NETEGRITY INC
Form 10-Q/A
December 04, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934, FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001.

[ ] 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 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, MA 02451
(Address of principal executive offices) (Zip Code)

(781) 890-1700
(Registrant's Telephone Number)

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 other 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 [X] No [ ]

As of November 12, 2001 there were 31,324,276 shares of Common Stock outstanding, exclusive of Treasury stock.

Netegrity, Inc.

The Registrant's 10-Q for the quarter ended September 30, 2001 filed with the Securities Exchange Commission on November 14, 2001 is amended as indicated on the following pages to correct certain clerical errors on the September 30, 2001 Consolidated Condensed Balance Sheet in the line items related to "Marketable securities" and "Other comprehensive income" and to make related corrections to Footnotes 1(b), 1(d) and the Liquidity And Capital Resources section of Management's Discussion.

PART I. - FINANCIAL INFORMATION

NETEGRITY, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

ASSETS
CURRENT ASSETS:
Cash, cash equivalents and marketable securities .....
Marketable securities .....
Accounts receivable-trade, net of allowances of $951 and $1,853 at December 31, 2000 and September 30, 2001, respectively .....
Prepaid expenses and other current assets .....

Total current assets .....
Property and equipment, net .....
Long-term marketable securities .....
Restricted cash .....
Other assets .....

Total Assets .....

LIABILITIES AND STOCKHOLDERS' EQUITY
CURRENT LIABILITIES:
Accounts payable-trade .....
Accrued compensation and benefits .....
Other accrued expenses .....
Deferred revenue .....

Total Current Liabilities .....

STOCKHOLDERS' EQUITY:
Common stock, voting, $.01 par value; 135,000 shares authorized;
30,184 shares issued and 30,146 shares outstanding at December 31, 2000;
31,267 shares issued and 31,229 outstanding at September 30, 2001 .....

Additional paid-in capital .....
Accumulated other comprehensive income .....
Accumulated deficit .....
Loan to officer .....

Less -- Treasury stock, at cost: 38 shares .....

Total Stockholders' Equity .....

Total Liabilities and Stockholders' Equity .....

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

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE THREE MONTHS ENDED SEPT	
	2000	2001
Revenues:		
License software	$ 10,586	$ 9,016
Services	3,922	6,780
Other	825	908
Total revenues	15,333	16,704
Cost of license software	695	136
Cost of services	2,259	3,027
Cost of other	513	522
Total cost of revenues	3,467	3,685
Gross profit	11,866	13,019
Selling, general and administrative expenses	9,956	12,275
Research and development costs	2,788	3,857
Non-recurring expenses	--	603
Loss from operations	(878)	(3,716
Interest income	1,789	1,324
Income (loss) before provision for income taxes	911	(2,392
Provision for income taxes	--	--
Net income (loss)	$ 911	$ (2,392
Net income (loss) per share attributable to common stockholders:		
Basic	$ 0.03	$ (0.08
Diluted	$ 0.03	$ (0.08
Weighted average shares outstanding:		
Basic	29,652	31,203
Diluted	34,008	31,203

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

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NETEGRITY, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE NINE MONTHS ENDED SEPTE	
	2000	2001
Revenues:		
License software	$ 22,198	$43,842
Services	7,873	20,887
Other	2,503	2,772
Total revenues	32,574	67,501
Cost of license software	1,528	1,503
Cost of services	4,581	10,675
Cost of other	1,497	1,671
Total cost of revenues	7,606	13,849
Gross profit	24,968	53,652
Selling, general and administrative expenses	23,283	40,617
Research and development costs	6,136	11,865
Non-recurring expenses	--	603
Income (loss) from operations	(4,451)	567
Interest income	4,321	4,098
Income (loss) before provision for income taxes	(130)	4,665
Provision for income taxes	--	607
Net income (loss)	$ (130)	$ 4,058
Net income (loss) per share attributable to common stockholders:		
Basic	$ 0.00	$ 0.13
Diluted	$ 0.00	$ 0.12
Weighted average shares outstanding:		
Basic	28,676	30,850
Diluted	28,676	32,962

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

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NETEGRITY, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	FOR
OPERATING ACTIVITIES:	
Net income (loss)	
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization	
Provision for doubtful accounts receivable	
Compensation expense related to warrant	

Changes in operating assets and liabilities:
Accounts receivable .....
Prepaid expenses and other current assets .....
Other assets .....
Accounts payable-trade .....
Accrued compensation and benefits .....
Other accrued expenses .....
Deferred revenue .....

Net cash provided by operating activities .....

INVESTING ACTIVITIES:
Restricted cash .....
Purchases of property and equipment .....
Purchases of marketable securities .....

Net cash used for investing activities .....

FINANCING ACTIVITIES:
Issuance of common stock under stock plans .....

Net cash provided by financing activities .....
Effect of exchange rate changes on cash and cash equivalents .....

Net increase (decrease) in cash and cash equivalents .....
Cash and cash equivalents at beginning of period .....

Cash and cash equivalents at end of period .....

