MatrixOne

Annual Report 2001

Changing the Way the World Brings Products to Market™

MatrixOne

Annual Report 2001

We are a leader in an industry based on product **collaboration** and can clearly see growing recognition of the profound **benefits** that collaboration delivers. It is truly a new and better way of doing **business.**

Financial Highlights

Fiscal Year	2001	2000	1999	1998	1997
STATEMENTS OF OPERATIONS DATA			*(in thousands)*		
Revenues:					
Software license	$ 84,290	$ 40,977	$ 21,851	$ 11,836	$ 8,450
Service	57,854	33,734	19,495	9,343	3,825
Total revenues	142,144	74,711	41,346	21,179	12,275
Gross profit	91,441	43,904	23,556	13,351	8,469
Operating expenses, excluding stock-based compensation	86,428	49,805	30,882	26,203	12,873
Stock-based compensation	4,142	3,593	622	—	—
Income (loss) from continuing operations	8,346	(6,453)	(7,704)	(10,876)	(3,669)
Income from discontinued operations	500	—	—	8,684	1,777
Net income (loss)	8,846	(6,453)	(7,704)	(2,192)	(1,892)
BALANCE SHEET DATA					
Cash and equivalents	$ 156,349	$ 153,455	$ 11,036	$ 8,123	$ 897
Total assets of continuing operations	217,626	184,417	29,887	22,912	8,478
Total stockholders' equity (deficit)	169,316	151,593	(6,042)	843	3,072

This year was an exciting and gratifying year for MatrixOne by every meaningful measure.

Dear Fellow Shareholders:

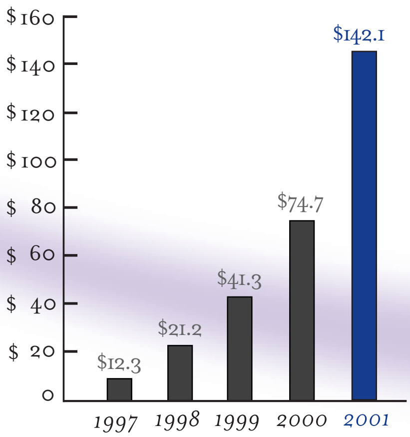
During the past year, MatrixOne® solidified its position as a leading provider of product collaboration software for the value chain. Quite simply, we helped more customers leverage the power of their extended value chain of suppliers, partners, customers and employees to accelerate the right products to market, at the lowest possible cost, with the highest degree of innovation. The result is a record financial performance that further validates MatrixOne's position as a powerful force in the product collaboration software market today and for years to come.

Customer success has always been our primary focus. As we help our customers realize economic benefits in today's challenging market, we deepen our commitment to their success – and to our own. Product collaboration solutions from MatrixOne help companies streamline operations, eliminate inefficiencies and reduce development costs throughout their organizations and across their value chains.

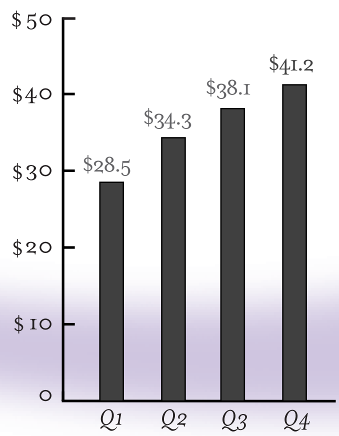
Product collaboration across the value chain is driving revenue growth for companies in every industry. By taking advantage of the knowledge, expertise and innovation within their value chains, our customers are realizing a significant competitive advantage by accelerating the right products to market. Simply put, those companies that leverage the power of their value chain will outperform the companies that do not.

This market shift, coupled with the success of our customers, has translated into strong financial performance for MatrixOne. In fiscal 2001, total revenues grew to $142.1 million, an increase of 90% compared to $74.7 million a year ago. Equally important, we posted four consecutive quarters of improving profitability. In fiscal 2001, net income from continuing operations, excluding stock-based compensation, was $12.5 million, or $0.25 per share, compared to a net loss of $2.9 million or $0.08 per share on a pro-forma basis, in fiscal 2000. Our balance sheet remains very strong, with no long-term debt and $156.3 million in cash and equivalents as of June 30, 2001.

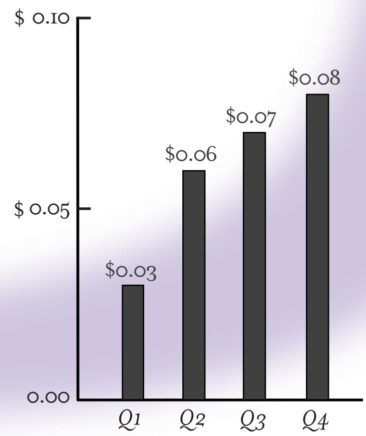
The people of MatrixOne remain our key differentiator, and their single focus continues to be on ensuring the success of our customers worldwide. During the last year, we strengthened our expertise in the product collaboration software market by adding experienced personnel. While keeping a cautious eye on expense growth, we filled many key revenue-generating and engineering positions at pivotal progress points. We are building an organization that will continue to support the growing needs of our loyal customers.



Total Revenues
by Fiscal Year *(in millions)*



Total Revenues
by Quarter for Fiscal 2001 *(in millions)*



Earnings Per Share*
by Quarter for Fiscal 2001

**Excluding Discontinued Operations and Stock-Based Compensation*


Our customers rate
MatrixOne's service,
technology, and product quality
as "Exceptional."

During this past year, MatrixOne packaged its extensive domain expertise with the world-class business processes learned from our customers, to create an integrated set of applications we call the Value Chain Portfolio™. The Value Chain Portfolio consists of easy-to-use, specific business process applications that can deliver return on investment measured in weeks, not months. As the market for product collaboration software matures, the Value Chain Portfolio will enable MatrixOne to attract new customers and further extend the capabilities of existing customers.

To address the evolving needs of our customers, we continued to enhance the capabilities of our eMatrix™ product collaboration platform, which features an Internet architecture and offers our customers extraordinary scalability, reliability and security. Working with our technology partners, we continued to deliver integrations that allow our products to communicate seamlessly with many of the world's leading commercial applications. We now offer more than forty packaged integrations that enable our customers to more effectively and efficiently share knowledge throughout their value chain via the Internet.

Our customers depend on MatrixOne to enable them to leverage the speed and innovation stored within their value chains. Some of the world's best-known and most innovative companies – including Procter & Gamble, adidas-Salomon and Johnson Controls – are driving the growing acceptance of global product collaboration as the means to achieve first mover advantage by harnessing the power in their value chains.

In the last fiscal year, we expanded our already strong position in the automotive, high-tech, medical equipment and aerospace industries, while also extending our reach into new markets, including consumer packaged goods and retail. The breadth of the industries relying on our solutions demonstrates their adaptability across a diverse set of industries. This flexibility positions us well to enter new markets as opportunities arise.

Results for Fiscal Year 2001 reflect our relentless commitment to growing both top-line revenue and bottom-line profitability.

Our partner economy continues to open new sales channels for our products in a wide variety of markets. Throughout the past year, we further strengthened our relationships with large consulting firms and system integration companies around the globe. New partners this year included PricewaterhouseCoopers, Cap Gemini Ernst & Young, Fujitsu, Siemens Business Services and Logica. Partnerships such as these, which are a key to our business model, are critical to the successful implementations of our products for our customers.

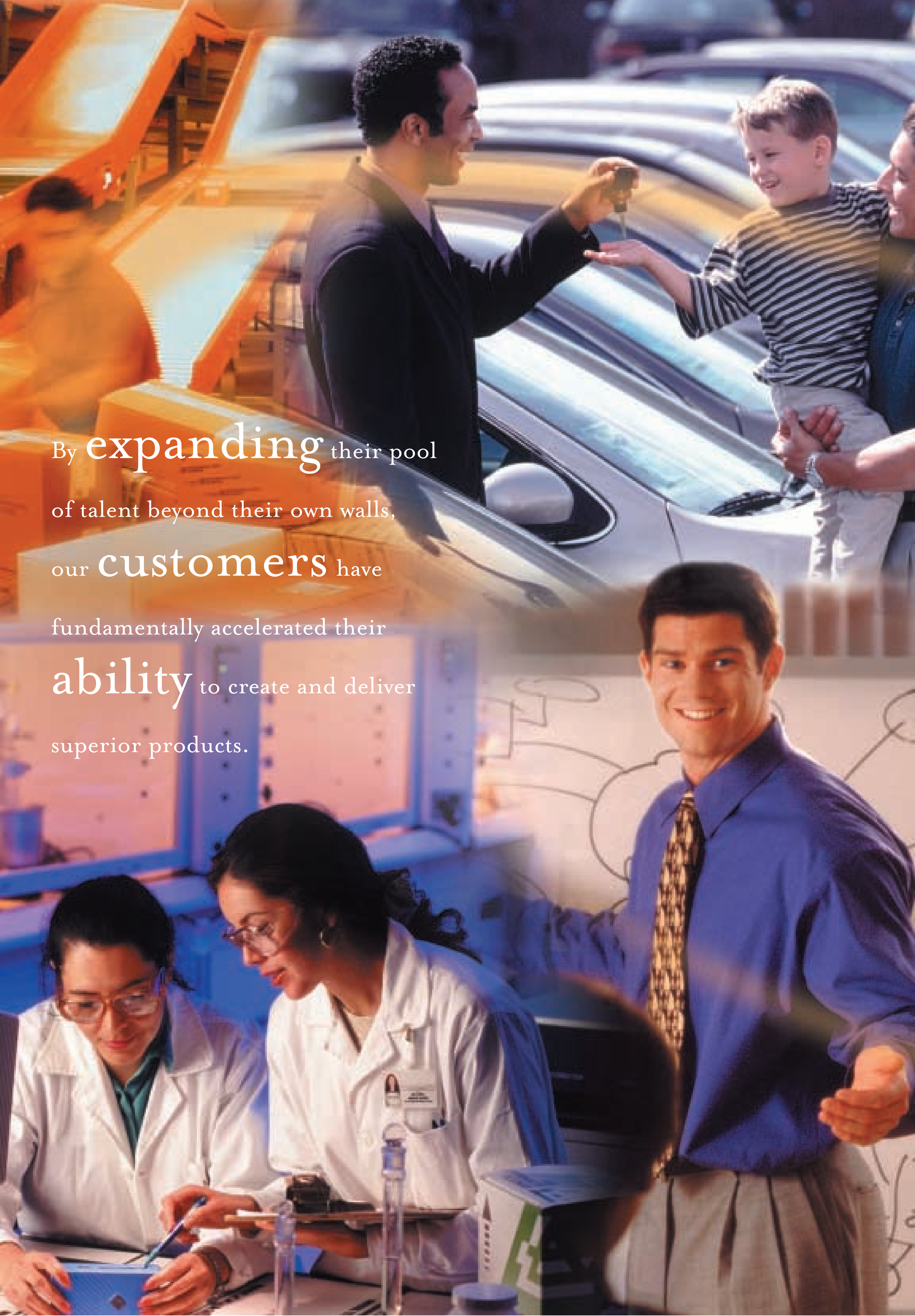
As we look to the future, we have the right people, the right vision and the right products to be a clear leader in the product collaboration software market. Despite a very challenging macro-economic environment, the fundamental drivers of our business remain strong. Our customers and prospects, across many vertical industries and geographies, recognize the value of accelerating the right products to market and leveraging the innovation in their value chain.

The product collaboration software market is still young, and investment in product collaboration software for the value chain continues to be a critical focus for many Global 2000 organizations. We believe MatrixOne is uniquely positioned to capitalize on this growing market opportunity. Our leadership position in the market is continually validated by our own performance and, more importantly, by our rapidly growing customer base.

Moving forward, we will continue to aggressively execute on our business strategy, forge new alliances and build and deliver technologically advanced collaboration solutions for our growing family of customers. I thank our shareholders for their continued confidence in MatrixOne, and I thank our employees and partners who continue their relentless work to advance MatrixOne's strong position in the product collaboration software market. Most importantly, I thank our customers who, with MatrixOne, are changing the way the world brings products to market.

Sincerely,

Mark F. O'Connell
President & CEO
MatrixOne, Inc.



By **expanding** their pool of talent beyond their own walls, our **customers** have fundamentally accelerated their **ability** to create and deliver superior products.

MatrixOne Is Changing the Way the World Brings Products to Market.

Over the years, companies across multiple industries focused on streamlining manufacturing and logistics processes to save money and create more efficient processes. These organizations are now realizing that the next major opportunity is to drive similar efficiencies into the product development process, not just inside their company, but across their value chain of suppliers, partners, customers and employees as well. MatrixOne is enabling this next wave of process improvements by helping companies to achieve operational excellence and execution in the product development cycle.

