intelligent collaborative commerce solutions

MatrixOne

annual report 2000

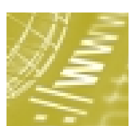
what we do.

At MatrixOne, we enable our customers to leverage the power of Intelligent Collaborative Commerce™ to dramatically improve their business results. We do this through leadership technology delivered and supported by an extensive worldwide network of committed employees and partners.

Collaboration is fluid. The unique combination of factors that works precisely for one situation won't quite fit the next set of circumstances. Different events call for different mixes of people, information, expertise, processes, groups, schedules, and even companies. Time and circumstance require flexibility in virtually every element that must come together to achieve true and effective collaboration.

MatrixOne is succeeding because we thoroughly understand the nature of collaboration and its requirements, and we are solving the hard technical problems that prevent free-flowing collaboration. This has led to our ability to partner with some of the world's leading companies. It has also attracted flagship customers across a spectrum of industries who have adopted MatrixOne technology as a fundamental part of their collaborative backbone. All of these factors have contributed to the momentum and the expanding global presence that marks the beginning of our first full year as a public company.

MatrixOne collabor@tion solutions



Enabling Our Customers' Success: Technological Leadership

Our advanced technology is enabling our customers to exploit the power of collaborating over the Internet to improve their business results. Intelligent Collaborative Commerce™ is an IT infrastructure that lets companies adapt almost instantly to changing business requirements, deliver information proactively and conduct secure business collaboration over the Internet.

Strength in Numbers: The Partner Economy

Just as no man is an island, no company alone can meet the diverse needs of commerce and industry. Collaborative, strategic alliances accelerate the success of both MatrixOne and our partners. Together, we can offer far greater benefits to our customers so that all of us—customers, partners, and MatrixOne—win.

The Collaborative Backbone: Customer Successes

Around the world and in numerous industries, leading companies are making MatrixOne technology an indispensable part of their infrastructure. Fast implementation and ongoing flexibility on top of very powerful collaboration capabilities made MatrixOne the intelligent choice.

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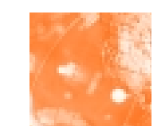
In Their Own Words: Industry Analysts, Partners, and Customers

Like many good collaborations, different thoughts from different directions combine to give a broader picture of the value that MatrixOne brings to the marketplace. From their individual perspectives, the industry analyst, the partner, and the customer communities offer observations.

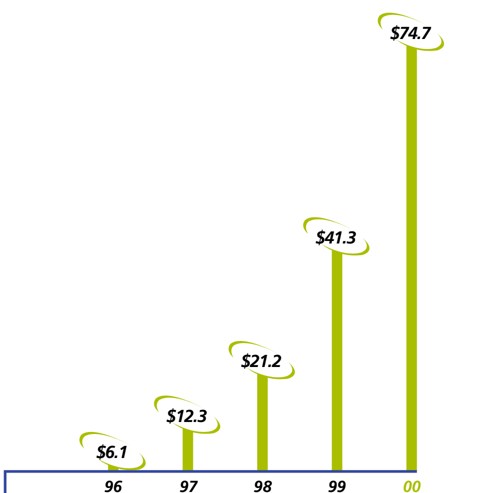


Expanding the Footprint: Global Growth

An important part of enabling worldwide, secure collaboration within and among companies, partners, suppliers, and customers is being able to support multinational enterprises. Throughout the year, we continued to build the global presence that allows us to do just that.

Financial Highlights

(in thousands)	2000	1999	1998	1997	1996
Statements of Operations Data					
Revenues:					
Software license	$ 40,977	$21,851	$ 11,836	$ 8,450	$ 4,420
Service	33,734	19,495	9,343	3,825	1,710
Total revenues	74,711	41,346	21,179	12,275	6,130
Gross profit	43,904	23,556	13,351	8,469	3,608
Operating expenses, excluding stock-based compensation	49,805	30,882	26,203	12,873	10,243
Stock-based compensation	3,593	622	—	—	—
Net loss from continuing operations	(6,453)	(7,704)	(10,876)	(3,669)	(6,635)
Net income (loss) from discontinued operations	—	—	8,684	1,777	(319)
Net loss	(6,453)	(7,704)	(2,192)	(1,892)	(6,954)
Balance Sheet Data					
Cash and equivalents	$153,455	$11,036	$ 8,123	$ 897	$ 1,089
Total assets of continuing operations	184,417	29,887	22,912	8,478	6,329
Total stockholders' equity (deficit)	151,593	(6,042)	843	3,072	4,998



Total Revenues by Fiscal Year
in millions

Total Revenues by Quarter for Fiscal 2000
in millions

we provide

business

solutions...

To Our Shareholders

We begin fiscal year 2001 as a public company with confidence and momentum in every aspect of our business. The list of customers we serve includes well-known leaders in their respective markets. Our global presence has expanded significantly, enabling us to better service and support large global customers. We have a strong and growing list of strategic alliance partners, with whom we can present formidable strength in major global and specific industry markets. Our technology continues to lead the industry and enables exceptional accomplishments by our customers. We also continue to attract and retain dynamic and energetic employees. Our balance sheet is very strong, and our solid financial position should help to propel future growth. Last, but most certainly not least, we posted a profit, excluding stock-based compensation, for the fourth quarter of fiscal year 2000.

The engine that drives us is collaboration—Internet-based collaboration to be specific. It is not only our business focus, it is also what enables us to succeed as a company. Collaboration is about helping people work openly together to share their information, business processes and ideas, and to improve innovation and time-to-market of customer-inspired new products and services. The basic idea of collaboration is quite simple. However, from a technology perspective, it is quite a challenge. We are meeting it. At MatrixOne we bring the key ingredients together in a powerful solution we call eMatrix™. We are enabling some of the world's most notable companies to make a fundamental shift in the way they do business with their suppliers and partners, and to deliver powerful results for their customers and for their own company by leveraging the power of the Internet.

A source of great pride and satisfaction is our growing list of customers. Some of the most recognized names in the world have placed their faith in us. This year, we have added such stellar companies as GE, JDS Uniphase and Tyco Electronics. Our customer base is broad and impressive, and most of our success can be attributed

Mark F. O'Connell *President & CEO*

to the strong customer partnerships we have developed over the years. Our customers have helped us develop our leading-edge technology and expand our product offerings based on meeting their pressing business objectives. Together we have a shared vision of how collaboration can transform the way a company works.

We continue to see business alliances and partnering as strategically viable ways to expand our presence across the world and across industries. In what we call "The Partner Economy," we see mutual value and great benefit for our customers in our teaming with companies whose products, services, or technology are complementary to our own. As with our customer list, some of the most notable companies in the business world choose to partner with MatrixOne—Ariba, Cap Gemini Ernst & Young, Fujitsu, Hewlett-Packard, KPMG Consulting and Sun to name a few.

The results for fiscal year 2000 reflect the growing acceptance and appreciation of MatrixOne technology, products, and services. We raised over $142.2 million in net proceeds from our very successful IPO and concurrent private placement, and we ended the year with $153.5 million in cash and equivalents. Total revenues for the year were $74.7 million, growing 81% over the previous year's $41.3 million. During the year, we aggressively increased our sales and engineering staffs, as we continued to emphasize expanding our customer base and accelerating research and development. We closed the year with 366 employees.

Our success this year has been possible because of the collaborative efforts and contributions from many people, and I thank each of them for their inspiration and commitment to our shared vision. On the financial side, we owe thanks to our early investors and venture capital firms who were willing to believe in our vision and the management team. We are indebted to our bankers, lawyers and accountants for their support prior to and during the IPO process. Within MatrixOne, every employee deserves our thanks for their endless commitment to our customers' success, their passion for excellence, and their creativity and innovation, all of which have become key attributes of the MatrixOne company culture.

As we turn our attention to the challenges and opportunities ahead, we feel very confident of our ability to meet and to profit from them. We believe we have the people, the partners, the customers, the expertise, and the financial backing to capitalize on our momentum, and we look forward to an exciting year ahead.

Mark F. O'Connell President & CEO

"We are enabling some of the world's most notable companies to make a fundamental shift in the way they do business with their suppliers and partners, and to deliver powerful results for their customers and for their own company by leveraging the power of the Internet."

Enabling our customers' success...