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

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NETEGRITY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The unaudited financial information furnished herein reflects all adjustments which are of a normal recurring nature, which in the opinion of management are necessary to fairly state the Company's financial position, cash flows and results of operations for the periods presented. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The results of operations for the nine months ended September 30, 2001 are not necessarily indicative of the results to be expected for the remainder of the year ending December 31, 2001. This information should be read in conjunction with the Company's audited financial statements for the fiscal year ended December 31, 2000, included in Form 10-K filed on February 28, 2001.

(b) CASH EQUIVALENTS AND MARKETABLE SECURITIES

Cash equivalents are stated at cost plus accrued interest, which approximates market value and have maturities of three months or less at the date of purchase. All investments-with a maturity greater than three months, which primarily consists of government securities and corporate debt, are accounted for under Financial Accounting Standards Board (FASB) No. 115, Accounting for certain investments in Debt and Equity Securities (SFAS 115). In accordance with SFAS 115, investments are classified as held to maturity, available for sale or trading securities. The Company determines the appropriate classification at the time of purchase. As of September 30, 2001, all investments in marketable securities are classified as trading securities. Investments that are bought and held principally for the purposes of selling them in the near term are designated as trading securities. Trading securities are measured at fair value in the Company's balance sheet. Changes in fair value of trading securities are reflected in interest income in the statement of operations. The net change in unrealized gains included in the statement of operations for the three and nine months ended September 30, 2001 was $170,000.

(c) REVENUE RECOGNITION

The Company's revenues are primarily generated from the sale of its proprietary SiteMinder products and services and from licensing the rights to use software products developed by Checkpoint Software Technologies, Ltd. to end users and resellers. (Such Checkpoint revenue is included in "other" revenue in the accompanying statement of operations.) The Company generates its services revenue from consulting and training services performed for customers and from support (i.e., maintenance). Revenues from software license agreements are recognized upon contract execution, provided all shipment obligations have been met, fees are fixed or determinable and collection is reasonably assured. The Company does not offer a right of return on its products. Revenues may include multiple software products and services sold together; these are allocated to each element based on the residual method in accordance with Statement of Position No. 98-9, SOFTWARE REVENUE RECOGNITION, WITH RESPECT TO CERTAIN TRANSACTIONS. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized when earned. The Company has established sufficient vendor specific objective evidence for professional services, training and maintenance and support services based on the price when these elements are sold separately. Accordingly, software license revenue is recognized under the residual method in arrangements in which software is licensed with professional services, training and maintenance and support services. Revenues for maintenance are recognized ratably over the term of the support period. Revenues from consulting and training services are recognized as the services are performed.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (SAB 101) as amended by SAB 101A and SAB 101B. SAB 101 summarizes the staff's views in applying generally accepted accounting principles to selected revenue recognition issues. The Company adopted SAB 101 in fiscal year 2000 without a material impact on it's financial position or results of operations.

(d) COMPREHENSIVE INCOME (LOSS)

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. For the three and nine months ended September 30, 2000, the comprehensive loss does not differ from the reported loss. For the three and nine months ended September 30, 2001, the difference between the comprehensive income (loss) of ($2.4 million) and $4.0 million, respectively, and the net income (loss) is due to the effect of the Company's cumulative translation adjustment.

(e) NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed using the weighted average number of shares of common stock outstanding. Diluted Earnings Per Share (EPS) is based upon the weighted average number of common and common equivalent shares outstanding during the period.

The following table sets forth basic and diluted income (loss) per share computational data for the periods presented (in thousands, except per share data):

	FOR THE THR
	2
Net income (loss) attributable to common stockholders	$
Weighted average shares outstanding used in computing basic net income (loss) per share	2
Weighted average common equivalent shares outstanding:	
employee stock options and warrants	
Total weighted average common and common equivalent shares outstanding used in computing diluted net income (loss) per share	3
Basic net income (loss) per share	$
Diluted net income (loss) per share	$

	(IN THO FOR THE NINE MONTH
	2000
Net income (loss) attributable to common stockholders	$ (130)
Weighted average shares outstanding used in computing basic net income (loss) per share	28,676
Weighted average common equivalent shares outstanding:	

employee stock options and warrants	--
Total weighted average common and common equivalent shares outstanding used in computing diluted net income (loss) per share	28,676
Basic net income (loss) per share	$ 0.00
Diluted net income (loss) per share	$ 0.00

Options to purchase a total of 2.2 million and 4.2 million weighted shares outstanding for the three months ended September 30, 2000 and 2001, respectively, and 1.5 million and 2.5 million weighted shares outstanding for the nine months ended September 30, 2000 and 2001, respectively, were outstanding but were not included in the computation of diluted EPS because the options are anti-dilutive.

(f) RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. Statement No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. Statement No. 142 discusses how intangible assets that are acquired should be accounted for in financial statements upon their acquisition and also how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Beginning on January 1, 2002, with the adoption of Statement No. 142, goodwill and certain purchased intangibles existing on June 30, 2001, will no longer be subject to amortization over their estimated useful life. Rather the goodwill and certain purchased intangibles will be subject to an annual assessment for impairment. The provisions of Statement No. 142 are required to be applied starting with fiscal years beginning after December 15, 2001. The adoption of SFAS No. 142 will not have a material impact on the Company's financial statements. The Company will apply SFAS 142 to the transaction discussed in Note 6.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, and the accounting and reporting provisions of APB No. 30, SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is currently reviewing this statement to determine its effect on the Company's financial statements.