To change the way the world brings products to market, MatrixOne automates world-class product development processes, enabling companies to facilitate their decision-making process and collaborate more efficiently with their value chain. By bringing suppliers into the product development process earlier, companies are able to incorporate their best practices, high-quality information and expertise to rapidly develop more innovative products.

The fundamental change in the marketplace is in harnessing the knowledge and expertise of the supplier and customer base to drive innovative products to market faster. Delivering innovative products, however, requires that this collaboration occur in the earliest stages of product concept and design. We have frequently heard that during the first 20% of the innovation phase, 80% of a product's cost, quality and performance attributes are locked in by a handful of crucial concept and design decisions. Once the execution phase begins and the product moves into manufacturing, the opportunities for significant improvement in these areas decrease dramatically, while the cost of change increases significantly.

Companies are increasingly outsourcing critical business processes, including the development of new products. The ability for a company to collaborate with its suppliers, partners, customers and employees has never been more important in ensuring that the right product is developed to meet the needs of the market. A new class of solution is required to enable this growing trend. MatrixOne's software facilitates product collaboration and eliminates barriers between an enterprise and its value chain to dramatically shorten the product development cycle.

By partnering with the most innovative companies in the world, MatrixOne continues to deepen its knowledge of world-class business processes. We package these processes with our own domain expertise to create the MatrixOne Value Chain Portfolio applications, which enable companies to easily automate product development processes. Empowered with the ability to expand their pool of talent beyond their own walls yet still securely control the integrity of their intellectual property, MatrixOne customers are able to accelerate the right products to market ahead of the competition. This is how MatrixOne is changing the way the world brings products to market.

MatrixOne is transforming simpler, materials-based supply chains into highly effective product collaboration communities that share intellectual capital about products and technology.

The Technology behind the Success

Today, companies struggle to unlock the information that is trapped within their value chains of suppliers, partners, customers and employees. MatrixOne empowers its customers to access and benefit from this knowledge, which is crucial to innovation in product development. We partner with our strategic customers to define world-class business processes, which we automate into commercially available, out-of-the-box applications - the MatrixOne Value Chain Portfolio.

The MatrixOne Value Chain Portfolio applications address specific business process needs at crucial points in a product's lifecycle. Each application combines our years of professional service experience and the world-class business processes of our customers, who are among the most innovative companies in the world. MatrixOne Value Chain Portfolio applications enable every person involved from development to delivery of new products to easily share knowledge, creating a seamless environment for product collaboration.

At the close of fiscal 2001, the Value Chain Portfolio included:

- Configurator Central™ - enables trading partners to custom-configure products
- Engineering Central™ - manages engineering change and bills of material
- Request Central™ - automates the request for quotation process
- Software Central™ - manages the software development and integration process
- Supplier Central™ - manages relationships with strategic suppliers
- Team Central - manages virtual project work spaces for real-time collaboration

The eMatrix product collaboration platform is the backbone upon which the Value Chain Portfolio applications, partner-developed applications and customer-developed applications are built. The eMatrix product collaboration platform is built on industry-standard Internet architectures, protocols and technologies, and can be deployed with confidence across a global organization and its value chain.

Our complete suite of integration products enable customers to link many of their commercial applications and legacy systems with MatrixOne solutions. These integrations enable users to access and share product knowledge in real-time over the Internet.

Our customers have come to rely on MatrixOne to bring leading-edge Internet technologies and our extensive domain expertise in the product collaboration software market to solve some of the most challenging problems they face. The following case studies on Procter & Gamble, adidas-Salomon and Johnson Controls clearly demonstrate MatrixOne's strong commitment to helping our customers change the way they bring products to market.

MatrixOne is helping Procter & Gamble organize and more effectively use product knowledge across its value chain.

Procter & Gamble

Product collaboration across the value chain

The Procter & Gamble Company (P&G) markets approximately 300 brands ranging from Tide® and Pampers®, to Folgers®, Crest® and Pantene® to nearly five billion consumers in more than 140 countries. Thanks to a long history of success and a dramatic period of global expansion in recent years, P&G now works with more than 900 manufacturing-related facilities, including 17 technical centers, spread across 73 countries around the world. This growth created a need to consolidate technical documents and data defining raw materials and products into one system for use by more than 10,000 of P&G's global Research and Development and Product Supply personnel.

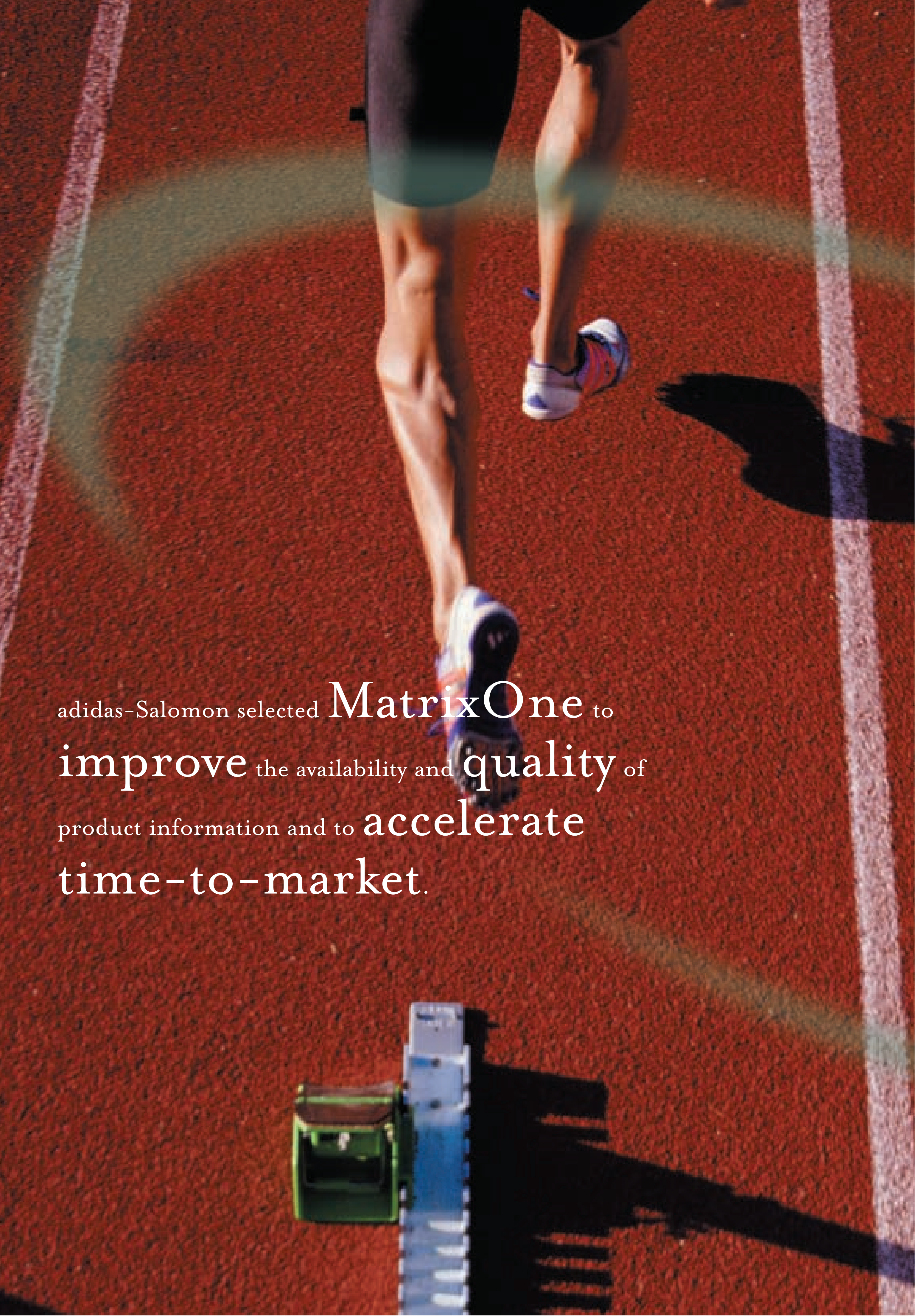
Michael A. Walsh, Director of P&G's Worldwide Technical Standards and Systems organization (part of Research and Development and Quality Assurance), explains, "We reached a point where it became difficult to share our knowledge on technical specifications and standards that govern what we make, how we make it and where in the world we are using it. We found ourselves buying multiple variants of the same materials and paying more than we should. MatrixOne is helping us organize and more effectively use our product knowledge. Based on the eMatrix product collaboration platform and working with MatrixOne, we have created a global system, which we call the Corporate Standards System (CSS). Unique in the consumer packaged goods industry, CSS has enabled us to substantially reduce duplication of information that resided in multiple systems around the world."

"MatrixOne software is now a key part of our ability to collaborate on products across our value chain."

–Michael A. Walsh

Director of Worldwide Technical Standards and Systems

With a company the size of P&G and with globally dispersed manufacturing and technical facilities, P&G needed a highly flexible system that could integrate with and feed its multiple versions of SAP and other software tools, while meeting the unique needs of each business category and the regulatory requirements of each nation. Walsh elaborates, "We have significantly reduced our materials costs by simplifying and standardizing globally. We have also cut the majority of time required to review, approve and globally implement new product standards. Most important, we have significantly improved the quality of our products by eliminating rework and improving technical accuracy. MatrixOne software is now a key part of our ability to collaborate on products across our value chain."


adidas-Salomon selected MatrixOne to improve the availability and quality of product information and to accelerate time-to-market.

adidas-Salomon

Accelerating the right products to market

With more than 13,000 employees, and design, manufacturing and distribution facilities scattered around the world, adidas-Salomon is one of the world's leading companies in the sporting industry. adidas-Salomon products include adidas footwear, apparel, accessories and gear, Salomon skis and snowboards and TaylorMade golf equipment. Such world-renowned athletes as Jesse Owens, Muhammad Ali, Kobe Bryant and Martina Hingis have rocketed to success wearing adidas-Salomon products.

adidas-Salomon ranks among the most innovative global organizations that rely on real-time worldwide product collaboration to maintain their leadership positions. A key corporate-wide goal for adidas-Salomon is to accelerate the right products to market by reducing its overall product creation and distribution process time – from concept to availability in stores – by half.

Claudia Kopp, PDM Global Marketing Lead for adidas-Salomon, explains, "To stay ahead of the competition while delivering a top-quality product, we must be flexible in order to get to market quickly. Our corporate key objectives are improved product lifecycle flexibility, increased speed and efficiency, and real-time global information accessibility. To achieve these goals, we needed a Web-based product collaboration solution that could span the entire product lifecycle and value chain, integrating all of our partners including retailers, distributors and suppliers."

adidas-Salomon is the first company in the industry to implement a global product collaboration solution from creation through distribution across all brands and product lines. The company selected MatrixOne to improve the quality of product information and to accelerate time-to-market by streamlining the product creation processes, which improves top-line growth while reducing costs.

"By enabling us to reuse information rather than recreate information across all brands, MatrixOne is helping adidas-Salomon accelerate the right products to market."

– Claudia Kopp
PDM Global Marketing Lead

Overall, more than 2,500 employees within adidas-Salomon who work with product information will collaborate through the eMatrix product collaboration platform. With this level of information and accessibility, security is critical. Access to information in the eMatrix product collaboration platform is controlled through a flexible system of Web-based applications that precisely define what information can be seen and manipulated by whom.

"We selected MatrixOne for its lower cost-of-ownership and ability to meet our global collaboration needs. By enabling us to reuse information rather than recreate information across all brands, MatrixOne is helping adidas-Salomon accelerate the right products to market," concludes Kopp.

To meet its corporate goals to

improve time, cost,

performance

and customer satisfaction,

Johnson Controls partnered with MatrixOne.

Johnson Controls
Trusted partner to innovative companies

A leading innovator in the automotive industry, Johnson Controls is one of the world's largest independent suppliers of automotive seating, interior systems and vehicle batteries. With 285 locations worldwide, Johnson Controls delivered interior systems for approximately 23 million 2001 model year vehicles produced worldwide.

To reduce value chain complexity across such a large enterprise and network of automaker customers and suppliers, Johnson Controls evaluated eBusiness solutions that combined best business practices with proven collaborative Internet technology. To help achieve its corporate goals of continually improving time, cost, performance and customer satisfaction metrics, Johnson Controls partnered with MatrixOne.

Through this strategic partnership, Johnson Controls and MatrixOne created a virtual private network – a collaborative engineering exchange – for the company's network of suppliers, employees, customers and partners. This eMatrix environment is the central repository for Johnson Controls' product data and the foundation of Johnson Controls' collaborative product commerce initiatives.

By driving collaborative commerce throughout its value chain, Johnson Controls is able to increase productivity and speed while concurrently reducing costs. John Waraniak, Director of eBusiness Speed for Johnson Controls, explains, "By changing the way we bring products and services to market, we will lower the cost of doing business, and we will do it faster, better and more profitably than any of our competitors. Superior product development performance is a key indicator of financial success; however, we realize that competition today is not just between products and services. It's between business models and value chains. Auto companies that do not know how to apply collaborative value chain practices and technologies will be beaten by those who do."

