

amdocs  
financial review  
2001

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## forward looking statements

Some of the information in this section contains forward looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995) that involve substantial risks and uncertainties. You can identify these statements by forward looking words such as “expect”, “anticipate”, “believe”, “seek”, “estimate”, “project”, “forecast”, “continue”, “potential” and similar words. Statements that we make in this section that are not statements of historical fact also may be forward looking statements. Forward looking statements are not guarantees of future performance, and involve risks, uncertainties and assumptions that may cause our actual results to differ materially from the expectations we describe in our forward looking statements. There may be events in the future that we are not accurately able to predict, or over which we have no control. You should not place undue reliance on forward looking statements. We do not promise to notify you if we learn that our assumptions or projections are wrong for any reason. We disclaim any obligation to update our forward looking statements.

## introduction

In this section, we discuss the general financial condition and the results of operations for Amdocs and its subsidiaries including:

- what factors affect our business,
- what our revenue and costs were in the fiscal years ended September 30, 2001, 2000 and 1999,
- why those revenue and costs were different from year to year,
- the sources of our revenue,
- how all of this affects our overall financial condition,
- what our expenditures were in the fiscal years ended September 30, 2001, 2000 and 1999, and
- the sources of our cash to pay for future capital expenditures.

In this section, we also analyze and explain the annual changes in the specific line items in our consolidated statements of income. This section should be read in conjunction with our consolidated financial statements, which follow.

## overview of business and trend information

We are a leading provider of software products and services to the communications industry. Our Business Support Systems (“BSS”) consist of families of software products and services designed to meet the mission-critical needs of specific communications market sectors. We provide primarily Customer Care and Billing, Customer Relationship Management or CRM, and Order Management Systems (collectively, “CC&B Systems”) for communications and Internet Protocol (“IP”) service providers. Our systems support a wide range of communications services, including wireline, wireless, broadband, electronic and mobile commerce and IP services. We also support companies that offer multiple service packages, commonly referred to as convergent services. In addition, we provide a full range of Directory Sales and Publishing Systems (“Directory Systems”) to publishers of both traditional printed yellow page and white page directories and electronic Internet directories.

Due to the complexity of BSS projects and the expertise required for system support, we also provide extensive customization, implementation, system integration, ongoing support, system enhancement, maintenance and outsourcing services.

In the future, we may consider, as part of our strategy, acquisitions and other initiatives in order to offer new products or services or otherwise enhance our market position or strategic strengths. See discussions below - "acquisitions" and "subsequent events".

We derive our revenue principally from:

- the initial sale of our products and related services, including license fees and customization, implementation and integration services, and
- recurring revenue from ongoing support, maintenance, outsourcing and other related services provided to our customers and, to a lesser degree, from incremental license fees resulting from increases in the number of a customer's subscribers.

We usually sell our software as part of an overall solution offered to a customer, in which significant customization and modification to our software generally is required. As a result, revenue generally is recognized over the course of these long-term projects. Initial license revenue is recognized as work is performed, using the percentage of completion method of accounting. Subsequent license fee revenue is recognized upon completion of the specified conditions in each contract. Service revenue that involves significant ongoing obligations, including fees for customization, implementation and modification, is also recognized as work is performed, under the percentage of completion method of accounting. Revenue from software solutions, that do not require significant customization and modification, is recognized upon delivery. In outsourcing contracts, revenue from the operation and maintenance of customers' billing systems is recognized in the period in which the bills are produced. Revenue from ongoing support services is recognized as work is performed. Revenue from third-party hardware and software sales is recognized upon delivery. Maintenance revenue is recognized ratably over the term of the maintenance agreement. As a result of a substantial portion of our revenue being subject to the percentage of completion accounting method, the size and timing of customer projects and our progress in completing such projects may significantly affect our annual and quarterly operating results.

Our business is subject to the effects of general global economic conditions and, in particular, market conditions in the communications industry. Recently, these conditions have reduced the high growth that the communications industry had experienced over the past several years. As a result, the market value, financial results and prospects, and capital spending levels of many communications companies have declined or degraded.

As a result of the current slowdown in the growth of the global communications market, in general our sales cycle has lengthened, which means that the time between our initial contact with a prospective customer and the signing of a sales contract has increased. Our sales cycle currently ranges between six to twelve months for the majority of our new sales. We believe that such lengthening of our sales cycle and the impact of the current general economic downturn on the communications industry may result in slower revenue growth rates for us than has been achieved in recent years.