NOTE 2: RESTRUCTURING CHARGES AND NON-RECURRING EXPENSES

The Company recorded a non-recurring expense of $603,000 during the third quarter of 2001. These costs are associated with the Company's restructuring plan and other non-recurring expenses.

A) RESTRUCTURING PLAN

On September 28, 2001, the Company announced a restructuring plan designed to reduce expenses and align its cost structure with its revised business outlook. The restructuring plan included a worldwide workforce reduction, and the consolidation of excess facilities.

The restructuring plan resulted in the reduction of the worldwide workforce by approximately 33 people, or 8%. Approximately 60%, 24% and 16% of the headcount reduction related to selling, general and administrative, development and other

areas respectively. The affected employees are entitled to severance and other benefits for which the Company recorded a charge of $342,000 in the third quarter of 2001. The Company recorded a charge of $25,000 for consolidation of excess facilities.

The following table summarizes the activity in the restructuring accruals for the period ended September 30, 2001.

	Beginning Accrual Balance	Amounts Paid	Accrual As of September 30, 2001
Workforce reduction	$342,000	--	$342,000
Consolidation of facilities	25,000	--	25,000
Total	$367,000	--	$367,000

B) OTHER NON-RECURRING EXPENSES

The Company recorded a non-recurring charge in the third quarter of 2001 of $236,000 which is included in accrued expenses. The other non-recurring charges include a contribution to the James Hayden Memorial Fund and the acceleration of his options.

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Remaining cash expenditures relating to the workforce reductions will be substantially paid in the fourth quarter of fiscal 2001. Amounts related to the net lease expense due to the consolidation of facilities will be paid over the respective lease terms through May 31, 2002. The Company expects to substantially complete its restructuring plan during the first half of fiscal 2002.

NOTE 3: SEGMENT REPORTING

(a) SEGMENT REPORTING

The Company considers that it has the following five reportable operating segments based on differences in products and services. Operating segments are defined as components of the enterprise about which separate financial information is available that is reviewed regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing their performance. The Company evaluates the performance of each reportable segment based on gross margins. Summarized unaudited financial information is as follows (in thousands):

	FOR THE THREE MONTHS ENDED SEPTEMB		
	2000		2
	REVENUE	GROSS MARGIN	REVENUE
Operating Segments:			
License software.....	$ 10,586	$ 9,891	$ 9,016

Services:			
Maintenance	1,402	1,402	3,503
Training and consulting	2,520	260	3,277
	3,922	1,662	6,780
Other			
Software and related products	425	92	505
Services	400	221	403
	825	313	908
Totals	$ 15,333	$11,866	$ 16,704

	FOR THE NINE MONTHS ENDED SEPTEM		2
	2000		
	GROSS REVENUE	MARGIN	REVENUE
Operating Segments:			
License software	$ 22,198	$ 20,670	$ 43,842
Services:			
Maintenance	2,363	2,363	9,335
Training and consulting	5,511	929	11,552
	7,874	3,292	20,887
Other			
Software and related products	1,287	337	1,079
Services	1,215	669	1,693
	2,502	1,006	2,772
Totals	$ 32,574	$ 24,968	$ 67,501

(B) GEOGRAPHIC INFORMATION

The geographic distribution of the Company's revenues are summarized in the following tables.

	FOR THE THREE MONTHS ENDED SEPTEMBER 30, (unaudited)		FOR THE NINE MONTHS END (unaudited
	2000	2001	2000
Revenues:			
North America	13,935	12,391	29,886
Europe	1,005	3,265	2,090
Asia Pacific	393	1,048	598
Total	15,333	16,704	32,574
Long-Lived Assets:			
North America			5,569

Europe	--
Asia Pacific	--
Total	5,569

NOTE 4: STOCKHOLDERS' EQUITY

In July 2000, the Board of Directors approved a three for two stock split of the Company's common stock in the form of a stock dividend which was effective September 1, 2000 for all holders of record as of August 18, 2000. All common share data presented in this 10-Q have been adjusted for the stock split.

NOTE 5: RELATED-PARTY TRANSACTIONS

On August 2, 2001, the Company entered into an agreement with Broadview International LLC ("Broadview"). The Managing Director of Broadview is a member of the Company's board of directors. Broadview will assist the Company in negotiating and structuring the acquisition from a defined set of companies with portal service products. For each acquisition transaction Broadview participates, it will be entitled to a transaction fee equal to $750,000 for which a definitive agreement is executed or a transaction is consummated within a twelve-month period.

NOTE 6: SUBSEQUENT EVENTS

On October 24, 2001, the Company signed a definitive agreement to acquire the stock of privately-held DataChannel, Incorporated, headquartered in Bellevue, Washington. DataChannel, a leading provider of enterprise portal solutions, delivers a standards based platform with robust administration, scalability and development capabilities. The consideration for the acquisition is $15 million in cash and 2.5 million in common shares.