> "By changing the way we bring products and services to market, we will lower the cost of doing business, and we will do it faster, better and more profitably than any of our competitors."
>
> – John Waraniak
> Director of eBusiness Speed

By collaborating directly with customers and suppliers early in the product development and program management processes, Johnson Controls accelerates the right products to market and can respond more rapidly and accurately to customers' needs throughout the product lifecycle.

Waraniak concludes, "Johnson Controls is one of the companies at the forefront of automotive collaborative commerce and our focus is on speed and execution. As a company, we realize the business practice and technological advances we are making with MatrixOne are good for consumers, our automaker customers and suppliers and ultimately, our shareholders. MatrixOne's collaborative solutions can become the defacto standard for changing the way companies do business and pursue new opportunities – new opportunities that improve both bottom-line productivity, as well as top-line growth."

Moving **forward**, we will continue to aggressively execute on our **business strategy**. With a solid balance sheet and a strong **financial** position, we believe we are well equipped to continue **building** on our **success**.

MatrixOne

Financial Contents

Selected Financial Data

You should read the data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes appearing elsewhere herein. The selected consolidated statement of operations data set forth below for the fiscal years ended June 30, 2001, July 1, 2000 and July 3, 1999 and the consolidated balance sheet data as of June 30, 2001 and July 1, 2000 are derived from our consolidated financial statements, which have been audited by Arthur Andersen LLP, independent public accountants, and are included elsewhere herein. The selected consolidated statement of operations data for the fiscal years ended June 27, 1998 and June 28, 1997 and the consolidated balance sheet data as of July 3, 1999, June 27, 1998 and June 28, 1997 are derived from our audited consolidated financial statements that are not included herein. In May 1998, we sold our legacy design and manufacturing software business, Adra Systems, to focus on our product collaboration software. The financial results of this divested business are reflected in our consolidated financial statements as discontinued operations.

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999	June 27, 1998	June 28, 1997
Consolidated Statements of Operations Data:	*(in thousands, except per share data)*				
Revenues:					
Software license	$ 84,290	$ 40,977	$ 21,851	$ 11,836	$ 8,450
Service	57,854	33,734	19,495	9,343	3,825
Total revenues	142,144	74,711	41,346	21,179	12,275
Cost of Revenues:					
Software license	8,212	4,424	3,323	1,237	725
Service	42,491	26,383	14,467	6,591	3,081
Total cost of revenues	50,703	30,807	17,790	7,828	3,806
Gross Profit	91,441	43,904	23,556	13,351	8,469
Operating Expenses:					
Selling and marketing	56,273	35,765	20,611	15,369	6,883
Research and development	19,749	8,553	5,792	7,242	4,267
General and administrative	10,406	5,487	4,479	3,592	1,723
Stock-based compensation	4,142	3,593	622	—	—
Total operating expenses	90,570	53,398	31,504	26,203	12,873
Income (Loss) From Operations	871	(9,494)	(7,948)	(12,852)	(4,404)
Other Income (Expense), Net	8,940	3,041	244	48	(140)
Benefit From (Provision For) Income Taxes	(1,465)	—	—	1,928	875
Income (Loss) From Continuing Operations	8,346	(6,453)	(7,704)	(10,876)	(3,669)
Income From Discontinued Operations	500	—	—	8,684	1,777
Net Income (Loss)	$ 8,846	$ (6,453)	$ (7,704)	$ (2,192)	$ (1,892)
Basic Net Income (Loss) Per Share:					
Continuing operations	$ 0.19	$ (0.36)	$ (1.74)	$ (2.88)	$ (0.98)
Discontinued operations	0.01	—	—	2.30	0.47
Net income (loss)	$ 0.20	$ (0.36)	$ (1.74)	$ (0.58)	$ (0.51)
Shares used in computation	43,543	17,966	4,428	3,777	3,729
Diluted Net Income (Loss) Per Share:					
Continuing operations	$ 0.17	$ (0.36)	$ (1.74)	$ (2.88)	$ (0.98)
Discontinued operations	0.01	—	—	2.30	0.47
Net income (loss)	$ 0.18	$ (0.36)	$ (1.74)	$ (0.58)	$ (0.51)
Shares used in computation	50,357	17,966	4,428	3,777	3,729
Pro Forma Basic and Diluted Net Loss Per Share(1):					
Continuing operations		$ (0.18)	$ (0.28)	$ (0.43)	$ (0.19)
Discontinued operations		—	—	0.34	0.09
Net loss		$ (0.18)	$ (0.28)	$ (0.09)	$ (0.10)
Shares used in computation		35,686	27,970	25,050	18,998

As of	June 30, 2001	July 1, 2000	July 3, 1999	June 27, 1998	June 28, 1997
Consolidated Balance Sheet Data:	*(in thousands)*				
Cash and Equivalents	$156,349	$153,455	$ 11,036	$ 8,123	$ 897
Working Capital (Deficit)	154,193	146,012	7,892	8,826	(848)
Total Assets of Continuing Operations	217,626	184,417	29,887	22,912	8,478
Long-Term Debt, Net of Current Portion	—	—	—	—	248
Redeemable Convertible Preferred Stock	—	—	17,015	11,015	—
Total Stockholders' Equity (Deficit)	169,316	151,593	(6,042)	843	3,072

(1)The shares used in computing pro forma basic and diluted net loss per share give effect to the conversion of all outstanding shares of our convertible preferred stock into shares of common stock, as if the conversion had occurred on the original date of issuance.

Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis together with our consolidated financial statements and related notes and other financial information appearing elsewhere in this Annual Report. This Annual Report, including the following discussion, contains trend analysis and other forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements in this Annual Report that are not statements of historical facts are forward-looking statements. These forward-looking statements are based on a number of assumptions and involve risks and uncertainties. Our actual results could differ materially from those anticipated in such forward-looking statements due to various factors, including, but not limited to, those set forth under "Cautionary Statements" and elsewhere in our Annual Report on Form 10-K.

Overview

MatrixOne, Inc. is a provider of product collaboration software. Our products include our eMatrix collaboration platform, Value Chain Portfolio applications, Application Exchange Framework, development tools and integration products. Our products facilitate collaboration among employees of global organizations and with an organization's customers, suppliers and other business partners through the Internet. Our products also allow the integration of different business processes and facilitate the exchange of information, ideas and knowledge among parties collaborating on business activities. This collaboration allows our customers to quickly and cost-effectively bring the right products and services to market.

We generate revenues from licensing our product collaboration software and providing professional services, training and maintenance and customer support services through our offices in the United States, Austria, Belgium, Canada, England, France, Germany, Italy, Japan, Korea, Singapore and the Netherlands and indirectly through our partner network throughout Europe and Asia/Pacific. Revenues by geographic region fluctuate each period based on the timing and the size of transactions. We expect revenues by geographic region to continue to fluctuate each period, and we expect revenues from our international operations to increase as we continue to expand our international sales and professional services organizations. During fiscal 2001, approximately 11.6% of our revenues were from Applied Materials, Inc. No single customer accounted for more than 10% of our annual revenues in fiscal 2000 or 1999.

We have incurred significant costs to develop our technology and products, recruit, hire and train personnel for our engineering, selling and marketing and services departments, and establish a corporate infrastructure. These costs have historically exceeded total revenues. As of June 30, 2001, we had an accumulated deficit of approximately $30.0 million. We anticipate that our operating expenses will substantially increase in future periods and may exceed projected increases in revenues. We expect to expand our selling and marketing and services organizations, develop new distribution channels for our products and services, fund greater levels of research and development, and improve our operational and financial systems. Accordingly, we may incur significant net losses in the future.

MatrixOne was incorporated in July 1983 as Adra Systems, Inc. In October 1997, we changed our name to MatrixOne, Inc., and in May 1998, we sold our legacy design and manufacturing software business, Adra Systems, to focus on our product collaboration software. The financial results of this divested business are reflected in our consolidated financial statements as discontinued operations.

Results of Operations

The following table sets forth consolidated statement of operations data expressed as a percentage of total revenues for each period indicated. The historical results are not necessarily indicative of results to be expected for any future period.

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Revenues:			
Software license	59.3%	54.8%	52.8%
Service	40.7	45.2	47.2
Total revenues	100.0	100.0	100.0
Cost of Revenues:			
Software license	5.8	5.9	8.0
Service	29.9	35.3	35.0
Total cost of revenues	35.7	41.2	43.0
Gross Profit	64.3	58.8	57.0
Operating Expenses:			
Selling and marketing	39.6	47.9	49.9
Research and development	13.9	11.4	14.0
General and administrative	7.3	7.3	10.8
Stock-based compensation	2.9	4.8	1.5
Total operating expenses	63.7	71.4	76.2
Income (Loss) From Operations	0.6	(12.6)	(19.2)
Other Income, Net	6.3	4.0	0.6
Provision For Income Taxes	(1.0)	—	—
Income (Loss) From Continuing Operations	5.9	(8.6)	(18.6)
Gain on Sale of Discontinued Operations	0.3	—	—
Net Income (Loss)	6.2%	(8.6)%	(18.6)%

Comparison of Fiscal Years Ended June 30, 2001 and July 1, 2000

Software License Revenues

We derive our software license revenues principally from licensing our product collaboration software including our eMatrix collaboration platform, Value Chain Portfolio applications, Application Exchange Framework, development tools and integration products. We generally recognize revenues from software licensing upon shipment or distribution over the Internet to a customer.

Software license revenues increased 105.7% to $84.3 million for fiscal 2001 from $41.0 million for fiscal 2000. The increase was due to revenues from new customers as well as additional software licensed to existing customers. We introduced our Value Chain Portfolio applications in the second quarter of fiscal 2001 and expanded our integration product offerings resulting in a 256.3% increase in the licensing of our integration products. Software license revenues in North America and Japan increased $40.7 million and $3.9 million, respectively, due to the factors previously discussed. Software license revenues in Europe decreased approximately $1.3 million due to a decrease in software licensed to both new and existing customers as a result of increased competition and a general weakening of the European economy.

Service Revenues

We provide services to our customers and systems integrators consisting of professional services, training and maintenance and customer support services. Our professional services, which include implementation and consulting services, are primarily provided on a time and materials basis. We also perform a limited number of professional services on a fixed-price basis. We recognize professional service revenues as the services are performed, on a percentage of completion basis or upon customer acceptance. We also offer training services to our customers, distributors and systems integrators either in our offices throughout the world or at customer locations. We recognize revenues from training services as the services are provided. Customers that license our products generally purchase annually renewable maintenance contracts, which provide customers with the right to receive unspecified software upgrades and technical support over the term of the contract. Revenues from maintenance contracts are recognized over the term of the contract on a straight-line basis.

Service revenues increased 71.5% to $57.9 million for fiscal 2001 from $33.7 million for fiscal 2000. The increase was primarily due to a 121.8% increase in maintenance revenues from new and renewed maintenance contracts, a 51.0% increase in professional services revenues as a result of an increase in the number of professional services employees providing billable implementation and consulting services and a 112.2% increase in training revenues from an increase in the number of customers and users utilizing our product collaboration software. Maintenance revenues represented 33.7% and 26.1% of service revenues for fiscal 2001 and 2000, respectively.

Cost of Software Licenses

Cost of software licenses consists of royalties paid to third parties for integrations and applications licensed to our customers and, to a lesser extent, to Oracle for Oracle database licenses. Cost of software licenses also includes the cost of manuals and product documentation, production media used to deliver our products and shipping costs. Our cost of software licenses fluctuates from period to period due to changes in the mix of software licensed and the extent to which we pay royalties to third parties on integration products and applications.

Cost of software licenses increased 85.6% to $8.2 million for fiscal 2001 from $4.4 million for fiscal 2000. The increase in cost of software licenses was primarily due to a $5.1 million increase in royalties resulting from increased licensing of third-party software, offset by a $0.7 million decrease in royalties for Oracle database licenses.

Cost of Services

Cost of services includes salaries and related expenses for services personnel and costs of contracting with systems integrators to provide consulting services. Typically, our customers reimburse us for the majority of our out-of-pocket expenses incurred during the course of a project, which are recorded as a reduction in cost of services. Cost of services fluctuates based on the mix of internal professional services personnel and more expensive systems integrators used for professional services projects. Our gross margins may fluctuate based on the actual costs incurred to provide professional services.

Cost of services increased 61.1% to $42.5 million for fiscal 2001 from $26.4 million for fiscal 2000 primarily due to increased personnel costs to support the growth in our professional services organization. We also increased both the use of systems integrators to provide consulting services for our customers and the amount of training we provided these systems integrators in an effort to increase the number of systems integrators with relevant eMatrix expertise.

