026, and none for 2000, 1999, and 1998, respectively.

Research and Development. Research and development expenses consist primarily of salary and benefits for our development and technical support staff. Excluding the effects of stock-based compensation of $1.9 million and $4.5 million in 2000 and 1999, respectively, research and development expenses increased 10% to approximately $162.3 million in 2000 from $148.2 million in 1999. From 1998 to 1999, excluding the effects of stock-based compensation of $4.5 million in 1999 and $0.7 million, research and development expenses increased 10% from $134.8 million in 1998 to $148.2 million in 1999. These increases from 1998 to 1999 and 2000 were primarily due to the increase in staffing and equipment expense to support growth in our product and service offerings. As a percentage of net revenue, research and development expenses were 23% in 2000, 23% in 1999, and 32% in 1998. Excluding the effects of stock-based compensation, as a percentage of net revenue, research and development expenses were 23% in 2000, 22% in 1999, and 32% in 1998. Research and development expenses as a percent of net revenue were disproportionately impacted in 1998 by the extent of 1998 revenue deferred to subsequent periods resulting from fair value allocations of revenue in multi-element arrangements and the change to a sell-through revenue recognition policy.

We believe that our ability to maintain our competitiveness depends in large part upon our ability to enhance existing products, develop and acquire new products and develop and integrate acquired products. The market for computer software is characterized by low barriers to entry and rapid technological change, and is highly competitive with respect to timely product introductions. The timing and amount of research and development expenses may vary significantly based upon the number of new products and significant upgrades under development and products acquired during a given period.

Marketing and Sales. Marketing and sales expens