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

FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA

This report and the documents incorporated in it by reference contain forward-looking statements about our plans, objectives, expectations and intentions. You can identify these statements by words such as "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate," "may," "will" and "continue" or similar words. You should read statements that contain these words carefully. They discuss our future expectations, contain projections of our future results of operations or our financial condition or state other forward-looking information, and may involve known and unknown risks over which we have no control. You should not place undue reliance on forward-looking statements. We cannot guarantee any future results, levels of activity, performance or achievements. Moreover, we assume no obligation to update forward-looking statements or update the reasons actual results could differ materially from those anticipated in forward-looking statements. The factors discussed in the sections captioned "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" in this report and the documents incorporated in it by reference identify important factors that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

This report and the documents incorporated in it by reference contain data related to the e-commerce market. These market data have been included in

studies published by the market research firms of Forrester Research and International Data Corporation. These data include projections that are based on a number of assumptions, including increasing worldwide business use of the Internet, the growth in the number of web access devices per user, the absence of any failure of the Internet, and the continued improvement of security on the Internet. If any of these assumptions is incorrect, actual results may differ from the projections based on those assumptions.

RISK FACTORS

The Private Securities Litigation Reform Act of 1995 contains certain safe harbors regarding forward-looking statements. In that context, the discussion in this Item contains forward-looking statements which involve certain degrees of risk and uncertainty,

including statements relating to liquidity and capital resources. Except for the historical information contained herein, the matters discussed in this section are such forward-looking statements that involve risks and uncertainties, including:

WE HAVE INCURRED SUBSTANTIAL LOSSES AND MAY NOT BE PROFITABLE IN THE FUTURE.

In recent years, we have incurred substantial losses. We cannot predict if we will achieve profitability for any substantial period of time. Failure to maintain levels of profitability as expected by investors may adversely affect the market price of our common stock. In the three months ended September 31, 2001, we had net loss of $2.4 million; in the nine months ended September 30, 2001, we had net income of $4.1 million. As a result of historical operating losses, at September 30, 2001, we had an accumulated deficit of $18.0 million. We have continued to invest in all areas, particularly in research and development and sales and marketing, in order to execute our business plan.

DISAPPOINTING QUARTERLY RESULTS COULD CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO FALL SUBSTANTIALLY.

Our quarterly revenues and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our quarterly revenues or operating results fall below the expectations of investors, the price of our common stock could fall substantially.

Our quarterly revenues may fluctuate for several reasons, including the following:

- customers choosing to push out their purchase commitment or purchase in smaller than expected quantities due to a general slowdown in the economy and/or the uncertainties associated with the events of September 11, 2001 and their aftermath;

- market acceptance of our SiteMinder and related products;

- our success in obtaining follow-on sales to existing customers;

- the long sales and deployment cycle of SiteMinder;

- our ability to hire and retain personnel, particularly in development, services and sales and marketing;

- the release of new versions of SiteMinder or other products; and

- the development of our direct and indirect sales channels.

In addition, because our revenues from services are largely correlated with our SiteMinder software revenues, a decline in SiteMinder software revenues could also cause a decline in our SiteMinder services revenues in the same quarter or in subsequent quarters. Other factors, many of which are outside our control, could also cause variations in our quarterly revenues and operating results.

Most of our expenses, such as employee compensation and rent, are relatively fixed. Moreover, our expense levels are based, in part, on our expectations regarding future revenue increases. As a result, any shortfall in revenues in relation to our expectations could cause significant changes in our operating results from quarter to quarter and could result in future losses.

OUR FUTURE SUCCESS WILL DEPEND ON OUR ABILITY TO MARKET SITEMINDER AND RELATED SERVICES SUCCESSFULLY.

The sale of SiteMinder licenses and related services provides a substantial majority of our total revenues. These sales accounted for 65% of our total revenues for the nine months ended September 30, 2001. We expect that our future financial performance will depend on SiteMinder sales. Prior to the release of SiteMinder 3.0 in June 1998, there had been very few commercial installations of SiteMinder. Since June 1998, commercial deployments of SiteMinder have grown to include not only business-to-business, e-business applications, but large intranet and multi-million user business-to-consumer deployments, as well. Broad market acceptance of SiteMinder will depend on the development of the market for access control and identity management, including usage of SiteMinder for business-

to-consumer applications, and customer demand for the specific functionality of SiteMinder. We cannot be sure that either will occur. If we fail in marketing SiteMinder products and services, for whatever reason, our business would be harmed.

OUR SUCCESS IS DEPENDENT ON OUR ABILITY TO ENHANCE OUR SITEMINDER PRODUCT LINE AND DEVELOP NEW PRODUCTS.

We believe our success is dependent, in large part, on our ability to enhance and broaden our SiteMinder product line to meet the evolving needs of both the business-to-business intranet and business-to-consumer market. We cannot be sure that we will be able to respond effectively to technological changes or new industry standards or developments. In the past, we have been forced to delay introduction of several new product versions. In the future, we could be adversely affected if we incur significant delays or are unsuccessful in enhancing our SiteMinder product line or developing new products, or if any of our enhancements or new products do not gain market acceptance.

OUR PERFORMANCE DEPENDS ON OUR ABILITY TO OBTAIN FOLLOW-ON SALES.