Technological Leadership

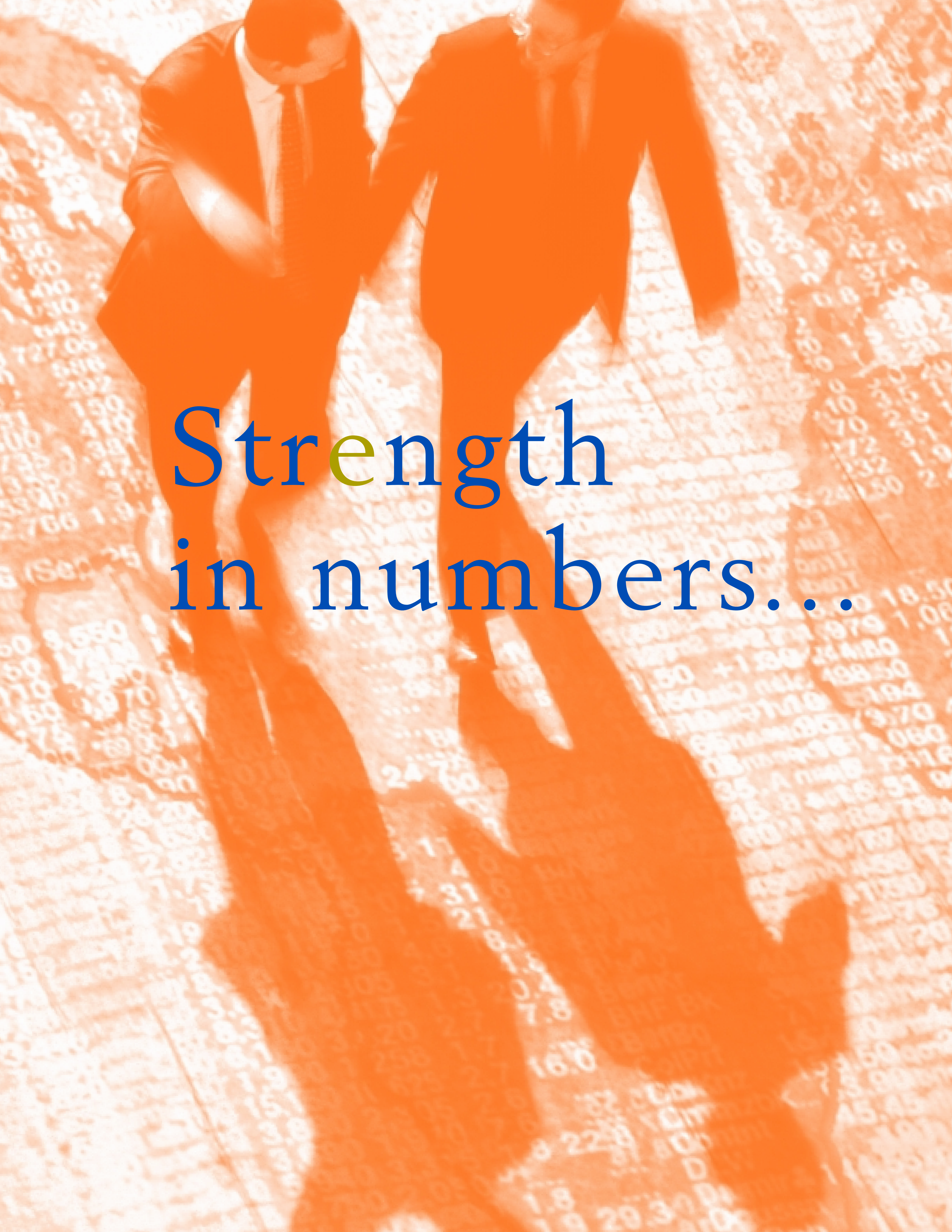
MatrixOne's award-winning, advanced technology enables our customers to improve their business results by exploiting the power of collaborating over the Internet. They do this through Intelligent Collaborative Commerce™, an IT infrastructure of business-process applications and technology that lets companies adapt almost instantly to changing business requirements, proactively deliver information, and conduct secure business collaboration over the Internet both within the company and among the company and its partners, suppliers, and customers.

With the MatrixOne Intelligent Collaborative Commerce solution, the Internet becomes a secure global extension for the critical business-process services—such as dynamic modeling, workflow, lifecycle, vaulting and security—that are the foundation for effective multi-party business collaboration. Our eMatrix 9 solution is the core framework that enables Intelligent Collaborative Commerce.

The eMatrix 9 framework is powerful technology built on and incorporating an extensive range of advanced architectures and protocols. It provides Internet-extended businesses with multiple levels of security based on standard protocols in a firewall-friendly form. Companies can deploy our eMatrix 9 Intelligent Collaborative Commerce solution in a variety of popular web-server architectures without changing their business logic. They can base their solution on any mix of distributed software architectures, including Enterprise Java Beans (EJB), Remote Method Invocation (RMI) and Common Object Request Broker Architecture (CORBA).

Our eMatrix 9 solution also offers B2B-enabling XML technology that allows companies to exchange messages and content with collaborating partners or industry exchanges. The messages can comply with the evolving standard vocabularies (such as RosettaNet, cXml, or BizTalk) or be independently defined between partners. Remote participants and applications can communicate through HTTP and HTTPS, and mobile users can be connected through WAP (wireless application protocol). In addition to our core framework, we also continue to expand our portfolio of innovative applications, such as Supplier Central, our most recent suite of applications.

MatrixOne combines these technologies seamlessly into one product. We are committed to maintaining our position of technological leadership in an open architecture environment that protects our customers' existing investments and helps facilitate higher levels of Internet collaboration.



Strength in numbers…

The Partner Economy

Just as no man is an island, no company alone can meet the wide-ranging needs of commerce and industry. Collaborative, strategic alliances accelerate the success of both MatrixOne and our partners. Together we can offer far greater benefits to our customers so that all of us—customers, partners, and MatrixOne—win. Here is a sampling of the partnerships and strategic alliances that are extending MatrixOne's reach around the world.

Ariba, Inc. is the leading business-to-business eCommerce platform provider. The company enables efficient online trade, integration and collaboration between B2B marketplaces, buyers, suppliers and commerce service providers. Together, MatrixOne and Ariba offer a many-to-many collaboration environment to companies using Ariba's eCommerce platform in B2B marketplaces and exchanges.

Cap Gemini Ernst & Young is one of the largest management and IT consulting firms in the world. They have extensive experience with MatrixOne in Europe and North America in a variety of industries, including manufacturing, process and consumer products. Cap Gemini Ernst & Young sees business collaboration as a very important and fast-growing area of benefit to their clients. MatrixOne technology is a key part of the infrastructure that delivers these benefits.

MatrixOne delivers e-Business solutions with Fujitsu for the automotive industry in Asia Pacific that help companies find their competitive advantage, and improve and strengthen relationships with their customers, clients, business partners and staff. Through consultation, technical design, and systems integration MatrixOne develops robust business models that engage all aspects of a 21st Century business.

Together with MatrixOne and KPMG Consulting, Hewlett-Packard offers a pre-configured, Internet business collaboration solution for manufacturers and their suppliers called Design2Profit. It is a rapid-deployment solution that creates a virtually integrated network that enhances collaboration among design team members, and enables companies to develop products faster and at lower cost.

KPMG Consulting, LLC is one of the world's leading providers of enterprise integration services. Over the past two years, MatrixOne and KPMG Consulting have delivered a number of successful worldwide engagements. The combined strengths of the companies help customers to quickly streamline business processes, anticipate and expedite response to customer requirements, guide design chain partners, and improve strategic product decisions.


The
collaborative
backbone...

Customer Successes

Around the world and in numerous industries, leading companies are making MatrixOne technology an indispensable part of their infrastructure. Fast implementation and ongoing flexibility on top of very powerful collaboration capabilities made MatrixOne the intelligent choice for companies such as these you see here.

Celestica, a world leader in electronics manufacturing services, works with our eMatrix solution to support collaboration among its manufacturing communities across 33 global locations and at customer sites worldwide. Celestica has experienced significant growth both organically and through acquisition. Our eMatrix solution supports this growth strategy by assisting in the rapid integration of acquisitions, a capability that is critical to Celestica's business.

FCI is the world's second-largest connector company. With some of its growth coming through acquisition, the company needs to align best practices and to optimize product development across its diverse culture. Our eMatrix solution provides the technology part of the answer by enabling close design and manufacturing collaboration among FCI's far-flung businesses. The FCI eMatrix solution also allows the company to capture and share data coming from its diverse legacy systems. The resulting standardized business processes have already helped FCI to shorten its development cycle and speed its time to market, crucial elements in its ongoing global success.

ON Semiconductor designs and manufactures analog power management and broadband integrated circuits. Using our eMatrix solution ON Semiconductor is creating an Internet-centric e-business environment for its customers, employees and suppliers to enable easy sharing of information and accelerate internal product development and engineering processes. Our eMatrix solution also enables ON Semiconductor to extend its processes to include early collaboration with customers and suppliers. The result? Radically improved business processes, customer responsiveness, and dissemination of product information through the digital information supply chain.

Posten AB, the Swedish Postal service, has implemented an eMatrix-powered system that will allow it to profitably offer customized services over the Internet to every one of the half-million companies it serves. Within the system, each postal service is a complete, self-contained component. By simply selecting components, Posten AB can rapidly create, configure and deliver tailored service solutions, which also can include third-party services offered by cooperating companies. Currently being built by Technica AB, the system also will support the development, sale, and administration of services. Comprehensive and flexible, it equips Posten AB to meet the demands of Sweden's B2B and B2C marketplaces.