Gross Profit

Gross profit increased 108.3% to $91.4 million for fiscal 2001 from $43.9 million for fiscal 2000. Gross profit as a percentage of total revenues, or gross margin, increased to 64.3% for fiscal 2001 from 58.8% for fiscal 2000. The increase in gross margin was primarily attributable to higher margin software license revenues growing faster than services revenues. Gross margin on software licenses increased to 90.3% for fiscal 2001 from 89.2% for fiscal 2000 due to a decrease in the relative proportion of software we licensed from third parties, primarily Oracle database licenses. Gross margin on services increased to 26.6% for fiscal 2001 from 21.8% for fiscal 2000 primarily due to an increase in maintenance revenues and an increase in gross margin on professional services due to operational efficiencies.

Selling and Marketing

Selling and marketing expenses include marketing costs, such as public relations and advertising, trade shows, marketing materials and customer user group meetings, and selling costs such as sales training events and commissions. Selling and marketing costs may fluctuate based on the timing of trade shows and user group events and the amount of sales commissions, which vary based upon revenues.

Selling and marketing expenses increased 57.3% to $56.3 million for fiscal 2001 from $35.8 million for fiscal 2000 due to higher commission expense related to the growth in our revenues, increased personnel costs related to the expansion of our worldwide sales and marketing organization and an increase in our marketing programs and events. Selling and marketing expenses as a percentage of total revenues decreased to 39.6% for fiscal 2001 from 47.9% for fiscal 2000 primarily due to operational efficiencies of our sales organization and a larger revenues base.

Research and Development

Research and development expenses include costs incurred to develop our intellectual property and are charged to expense as incurred. To date, software development costs have been charged to expense as incurred, because the costs incurred from the attainment of technological feasibility to general product release have not been significant. Research and development costs may fluctuate based on the utilization of domestic and foreign third-party contractors, which are generally more expensive than our internal engineering personnel, and the use of third parties to develop specific software applications and integration products.

Research and development expenses increased 130.9% to $19.7 million for fiscal 2001 from $8.6 million for fiscal 2000 due to increased personnel costs related to the expansion of our research and development organization and an increase in the use of third-party contractors to assist in the development of our software. Research and development expenses as a percentage of total revenues increased to 13.9% for fiscal 2001 from 11.4% for fiscal 2000 due to the factors previously discussed.

General and Administrative

General and administrative expenses consist primarily of compensation of executive, finance, investor relations, human resource and administrative personnel, legal and accounting services and provisions for doubtful accounts.

General and administrative expenses increased 89.6% to $10.4 million for fiscal 2001 from $5.5 million for fiscal 2000 primarily due to an increase in personnel costs to support the growth in our business and provisions for doubtful accounts due to a larger revenues base. General and administrative expenses as a percentage of total revenues were 7.3% for both fiscal 2001 and 2000.

Stock-Based Compensation

Stock-based compensation relates to the issuance of stock options with exercise prices below the deemed fair value of our common stock on the date of grant. In connection with certain stock option grants during fiscal 2000 and 1999, we recorded deferred stock-based compensation totaling approximately $17.7 million. Deferred stock-based compensation represents the difference between the option exercise price and the deemed fair value of our common stock on the date of grant and is reported as deferred stock-based consideration, a component of stockholders' equity (deficit). Deferred stock-based compensation is amortized through charges to operations over the vesting period of the options, which is generally four years. Stock-based compensation was $4.1 million and $3.6 million for fiscal 2001 and 2000, respectively. We expect to record stock-based compensation of $4.1 million, $3.5 million and $0.7 million in fiscal 2002, 2003 and 2004, respectively.

Other Income (Expense), Net

Other income (expense), net fluctuates based on the amount of cash available for investment, interest expense related to borrowings under our credit facilities, realized and unrealized gains and losses on foreign currency transactions and gains and losses on sales and disposals of fixed assets. Other income, net increased $5.9 million to $8.9 million for fiscal 2001 from $3.0 million for fiscal 2000 primarily due to an increase in interest income from higher levels of cash available for investment as a result of the receipt of the proceeds from our initial public offering of common stock and concurrent private placement in March 2000.

Income Taxes

During fiscal 2001, we provided for income taxes at an effective rate of approximately 14% of income before income taxes. This effective tax rate differs from the statutory rate primarily due to certain nondeductible expenses and the change in the valuation allowance for our deferred tax asset. No provision for income taxes was recorded in fiscal 2000 due to accumulated net losses. During fiscal 2001 and 2000, we did not record any tax benefits relating to prior losses or other tax benefits due to the uncertainty surrounding the timing of the realization of these future tax benefits, which were $29.9 million in the aggregate at June 30, 2001. We expect to provide for income taxes in fiscal 2002 at approximately the same effective tax rate as fiscal 2001. This rate will include the realization of previously unrecorded tax benefits.

Discontinued Operations

During fiscal 2001, we settled a dispute relating to the May 1998 sale of Adra Systems, Inc., our legacy design and manufacturing software business, and recognized a gain of $0.5 million, representing the difference between the amount we originally accrued and the settlement amount.

Comparison of Fiscal Years Ended July 1, 2000 and July 3, 1999

Software License Revenues

Software license revenues increased 87.5% to $41.0 million for fiscal 2000 from $21.9 million for fiscal 1999. The increase was primarily due to increased software licensing in Europe, North America and Japan of $9.5 million, $5.5 million and $4.1 million, respectively. The increase in software license revenues in Europe was primarily due to an increase in software licensed to new customers by our subsidiaries in Germany, France, the Netherlands and the United Kingdom and software licensed by our newly formed subsidiaries in Italy and Austria. The increase in North America software license revenues was primarily due to software licensed to new customers and additional software licensed to existing customers. Our subsidiary in Japan was formed in late fiscal 1999 and recorded its first license revenues in fiscal 2000.

Service Revenues

Service revenues increased 73.0% to $33.7 million for fiscal 2000 from $19.5 million for fiscal 1999. The increase was primarily due to a 67.7% increase in professional services revenues and a 101.9% increase in maintenance revenues from new and renewed maintenance contracts. Maintenance revenues represented 26.1% and 22.3% of service revenues for fiscal 2000 and 1999, respectively.

Cost of Software Licenses

Cost of software licenses increased 33.1% to $4.4 million for fiscal 2000 from $3.3 million for fiscal 1999. The increase in cost of software licenses was primarily due to an increase in the licensing of third-party software.

Cost of Services

Cost of services increased 82.4% to $26.4 million for fiscal 2000 from $14.5 million for fiscal 1999 primarily due to increased personnel costs to support the growth in our professional services organization. We also increased both the use of systems integrators to provide consulting services for our customers and the amount of training we provided these systems integrators in an effort to increase the number of systems integrators with relevant eMatrix expertise.

Gross Profit

Gross profit increased 86.4% to $43.9 million for fiscal 2000 from $23.6 million for fiscal 1999. Gross profit as a percentage of total revenues, or gross margin, increased to 58.8% for fiscal 2000 from 57.0% for fiscal 1999. The increase in gross margin was primarily attributable to higher margin software license revenues growing faster than services revenues. Gross margin on software licenses increased to 89.2% for fiscal 2000 from 84.8% for fiscal 1999 due to a decrease in the relative proportion of software we licensed from third parties. Gross margin on services decreased to 21.8% for fiscal 2000 from 25.8% for fiscal 1999 due to the increased use in the fiscal 2000 period of systems integrators to provide consulting services and increased costs associated with training both new personnel in our services organization and systems integrators.

Selling and Marketing

Selling and marketing expenses increased 73.5% to $35.8 million for fiscal 2000 from $20.6 million for fiscal 1999 due to higher commission expense related to the growth in our revenues and increased personnel costs related to the expansion of our worldwide sales organization. Selling and marketing expenses as a percentage of total revenues decreased to 47.9% for fiscal 2000 from 49.9% for fiscal 1999 primarily due to increased productivity of our sales organization and a larger revenues base.

Research and Development

Research and development expenses increased 47.7% to $8.6 million for fiscal 2000 from $5.8 million for fiscal 1999 due to increased personnel costs related to the expansion of our research and development organization and an increase in the use of third-party contractors to assist in the development of our software. Research and development expenses as a percentage of total revenues decreased to 11.4% for fiscal 2000 from 14.0% for fiscal 1999 due to a larger revenues base.

General and Administrative

General and administrative expenses increased 22.5% to $5.5 million for fiscal 2000 from $4.5 million for fiscal 1999 due to an increase in personnel costs to support the growth in our business. General and administrative expenses as a percentage of total revenues decreased to 7.3% for fiscal 2000 from 10.8% for fiscal 1999 primarily due to a larger revenues base.

Stock-Based Compensation

Stock-based compensation increased to $3.6 million for fiscal 2000 from $0.6 million for fiscal 1999 due to the recognition of additional deferred stock-based compensation of $13.6 million in fiscal 2000.

Other Income (Expense), Net

Other income, net increased $2.8 million to $3.0 million for fiscal 2000 from $0.2 million for fiscal 1999 primarily due to a $2.8 million increase in interest income from higher levels of cash available for investment as a result of the receipt of the proceeds from our initial public offering of common stock and concurrent private placement in March 2000.

Income Taxes

No provision for income taxes was recorded for either fiscal 2000 or 1999 due to accumulated net losses.

Liquidity and Capital Resources

We have primarily financed our operations through the sale of common stock and convertible preferred stock and borrowings under our lines of credit.

As of June 30, 2001, we had cash and equivalents of $156.3 million, an increase of $2.9 million from July 1, 2000. Our working capital was $154.2 million and $146.0 million as of June 30, 2001 and July 1, 2000, respectively. The increase in working capital was primarily attributable to an increase in cash generated from our profitable operations and an increase in accounts receivable.

We have a $7.0 million line of credit that bears interest at the bank's prime rate plus 0.5% on any outstanding balances and expires December 28, 2001. Borrowings under this line of credit are limited to 80% of eligible accounts receivable from customers in the United States less amounts reserved for foreign currency contracts. In addition, we have a $1.0 million working capital line of credit that bears interest at the bank's prime rate plus 0.5% and expires on December 28, 2001. Borrowings under this working capital line of credit are limited to 90% of eligible foreign accounts receivable billed and collected in the United States. As of June 30, 2001, we had no borrowings outstanding under these lines of credit and $8.0 million available. These lines of credit are collateralized by all of our assets and have financial and other covenants. We were in compliance with these financial and other covenants as of June 30, 2001.

Our German subsidiary also has a working capital line of credit of 0.5 million DM ($0.2 million), which has no stated expiration date. Borrowings under this line of credit are limited to 100% of the accounts receivable of our German subsidiary and bear interest at 12% per annum. As of June 30, 2001, we had no borrowings under this line of credit and $0.5 million DM ($0.2 million) available.

Net cash provided by continuing operations for fiscal 2001 was $10.8 million resulting from our income from continuing operations, an increase in deferred revenues, accrued expenses and accounts payable offset by increases in accounts receivable and prepaid expenses and other current assets. Net cash provided by continuing operations was $6.8 million in fiscal 2000 resulting from an increase in deferred revenues, accrued expenses and accounts payable offset by our net loss from continuing operations and increases in accounts receivable and prepaid expenses and other current assets.

Net cash used in discontinued operations was $0.3 million for both fiscal 2001 and 2000. The net cash used in discontinued operations in fiscal 2001 includes a payment of $0.3 million to settle a dispute relating to the May 1998 sale of Adra Systems, Inc., our legacy design and manufacturing software business. The net cash used in discontinued operations in fiscal 2000 reflects payments of the legal and accounting fees incurred in connection with the sale of Adra Systems, Inc.

Net cash used in investing activities was $11.2 million and $3.7 million for fiscal 2001 and 2000, respectively, and reflects our investments in computer hardware and software, leasehold improvements and office equipment. Net cash used in investing activities also includes security deposits on leased facilities aggregating $2.0 million and $0.9 million in fiscal 2001 and 2000, respectively. We expect that capital expenditures for the next 12 months will be approximately $12.0 million primarily for the acquisition of computer hardware and software, leasehold improvements and office equipment.

Net cash provided by financing activities was $4.1 million in fiscal 2001 and consisted of the proceeds received from stock option exercises and purchases of common stock under our employee stock purchase plan. Net cash provided by financing activities was $140.0 million for fiscal 2000 and reflects the net proceeds received from our initial public offering of common stock and concurrent private placement of approximately $142.2 million and the repayments of our lines of credit.

We currently anticipate that our cash and equivalents and available credit facilities will be sufficient to fund our anticipated cash requirements for working capital and capital expenditures for at least the next 12 months. We may need to raise additional funds, however, in order to fund more rapid expansion of our business, develop new and enhance existing products and services, or acquire complementary products, businesses or technologies. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders may be reduced, our stockholders may experience additional dilution, and such securities may have rights, preferences or privileges senior to those of our stockholders. Additional financing may not be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, our ability to fund our expansion, take advantage of unanticipated opportunities or develop or enhance our services or products would be significantly limited.