Customers typically place small initial orders for SiteMinder installations to allow them to evaluate its performance. Our strategy is to pursue more significant follow-on sales after these initial installations. Our financial performance depends on successful initial deployments of SiteMinder that, in

turn, lead to follow-on sales. We cannot be sure that initial deployments of SiteMinder by our customers will be successful, or that we will be able to obtain follow-on sales.

WE FACE SIGNIFICANT COMPETITION FROM OTHER TECHNOLOGY COMPANIES AND WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY.

The market for access control and intranet management products and services is highly competitive. We expect the level of competition to increase as a result of the anticipated growth of e-business. Until recently, our primary source of competition was from software developed in-house. In addition, we have faced competition from web development professional services organizations. Today our primary competitors include IBM, RSA/Securant, Entrust, Open Network Technology, Baltimore Technologies, Oblix and many early-stage companies. In addition, a number of other security and software companies have indicated that they offer products which may compete with ours. We expect that additional competitors will emerge in the future. Current and potential competitors have established, or may in the future establish, cooperative relationships with third parties to increase the availability of their products to the marketplace. It is possible that new competitors or alliances may emerge and rapidly acquire significant market share. Potential competitors may have significantly greater financial, marketing, technical and other competitive resources than we have. If, in the future, a competitor chooses to bundle a competing secure user management product with other e-commerce applications, the demand for our products might be substantially reduced. Many of these factors are out of our control, and there can be no assurance that we can maintain or enhance our competitive position against current and future competitors.

REGULATIONS OR CONSUMER CONCERNS REGARDING THE USE OF "COOKIES" ON THE INTERNET COULD REDUCE THE FUNCTIONALITY OF SITEMINDER.

SiteMinder uses cookies to support its single sign-on functionality. A cookie is information keyed to a specific user that is stored on the hard drive of the user's computer, typically without the user's knowledge. Cookies are generally removable by the user, and can be refused by the user at the point at which the information would be stored on the user's hard drive. A number of governmental bodies and commentators in the United States and abroad have urged passage of laws limiting or abolishing the use of cookies. The passage of

laws limiting or abolishing the use of cookies, or the widespread deletion or refusal of cookies by web site users, could reduce or eliminate the effectiveness of single sign-on and could reduce market demand for SiteMinder.

WE MUST HIRE AND RETAIN SKILLED PERSONNEL.

Qualified personnel are in great demand throughout the software industry. Our success depends, in large part, upon our ability to attract, train, motivate and retain highly skilled employees, particularly software engineers, professional services personnel, sales and marketing personnel, and other senior personnel. Our failure to attract and retain the highly trained technical personnel that are integral to our product development, professional services and direct sales teams may limit the rate at which we can generate sales and develop new products or product enhancements. This could have a material adverse effect on our business, operating results and financial condition.

OUR SUCCESS DEPENDS ON OUR ABILITY TO DEVELOP OUR DIRECT SALES AND INDIRECT

DISTRIBUTION CHANNELS.

To increase our revenues, we must develop our direct sales channel and increase the number of our indirect channel partners. A failure to do so could have a material adverse effect on our business, operating results and financial condition. There is intense competition for sales personnel in our business, and we cannot be sure that we will be successful in attracting, integrating, motivating and retaining sales personnel. In addition, we must increase the number of strategic partnerships and other third-party relationships with system integrators, vendors of Internet-related systems and application software and resellers. Our existing, or future, channel partners may choose to devote greater resources to marketing and supporting the products of other companies. In addition, we will need to resolve potential conflicts among our sales force and channel partners. If we fail to develop these relationships, our revenue could suffer.

OUR FAILURE TO EXPAND OUR PROFESSIONAL SERVICES RESOURCES COULD LIMIT THE SUCCESS OF SITEMINDER.

Our professional services organization and our system integrators provide critical support to our customers' installation and deployment of SiteMinder. If we fail to expand our professional services resources and or adequately develop our system integrator relationships, our ability to increase sales of SiteMinder may be limited. In addition, if we cannot adequately support SiteMinder installations, our customers' use of our products may fail, which could harm our reputation and hurt our business.

OUR LENGTHY SALES CYCLE MAKES IT DIFFICULT TO PREDICT OUR QUARTERLY OPERATING RESULTS.

We have a long sales cycle because we generally need to educate potential customers regarding the use and benefits of SiteMinder. Our sales cycle varies depending on the size and type of customer contemplating a purchase and whether we have conducted business with a potential customer in the past. These potential customers frequently need to obtain approvals from multiple decision makers prior to making purchase decisions. Our long sales cycle, which can range from several weeks to several months or more, makes it difficult to predict the quarter in which sales will occur. Delays in sales could cause significant variability in our revenues and operating results for any particular period.

OUR FAILURE TO MANAGE OUR RAPID GROWTH EFFECTIVELY COULD HURT OUR BUSINESS.

Our failure to manage our rapid growth effectively could have a material adverse effect on the quality of our products, our ability to retain key personnel and our business, operating results and financial condition. We have been experiencing a period of rapid growth that has been placing a significant strain on all of our resources. From December 31, 2000 to September 30, 2001, the number of our employees increased from 292 to 404. To manage future growth effectively we must maintain and enhance our financial and accounting systems and controls, integrate new personnel and manage expanded operations.