Question

From their independent perspectives, what do the industry analyst, the partner, and the customer communities have to say about MatrixOne?

A. *"eMatrix 9 marks a milestone for MatrixOne, establishing it as a leading strategic platform for extended enterprises. It is the most open and interoperable enterprise application that D.H. Brown has ever evaluated."*

Wayne Collier, President, Engineering, Manufacturing and Design D.H. Brown Associates, Inc.

A. *"eMatrix 9 represents the future of enterprise applications. The eMatrix architectural foundation provides an environment well-suited for creating new c-commerce applications that can leverage a company's existing IT investments, gracefully adopt new technologies that offer additional business advantages, and—most importantly—adapt rapidly to changing business requirements."*

Jack E. Maynard, Research Director, Enterprise Business Applications, Aberdeen Group

Larry Mueller,
President and COO,
Ariba

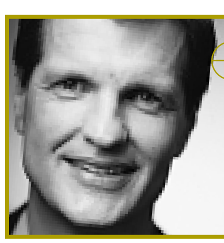
A. *"We believe collaboration will be an increasingly valuable service offered by B2B marketplaces. The highly configurable eMatrix solution is well-suited to meet the collaboration needs of Ariba marketplace customers and marketplace participants across a broad range of industries, from financial services to consumer goods to manufacturing. The robust eMatrix security and data privacy architecture also ensures that each participant's intellectual property is closely guarded—a key requirement for marketplace collaboration."*

Answers

David M. Cefai, Director,
Corporate Information Technology,
I.T. Solutions Deployment

A. *"Celestica works with leading OEMs in industries such as information technology and telecommunications. Because our customers represent some of the fastest-growing companies in the world, we have to respond quickly and effectively to new requirements and opportunities. We do this by using collaborative software like eMatrix that helps us to link our global manufacturing resources, and rapidly integrate new acquisitions."*

A. *"The eMatrix software provides customers with a platform and a set of applications that help them collaborate through the use of the Internet—be it within their own departments and divisions or among their customers, suppliers, and other business partners. Our combined strengths make MatrixOne and KPMG Consulting a very powerful resource."*



Thomas Wilde,
Executive Vice President of
KPMG Consulting

Expanding the Footprint: Global Growth

An important part of enabling worldwide, secure collaboration within and among companies, partners, suppliers, and customers is being able to support multinational enterprises. MatrixOne is continuing to build the worldwide presence that allows us to do just that. We are growing in three global dimensions: geographically, horizontally across industries, and vertically within specific industries.

The Company now has customers in over 40 countries, with approximately half of our business coming from outside North America. We've established direct subsidiaries in Austria, Canada, France, Germany, Italy, Japan, The Netherlands, and the United Kingdom. We continue to add to our growing technology, service, distribution and consulting partner network around the globe.

We serve a varied and expanding range of industries. Currently, these include aerospace/defense, automotive, communications, consumer products, high technology, machinery and medical products and equipment. The list is growing because MatrixOne technology solves problems that are common across most industries. We continue to aggressively expand our consulting capabilities with additions to our professional services organization and our network of systems integrators and consulting partners.

Well over 400 large and medium-size enterprises use MatrixOne Internet technology to compete more effectively using our Intelligent Collaborative Commerce solution. Importantly, many of these companies are the leaders of their industries. Industry leaders like them are proving the value of MatrixOne every day, a lesson not likely to be lost on the rest of their industries and beyond.

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 July 1, 2000, July 3, 1999 and June 27, 1998 and the consolidated balance sheet data as of July 1, 2000 and July 3, 1999 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 28, 1997 and June 29, 1996 and the consolidated balance sheet data as of June 27, 1998, June 28, 1997 and June 29, 1996 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 Internet suite of products. The financial results of this divested business are reflected in our consolidated financial statements as discontinued operations.

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998	June 28, 1997	June 29, 1996
		(in thousands, except per share data)			
Consolidated Statements of Operations Data:					
Revenues:					
Software license	$ 40,977	$21,851	$ 11,836	$ 8,450	$ 4,420
Service	33,734	19,495	9,343	3,825	1,710
Total revenues	74,711	41,346	21,179	12,275	6,130
Cost of revenues:					
Software license	4,424	3,323	1,237	725	359
Service	26,383	14,467	6,591	3,081	2,163
Total cost of revenues	30,807	17,790	7,828	3,806	2,522
Gross profit	43,904	23,556	13,351	8,469	3,608
Operating expenses:					
Selling and marketing	35,765	20,611	15,369	6,883	4,944
Research and development	8,553	5,792	7,242	4,267	4,953
General and administrative	5,487	4,479	3,592	1,723	346
Stock-based compensation	3,593	622	—	—	—
Total operating expenses	53,398	31,504	26,203	12,873	10,243
Loss from operations	(9,494)	(7,948)	(12,852)	(4,404)	(6,635)
Other income (expense), net	3,041	244	48	(140)	—
Benefit from income taxes	—	—	1,928	875	—
Net loss from continuing operations	(6,453)	(7,704)	(10,876)	(3,669)	(6,635)
Net income (loss) from discontinued operations	—	—	8,684	1,777	(319)
Net loss	$ (6,453)	$ (7,704)	$ (2,192)	$ (1,892)	$ (6,954)
Basic and diluted net income (loss) per share:					
Continuing operations	$ (0.36)	$ (1.74)	$ (2.88)	$ (0.98)	$ (1.84)
Discontinued operations	—	—	2.30	0.47	(0.09)
Net loss	$ (0.36)	$ (1.74)	$ (0.58)	$ (0.51)	$ (1.93)
Shares used in computation	17,966	4,428	3,777	3,729	3,606
Pro forma basic and diluted net income (loss) per share:					
Continuing operations	$ (0.18)	$ (0.28)	$ (0.43)	$ (0.19)	$ (0.35)
Discontinued operations	—	—	0.34	0.09	(0.02)
Net loss	$ (0.18)	$ (0.28)	$ (0.09)	$ (0.10)	$ (0.37)
Shares used in computation[1]	35,686	27,970	25,050	18,998	18,874

As of	July 1, 2000	July 3, 1999	June 27, 1998	June 28, 1997	June 29, 1996
			(in thousands)		
Consolidated Balance Sheet Data:					
Cash and equivalents	$153,455	$11,036	$ 8,123	$ 897	$ 1,089
Working capital (deficit)	146,012	7,892	8,826	(848)	210
Total assets of continuing operations	184,417	29,887	22,912	8,478	6,329
Long-term debt, net of current portion	—	—	—	248	302
Redeemable convertible preferred stock	—	17,015	11,015	—	—
Total stockholders' equity (deficit)	151,593	(6,042)	843	3,072	4,998

[1]The shares used in computing pro forma basic and diluted net income (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 this Annual Report.

Overview

We are a provider of Internet business collaboration software, which with the release of eMatrix 9, the latest version of our core software, we now refer to as "Intelligent Collaborative Commerce™ Solutions." Our eMatrix suite of products serves as an Internet platform facilitating collaboration among different departments and geographic locations of global organizations. Our eMatrix software products also serve as a backbone for an enterprise to collaborate through the Internet with its customers, suppliers and other business partners. Enterprises use our eMatrix product line to integrate different business processes and facilitate the exchange of information, ideas and knowledge among parties collaborating on business activities, such as conceptual planning for new products, product design, design for manufacturability, plant resource utilization, new product introduction and customer service and support. This collaboration allows our customers to quickly and cost-effectively bring the right products and services to market.

We generate revenues from licensing our eMatrix software products and providing professional services, training and maintenance and customer support services through our offices in the United States, Austria, Canada, England, France, Germany, Italy, Japan 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 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. No single customer has accounted for more than 10% of our annual revenues in any of the last three fiscal years.

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 a result, we have incurred net losses from continuing operations in each of the past three years. As of July 1, 2000, we had an accumulated deficit of approximately $38.8 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 Internet business collaboration suite of products. The financial results of this divested business are reflected in our consolidated financial statements as discontinued operations.