Income Taxes

As of June 30, 2001, we had net operating loss carryforwards in the U.S. of $80.1 million, which include deductions of approximately $69.3 million related to the exercise of stock options, and research and development tax credit carryforwards in the U.S. of $0.3 million. These net operating loss and tax credit carryforwards will begin to expire at various dates beginning in fiscal 2002, if not utilized. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating loss and tax credit carryforwards in the event of an ownership change of a corporation. Our ability to utilize net operating loss and tax credit carryforwards on an annual basis could be limited as a result of an ownership change as defined by Section 382 of the Internal Revenue Code. We have completed several financings and believe that we have incurred ownership changes, which we do not believe will have a material impact on our ability to utilize our net operating loss and tax credit carryforwards.

As of June 30, 2001, we also had net operating loss carryforwards in various countries in which our subsidiaries operate aggregating $18.5 million. Certain of these net operating loss carryforwards begin to expire in fiscal 2002.

Because of the uncertainty regarding our ability to use our U.S. and foreign net operating loss and tax credit carryforwards, we have provided a full valuation allowance on these and all other deferred tax assets as of June 30, 2001.

Conversion to the Euro

We have arranged for the necessary modifications to our internal information technology and other systems to accommodate Euro-denominated transactions. Our European subsidiaries currently process Euro-denominated transactions. In addition, our products support the Euro currency symbol. We do not expect any material negative business implications due to the conversion to the Euro. Based on the foregoing, we do not believe the Euro will have a significant effect on our business, financial position, cash flows or results of operations. However, we will continue to assess the impact of Euro conversion issues as the applicable accounting, tax, legal and regulatory guidance evolves.

Qualitative and Quantitative Disclosures About Market Risk

We have international offices in Austria, Belgium, Canada, England, France, Germany, Italy, Japan, Korea, Singapore and the Netherlands. At June 30, 2001 and July 1, 2000, approximately 18.8% and 14.4%, respectively, of our total assets were located at our international subsidiaries. Approximately 27.4%, 39.2% and 26.1% of our revenues for fiscal 2001, 2000 and 1999, respectively, were from our operations outside North America. In addition, approximately 25.4%, 25.8% and 21.5% of our expenses for fiscal 2001, 2000 and 1999, respectively, were from our operations outside the U.S. These subsidiaries transact business in both local and foreign currency. Therefore, we are exposed to foreign currency exchange risks and fluctuations in foreign currencies, along with economic and political instability in the foreign countries in which we operate, all of which could adversely impact our results of operations and financial condition.

We use forward contracts to reduce our exposure to foreign currency risk due to fluctuations in exchange rates underlying the value of accounts receivable and accounts payable denominated in foreign currencies held until such receivables are collected and payables are disbursed. A forward contract obligates us to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates. These forward contracts, to qualify as hedges of existing assets or liabilities, are denominated in the same currency in which the underlying foreign currency receivables or payables are denominated and bear a contract value and maturity date that approximate the value and expected settlement date, respectively, of the underlying transactions. For contracts that are designated and effective as hedges, unrealized gains and losses on open contracts at the end of each accounting period, resulting from changes in the fair value of these contracts, are recognized in earnings in the same period as gains and losses on the underlying foreign denominated receivables or payables are recognized and generally offset.

We do not enter into or hold derivatives for trading or speculative purposes, and we only enter into contracts with highly rated financial institutions. At June 30, 2001, there were no outstanding forward contracts.

We plan to increase our use of forward contracts and other instruments in the future to reduce our exposure to exchange rate fluctuations from accounts receivable and accounts payable and intercompany accounts receivable and intercompany accounts payable denominated in foreign currencies, and we may not be able to do this successfully. Accordingly, we may experience economic loss and a negative impact on earnings and equity as a result of foreign currency exchange rate fluctuations. Also, as we continue to expand our operations outside of the United States, our exposure to fluctuations in currency exchange rates could increase.

We deposit our cash in highly rated financial institutions in North America, Europe and the Far East. We invest in diversified U.S. and international money market mutual funds, U.S. Treasury and agency securities, and commercial paper registered and traded in the U.S. with remaining maturities of less than 90 days. At June 30, 2001, we had $143.2 million, $0.6 million, $5.3 million and $1.2 million invested in the U.S., Canada, Continental Europe and England, respectively. Due to the short-term nature of our investments, we believe we have minimal market risk.

Our investments are subject to interest rate risk. All of our investments have remaining maturities of three months or less. If these short-term assets are reinvested in a declining interest rate environment, we would experience an immediate negative impact on other income. The opposite holds true in a rising interest rate environment. Since January 1, 2001, the Federal Reserve Board, European Central Bank and Bank of England have significantly decreased certain benchmark interest rates, which has led to a general decline in market interest rates. This decline in market interest rates has resulted in a significant decrease in our interest income in the past two fiscal quarters, despite an increase in our investable cash balances. Based on current economic forecasts, we expect the yields on our investments to continue to decline into fiscal 2002. Accordingly, we expect our investment income to also decrease.

Consolidated Balance Sheets

(In thousands, except per share amounts)

	June 30, 2001	July 1, 2000
Assets		
Current Assets:		
Cash and equivalents	$ 156,349	$ 153,455
Accounts receivable, less allowance for doubtful accounts of $1,387 and $927	42,619	21,388
Prepaid expenses and other current assets	3,535	3,993
Total current assets	202,503	178,836
Property and Equipment, Net	12,291	4,615
Other Assets	2,832	966
	$ 217,626	$ 184,417
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 9,966	$ 5,921
Accrued expenses	21,125	16,026
Deferred revenue	17,219	10,877
Total current liabilities	48,310	32,824
Commitments and Contingencies (Note 6)		
Stockholders Equity:		
Preferred stock, $0.01 par value, 5,000 shares authorized, 0 shares issued and outstanding	—	—
Common stock, $0.01 par value, 100,000 shares authorized, 45,194 and 41,978 shares issued and outstanding	452	420
Additional paid-in capital	209,065	205,344
Notes receivable from stockholders	—	(738)
Deferred stock-based consideration	(8,297)	(14,088)
Accumulated deficit	(29,980)	(38,826)
Accumulated other comprehensive loss	(1,924)	(519)
Total stockholders' equity	169,316	151,593
	$ 217,626	$ 184,417

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

Consolidated Statements of Operations

(In thousands, except per share amounts)

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Revenues:			
Software license	$ 84,290	$ 40,977	$ 21,851
Service	57,854	33,734	19,495
Total revenues	142,144	74,711	41,346
Cost of Revenues:			
Software license	8,212	4,424	3,323
Service(1)	42,491	26,383	14,467
Total cost of revenues	50,703	30,807	17,790
Gross profit	91,441	43,904	23,556
Operating Expenses:			
Selling and marketing(1)	56,273	35,765	20,611
Research and development(1)	19,749	8,553	5,792
General and administrative(1)	10,406	5,487	4,479
Stock-based compensation(1)	4,142	3,593	622
Total operating expenses	90,570	53,398	31,504
Income (loss) from operations	871	(9,494)	(7,948)
Other Income (Expense):			
Interest income	9,120	3,180	346
Interest expense	—	(46)	(109)
Other income (expense), net	(180)	(93)	7
Total other income	8,940	3,041	244
Income (loss) from continuing operations before income taxes	9,811	(6,453)	(7,704)
Provision for Income Taxes	(1,465)	—	—
Income (loss) from continuing operations	8,346	(6,453)	(7,704)
Gain on Sale of Discontinued Operations	500	—	—
Net Income (Loss)	$ 8,846	$ (6,453)	$ (7,704)
Basic Net Income (Loss) Per Share:			
Continuing operations	$ 0.19	$ (0.36)	$ (1.74)
Discontinued operations	0.01	—	—
Net income (loss)	$ 0.20	$ (0.36)	$ (1.74)
Shares used in computing basic net income (loss) per share	43,543	17,966	4,428
Diluted Net Income (Loss) Per Share:			
Continuing operations	$ 0.17	$ (0.36)	$ (1.74)
Discontinued operations	0.01	—	—
Net income (loss)	$ 0.18	$ (0.36)	$ (1.74)
Shares used in computing diluted net income (loss) per share	50,357	17,966	4,428
Pro Forma Basic and Diluted Net Loss Per Share:			
Net loss		$ (0.18)	$ (0.28)
Shares used in computing pro forma basic and diluted net loss per share		35,686	27,970

(1) The following summarizes the departmental allocation of stock-based compensation:

Cost of Service Revenues	$ 999	$ 816	$ 221
Selling and Marketing	1,263	1,154	234
Research and Development	801	708	103
General and Administrative	1,079	915	64
Total stock-based compensation	$ 4,142	$ 3,593	$ 622

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

Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)

(In thousands)

	Redeemable Convertible Preferred Stock		Preferred Stock		Common Stock	
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount
BALANCE, JUNE 27, 1998	1,899	$ 11,015	3,547	$ 3,547	3,816	$ 38
Comprehensive loss						
Foreign currency translation adjustments	—	—	—	—	—	—
Net loss	—	—	—	—	—	—
Comprehensive loss						
Retirement of treasury stock	—	—	(154)	(154)	(15)	—
Stock option exercises	—	—	—	—	861	9
Issuance of common stock in exchange for notes receivable	—	—	—	—	342	3
Deferred stock-based compensation	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	—	—
Issuance of Series H redeemable convertible preferred stock	750	6,000	—	—	—	—
BALANCE, JULY 3, 1999	2,649	17,015	3,393	3,393	5,004	50
Comprehensive loss:						
Foreign currency translation adjustments	—	—	—	—	—	—
Net loss	—	—	—	—	—	—
Comprehensive loss						
Stock option exercises	—	—	—	—	1,767	17
Conversion of preferred stock into common stock	(2,649)	(17,015)	(3,393)	(3,393)	26,763	268
Issuance of common stock, net of offering cost of $11,987	—	—	—	—	6,200	62
Cashless exercise of warrant	—	—	—	—	168	2
Issuance of common stock in exchange for notes receivable	—	—	—	—	2,076	21
Repayment of notes receivable	—	—	—	—	—	—
Deemed fair value of warrant issued to a customer	—	—	—	—	—	—
Amortization of warrant to reduce revenues	—	—	—	—	—	—
Deferred stock-based compensation	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	—	—
Reversal of stock-based compensation from stock option cancellations	—	—	—	—	—	—
BALANCE, JULY 1, 2000	—	—	—	—	41,978	420
Comprehensive income:						
Foreign currency translation adjustments	—	—	—	—	—	—
Net income	—	—	—	—	—	—
Comprehensive income						
Stock option exercises	—	—	—	—	3,141	31
Purchases under employee stock purchase plan	—	—	—	—	75	1
Repayment of notes receivable	—	—	—	—	—	—
Amortization of warrant to reduce revenues	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	—	—
Reversal of stock-based compensation from stock option cancellations	—	—	—	—	—	—
BALANCE, JUNE 30, 2001	—	$ —	—	$ —	45,194	$ 452

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

Additional Paid-in Capital	Treasury Stock Number of Shares	Treasury Stock Cost	Notes Receivable from Stockholders	Deferred Stock-based Consideration	Accumulated Deficit	Comprehensive Income (Loss)	Accumulated Other Comprehensive Loss	Total Stockholders' Equity (Deficit)
$ 22,370	169	$ (441)	$ —	$ —	$ (24,669)		$ (2)	$ 843
—	—	—	—	—	—	$ (172)	(172)	(172)
—	—	—	—	—	(7,704)	(7,704)	—	(7,704)
						$ (7,876)		
(287)	(169)	441	—	—	—		—	—
360	—	—	—	—	—		—	369
114	—	—	(117)	—	—		—	—
4,080	—	—	—	(4,080)	—		—	—
—	—	—	—	622	—		—	622
—	—	—	—	—	—		—	—
26,637	—	—	(117)	(3,458)	(32,373)		(174)	(6,042)
—	—	—	—	—	—	$ (345)	(345)	(345)
—	—	—	—	—	(6,453)	(6,453)	—	(6,453)
						$ (6,798)		
841	—	—	—	—	—		—	858
20,140	—	—	—	—	—		—	17,015
142,163	—	—	—	—	—		—	142,225
(2)	—	—	—	—	—		—	—
895	—	—	(916)	—	—		—	—
—	—	—	295	—	—		—	295
1,788	—	—	—	(1,788)	—		—	—
—	—	—	—	447	—		—	447
13,574	—	—	—	(13,574)	—		—	—
—	—	—	—	3,593	—		—	3,593
(692)	—	—	—	692	—		—	—
205,344	—	—	(738)	(14,088)	(38,826)		(519)	151,593
—	—	—	—	—	—	$ (1,405)	(1,405)	(1,405)
—	—	—	—	—	8,846	8,846	—	8,846
						$ 7,441		
2,341	—	—	—	—			—	2,372
1,688	—	—	—	—	—		—	1,689
—	—	—	738	—	—		—	738
—	—	—	—	1,341	—		—	1,341
—	—	—	—	4,142	—		—	4,142
(308)	—	—	—	308	—		—	—
$ 209,065	—	$ —	$ —	$ (8,297)	$ (29,980)		$ (1,924)	$ 169,316