IF WE LOSE THE SERVICES OF BARRY BYCOFF OR ANY OTHER MEMBER OF OUR MANAGEMENT TEAM, OUR BUSINESS COULD SUFFER.

Our future success depends, to a significant degree, on the skill, experience and efforts of Barry Bycoff, our chief executive officer, and the rest of our management team. The loss of any member of our management team could have a material adverse effect on our

business, operating results and financial condition. We also depend on the ability of our officers and key employees to work effectively as a team.

AS WE CONTINUE TO EXPAND OUR INTERNATIONAL OPERATIONS, WE WILL FACE CONTINUED RISKS TO OUR SUCCESS.

We intend to continue to expand our international operations in the future. This expansion will require additional resources and management attention, and will subject us to increased regulatory, economic and political risks. We have very little experience in international markets. As a result, we cannot be sure that our continued expansion into global markets will be successful. In addition, we will face increased risks in doing business internationally. These risks could reduce demand for our products and services, increase the prices at which we can sell our products and services, or otherwise have an adverse effect on our operating results. Among the risks we believe are most likely to affect us are:

- longer decision making cycles
- longer payment cycles and problems in collecting accounts receivable;
- adverse changes in trade and tax regulations, including restrictions on the import and export of sensitive technologies, such as encryption technologies, that we use or may wish to use in our software products;
- the absence or significant lack of legal protection for intellectual property rights;
- difficulties in managing an organization spread over several countries, including complications arising from cultural, language and time differences that may lengthen sales and implementation cycles;
- currency risks, including fluctuations in exchange rates; and
- political and economic instability.

OUR SUCCESS DEPENDS ON OUR ABILITY TO PROTECT OUR PROPRIETARY RIGHTS.

Our success depends to a significant degree upon the protection of our software and other proprietary technology. The unauthorized reproduction or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it. This could have a material adverse effect on our business, operating results and financial condition. We depend upon a combination of trademark, trade secret and copyright laws, license agreements and non-disclosure and other contractual provisions to protect proprietary and distribution rights in our products. In addition, we attempt to protect our proprietary information and the proprietary information of our vendors and partners through confidentiality and/or license agreements with our employees and others. Although we have taken steps to protect our proprietary technology, they may be inadequate. Existing trade secret, copyright and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive, even if we were to prevail.

CLAIMS BY OTHER COMPANIES THAT WE INFRINGE THEIR PROPRIETARY TECHNOLOGY COULD HURT OUR FINANCIAL CONDITION.

If we discover that any of our products violated third party proprietary

rights, there can be no assurance that we would be able to reengineer our product or to obtain a license on commercially reasonable terms to continue offering the product without substantial reengineering. We do not conduct comprehensive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly evolving technology environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract our management from our business. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from

selling our products. Any of these events could have a material adverse effect on our business, operating results and financial condition.

OUR BUSINESS COULD BE ADVERSELY AFFECTED IF OUR PRODUCTS CONTAIN ERRORS.

Software products as complex as ours may contain undetected errors or "bugs" that result in product failures. The occurrence of errors could result in loss of, or delay in, revenues, loss of market share, failure to achieve market acceptance, diversion of development resources, injury to our reputation, or damage to our efforts to build brand awareness, any of which could have a material adverse effect on our business, operating results and financial condition.

WE COULD INCUR SUBSTANTIAL COSTS RESULTING FROM PRODUCT LIABILITY CLAIMS RELATING TO OUR CUSTOMERS' USE OF OUR PRODUCTS.

Many of the e-commerce applications supported by our products are critical to the operations of our customers' businesses. Any failure in a customer's web site or application caused or allegedly caused by our products could result in a claim for substantial damages against us, regardless of our responsibility for the failure. Although we maintain general liability insurance, including coverage for errors and omissions, there can be no assurance that our existing coverage will continue to be available on reasonable terms or will be available in amounts sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim.

ACQUISITIONS MAY INCREASE RISKS

On October 24, 2001, the Company signed a definitive agreement to acquire the stock of privately-held DataChannel, Incorporated. (See Note 6 of Notes to the Company's Consolidated Financial Statements). In the future, we may pursue other acquisitions to obtain complementary products, services and technologies. Any such acquisition may not produce the revenues, earnings or business synergies that we anticipated, and an acquired product, service or technology might not perform as we expected. In pursuing any acquisition, our management could spend a significant amount of time and effort in identifying and completing the acquisition. If we complete an acquisition, we would probably have to devote a significant amount of management resources to integrate the acquired business with our existing business.

To pay for an acquisition, we might use our stock or cash. Alternatively, we might borrow money from a bank or other lender. If we use our stock, our stockholders would experience dilution of their ownership interests. If we use

cash or debt financing, our financial liquidity will be reduced.

THE MARKET PRICE OF OUR COMMON STOCK HAS BEEN AND MAY CONTINUE TO BE VOLATILE.

Our stock price, like that of other technology companies, has been extremely volatile. The announcement of new products, services, technological innovations or distribution partners by us or our competitors, quarterly variations in our operating results, changes in revenues or earnings estimates by securities analysts and speculation in the press or investment community are among the factors affecting our stock price.