This Annual Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of the following factors and those set forth elsewhere in this Annual Report: the significant change in our business; the market acceptance of our products; the newly emerging market and demand for business collaboration software; our history of losses and ability to achieve and maintain profitability; our ability to obtain additional capital; quarterly revenue and operating result fluctuations; our lengthy and variable sales cycle; the delay or non-placement of expected large software or service orders in any quarter; our ability to compete successfully in the future; our ability to develop new products and services that keep pace with technology; our ability to generate additional revenue from existing customers; our ability to develop and maintain successful relationships with systems integrators and complementary technology vendors; our international operations; our dependence on licensed third-party technology; the unavailability or failure to perform of systems integrators;

our ability to expand our sales and distribution channels; our performance of consulting projects on a fixed-price basis; our ability to manage our growth; our dependence on key personnel; future acquisitions; possible product defects; our failure to protect our intellectual property and the costs of defending our intellectual property; Year 2000 issues; the volatility of our stock; the control of our directors and officers; and certain anti-takeover provisions applicable to us. Further information on factors that could cause actual results to differ from those anticipated is detailed in various publicly available documents filed by us from time to time with the Securities and Exchange Commission, including but not limited to, those appearing under the caption "Cautionary Statements" in our Annual Report on Form 10-K filed in September 2000. Any forward-looking statements should be considered in light of those factors.

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	July 1, 2000	July 3, 1999	June 27, 1998
Revenues:			
Software license	54.8%	52.8%	55.9%
Service	45.2	47.2	44.1
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Software license	5.9	8.0	5.8
Service	35.3	35.0	31.1
Total cost of revenues	41.2	43.0	36.9
Gross profit	58.8	57.0	63.1
Operating expenses:			
Selling and marketing	47.9	49.9	72.6
Research and development	11.4	14.0	34.2
General and administrative	7.3	10.8	17.0
Stock-based compensation	4.8	1.5	—
Total operating expenses	71.4	76.2	123.8
Loss from operations	(12.6)	(19.2)	(60.7)
Other income, net	4.0	0.6	0.2
Benefit from income taxes	—	—	9.1
Net loss from continuing operations	(8.6)	(18.6)	(51.4)
Net income from discontinued operations	—	—	41.1
Net loss	(8.6)%	(18.6)%	(10.3)%

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

Software license revenues. We derive our software license revenues principally from the licensing of our eMatrix suite of products, including software applications and integration products developed jointly with third parties, and, to a lesser extent, from providing Oracle database licenses. We recognize revenues from software licensing upon shipment or distribution over the Internet to a customer.

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. We provide services to our customers and systems integrators consisting of professional services, training and maintenance and customer support. Our professional services, which include implementation and consulting services, are provided on a time and materials or 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. Revenues from maintenance and support services contracts are expected to increase in absolute dollars and as a percentage of service revenues due to the expansion of our customer base and increases in software licenses.

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 consists of royalties paid to Oracle for Oracle database licenses and to other third parties for integration products and applications licensed to our customers. Cost of software licenses also includes the cost of manuals and product documentation, production media used to deliver our products, shipping costs and related labor. 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 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 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.

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 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 on revenues.

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 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 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 consist primarily of compensation of executive, finance, human resource and administrative personnel, legal and accounting services and an allocation of related facility expenses.

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 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 $3.6 million and $0.6 million for fiscal 2000 and 1999, respectively. We expect to record stock-based compensation of $4.2 million, $4.2 million, $3.6 million and $0.7 million in fiscal 2001, 2002, 2003 and 2004, respectively, relating to certain stock option grants during fiscal 2000 and 1999.

Other income (expense), net. Other income (expense), net fluctuates based on the amount of cash available for investment, borrowings under our line of credit, interest expense related to our term loan and realized and unrealized gains and losses on foreign currency transactions. Other income, net increased $2.8 million to $3.0 million for fiscal 2000 from $0.2 million for fiscal 1999. The increase was 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.

Income taxes. No provision for income taxes has been recorded for either fiscal 2000 or 1999 due to accumulated net losses. We did not record any tax benefits relating to these losses or other tax benefits due to the uncertainty surrounding the timing of the realization of these future tax benefits, which were $14.5 million in the aggregate at July 1, 2000.

Comparison of Fiscal Years Ended July 3, 1999, and June 27, 1998

Software license revenues. Software license revenues increased 84.6% to $21.9 million for fiscal 1999 from $11.8 million for fiscal 1998. Software license revenues in North America increased 79.6% to $16.3 million for fiscal 1999 from $9.1 million in 1998. The increase in North American software license revenues is primarily due to software licensed to several new customers and additional software licensed to existing customers, as a result of increased market acceptance of our products. International software license revenues increased 101.1% to $5.6 million for fiscal 1999 from $2.8 million in fiscal 1998. The increase in international software license revenues is due to 134.1% growth in software licensed by our German subsidiary and software licensed by our newly formed subsidiaries in the United Kingdom and The Netherlands.

Service revenues. Service revenues increased 108.7% to $19.5 million in fiscal 1999 from $9.3 million in fiscal 1998. The increase was primarily due to an 85.9% increase in professional services revenues in fiscal 1999 relating to consulting services and a 170.0% increase in maintenance revenues in fiscal 1999 for new and renewed maintenance contracts. Maintenance revenues represented 22.3% and 17.3% of service revenues in fiscal 1999 and 1998, respectively.

Cost of software licenses. Cost of software licenses increased 168.6% to $3.3 million in fiscal 1999 from $1.2 million in fiscal 1998. The increase in cost of software licenses in fiscal 1999 was primarily due to a 277.8% increase in aggregate royalties from increased licensing of third-party software. We began licensing a significant amount of Oracle and third-party integration software during fiscal 1999.

Cost of services. Cost of services increased 119.5% to $14.5 million in fiscal 1999 from $6.6 million in fiscal 1998. The increase in cost of services was primarily due to increased personnel costs to support the growth in our services organization. We also increased both the use of systems integrators to provide consulting services for our customers and the amount of training we provide these systems integrators in an effort to increase the number of systems integrators with relevant eMatrix expertise.

Gross profit. Gross profit increased 76.4% to $23.6 million in fiscal 1999 from $13.4 million in fiscal 1998. Gross margin was 57.0% and 63.1% in fiscal 1999 and 1998, respectively. The decrease in gross margin was primarily attributable to lower margin service revenues growing faster than software license revenues. Gross margin on software licenses was 84.8% and 89.5% in fiscal 1999 and 1998, respectively. The decrease in gross margin on software licenses was due to an increase in the relative proportion of software licensed from third parties. Gross margin on services decreased to 25.8% in fiscal 1999 from 29.5% in fiscal 1998 due to our increased use of systems integrators to provide consulting services to our customers.

Selling and marketing. Selling and marketing expenses increased 34.1% to $20.6 million in fiscal 1999 from $15.4 million in fiscal 1998. The increase in selling and marketing expenses was primarily due to increased personnel costs relating to the growth in our worldwide sales organization and higher commission expense related to the growth in our revenues. Selling and marketing expenses as a percentage of total revenues decreased to 49.9% in fiscal 1999 from 72.6% in fiscal 1998 due primarily to a larger revenues base.

Research and development. Research and development expenses decreased 20.0% to $5.8 million in fiscal 1999 from $7.2 million in fiscal 1998. Research and development expenses as a percentage of total revenues decreased to 14.0% in fiscal 1999 from 34.2% in fiscal 1998. The decrease was primarily due to our replacement of outside domestic contractors with our internal engineering organization, the increased use of partners to more efficiently develop applications and integration products and the replacement of some third-party contractors with a contract research and development group in India in fiscal 1999.

General and administrative. General and administrative expenses increased 24.7% to $4.5 million in fiscal 1999 from $3.6 million in fiscal 1998. The increase in general and administrative expenses was primarily due to increases in personnel costs to support the growth in our business and additional provisions for accounts receivable. General and administrative expenses as a percentage of total revenues decreased to 10.8% in fiscal 1999 from 17.0% in fiscal 1998 due primarily to a larger revenues base.

Stock-based compensation. Stock-based compensation was $0.6 million for fiscal 1999.

Other income (expense), net. Other income, net increased to $0.2 million in fiscal 1999 from $48,000 in fiscal 1998 due to higher cash balances available for investment and related interest income.

Discontinued operations. During fiscal 1998, we decided to focus our business on our eMatrix suite of software products and services. On May 7, 1998, we sold substantially all of the net assets of our legacy design and manufacturing software business, Adra Systems, to SofTech, Inc. The purchase price consisted of $7.0 million of cash, a $4.4 million promissory note that was paid in full in July 1998, and contingent payments of up to $2.2 million based on SofTech's revenues after the acquisition. SofTech has notified us that no contingent payments were due. We recorded a $6.7 million gain on the sale of the net assets of Adra Systems, comprised of the cash and promissory note proceeds of $11.4 million less estimated transaction costs of $2.3 million, income taxes of $1.5 million and net assets sold of $0.9 million. The transaction costs consisted principally of investment banking, legal and accounting fees and bonus and severance arrangements with some employees. During fiscal 1999, revenues from Adra Systems were approximately $12.4 million for the period through May 7, 1998. At July 1, 2000 and July 3, 1999, accrued transaction costs relating to the sale of the net assets of Adra Systems, included in accrued expenses, were $0.6 million and $1.0 million, respectively.