Consolidated Statements of Cash Flows

(In thousands)

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Cash Flows From Operating Activities:			
Net income (loss)	$ 8,846	$ (6,453)	$ (7,704)
Gain on sale of discontinued operations	(500)	—	—
Net income (loss) from continuing operations	8,346	(6,453)	(7,704)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by (used in) continuing operations:			
Depreciation	2,207	1,454	1,257
Stock-based consideration	5,483	4,040	622
Provision for doubtful accounts	667	404	689
Changes in assets and liabilities:			
Accounts receivable	(22,639)	(7,336)	(8,648)
Prepaid expenses and other current assets	(994)	(3,783)	62
Accounts payable	3,217	2,050	1,277
Accrued expenses	7,763	9,300	1,226
Deferred revenue	6,735	7,081	2,877
Net cash provided by (used in) continuing operations	10,785	6,757	(8,342)
Net cash used in discontinued operations	(292)	(340)	(1,056)
Cash Flows From Investing Activities:			
Purchases of property and equipment	(10,017)	(3,139)	(1,306)
Other assets	(1,958)	(898)	(32)
Collection of notes receivable	738	295	4,400
Net cash provided by (used in) investing activities	(11,237)	(3,742)	3,062
Cash Flows From Financing Activities:			
Proceeds from lines of credit	—	2,263	4,000
Repayments of lines of credit	—	(5,313)	(950)
Repayments of term loan	—	—	(221)
Proceeds from issuance of redeemable convertible preferred stock, net	—	—	6,000
Proceeds from issuance of common stock, net	—	142,225	—
Proceeds from stock option exercises	2,372	858	369
Proceeds from purchases of common stock under employee stock purchase plan	1,689	—	—
Net cash provided by financing activities	4,061	140,033	9,198
Effect of Exchange Rates on Cash and Equivalents	(423)	(289)	51
Net Increase In Cash and Equivalents	2,894	142,419	2,913
Cash and Equivalents, Beginning of Year	153,455	11,036	8,123
Cash and Equivalents, End of Year	$ 156,349	$ 153,455	$ 11,036
Supplemental Disclosure of Cash Flow Information:			
Cash paid for interest	$ —	$ 46	$ 109
Cash paid for income taxes	$ 289	$ —	$ —
Noncash Financing Activity:			
Issuance of common stock in exchange for notes receivable from stockholders	$ —	$ 916	$ 117

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

Note 1: Description of the Company and Summary of Significant Accounting Policies

Description of the Company
MatrixOne, Inc. (the "Company") is a provider of product collaboration software designed to enable interactive product collaboration among employees of global organizations and with an organization's customers, suppliers and other business partners through the Internet. The Company licenses its software both directly to end users and through a network of domestic and international distributors. The Company has its headquarters in the United States ("U.S."), with offices in Austria, Belgium, Canada, England, France, Germany, Italy, Japan, Korea, Singapore and the Netherlands and throughout the U.S.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Basis of Presentation and Principles of Consolidation
The Company operates on a 52-to-53 week fiscal year that ends on the Saturday closest to June 30th. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Foreign Currency Translation and Transactions
The functional currency of each subsidiary is the local currency. Assets and liabilities of foreign subsidiaries are translated at the rates in effect at the balance sheet date, while stockholders' equity (deficit) is translated at historical rates. Statements of operations and cash flow amounts are translated at the average rate for the period. Translation adjustments are included as a component of accumulated other comprehensive loss. During fiscal 2001 and 2000, realized and unrealized foreign currency transaction gains (losses) aggregated $225 and ($93), respectively, and were included in other income (expense), net. Foreign currency gains and losses in fiscal 1999 arising from foreign currency transactions are reflected in the loss from operations and were not significant.

Derivative Financial Instruments
The Company uses forward contracts to reduce its exposure to foreign currency risk due to fluctuations in exchange rates underlying the value of accounts receivable and accounts payable denominated in foreign currencies (primarily European and Asian currencies) until such receivables are collected and payables are disbursed. A forward contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates. These foreign currency forward exchange contracts, to qualify as hedges of existing assets or liabilities, are denominated in the same currency in which the underlying foreign currency receivables or payables are denominated and bear a contract value and maturity date that approximate the value and expected settlement date, respectively, of the underlying transactions. For contracts that are designated and effective as hedges, unrealized gains and losses on open contracts at the end of each accounting period, resulting from changes in the fair value of these contracts, are recognized in earnings in the same period as gains and losses on the underlying foreign denominated receivables or payables are recognized and generally offset. The Company does not enter into or hold derivatives for trading or speculative purposes and only enters into contracts with highly rated financial institutions. At June 30, 2001, there were no outstanding forward contracts.

Comprehensive Income (Loss)
Comprehensive income (loss) includes net income (loss) as well as other changes in stockholders' equity (deficit), except stockholders' investments and distributions and deferred stock-based consideration.

Revenue Recognition
The Company generates revenues from licensing its software and providing professional services, training and maintenance and customer support services. The Company executes separate contracts that govern the terms and conditions of each software license and maintenance arrangement and each professional services arrangement. These contracts may be an element in a multiple-element arrangement. Revenues under multiple-element arrangements, which may include several different software products or services sold together, are allocated to each element based on the residual method.

The Company uses the residual method when fair value does not exist for one of the delivered elements in an arrangement. Under the residual method, the fair value of the undelivered elements is deferred and subsequently recognized. The Company has established sufficient vendor specific objective evidence for professional services, training and maintenance and customer support services based on the price charged 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 customer support services.

The Company recognizes software license revenues upon execution of a signed license agreement, delivery of the software to a customer and determination that collection of a fixed license fee is probable. For delivery over the Internet, the software is considered to have been delivered upon confirmation by the customer of the file transfer. Since the Company has no obligation to an end user of a distributor, software license revenues from distributors are recognized upon delivery to the distributor. The Company provides for sales returns at the time of delivery on an estimated basis.

Service revenues include professional services, training and maintenance and customer support fees. Professional services are not essential to the functionality of the other elements in an arrangement and are accounted for separately. Professional services revenues are recognized as the services are performed for time and material contracts or on a percentage-of-completion basis for fixed-price contracts. If conditions for acceptance are required, professional services revenues are recognized upon customer acceptance. Training revenues are recognized as the services are provided.

The Company recognizes revenue from software subscription arrangements ratably over the term of the contract on a straight-line basis. Fees from revenue sharing, royalty and subscriber arrangements with and through partners are recognized as revenue when they are fixed and determinable, generally upon receipt of a statement from the partner.

Maintenance and customer support fees include the right to unspecified upgrades on a when-and-if-available basis and ongoing technical support. Maintenance and customer support fees are recognized ratably over the term of the contract on a straight-line basis. When a maintenance and customer support fee is included with a software license fee, the Company allocates a portion of the software license fee to maintenance and customer support fees based on the renewal rate of the maintenance and customer support fees.

Cash Equivalents

The Company considers all time deposits and short-term investments with remaining maturities of 90 days or less to be cash equivalents. The Company's cash equivalents are primarily comprised of diversified U.S. and international money market mutual funds, which are reported at cost, and U.S. Treasury and agency securities and commercial paper registered and traded in the U.S., which are reported at amortized cost. The reported value of the Company's cash equivalents approximates market value.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents and notes receivable. The book values of these financial instruments approximated their respective fair values as of each balance sheet presented due to their short-term maturities.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash, cash equivalents and accounts receivable. Concentration of credit risk with respect to cash and cash equivalents is limited because the Company deposits its cash in highly rated financial institutions and invests in diversified money market mutual funds. The Company only invests in A1/P1 rated commercial paper registered and traded in the U.S. and limits its investment in any one issuer to $5,000 and, therefore, believes credit risk related to its investments in commercial paper is limited.

Concentration of credit risk with respect to accounts receivable is limited to certain customers to whom the Company makes substantial sales. To reduce its credit risk, the Company routinely assesses the financial strength of its customers. The Company maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

One customer represented approximately 11.6% of the Company's total revenues during fiscal 2001 and approximately 10.7% of the Company's accounts receivable at June 30, 2001. No one customer accounted for more than 10% of the Company's total revenues during fiscal 2000 or 1999 or more than 10% of the Company's accounts receivable at July 1, 2000.

Property and Equipment

Property and equipment are recorded at cost. Internal and external costs incurred to develop, implement and install computer software for internal use are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets (computer equipment and software, two to five years; furniture and fixtures, five to 10 years; office equipment, three to five years; leasehold improvements, shorter of useful life or remaining lease term). Maintenance and repair expenditures are charged to operations when incurred, and additions and improvements are capitalized. The Company reviews its property and equipment whenever events or changes in circumstances may indicate that the carrying amount of certain assets may not be recoverable and recognizes an impairment loss when it is probable that the estimated cash flows are less than the carrying value of these assets. Property and equipment to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. During fiscal 2001, net losses on disposals and impairment of property and equipment were $293 and were included in other income (expense), net.

(In thousands, except per share amounts)

Stock-Based Compensation

The Company records stock-based compensation issued to employees using the intrinsic value method and stock-based compensation issued to non-employees using the fair value method. Stock-based compensation is recognized on options issued to employees if the option exercise price is less than the market price of the underlying stock on the date of grant.

Research and Development and Software Development Costs

Research and development costs are charged to expense as incurred. Software development costs are included in research and development and are charged to expense as incurred. After technological feasibility is established, material software development costs are capitalized. The capitalized cost is then amortized on a straight-line basis over the estimated product life, or in the ratio of current revenues to total projected product revenues, whichever is greater. To date, the period between achieving technological feasibility, which the Company has defined as when beta testing commences, and the general availability of such software has been minimal, and software development costs qualifying for capitalization have been insignificant. Accordingly, the Company has not capitalized any software development costs for the periods presented.

Income Taxes

The Company accounts for income taxes under the asset and liability method, which recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the tax basis of assets and liabilities and their financial statement reported amounts. The Company records a valuation allowance against deferred tax assets when it is more likely than not that such assets will not be realized.

Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the shares used in the calculation of basic net income (loss) per share plus the dilutive effect of common stock equivalents, such as stock options, warrants and convertible preferred stock, using the treasury stock method. Common stock equivalents are excluded from the computation of dilutive net income (loss) per share if their effect is anti-dilutive.

Note 2: Details of Financial Statement Components

As of		June 30, 2001		July 1, 2000
Cash and Equivalents:				
Cash	$	5,950	$	762
U.S. Treasury and agency securities		78,155		82,159
Money market mutual funds		37,393		35,785
Commercial paper		34,851		34,749
	$	156,349	$	153,455
Property and Equipment:				
Computer equipment and software	$	12,849	$	6,005
Furniture and fixtures		1,976		357
Leasehold improvements		1,923		1,027
Office equipment		836		392
		17,584		7,781
Accumulated depreciation		(5,293)		(3,166)
	$	12,291	$	4,615
Accrued Expenses:				
Compensation	$	13,356	$	10,547
Taxes		3,239		2,021
Other		2,545		1,741
Royalties		1,985		925
Discontinued operations		—		792
	$	21,125	$	16,026

Note 3: Discontinued Operations

In 1998, the Company decided to focus its business on its product collaboration software and related services. On May 7, 1998, the Company sold substantially all of the net assets of its legacy design and manufacturing business, which had been operated as a wholly-owned subsidiary of the Company under the name Adra Systems, Inc. ("Adra Systems"), to SofTech, Inc. The purchase price consisted of $7,000 of cash, a $4,400 promissory note, which accrued interest at 7% and was collected on July 2, 1998, and contingent payments of up to $2,200 based on SofTech's revenues after the acquisition. SofTech has notified the Company that no contingent payments were due.

(In thousands, except per share amounts)

In fiscal 2001, the Company paid $275, plus legal fees, to settle a dispute relating to the May 1998 sale of Adra Systems, Inc., and recognized a gain on the sale of discontinued operations of $500, representing the difference between the amount originally accrued and the settlement amount.

At July 1, 2000, accrued costs relating to the sale of the net assets of Adra Systems, included in accrued expenses, were $792.

Note 4: Income Taxes

The following is the geographic pretax income (loss):

Year Ended	June 30 2001	July 1, 2000	July 3, 1999
United States	$ 15,825	$ (2,237)	$ (4,937)
Foreign	(5,514)	(4,216)	(2,767)
	$ 10,311	$ (6,453)	$ (7,704)

During fiscal 2001, the provision for income taxes of $1,465 primarily consisted of current U.S. federal and state taxes and minimum taxes due in certain foreign countries. No provision for income taxes was recorded in fiscal 2000 and 1999 due to reported net losses.