The stock market in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating performance. Recently, when the market price of a stock has been volatile, holders of that stock have often instituted securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management.

The events of September 11, 2001 and their aftermath have also caused significant volatility in the stock markets. The continued threat of terrorism in the United States and abroad, the resulting military action and heightened security measures undertaken in response to that threat can be expected to cause continued volatility in securities markets.

WE MAY LOSE MONEY ON FIXED-PRICE CONSULTING CONTRACTS.

In the future, an increased portion of our SiteMinder services revenues may be derived from fixed-price contracts. We work with complex technologies in compressed time frames and it can be difficult to judge the time and resources necessary to complete a project. If we miscalculate the resources or time we need to complete work under fixed-price contracts, our operating results could be materially harmed.

CERTAIN PROVISIONS OF OUR CHARTER AND OF DELAWARE LAW MAKE A TAKEOVER OF OUR COMPANY MORE DIFFICULT.

Our corporate documents and Delaware law contain provisions that might enable our management to resist a takeover of our company. These provisions might discourage, delay or prevent a change in the control of Netegrity or a change in our management. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

RESULTS OF OPERATIONS

The following information should be read in conjunction with the consolidated financial statements and notes thereto:

% OF TOTAL REVENUES

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001	2000	2
Revenues:		
License software	69%	
Services	26	
Other	5	
Total revenues	100	
Cost of Revenues:		
Cost of license software	5	
Cost of services	15	
Cost of other	3	
Total cost of revenues	23	
Gross profit	77	
Selling, general and administrative expenses	65	
Research and development costs	18	
Non-recurring expenses	--	
Loss from operations	(6)	
Interest income	12	
Income (loss) before provision for income taxes	6	
Provision for income taxes	--	
Net income (loss)	6%	

Revenues. Total revenues increased by $1.4 million, or 9%, to $16.7 million in the three months ended September 30, 2001, from $15.3 million in the three months ended September 30, 2000.

License software revenues decreased by $1.6 million, or 15%, to $9.0 million in the three months ended September 30, 2001, from $10.6 million in the three months ended September 30, 2000. This decrease is due to the difficult economic environment, exacerbated by the events of September 11, 2001, which led deals to be reduced in size or deferred.

Services revenues increased by $2.9 million, or 73%, to $6.8 million in the three months ended September 30, 2001, from $3.9 million in the three months ended September 30, 2000. This increase reflects the continued growth in the installed base of SiteMinder software licenses and the increasing demand to provide installation and integration services for customers.

Other revenues increased by $83,000 or 10%, to $908,000 in the three months ended September 30, 2001, from $825,000 in the three months ended September 30, 2000.

Cost of revenues. Total cost of revenues increased by $218,000 or 6%, to $3.7 million in three months ended September 30, 2001, from $3.5 million in the

three months ended September 30, 2000.

Cost of license software decreased by $559,000 to $136,000, or 80%, in the three months ended September 30, 2001 from $695,000 in the three months ended September 30, 2000. This variance is primarily due to the proportional decrease in software revenues for the same period in addition to lower royalty and production costs.

Cost of services increased by $768,000 or 34%, to $3.0 million in the three months ended September 30, 2001 from $2.3 million in the three months ended September 30, 2000. The increase is primarily due to growth in personnel related expenses for our consulting and education organizations as a result of increased SiteMinder service revenues.

Cost of other increased by $9,000 or 2%, to $522,000 in the three months ended September 30, 2001 from $513,000 in the three months ended September 30, 2000.

Selling, general and administrative expenses. Selling, general and administrative expenses increased by $2.3 million, or 23%, to $12.3 million in the three months ended September 30, 2001, from $10.0 million in the three months ended September 30, 2000. This increase is primarily a result of our continuing to build our sales and marketing infrastructure to support planned growth in sales of our SiteMinder products and related services.

Research and development costs. Research and development costs increased by $1.1 million, or 38%, to $3.9 million in the three months ended September 30, 2001, from $2.8 million in the three months ended September 30, 2000. The increase was primarily due to our continued development of SiteMinder, Secure Reverse Proxy, TransactionMinder and AffiliateMinder and our increase in research and development personnel.

Interest income. Interest income decreased by $465,000, or 26%, to $1.3 million in the three months ended September 30, 2001, from $1.8 million, in the three months ended September 30, 2000. This decrease is mainly attributable to a lower average interest rate in the three months ended September 30, 2001.

Provision for income taxes. For the three months ended September 30, 2001 and September 30, 2000 there was no provision for income taxes due to the Company's loss position for the period in 2001 and a reduction of the valuation allowance in 2000.

RESULTS OF OPERATIONS

The following information should be read in conjunction with the consolidated financial statements and notes thereto:

	% OF TOTAL REVENUES	
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001	2000	2001

Revenues:		
License software	68%	65%
Services	24	31
Other	8	4
Total revenues	100	100
Cost of Revenues:		
Cost of license software	5	2
Cost of services	14	16
Cost of other	4	2
Total cost of revenues	23	21
Gross profit	77	79
Selling, general and administrative expenses (including non-cash stock compensation of 1% and 0% of revenue for the three months ended September 30, 2000 and 2001, respectively	72	60
Research and development costs	19	18
Non-recurring expenses	--	1
Income (loss) from operations	(14)	1
Interest income	13	6
Income (loss) before provision for income taxes	(1)	7
Provision for income taxes	--	1
Net income (loss)	(1)%	6%

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Revenues. Total revenues increased by $34.9 million, or 107%, to $67.5 million in the nine months ended September 30, 2001, from $32.6 million in the nine months ended September 30, 2000.