Income taxes. No provision for income taxes was recorded in fiscal 1999 or 1998 due to accumulated net losses. We did not record any tax benefits relating to these losses or other tax benefits due to the uncertainty surrounding the timing of the realization of these future tax benefits, which were $9.9 million in the aggregate at July 3, 1999.

Liquidity and Capital Resources

We have primarily financed our operations through the sale of convertible preferred stock and common stock, borrowings under our lines of credit, cash generated from our legacy design and manufacturing business, Adra Systems, and the cash proceeds from the sale of Adra Systems in fiscal 1998.

As of July 1, 2000, we had cash and equivalents of $153.5 million, an increase of $142.4 million from July 3, 1999. On March 6, 2000, we completed our initial public offering of 5,750,000 shares of common stock at a purchase price of $25.00 per share and a concurrent private placement of 450,000 shares of common stock at a purchase price of $23.25 per share. The net proceeds from these sales of our common stock were approximately $142.2 million. Our working capital was $146.0 million and $7.9 million as of July 1, 2000 and July 3, 1999, respectively. The increase in working capital was primarily attributable to the net proceeds received from our initial public offering and concurrent private placement.

We have a $7.0 million line of credit that bears interest at the bank's prime rate plus 0.5% and expires December 28, 2000. 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, 2000. 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 July 1, 2000, we had no borrowings outstanding under these lines of credit and $6.0 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 July 1, 2000.

Our German subsidiary also has a working capital line of credit of 0.5 million DM ($0.2 million), which was available for borrowing at July 1, 2000. Borrowings under this line of credit are limited to 100% of accounts receivable of the German subsidiary and bear interest at 10.25%.

Net cash provided by continuing operations for fiscal 2000 was $6.8 million 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 continuing operations was $8.3 million in fiscal 1999 due to the net loss incurred from the expansion of our operations and the increase in our accounts receivable.

Net cash used in discontinued operations was $0.3 million and $1.1 million for fiscal 2000 and 1999, respectively, and reflects payments of the severance and legal and accounting fees incurred in connection with the sale of our legacy design and manufacturing business.

Net cash used in investing activities was $3.7 million for fiscal 2000 and reflects our investments in computer hardware, computer software and other technology, leasehold improvements and office equipment. Net cash provided by investing activities was $3.1 million in fiscal 1999 and included a $4.4 million payment of a promissory note from the sale of assets of Adra Systems, offset in part by capital expenditures. We expect that capital expenditures for the next 12 months will be approximately $4.5 million, primarily for the acquisition of computer hardware, computer software and other technology, leasehold improvements and office equipment.

Net cash provided by financing activities was $140.0 million for fiscal 2000 and reflects the net proceeds received from our initial public offering and concurrent private placement of approximately $142.2 million and the repayments of our lines of credit. Net cash provided by financing activities was $9.2 million in fiscal 1999 and consisted of the sale of $6.0 million of redeemable convertible preferred stock and $3.1 million of net borrowings from 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 eMatrix 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 July 1, 2000, we had net operating loss carryforwards in the U.S. of $20.3 million and research and development tax credit carryforwards in the U.S. of $0.7 million. These net operating loss and tax credit carryforwards will begin to expire at various dates beginning in fiscal 2001, 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 July 1, 2000, we also had net operating loss carryforwards in various countries in which our subsidiaries operate aggregating $11.7 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.

Year 2000 Readiness Disclosure Statement

We executed a plan designed to make our products, information technology systems and equipment Year 2000 compliant. To date, we have experienced no significant problems in our products, business interruptions or material adverse effects from the Year 2000 issue. However, we could still experience material unanticipated problems and costs caused by undetected errors or defects from the Year 2000 issue. We cannot guarantee that our Year 2000 readiness plan has been successfully implemented, and our actual results could still differ materially from our plan.

Conversion to the Euro

We have arranged for the necessary modifications of 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 are also assessing the business implications of the conversion to the Euro, including long-term competitive implications and the effect of market risk with respect to financial instruments. 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. We will continue to assess the impact of Euro conversion issues as the applicable accounting, tax, legal and regulatory guidance evolves.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133, as amended by SFAS No. 137 and No. 138, will be effective for our financial reporting beginning in the first quarter of fiscal 2001. SFAS No. 133 will require us to recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The accounting for gains and losses from changes in the fair value of a particular derivative will depend on the intended use of the derivative. We do not expect the adoption of SFAS No. 133 to have a material impact on our results of operations or financial position.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 provides guidance on the recognition, disclosure and presentation of revenue in financial statements. We will adopt the provisions of SAB 101 for all transactions during fiscal 2002. We are currently evaluating the impact of SAB 101 on our financial statements and related disclosures, but we do not expect that any impact will be material.

In March 2000, the FASB issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation—An Interpretation of APB Opinion No. 25" ("FIN 44"). FIN 44 clarifies the definition of employees for purposes of applying APB Opinion No. 25, the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequences of various modifications to the terms of a previously fixed stock option or award, and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 1, 2000, but certain conclusions in this Interpretation cover specific events that occurred after either December 15, 1998 or January 12, 2000. We do not expect that the adoption of FIN 44 will have a material effect on our results of operations or financial position.

Qualitative and Quantitative Disclosures About Market Risk

We have international offices in Austria, Canada, England, France, Germany, Italy, Japan and The Netherlands. At July 1, 2000 and July 3, 1999, approximately 14.4% and 27.4%, respectively, of our total assets were located at our international subsidiaries and approximately 39.2%, 26.1% and 26.1% of our revenues and 25.8%, 21.5% and 17.2% of our expenses for fiscal 2000, 1999 and 1998, respectively, were from our operations outside North America. These subsidiaries transact business in local currency or the Euro, but transact business with the U.S. parent in U.S. dollars. 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, primarily European and Asian, 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 or to make an equivalent U.S. dollar payment equal to the value of such exchange. 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 spot exchange rate, 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 July 1, 2000, we had two forward contracts denominated in Japanese yen. The outstanding forward contracts as of July 1, 2000 are presented in the table below. The table presents the notional amounts, at contract exchange rates, and the contractual foreign currency exchange rates. Notional exchange rates are quoted using market conventions where the currency is expressed in currency units per U.S. dollar.

Table of Forward Contracts:

Functional Currency	Maturity Date	Notional Amount	Notional Exchange Rate
Japanese Yen	07/31/00	$911,985	103.66
Japanese Yen	08/31/00	$177,283	103.21

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.

Our interest income is sensitive to changes in the general level of U.S. interest rates, and to a lesser extent, interest rates in Europe and Japan, particularly since the majority of our investments are in short-term instruments. We deposit our cash in highly rated financial institutions in North America, Europe and Japan and invest in diversified money market investments, U.S. Treasury and Agency Securities, and Commercial Paper of U.S. Corporations with remaining maturities of less than 90 days. Due to the short-term nature of our investments, we believe that we have minimal market risk.

Consolidated Balance Sheets

(In thousands, except per share amounts)

	July 1, 2000	July 3, 1999
Assets		
Current assets:		
Cash and equivalents	$153,455	$ 11,036
Accounts receivable, less allowance for doubtful accounts of $927 and $772	21,388	14,670
Prepaid expenses and other current assets	3,993	1,100
Total current assets	178,836	26,806
Property and Equipment, net	4,615	2,973
Other Assets	966	108
	$184,417	$ 29,887
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Line of credit	$ —	$ 3,050
Accounts payable	5,921	3,968
Accrued expenses	16,026	7,270
Deferred revenue	10,877	4,626
Total current liabilities	32,824	18,914
Redeemable convertible preferred stock	—	17,015
Commitments and contingencies (Note 6)		
Stockholders' equity (deficit):		
Convertible preferred stock, $.01 and $1.00 par value, 5,000 and 3,552 shares authorized, 0 and 3,547 shares issued, 0 and 3,393 shares outstanding	—	3,393
Common stock, $.01 par value; 100,000 shares authorized; 41,978 and 5,004 shares issued and outstanding	420	50
Additional paid-in capital	205,344	26,637
Notes receivable from stockholders	(738)	(117)
Deferred stock-based consideration	(14,088)	(3,458)
Accumulated deficit	(38,826)	(32,373)
Accumulated other comprehensive loss	(519)	(174)
Total stockholders' equity (deficit)	151,593	(6,042)
	$184,417	$ 29,887

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

Consolidated Statements of Operations

(In thousands, except per share amounts)