At June 30, 2001, the Company had available U.S. federal and state net operating loss ("NOL") carryforwards of approximately $80,140 and approximately $274 of available U.S. federal and state tax credits to reduce future U.S. income taxes. These NOLs include deductions of approximately $69,338 related to certain stock option exercises. The tax benefit from the NOLs related to the exercise of stock options will be recorded as an increase to additional paid in capital as these NOLs are utilized. The NOLs and tax credit carryforwards expire commencing in fiscal 2002. Use of these NOLs and tax credits may be limited due to certain changes in ownership.

At June 30, 2001, the Company also had NOLs in certain foreign countries aggregating approximately $18,512 that are also subject to certain limitations. These NOLs expire commencing in fiscal 2002.

The Company has recorded a valuation allowance against its deferred tax asset due to the fact it is more likely than not that the deferred tax asset will not be realized. Management regularly evaluates the realizability of its deferred tax assets and may adjust the valuation allowance based on such analysis.

The components of the deferred tax asset are as follows:

As of	June 30, 2001	July 1, 2000
Net operating loss carryforwards	$ 25,970	$ 11,531
Accrued liabilities	2,139	981
Deferred revenue	743	928
Allowance for doubtful accounts	442	345
Stock compensation	414	—
Tax credits	281	680
Depreciation	(44)	45
Total deferred tax assets	29,945	14,510
Valuation allowance	(29,945)	(14,510)
Net deferred tax asset	$ —	$ —

The reconciliation between the statutory federal income tax rate and the Company's effective tax rate is as follows:

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
U.S. federal statutory rate	35.0%	35.0%	35.0%
State tax, net of federal tax benefit	6.0	6.0	6.0
Nondeductible stock compensation expense	7.0	—	—
Nondeductible meals and entertainment	1.5	—	—
Provision for valuation allowance	(35.3)	(41.0)	(41.0)
	14.2%	— %	— %

(In thousands, except per share amounts)

Note 5: Line of Credit and Debt

On December 29, 2000, the Company extended its line of credit of $7,000 through December 28, 2001. Borrowings under the line of credit are limited to 80% of eligible accounts receivable from customers in the U.S., less amounts reserved for foreign currency contracts. In addition, on February 1, 2001, the Company extended its working capital line of credit of $1,000, which expires December 28, 2001. Borrowings under the working capital line of credit are limited to 90% of eligible foreign accounts receivable billed and collected in the U.S. These lines of credit are collateralized by all of the Company's assets, have financial and other covenants and bear interest at the bank's prime rate (6.75% at June 30, 2001) plus 0.5%. As of June 30, 2001, there were no borrowings under these lines of credit and $8,000 available.

On April 3, 2000, the Company's wholly-owned subsidiary in Germany obtained a 500 DM ($216) line of credit, which has no stated expiration date. Borrowings under this line of credit are limited to 100% of accounts receivable of the German subsidiary and bear interest at 12.0% per annum. As of June 30, 2001, there were no borrowings under this line of credit and 500 DM ($216) available.

The Company had a term loan that was payable in 33 equal installments of $21 that commenced on October 31, 1996. The term loan was paid in full during fiscal 1999.

Note 6: Commitments and Contingencies

Commitments

The Company leases its facilities, automobiles and certain office equipment under various operating leases that expire through fiscal 2011. Certain of the facility leases require the Company to pay its proportionate share of building expenses and provide the Company with the option to renew its lease for an extended period. Aggregate rental expense under operating leases was approximately $4,020, $2,123 and $1,616 for fiscal 2001, 2000 and 1999, respectively.

Future minimum lease commitments, by fiscal year, as of June 30, 2001 are as follows:

	Facilities	Autos and Equipment	Total
2002	$ 4,176	$ 743	$ 4,919
2003	3,616	520	4,136
2004	3,226	265	3,491
2005	2,633	77	2,710
2006	2,531	46	2,577
Thereafter	8,404	44	8,448
	$ 24,586	$ 1,695	$ 26,281

Contingencies

During the period between July 24, 2001 and August 22, 2001, four purported securities class action lawsuits were filed in the United States District Court for the Southern District of New York. The complaints, which are virtually identical, name as defendants the Company, two of its officers, and certain underwriters involved in the Company's initial public offering of common stock. The complaints are allegedly brought on behalf of purchasers of the Company's common stock during the period from February 29, 2000 to December 6, 2000 and assert, among other things, that the Company's initial public offering prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of the Company's initial public offering underwriters in allocating shares in the Company's initial public offering to the underwriters' customers. The actions seek rescission and various damages, fees and costs associated with the litigation, and interest. The Company understands that various plaintiffs have filed substantially similar lawsuits against over one hundred other publicly traded companies in connection with the underwriting of their initial public offerings. The Company and its officers and directors believe that the allegations in the complaints are without merit and intend to contest them vigorously. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of these pending lawsuits. Even if successfully defended, these lawsuits could result in significant expense to the Company and the diversion of its management and technical resources, which would have a material adverse effect on the Company's operating results. The Company has not recorded an accrual related to these complaints.

The Company may from time to time become a party to various other legal proceedings arising in the ordinary course of business. Management believes that the outcomes of these proceedings will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

(In thousands, except per share amounts)

Note 7: Redeemable Convertible Preferred Stock

As of the closing of the Company's initial public offering of common stock, each share of Class G and Class H redeemable convertible preferred stock was converted into 4.275 and 4.5 shares, respectively, of common stock and all the rights, preferences and privileges of the Class G and H redeemable convertible preferred stock terminated.

On June 17, 1999, the Company sold 750 shares of Class H redeemable convertible preferred stock at $8.00 per share for $6,000.

As of July 3, 1999, redeemable convertible stock was comprised of the following:

	Shares Authorized	Shares Issued	Shares Outstanding	Redemption Value
Class G, $1.00 par value	2,000	1,899	1,899	$ 11,015
Class H, $1.00 par value	750	750	750	6,000
	2,750	2,649	2,649	$ 17,015

Note 8: Stockholders' Equity (Deficit)

Common Stock

On August 10, 1999, the Board of Directors (the "Board") voted to approve a 3-for-2 stock split, effected as a 50% stock dividend, provide for a single class of common stock, eliminate the Class B common stock and increase the number of authorized shares of common stock from 12,000 to 40,000. On December 9, 1999, the Board voted to approve a 3-for-1 stock split, which was effected as a 200% stock dividend on February 23, 2000. The consolidated financial statements for all periods presented have been restated to reflect both stock splits.

On December 9, 1999, the Board approved, effective upon the closing of the initial public offering, a change in the total number of shares which the Company is authorized to issue to 105,000 shares, of which 100,000 shares are common stock and 5,000 shares are preferred stock. As of June 30, 2001, 21,675 shares of common stock had been authorized for issuance pursuant to the exercise of stock options and other stock rights.

On February 1, 2000, the Company entered into software license and maintenance agreements and a professional services agreement with a customer. In connection with these agreements, a party related to this customer agreed to purchase 450 shares of common stock in a private placement. The sale price was the initial public offering price less underwriters' discounts and commissions, or $23.25 per share. The sale occurred contemporaneously with the Company's initial public offering of common stock. The proceeds from the private placement were $10,462.

On March 6, 2000, the Company completed its initial public offering of 5,750 shares of common stock, which included the exercise of the underwriters' over-allotment option of 750 shares, at $25.00 per share. The proceeds from the initial public offering were $131,763, after deducting the underwriters' discounts and commissions and offering expenses of $11,987.

Preferred Stock

As of the closing of the Company's initial public offering, each share of Class A through F convertible preferred stock was converted into 4.5 shares of common stock and all the rights, preferences and privileges of the Class A through Class F convertible preferred stock terminated.

As of July 3, 1999, convertible preferred stock was comprised of the following:

	Shares Authorized	Shares Issued	Shares Outstanding	Amount
Class A, $1.00 par value	615	615	512	$ 512
Class B, $1.00 par value	492	491	444	444
Class C, $1.00 par value	1,195	1,194	1,194	1,194
Class D, $1.00 par value	683	680	676	676
Class E, $1.00 par value	167	167	167	167
Class F, $1.00 par value	400	400	400	400
	3,552	3,547	3,393	$ 3,393

Notes Receivable from Stockholders

In connection with the exercise of stock options during fiscal 2000 and 1999, the Company issued 2,076 and 342 shares of common stock, respectively, in exchange for notes receivable from stockholders with principal balances aggregating $916 and $117, respectively. During fiscal 2001 and 2000, the Company received payments of notes receivable aggregating $738 and $295, respectively.

Warrants

In May 1997, the Company issued a warrant, with an exercise price of $0.44, to purchase 169 shares of common stock in conjunction with its line of credit. No value has been ascribed to this warrant as the amount would not be material to the Company's consolidated financial statements. In March 2000, the holder of the warrant executed a cashless exercise and received 168 shares of common stock.

On February 1, 2000, the Company issued the purchaser of the common stock issued in the private placement a warrant to purchase 200 shares of common stock, which became exercisable following the closing of the initial public offering (March 6, 2000) for a term of 18 months at an exercise price of $31.25 per share. In connection with the issuance of the warrant, the Company recorded a charge of $1,788, which represents the fair value of the warrant using the Black-Scholes option-pricing model. This charge is included in deferred stock-based consideration, which is reported as a component of stockholders' equity (deficit). This deferred consideration is amortized through charges to reduce revenues as the elements in the arrangement are delivered. During fiscal 2001 and 2000, the Company recorded charges to reduce revenues of $1,341 and $447, respectively, related to the warrant. The warrant expired on September 6, 2001.

2000 Employee Stock Purchase Plan

In December 1999, the Board adopted the 2000 Employee Stock Purchase Plan (the "Purchase Plan") to be effective upon the completion of the Company's initial public offering. The Company has reserved a total of 1,350 shares of common stock for issuance under the Purchase Plan. Eligible employees may purchase common stock under the Purchase Plan at 85% of the lesser of the average market price of the Company's common stock on the first or last day of the applicable six month payment period. During fiscal 2001, 75 shares of common stock were purchased under the Purchase Plan. No common stock was purchased under the Purchase Plan during fiscal 2000.

Stock Option Plans

In January 2000, the Board adopted the 1999 Stock Plan (the "1999 Plan") to be effective upon the completion of the Company's initial public offering. In fiscal 2001, the 1999 Plan was amended to increase the number of shares of common stock reserved for issuance from 1,500 to 3,000 shares. The 1999 Plan provides for the granting of incentive and nonqualified stock options, stock issuances and opportunities to make direct purchases of stock to employees, officers or consultants of the Company.

In fiscal 1996, the Company adopted a stock plan (the "1996 Plan") pursuant to which 13,950 shares of the Company's common stock are reserved for issuance. The 1996 Plan provides for the granting of incentive stock options, nonqualified stock options and other stock rights. Options may be granted at not less than the fair market value of the Company's common stock on the date of grant, as determined by the Board.

The Company's 1987 Stock Option Plan (the "1987 Plan") has been terminated; however, options issued under the 1987 Plan remain outstanding. The 1987 Plan provided for the granting of both incentive stock options and nonqualified stock options. Incentive stock options were granted at the fair market value of the common stock on the date of grant, as determined by the Board.

Options granted under the 1999, 1996 and 1987 Plans generally vest over four years and expire no later than ten years from the date of the grant. There were 1,634 shares available for future grant under the 1999 and 1996 Plans at June 30, 2001.

(In thousands, except per share amounts)

The following is a summary of the status of the Company's stock options as of June 30, 2001, July 1, 2000 and July 3, 1999 and the stock option activity for all stock option plans during the years ending on those dates:

	June 30, 2001		July 1, 2000		July 3, 1999	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding:						
Beginning balance	10,318	$ 1.67	11,742	$ 0.45	10,125	$ 0.43
Granted	2,370	$ 28.60	2,802	$ 5.07	4,806	$ 0.46
Exercised	(3,141)	$ 0.76	(3,843)	$ 0.46	(1,203)	$ 0.40
Canceled	(299)	$ 10.39	(383)	$ 1.04	(1,986)	$ 0.42
Ending balance	9,248	$ 8.60	10,318	$ 1.67	11,742	$ 0.45
Exercisable	4,025	$ 3.43	4,377	$ 0.66	5,157	$ 0.43

Information regarding options outstanding as of June 30, 2001 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
$ 0.33 - $ 0.44	4,555	6.58	$ 0.44	3,113	$ 0.44
$ 0.67 - $ 1.11	1,518	8.05	$ 1.03	378	$ 1.11
$ 3.33 - $ 8.00	547	8.41	$ 6.87	169	$ 6.52
$ 10.56 - $ 13.56	365	9.11	$ 12.14	55	$ 12.97
$ 14.25 - $ 19.96	420	9.40	$ 15.79	20	$ 16.00
$ 20.13 - $ 29.56	473	9.22	$ 23.91	53	$ 22.93
$ 30.19 - $ 36.50	1,294	9.09	$ 35.97	224	$ 36.14
$ 36.88 - $ 69.50	76	8.61	$ 43.88	13	$ 44.08
	9,248	7.66	$ 8.60	4,025	$ 3.43

In connection with certain stock option grants to employees, the Company recorded deferred stock-based compensation of $13,574 and $4,080 in fiscal 2000 and 1999, respectively. Deferred stock-based compensation represents the difference between the option price and the deemed fair value of the Company's common stock on the date of grant and is reported as stock-based consideration, a component of stockholders' equity (deficit). Deferred stock-based compensation is amortized through charges to operations over the vesting period of the options, which is generally four years. Stock-based compensation was $4,142, $3,593 and $622 for fiscal 2001, 2000 and 1999, respectively.