License software revenues increased by $21.6 million, or 98%, to $43.8 million in the nine months ended September 30, 2001, from $22.2 million in the nine months ended September 30, 2000. This increase is due to the continued increase in market awareness and the acceptance of the SiteMinder product and expansion of our sales organization.

Services revenues increased by $13.0 million, or 165%, to $20.9 million in the nine months ended September 30, 2001, from $7.9 million in the nine months ended September 30, 2000. This increase reflects the continued growth in the installed base of SiteMinder software licenses and the increasing demand to provide installation and integration services for customers.

Other revenues increased by $269,000, or 11%, to $2.8 million in the nine months ended September 30, 2001, from $2.5 million in the nine months ended September 30, 2000.

Cost of revenues. Total cost of revenue increased by $6.2 million or 82%, to $13.8 million in nine months ended September 30, 2001, from $7.6 million in the nine months ended September 30, 2000.

Cost of license software decreased by $25,000 or 2% to $1.5 million in the nine months ended September 30, 2001 from $1.5 million in the nine months ended September 30, 2000.

Cost of services increased by $6.1 million or 133%, to $10.7 million in the nine months ended September 30, 2001 from $4.6 million in the nine months ended September 30, 2000. The increase is primarily due to growth in personnel related expenses for our consulting and education organizations as a result of increased SiteMinder service revenues.

Cost of other increased by $174,000 or 12%, to $1.7 million in the nine months ended September 30, 2001 from $1.5 million in the nine months ended September 30, 2000. This increase is primarily due to the proportional increase in other revenues for the same period in prior year.

Selling, general and administrative expenses. Selling, general and administrative expenses increased by $17.3 million, or 74%, to $40.6 million in the nine months ended September 30, 2001, from $23.3 million in the nine months ended September 30, 2000. This increase is primarily a result of our continuing to build our sales and marketing infrastructure to support planned growth in sales of our SiteMinder product and services.

Research and development costs. Research and development costs increased by $5.7 million, or 93%, to $11.9 million in the nine months ended September 30, 2001, from $6.1 million in the nine months ended September 30, 2000. The increase was primarily due to our continued development of SiteMinder, Secure Reverse Proxy, TransactionMinder and AffiliateMinder and our increase in research and development personnel.

Interest income. Interest income decreased by $223,000, or 5%, to $4.1 million in the nine months ended September 30, 2001, from $4.3 million in the nine months ended September 30, 2000. 1. This decrease is mainly attributable to a lower average interest rate in the nine months ended September 30, 2001.

Provision for income taxes. Provision for income taxes for the nine months ended September 30, 2001 was $607,000. The provision is lower than the statutory rate due to a reduction in the valuation allowance related to federal net operating loss carryforwards. The resulting provision relates primarily to state and foreign taxes. For the nine months ended September 30, 2000 we had no provision for income taxes due to the Company's breakeven position for the period.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities in the nine months ended September 30, 2001 was $8.1 million, primarily due to net income and increases in other accrued expenses and deferred revenue, partially offset by an increase in accounts receivable and a decrease in accrued compensation and benefits.

Cash used for investing activities was $79.2 million in the nine months ended September 30, 2001. Investing activities for the period consisted primarily of the purchase of marketable securities of $75.3 million. In addition, the Company purchased $4.2 million of equipment and software, consisting largely of computer

servers, workstations, networking equipment and business application software.

Cash provided by financing activities in the nine months ended September 30, 2001 was $6.6 million which primarily related to the exercise of stock options.

As of September 30, 2001, our primary financial commitments consisted of obligations outstanding under operating leases.

As of September 30, 2001, we had cash and cash equivalents totaling $51.2 million, short term marketable securities of $55.0 million and working capital of $100.5 million. The Company also had $20.3 million in long-term marketable securities.

On October 24, 2001, the Company signed a definitive agreement to acquire the stock of privately-held DataChannel, Incorporated. The consideration for the acquisition is $15 million in cash and 2.5 million in common shares. (See Note 6 of Notes to the Company's Consolidated Condensed Financial Statements.)

In recent years, we have significantly increased our operating expenses. In the foreseeable future, we expect to maintain our current levels of operating expenses. These operating expenses and capital expenditures will constitute a material use of our cash resources. In addition, we may utilize cash resources to fund acquisitions or investments in businesses, technologies, products or services that are complementary to our business. We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash requirements for working capital and capital expenditures for at least the next twelve months.

SIGNATURE

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

NETEGRITY, INC.

Date: December 4, 2001

By: /s/ Barry N. Bycoff

Barry N. Bycoff
President, Chief Executive Officer, Director and Chairman of the Board

Date: December 4, 2001

By: /s/ Charles Kroll

Charles Kroll
Vice President of Finance
(Chief Accounting Officer)