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998
Revenues:			
Software license	$40,977	$21,851	$ 11,836
Service	33,734	19,495	9,343
Total revenues	74,711	41,346	21,179
Cost of revenues:			
Software license	4,424	3,323	1,237
Service(1)	26,383	14,467	6,591
Total cost of revenues	30,807	17,790	7,828
Gross profit	43,904	23,556	13,351
Operating expenses:			
Selling and marketing(1)	35,765	20,611	15,369
Research and development(1)	8,553	5,792	7,242
General and administrative(1)	5,487	4,479	3,592
Stock-based compensation(1)	3,593	622	—
Total operating expenses	53,398	31,504	26,203
Loss from operations	(9,494)	(7,948)	(12,852)
Other income (expense):			
Interest income	3,180	346	178
Interest expense	(46)	(109)	(109)
Other income (expense), net	(93)	7	(21)
Total other income (expense)	3,041	244	48
Loss from continuing operations before income taxes	(6,453)	(7,704)	(12,804)
Benefit from income taxes	—	—	1,928
Net loss from continuing operations	(6,453)	(7,704)	(10,876)
Discontinued operations (Note 3):			
Income from discontinued operations (net of income taxes of $439 in 1998)	—	—	1,973
Gain on sale of discontinued operations (net of income taxes of $1,489 in 1998)	—	—	6,711
Net income from discontinued operations	—	—	8,684
Net loss	$ (6,453)	$ (7,704)	$ (2,192)
Basic and diluted net income (loss) per share:			
Continuing operations	$ (0.36)	$ (1.74)	$ (2.88)
Discontinued operations	—	—	2.30
Net loss	$ (0.36)	$ (1.74)	$ (0.58)
Shares used in computing basic and diluted net income (loss) per share	17,966	4,428	3,777
Pro forma basic and diluted net loss per share:			
Continuing operations	$ (0.18)	$ (0.28)	$ (0.43)
Discontinued operations	—	—	0.34
Net loss	$ (0.18)	$ (0.28)	$ (0.09)
Shares used in computing pro forma basic and diluted net loss per share	35,686	27,970	25,050
(1)The following summarizes the departmental allocation of stock-based compensation:			
Cost of service revenues	$ 816	$ 221	$ —
Selling and marketing	1,154	234	—
Research and development	708	103	—
General and administrative	915	64	—
Total stock-based compensation	$ 3,593	$ 622	$ —

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

MatrixOne, Inc.

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

(In thousands)

	Redeemable Convertible Preferred Stock		Convertible Preferred Stock		Common Stock			Treasury Stock							
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Additional Paid-in Capital	Number of Shares	Cost	Notes Receivable from Stockholders	Deferred Stock-Based Consideration	Accumulated Deficit	Comprehensive Loss	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (Deficit)
Balance, June 28, 1997	—	$ —	3,547	$ 3,547	3,798	$ 38	$ 22,466	169	$(441)	$ —	$ —	$(22,477)		$ (61)	$ 3,072
Comprehensive loss:															
Foreign currency translation adjustments	—	—	—	—	—	—	—	—	—	—	—	—	$ 59	59	59
Net loss	—	—	—	—	—	—	—	—	—	—	—	(2,192)	(2,192)	—	(2,192)
Comprehensive loss	—	—	—	—	—	—	—	—	—	—	—	—	$(2,133)	—	—
Stock option exercises	—	—	—	—	18	—	6	—	—	—	—	—		—	6
Issuance of Series G redeemable convertible preferred stock, net of offering costs of $102	1,899	11,015	—	—	—	—	(102)	—	—	—	—	—		—	(102)
Balance, June 27, 1998	1,899	11,015	3,547	3,547	3,816	38	22,370	169	(441)	—	—	(24,669)		(2)	843
Comprehensive loss:															
Foreign currency translation adjustments	—	—	—	—	—	—	—	—	—	—	—	—	$ (172)	(172)	(172)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(7,704)	(7,704)	—	(7,704)
Comprehensive loss	—	—	—	—	—	—	—	—	—	—	—	—	$(7,876)	—	—
Retirement of treasury stock	—	—	(154)	(154)	(15)	—	(287)	(169)	441	—	—	—		—	—
Stock option exercises	—	—	—	—	861	9	360	—	—	—	—	—		—	369
Issuance of common stock in exchange for notes receivable	—	—	—	—	342	3	114	—	—	(117)	—	—		—	—
Deferred stock-based compensation	—	—	—	—	—	—	4,080	—	—	—	(4,080)	—		—	—
Stock-based compensation	—	—	—	—	—	—	—	—	—	—	622	—		—	622
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	26,637	—	—	(117)	(3,458)	(32,373)		(174)	(6,042)
Comprehensive loss:															
Foreign currency translation adjustments	—	—	—	—	—	—	—	—	—	—	—	—	$ (345)	(345)	(345)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(6,453)	(6,453)	—	(6,453)
Comprehensive loss	—	—	—	—	—	—	—	—	—	—	—	—	$(6,798)	—	—
Stock option exercises	—	—	—	—	1,767	17	841	—	—	—	—	—		—	858
Conversion of preferred stock into common stock	(2,649)	(17,015)	(3,393)	(3,393)	26,763	268	20,140	—	—	—	—	—		—	17,015
Issuance of common stock, net of offering cost of $11,987	—	—	—	—	6,200	62	142,163	—	—	—	—	—		—	142,225
Cashless exercise of warrant	—	—	—	—	168	2	(2)	—	—	—	—	—		—	—
Issuance of common stock in exchange for notes receivable	—	—	—	—	2,076	21	895	—	—	(916)	—	—		—	—
Repayment of notes receivable	—	—	—	—	—	—	—	—	—	295	—	—		—	295
Deemed fair value of warrant issued to a customer	—	—	—	—	—	—	1,788	—	—	—	(1,788)	—		—	—
Amortization of warrant to reduce revenues	—	—	—	—	—	—	—	—	—	—	447	—		—	447
Deferred stock-based compensation	—	—	—	—	—	—	13,574	—	—	—	(13,574)	—		—	—
Stock-based compensation	—	—	—	—	—	—	—	—	—	—	3,593	—		—	3,593
Reversal of stock-based compensation from stock option cancellations	—	—	—	—	—	—	(692)	—	—	—	692	—		—	—
Balance, July 1, 2000	—	$ —	—	$ —	41,978	$420	$205,344	—	$ —	$(738)	$(14,088)	$(38,826)		$(519)	$151,593

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

Consolidated Statements of Cash Flows

(In thousands)

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998
Cash flows from operating activities:			
Net loss	$ (6,453)	$ (7,704)	$ (2,192)
Net income from discontinued operations	—	—	(8,684)
Net loss from continuing operations	(6,453)	(7,704)	(10,876)
Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) continuing operations:			
Depreciation	1,454	1,257	834
Stock-based consideration	4,040	622	—
Provision for doubtful accounts	404	689	496
Deferred income tax benefit	—	—	(1,928)
Changes in assets and liabilities:			
Accounts receivable	(7,336)	(8,648)	(1,957)
Prepaid expenses and other current assets	(3,783)	62	(229)
Accounts payable	2,050	1,277	541
Accrued expenses	9,300	1,226	2,307
Deferred revenue	7,081	2,877	625
Net cash provided by (used in) continuing operations	6,757	(8,342)	(10,187)
Net cash provided by (used in) discontinued operations	(340)	(1,056)	3,611
Cash flows from investing activities:			
Purchases of property and equipment	(3,139)	(1,306)	(1,527)
Other assets	(898)	(32)	(25)
Collection of notes receivable	295	4,400	—
Net proceeds from sale of discontinued operations	—	—	6,668
Net cash provided by (used in) investing activities	(3,742)	3,062	5,116
Cash flows from financing activities:			
Repayments of debt	—	(221)	(292)
Proceeds from lines of credit	2,263	4,000	1,250
Repayments of lines of credit	(5,313)	(950)	(3,250)
Proceeds from issuance of common stock, net	142,225	—	—
Proceeds from issuance of redeemable convertible preferred stock, net	—	6,000	10,913
Proceeds from stock option exercises	858	369	6
Net cash provided by financing activities	140,033	9,198	8,627
Effect of exchange rates on cash and equivalents	(289)	51	59
Net increase in cash and equivalents	142,419	2,913	7,226
Cash and equivalents, beginning of year	11,036	8,123	897
Cash and equivalents, end of year	$153,455	$11,036	$ 8,123
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 46	$ 109	$ 109
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 Internet business collaboration software designed to enable interactive collaboration over the Internet among geographically dispersed departments and divisions within an enterprise and with an enterprise's customers, suppliers and other business partners. The Company licenses its software both directly to end users and through a network of domestic and international systems integrators and distributors. The Company has its headquarters in the United States ("U.S."), with offices in Austria, Canada, England, France, Germany, Italy, Japan and The Netherlands and throughout the U.S.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the 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. 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. Foreign currency gains and losses arising from transactions are reflected in the loss from operations and were not significant in fiscal years 1999 or 1998. During fiscal 2000, realized and unrealized foreign currency transaction losses aggregated $93 and were included in other income (expense), net.