(In thousands, except per share amounts)

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

The fair value of options granted in fiscal 2001, 2000 and 1999 have been determined using the Black-Scholes option pricing model. The assumptions used are as follows:

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Risk-free interest rate	4.54 – 6.23%	5.80 – 6.50%	5.10%
Expected dividend yield	None	None	None
Expected lives	4 years	5 years	5 years
Expected volatility (0% before January 1, 2000)	100%	85%	—

The weighted average fair value of options granted in fiscal 2001, 2000 and 1999 were $20.80, $7.44 and $0.95 per share, respectively.

Had compensation expense for stock options been determined based on fair value as prescribed by Statement of Accounting Standards ("SFAS") No. 123, the Company's pro forma net income (loss) and basic and diluted net income (loss) per share would have been as follows:

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Net Income (Loss):			
As reported	$ 8,846	$ (6,453)	$ (7,704)
Pro forma	$ (1,418)	$ (7,500)	$ (8,027)
Basic and Diluted Net Income (Loss) Per Share:			
As reported:			
Basic net income (loss) per share	$ 0.20	$ (0.36)	$ (1.74)
Diluted net income (loss) per share	$ 0.18	$ (0.36)	$ (1.74)
Pro forma:			
Basic net loss per share	$ (0.03)	$ (0.42)	$ (1.81)
Diluted net loss per share	$ (0.03)	$ (0.42)	$ (1.81)

Because the method prescribed by SFAS No. 123 has not been applied to stock options granted prior to June 30, 1995 and no expected volatility factor has been used to value any stock options granted prior to January 1, 2000, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

Note 9: Employee Benefit Plans

Eligible employees of the Company's U.S. operations may elect to participate in the Company's 401(k) plan. The Company does not make contributions to the 401(k) plan. Employees of certain of the Company's subsidiaries are provided with savings plans to which the Company and the employee contribute. Contributions to these plans were not material in fiscal 2001, 2000 or 1999.

(In thousands, except per share amounts)

Note 10: Segment and Geographic Information

Operating segments are identified as components of an enterprise about which separate discrete financial information is available to the chief operating decision maker, or decision-making group, in assessing performance and allocating resources. The Company's decision-making group, its executive management team, views the Company's operations and manages its business principally as one segment with two offerings: product collaboration software and related services. The executive management team evaluates these offerings based on their respective gross margins. Therefore, the financial information presented in these financial statements represents all the material financial information related to the company's principal operating segment.

Revenues and property and equipment by significant geographic region are as follows:

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Revenues:			
North America	$ 103,257	$ 45,398	$ 30,557
Germany	8,222	9,519	6,048
France	5,835	6,162	2,243
Asia Pacific	11,053	4,870	—
Europe (excluding Germany and France)	13,777	8,762	2,498
Total international	38,887	29,313	10,789
	$ 142,144	$ 74,711	$ 41,346

The Company reports revenue in the geographic region of the customer at the time of the license. However, the customer may deploy licenses in other geographic regions.

As of	June 30, 2001	July 1, 2000
Property and Equipment:		
North America	$ 10,710	$ 3,844
Germany	237	202
France	267	178
Asia Pacific	357	87
Europe (excluding Germany and France)	720	304
Total international	1,581	771
	$ 12,291	$ 4,615

(In thousands, except per share amounts)

Note 11: Net Income (Loss) Per Share

The Company's capital structure in fiscal 2000 and 1999 is not comparable to its current capital structure due to the conversion of all shares of convertible preferred stock into common stock concurrent with the closing of the Company's initial public offering in March 2000. Accordingly, pro forma basic and diluted net loss per share has been presented for fiscal 2000 and 1999 assuming the conversion of all outstanding shares of convertible preferred stock into common stock, as if the conversion had occurred on the original date of issuance.

The calculation of basic and diluted and pro forma basic and diluted net income (loss) per share is as follows:

Year Ended	June 30, 2001	July 1, 2000	July 3, 1999
Net Income (Loss):			
Income (loss) from continuing operations	$ 8,346	$ (6,453)	$ (7,704)
Gain on sale of discontinued operations	500	—	—
Net income (loss)	$ 8,846	$ (6,453)	$ (7,704)
Shares Used In Computing Basic and Diluted and Pro Forma Basic and Diluted Net Income (Loss) Per Share:			
Weighted average shares outstanding used in computing basic net income (loss) per share	43,543	17,966	4,428
Dilutive effect of stock options	6,814	—	—
Shares used in computing diluted net income (loss) per share	50,357	17,966	4,428
Adjustment to reflect the effect of the conversion of preferred stock		17,720	23,542
Shares used in computing pro forma basic and diluted net loss per share		35,686	27,970
Basic and Diluted and Pro Forma Basic and Diluted Net Income (Loss) Per Share:			
Basic income (loss) per share from continuing operations	$ 0.19	$ (0.36)	$ (1.74)
Basic income per share from discontinued operations	0.01	—	—
Basic net income (loss) per share	$ 0.20	$ (0.36)	$ (1.74)
Diluted income (loss) per share from continuing operations	$ 0.17	$ (0.36)	$ (1.74)
Diluted income per share from discontinued operations	0.01	—	—
Diluted net income (loss) per share	$ 0.18	$ (0.36)	$ (1.74)
Pro forma basic and diluted net loss per share		$ (0.18)	$ (0.28)

Potentially dilutive common stock options and warrants aggregating 1,320, 10,518 and 11,910 for fiscal 2001, 2000 and 1999, respectively, have been excluded from the computation of basic and dilutive net income (loss) per share because their inclusion would be anti-dilutive.

(In thousands, except per share amounts)

Note 12: Quarterly Financial Information (Unaudited)

Year Ended June 30, 2001	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues	$ 28,548	$ 34,291	$ 38,105	$ 41,200	$142,144
Gross profit	$ 18,800	$ 22,941	$ 24,195	$ 25,505	$ 91,441
Income from continuing operations	$ 529	$ 2,189	$ 2,582	$ 3,046	$ 8,346
Income from discontinued operations	$ —	$ —	$ —	$ 500	$ 500
Net income	$ 529	$ 2,189	$ 2,582	$ 3,546	$ 8,846
Basic income per share from continuing operations	$ 0.01	$ 0.05	$ 0.06	$ 0.07	$ 0.19
Basic income per share from discontinued operations	$ —	$ —	$ —	$ 0.01	$ 0.01
Basic net income per share	$ 0.01	$ 0.05	$ 0.06	$ 0.08	$ 0.20
Diluted income per share from continuing operations	$ 0.01	$ 0.04	$ 0.05	$ 0.06	$ 0.17
Diluted income per share from discontinued operations	$ —	$ —	$ —	$ 0.01	$ 0.01
Diluted net income per share	$ 0.01	$ 0.04	$ 0.05	$ 0.07	$ 0.18
Shares used in computing basic net income per share	42,258	43,022	43,982	44,901	43,543
Shares used in computing diluted net income per share	50,384	50,157	50,360	50,518	50,357

Year Ended July 1, 2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues	$ 13,881	$ 16,167	$ 19,837	$ 24,826	$ 74,711
Gross profit	$ 7,849	$ 9,075	$ 11,554	$ 15,426	$ 43,904
Net loss	$ (1,419)	$ (2,079)	$ (2,915)	$ (40)	$ (6,453)
Basic and diluted net loss per share	$ (0.27)	$ (0.35)	$ (0.15)	$ (0.00)	$ (0.36)
Shares used in computing basic and diluted net loss per share	5,203	5,868	18,907	41,888	17,966
Pro forma basic and diluted net loss per share	$ (0.04)	$ (0.06)	$ (0.08)	$ (0.00)	$ (0.18)
Shares used in computing pro forma basic and diluted net loss per share	31,965	32,630	36,258	41,888	35,686

Report of Independent Public Accountants

To MatrixOne, Inc.:

We have audited the accompanying consolidated balance sheets of MatrixOne, Inc. (a Delaware corporation) as of June 30, 2001 and July 1, 2000 and the related consolidated statements of operations, redeemable convertible preferred stock and stockholders' equity (deficit) and cash flows for each of the three years in the period ended June 30, 2001. These financial statements are the responsibility of MatrixOne, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MatrixOne, Inc. and its subsidiaries as of June 30, 2001 and July 1, 2000 and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Boston, Massachusetts
July 26, 2001

Common Stock Information

Our common stock is quoted on the NASDAQ National Market under the symbol "MONE" and public trading commenced on March 1, 2000. Prior to that time, there was no public market for our common stock. The price range per share reflected in the table below is the high and low bid information for our common stock as reported by NASDAQ for the periods indicated.

	High	Low
Fiscal Year Ended June 30, 2001:		
First quarter	$ 49.00	$ 17.19
Second quarter	$ 39.63	$ 6.75
Third quarter	$ 36.00	$ 13.25
Fourth quarter	$ 27.49	$ 10.19
Fiscal Year Ended July 1, 2000:		
Third quarter (from March 1, 2000)	$ 84.44	$ 30.25
Fourth quarter	$ 45.19	$ 12.75

On September 10, 2001, there were approximately 503 stockholders of record of our common stock. This number does not include stockholders for whom shares were held in a "nominee" or "street" name. On September 10, 2001, the last reported sale price per share of our common stock on the NASDAQ National Market was $9.20.

We have never declared or paid any cash dividends on our capital stock. We currently intend to retain future earnings, if any, to finance the expansion and growth of our business and do not expect to pay any cash dividends in the foreseeable future. Payment of future cash dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs and plans for expansion. Our credit facility currently prohibits the payment of cash dividends on our capital stock.

MatrixOne

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Corporate Information

Directors

Ellen Carnahan
Managing Director
William Blair Capital
Partners, L.L.C.

W. Patrick Decker
President and
Chief Operating Officer
Kronos Incorporated

Daniel J. Holland
Senior Advisor and Partner
One Liberty Ventures

James F. Morgan
Former Corporate Advisor

Mark F. O'Connell
President and
Chief Executive Officer
MatrixOne, Inc.

Charles R. Stuckey, Jr.
Chairman of the Board
RSA Security, Inc.

Executive Officers

Mark F. O'Connell
President and
Chief Executive Officer

Maurice L. Castonguay
Vice President of Finance
and Administration,
Chief Financial Officer
and Treasurer

David W. McNelis
Vice President
of Engineering

Johannes T. J. Ruigrok
Senior Vice President
of Global Sales

Michael Segal
Senior Vice President
of Customer Success

Jane E. Seitz
Vice President of
Human Resources

Transfer Agent and Registrar

EquiServe Trust Company is the transfer agent and registrar for the Company's common stock and maintains stockholder accounting records. The transfer agent will respond to questions regarding changes in address, name or ownership, lost certificates and consolidation of accounts.

A change of address should be reported promptly by sending a signed and dated letter to EquiServe Trust Company. Stockholders should state the name in which the stock is registered, account number, social security number, certificate number, and the new address. Please mail correspondence to:

Fleet National Bank
c/o EquiServe Trust Company
Shareholder Services
P.O. Box 43010
Providence, Rhode Island 02940-3010
Telephone 781.575.3400
Internet Address:
http://www.equiserve.com

Financial Information

A copy of the Annual Report on Form 10-K and other periodic reports filed with the Securities and Exchange Commission and additional information about the Company, its products and the markets it serves can be obtained without charge by telephone, fax or written request to the Office of Investor Relations at the corporate office.

You can sign up for the Company's email alert system at http://investor.matrixone.com, which will give you email notification of updates to the Company's investor relations Website.

Annual Meeting

The Annual Meeting of Stockholders will be held on November 9, 2001, at 10:00 A.M., at Testa, Hurwitz & Thibeault, LLP, Conference Center, 20th Floor, High Street Tower, 125 High Street, Boston, Massachusetts 02110.

Independent Auditors

Arthur Andersen LLP
Boston, Massachusetts

Legal Counsel

Testa, Hurwitz & Thibeault, LLP
Boston, Massachusetts

Corporate Office

MatrixOne, Inc.
210 Littleton Road, Westford, Massachusetts 01886
Corporate Telephone 978.589.4000 Investor Relations Telephone 978.589.4040
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MatrixOne

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