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 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 or to make an equivalent U.S. dollar payment equal to the value of such exchange. 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, discounts or premiums (the difference between the spot exchange rate and the forward exchange rate at inception of the contract) are accreted or amortized to other income (expense) over the life of the contract using the straight-line method, while unrealized gains and losses on open contracts at the end of each accounting period, resulting from changes in the spot exchange rate, 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 July 1, 2000, the Company had two forward contracts denominated in Japanese yen, which mature at various dates through August 2000 and aggregated $1,089. Unrealized losses from these contracts offset the related unrealized gains from the hedged accounts receivable. The deferred gains resulting from these contracts were not material.

Comprehensive Loss. Comprehensive loss includes net 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 in accordance with Statement of Position 98-9, "Software Revenue Recognition, with Respect to Certain Arrangements."

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. 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 original maturities of 90 days or less to be cash equivalents. The Company's cash equivalents are primarily comprised of money market mutual funds, which are reported at cost, and U.S. Treasury and Agency Securities and Commercial Paper of U.S. Corporations, 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, notes receivable and debt instruments. 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 investments. The Company only invests in A1/P1 rated Commercial Paper 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.

No one customer accounted for more than 10% of the Company's total revenues during fiscal years 2000, 1999 or 1998, and no one customer represented greater than 10% of the Company's accounts receivable at July 1, 2000 or July 3, 1999.

Property and Equipment. Property and equipment are recorded at cost. Internal and external costs incurred to develop 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, four 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.

Stock-Based Compensation. The Company records stock-based compensation issued to employees using the intrinsic value method and stock-based compensation issued to nonemployees 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.

(In thousands, except per share amounts)

Recently Issued Accounting Pronouncements. In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133, as amended by SFAS No. 137 and No. 138, will be effective for the Company's financial reporting beginning in the first quarter of fiscal 2001. SFAS No. 133 will require the Company to recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The accounting for gains and losses from changes in the fair value of a particular derivative will depend on the intended use of the derivative. The Company does not expect the adoption of SFAS No. 133 to have a material impact on the results of its operations or financial position.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 provides guidance on the recognition, disclosure and presentation of revenue in financial statements. The Company will adopt the provisions of SAB 101 for all transactions during fiscal 2002. The Company is currently evaluating the impact of SAB 101 on its financial statements and related disclosures but does not expect that any impact will be material.

In March 2000, the FASB issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation—An Interpretation of APB Opinion No. 25" ("FIN 44"). FIN 44 clarifies the definition of employees for purposes of applying APB Opinion No. 25, the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequences of various modifications to the terms of a previously fixed stock option or award and the accounting for an exchange of stock compensation awards in a business combination. This interpretation is effective July 1, 2000, but certain conclusions in this interpretation cover specific events that occurred after either December 15, 1998 or January 12, 2000. The Company does not expect the adoption of FIN 44 to have a material effect on its results of operations or financial position.

Note 2: Details of Financial Statement Components

As of	July 1, 2000	July 3, 1999
Cash and Equivalents:		
Cash	$ 762	$ 1,633
U.S. Treasury and agency securities	82,159	—
Money market mutual funds	35,785	9,403
Commercial paper	34,749	—
	$153,455	$11,036
Property and Equipment:		
Computer equipment and software	$ 6,005	$ 3,845
Leasehold improvements	1,027	942
Furniture and fixtures	357	156
Office equipment	392	122
	7,781	5,065
Accumulated depreciation	(3,166)	(2,092)
	$ 4,615	$ 2,973
Accrued Expenses:		
Compensation	$ 10,547	$ 3,629
Discontinued operations	610	950
Royalties	925	1,280
Taxes	2,021	275
Other	1,923	1,136
	$ 16,026	$ 7,270

Note 3: Discontinued Operations

In 1998, the Company decided to focus its business on its eMatrix software suite of products and 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.

The Company recorded a $6,711 gain on the sale of the net assets of Adra Systems, comprised of the cash and promissory note proceeds of $11,400 less estimated transaction costs of $2,338, income taxes of $1,489 and net assets sold of $862. The transaction costs consisted principally of investment banking, legal and accounting fees, and bonus and severance arrangements with certain employees. The net assets sold consisted of the following:

Current assets	$ 3,598
Property and equipment, net	725
Total assets	4,323
Current liabilities	(3,461)
Net assets sold	$ 862

The consolidated financial statements of the Company have been restated to reflect the financial results of Adra Systems as a discontinued operation. Reported revenues, expenses and cash flows exclude the operating results of Adra Systems. During fiscal 1999, revenues from Adra Systems were approximately $12,434 for the period through May 7, 1998. At July 1, 2000 and July 3, 1999, accrued transaction costs relating to the sale of the net assets of Adra Systems, included in accrued expenses, were $610 and $950, respectively.

Note 4: Income Taxes

At July 1, 2000, the Company had available U.S. federal and state net operating loss ("NOL") carryforwards of approximately $20,310 and approximately $680 of available U.S. federal and state tax credits to reduce future U.S. income taxes. The NOLs and tax credit carryforwards expire commencing in fiscal 2001. Use of these NOLs and tax credits may be limited due to certain changes in ownership.

The Company also has NOLs in certain foreign countries aggregating approximately $11,740 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 uncertainty surrounding the timing of the realization of these tax benefits. Realization of these tax benefits is dependent on generating sufficient taxable income.

The components of the deferred tax asset are as follows:

As of	July 1, 2000	July 3, 1999
Net operating loss carryforwards	$ 11,531	$ 7,170
Deferred revenue	928	1,163
Tax credits	680	658
Accrued liabilities	981	563
Allowance for doubtful accounts	345	289
Depreciation	45	71
Total deferred tax assets	14,510	9,914
Valuation allowance	(14,510)	(9,914)
Net deferred tax asset	$ —	$ —

During fiscal 1998, the Company recognized an income tax benefit from continuing operations of $1,928 to offset the income taxes related to discontinued operations.

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

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998
Federal statutory rate	35%	35%	35%
State tax, net of federal tax benefit	6	6	6
Income tax benefit used to offset income taxes from discontinued operations	—	—	(15)
Provision for valuation allowance	(41)	(41)	(41)
	—%	—%	(15)%

The effective tax rate for discontinued operations was 18% for fiscal 1998.

Note 5: Line of Credit and Debt

On December 28, 1999, the Company extended its line of credit of $7,000 through December 28, 2000. Borrowings under the 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, on January 21, 2000, the Company obtained a working capital line of credit of $1,000, which expires December 28, 2000. Borrowings under the working capital line of credit are limited to 90% of eligible foreign accounts receivable billed and collected in the United States. 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 (9.5% at July 1, 2000) plus 0.5%. As of July 1, 2000, there were no borrowings under these lines of credit and $6,006 available.

(In thousands, except per share amounts)

On April 3, 2000, the Company's wholly-owned subsidiary in Germany obtained a 500 DM ($244) line of credit. Borrowings under this line of credit are limited to 100% of accounts receivable and bear interest at 10.25%.

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 2006. 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 $2,123, $1,616 and $1,187 for fiscal 2000, 1999 and 1998, respectively.

Future minimum lease commitments, by fiscal year, as of July 1, 2000 are as follows:

	Facilities	Autos and Equipment	Total
2001	$1,478	$373	$1,851
2002	1,023	320	1,343
2003	694	127	821
2004	487	44	531
2005	11	2	13
Thereafter	11	—	11
	$3,704	$866	$4,570

During fiscal 1999, the Company entered into an agreement for telecommunication services at favorable pricing based on minimum purchase requirements of approximately $325 each year through fiscal 2001.

Contingencies. On August 10, 2000, SofTech, Inc. commenced an arbitration against the Company before the American Arbitration Association in Boston, Massachusetts alleging fraud, unfair and deceptive trade practices, and breach of contract in connection with the sale of assets of Adra to SofTech in 1998. The Company intends to vigorously defend each claim asserted in the arbitration demand.

The Company may from time to time become a party to various other legal proceedings arising in the ordinary course of our 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.

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. On October 1, 1997, the Company sold 1,899 shares of Series G redeemable convertible preferred stock at $5.80 per share for $11,015.

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 July 1, 2000, 20,175 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. These notes are full recourse to the stockholders and are additionally collateralized by the underlying shares of common stock. The notes receivable are payable in full on varying dates through December 27, 2002 and bear interest at 8%. During fiscal 2000, the Company also received payment of notes receivable aggregating $295. These notes receivable have been reported as a reduction to stockholders' equity.

Warrants. In May 1997, the Company issued a warrant to purchase 169 shares of common stock in conjunction with its line of credit. The warrants had an exercise price of $0.44 and were to expire in May 2002. No value has been ascribed to these warrants as the amount would not be material to the financial statements. In March 2000, the holder of the warrants 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 will be amortized through charges to reduce revenues as the elements in the arrangement are delivered. During fiscal 2000, the Company recorded a charge to reduce revenues of $447 related to the warrant.

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. No common stock was purchased under the Purchase Plan during fiscal 2000.

(In thousands, except per share amounts)

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. The Company has reserved a total of 1,500 shares of common stock for issuance under the 1999 Plan, which provides for the grant 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 both 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 2,205 shares available for future grant under the 1999 and 1996 Plans at July 1, 2000.

The following is a summary of the status of the Company's stock options as of July 1, 2000, July 3, 1999 and June 27, 1998 and the stock option activity for all stock option plans during the years ending on those dates:

	July 1, 2000		July 3, 1999		June 27, 1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding:						
Beginning balance	11,742	$0.45	10,125	$0.43	5,619	$0.42
Granted	2,802	$5.07	4,806	$0.46	5,832	$0.44
Exercised	(3,843)	$0.46	(1,203)	$0.40	(18)	$0.43
Canceled	(383)	$1.04	(1,986)	$0.42	(1,308)	$0.43
Ending balance	10,318	$1.67	11,742	$0.45	10,125	$0.43
Exercisable	4,377	$0.66	5,157	$0.43	4,479	$0.41

Information regarding options outstanding as of July 1, 2000 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 0.33–$ 0.44	7,292	7.17	$ 0.43	3,973	$ 0.43
$ 0.67–$ 1.11	1,958	9.05	$ 1.02	298	$ 1.02
$ 3.33	131	9.24	$ 3.33	24	$ 3.33
$ 6.67–$ 8.00	548	9.44	$ 7.73	62	$ 7.71
$13.00–$19.38	210	9.63	$13.18	13	$13.00
$21.00–$27.81	133	9.65	$22.03	7	$21.00
$32.13–$69.50	46	9.48	$37.15	—	$ —
	10,318	7.76	$ 1.67	4,377	$ 0.66

In connection with certain stock option grants to employees, the Company recorded deferred stock-based compensation of $13,574 and $4,080 for 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 $3,593 and $622 for fiscal 2000 and 1999, respectively.

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 2000, 1999 and 1998 have been determined using the Black-Scholes option-pricing model. The assumptions used are as follows:

	July 1, 2000	July 3, 1999	June 27, 1998
Risk-free interest rate	5.80–6.50%	5.10%	5.70%
Expected dividend yield	None	None	None
Expected lives	5 years	5 years	5 years
Expected volatility (85% after January 1, 2000)	85%	—	—

The weighted average fair value of options granted in fiscal 2000, 1999 and 1998 were $7.44, $0.95 and $0.11 per share, respectively.

Had compensation expense for stock options been determined based on fair value as proscribed by SFAS No. 123, the Company's pro forma net loss would have been as follows:

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998
Net Loss:			
As reported	$(6,453)	$(7,704)	$(2,192)
Pro forma	$(7,500)	$(8,027)	$(2,411)
Basic and Diluted Net Loss Per Share:			
As reported	$ (0.36)	$ (1.74)	$ (0.58)
Pro forma	$ (0.42)	$ (1.81)	$ (0.64)

Because the method proscribed 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 North American offices 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. The Company's contributions to these plans were not material.

Note 10: Segment and Geographic Information

The Company measures operating results as a single reportable segment. The Company reports revenue in the geographic region of the customer at the time of the license. However, the customer has the right to redeploy licenses anywhere in the world. The Company does report, for internal purposes, operating results by subsidiary, which operate in specific countries. Revenues and property and equipment by significant geographic region are as follows:

(In thousands, except per share amounts)

Year Ended	July 1, 2000	July 3, 1999	June 27, 1998
Revenues:			
North America	$45,398	$30,557	$15,644
Germany	9,519	6,048	2,573
France	6,162	2,243	2,144
Asia/Pacific	4,870	—	—
Europe (excluding Germany and France)	8,762	2,498	818
Total international	29,313	10,789	5,535
	$74,711	$41,346	$21,179

As of	July 1, 2000	July 3, 1999
Property and Equipment:		
North America	$ 3,844	$ 2,498
Germany	202	123
France	178	166
Asia/Pacific	87	—
Europe (excluding Germany and France)	304	186
Total international	771	475
	$ 4,615	$ 2,973

Note 11: Net Income (Loss) Per Share

The Company's historical capital structure is not indicative of its prospective 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 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	July 1, 2000	July 3, 1999	June 27, 1998
Basic and Diluted Net Income (Loss) Per Share:			
Net loss from continuing operations	$ (6,453)	$ (7,704)	$(10,876)
Net income from discontinued operations	—	—	8,684
Net loss	$ (6,453)	$ (7,704)	$ (2,192)
Basic and diluted net loss per share from continuing operations	$ (0.36)	$ (1.74)	$ (2.88)
Basic and diluted net income per share from discontinued operations	—	—	2.30
Basic and diluted net loss per share	$ (0.36)	$ (1.74)	$ (0.58)
Shares used in computing basic and diluted net income (loss) per share	17,966	4,428	3,777
Pro Forma Basic and Diluted Net Income (Loss) Per Share:			
Shares used in computing basic and diluted net income (loss) per share	17,966	4,428	3,777
Adjustment to reflect the effect of the conversion of preferred stock	17,720	23,542	21,273
Shares used in computing pro forma basic and diluted net income (loss) per share	35,686	27,970	25,050
Pro forma basic and diluted net loss per share from continuing operations	$ (0.18)	$ (0.28)	$ (0.43)
Pro forma basic and diluted net income per share from discontinued operations	—	—	0.34
Pro forma basic and diluted net loss per share	$ (0.18)	$ (0.28)	$ (0.09)

Potentially dilutive common stock options and warrants aggregating 10,518, 11,910 and 10,293 for fiscal 2000, 1999 and 1998, respectively, have been excluded from the computation of basic and dilutive net income (loss) per share because their inclusion would be anti-dilutive.

Note 12: Quarterly Financial Information (unaudited)

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

Year Ended July 3, 1999	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues	$ 8,200	$ 9,531	$10,468	$13,147	$41,346
Gross profit	$ 4,760	$ 5,373	$ 5,488	$ 7,935	$23,556
Net loss	$ (2,039)	$ (2,107)	$ (2,591)	$ (967)	$ (7,704)
Basic and diluted net loss per share	$ (0.53)	$ (0.50)	$ (0.54)	$ (0.20)	$ (1.74)
Shares used in computing basic and diluted net loss per share	3,829	4,234	4,773	4,926	4,428
Pro forma basic and diluted net loss per share	$ (0.07)	$ (0.08)	$ (0.09)	$ (0.03)	$ (0.28)
Shares used in computing pro forma basic and diluted net loss per share	27,217	27,621	28,162	28,936	27,970

Report of Independent Public Accountants

To MatrixOne, Inc.:

We have audited the accompanying consolidated balance sheets of MatrixOne, Inc. (a Delaware corporation) as of July 1, 2000 and July 3, 1999 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 July 1, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our 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 July 1, 2000 and July 3, 1999 and the results of their operations and their cash flows for each of the three years in the period ended July 1, 2000, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Boston, Massachusetts
July 24, 2000

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 the Company's 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.

Year ended July 1, 2000:	High	Low
Third quarter (from March 1, 2000)	$84.438	$30.250
Fourth quarter	$45.188	$12.750

On September 8, 2000, there were approximately 552 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 8, 2000, the last reported sale price per share of our common stock on the Nasdaq National Market was $39.25.

On March 6, 2000, we issued and sold 450,000 shares of our common stock to G.E. Capital Equity Investments, Inc. at a price of $23.25 per share. These shares of common stock were not registered under the Securities Act and no underwriters were involved. This sale was made in reliance upon the exemption from the registration provisions of the Securities Act provided by Sections 2(3) and 4(2) thereof for transactions not involving a public offering. These shares are deemed restricted securities for the purposes of the Securities Act.

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.

corporate information

Directors

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

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 and
Chief Executive Officer
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

Stephen P. Dunn
Vice President of
Xchange Business Development

Brian M. Gallagher
Vice President of Sales, Americas

Paul B. Gilmartin
Vice President of Product Management

David W. McNelis
Vice President of Engineering

Johannes T. J. Ruigrok
Senior Vice President of Worldwide Sales
and Marketing

Michael Segal
Senior Vice President of Customer Success

Jane E. Seitz
Vice President of Human Resources

Sam Zawaideh
Vice President of Xchange Business

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Investor Relations Telephone (978) 322-2200
Internet Address: http://www.matrixone.com

Transfer Agent and Registrar

EquiServe Trust Company, N.A. 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:

EquiServe Trust Company, N.A.
Boston EquiServe Division
Shareholder Services
P.O. Box 8040
Boston, Massachusetts 02266-8040
Telephone (781) 575-3400
Internet home page: 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, including exhibits, 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 e-mail alert system at http://investor.matrixone.com, which will give you e-mail notification of updates to the Company's investor relations website.

Annual Meeting

The Annual Meeting of Stockholders will be held on Monday, November 6, 2000 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

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MatrixOne

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