As a result of the September 11, 2001 terrorist attacks on the United States and the subsequent military response by the United States in Afghanistan, the global economy has been negatively affected. These events

may adversely affect our revenue and our profitability and could also result in a disruption of our business or the businesses of our customers.

License and service fee revenue from the sale of CC&B Systems amounted to \$1,379.7 million in the year ended September 30, 2001, representing 89.9% of our revenue for such period, as compared to \$986.5 million in fiscal 2000 and \$468.2 million in fiscal 1999, where license and service fee revenue from the sale of CC&B Systems represented 88.2% and 74.7%, respectively, of our revenue for such periods.

We believe that we are a leading global provider of CC&B Systems. We provide a broad set of CC&B Systems, with proven functionality and scalability and accompanied by a comprehensive range of support services.

We believe that the demand for our CC&B Systems will continue to increase due to, among other key factors:

- the growth and deregulation of the communications market,
- the global penetration and expansion of communications services,
- the proliferation of new communications products and services, especially IP and data services,
- rapid technological changes, such as the introduction of wireless Internet services via GPRS (General Packet Radio Services) and UMTS (Universal Mobile Telecommunications System) technology,
- intensifying competition among communications carriers, and
- a shift from in-house management to vendor solutions and outsourcing.

We also believe that a key driver of demand is the continuing trend for communications service providers to offer to their subscribers multiple service packages, commonly referred to as convergent services (combinations of voice, broadband, electronic and mobile commerce and IP services).

In addition, we believe that our CC&B solutions enable communications providers to improve productivity and reduce costs.

License and service fee revenue from the sale of Directory Systems totaled \$154.2 million in the year ended September 30, 2001, accounting for 10.1% of our revenue for such period, as compared to \$131.8 million in fiscal 2000 and \$158.6 million in fiscal 1999, when license and service fee revenue from the sale of Directory Systems represented 11.8% and 25.3%, respectively, of our revenue for such periods.

We believe that we are a leading provider of Directory Systems in most of the markets that we serve.

We expect that the demand for our Directory Systems will remain relatively stable in future periods and that the contribution to total revenue, as a percentage of revenue, of license and service fees from Directory Systems services will, as a result, continue to decrease over time.

## research and development, patents and licenses

Our research and development activities involve the development of new software modules and product offerings in response to an identified market demand, either in conjunction with a customer project or as part of our internal product development programs. We also expend additional amounts on applied research and software development activities to keep abreast of new technologies in the communications and IP markets. Research and development expenditures amounted to \$105.8 million, \$74.9 million and \$40.9 million in fiscal 2001, 2000 and 1999, respectively, representing 6.9%, 6.7% and 6.5%, respectively, of our revenue in these fiscal years. In the next several years we intend to continue to make substantial investments in our research and development activities.

We regard significant portions of our software products and systems as proprietary and rely on a combination of statutory and common law copyright, trademark and trade secret laws, customer licensing agreements, employee and third-party nondisclosure agreements and other methods to protect our proprietary rights. We generally enter into confidentiality agreements with our employees, consultants, customers and potential customers and limit access to, and distribution of, our proprietary information. We believe that the sophistication and complexity of our BSS offerings make it very difficult to copy such information or to subject such information to unauthorized use. We maintain sole ownership of our software products.

## investment

In January 2001 we formed Certen Inc. ("Certen") with Bell Canada to provide customer care and billing solutions to Bell Canada and some of its affiliated companies. Certen is owned 90% by Bell Canada and 10% by us. Commencing on the 30-month anniversary of the transaction, convertible debentures issued by Certen to us will be convertible into an additional 35% ownership interest in Certen. The relative ownership interests of the shareholders might further be modified through the exercise of a series of contractual rights, commencing on the 30-month anniversary of the transaction. We will provide the customer care and billing software required by Certen, including customization, installation, maintenance and other services. We account for our investment in Certen under the cost method.

## convertible notes

In May 2001 we issued to qualified institutional buyers \$500.0 million aggregate principal amount of 2% Convertible Notes due June 1, 2008 (the "Notes"). On September 25, 2001, following a shelf registration on Form F-3, the Notes began trading in the public market. We are obligated to pay interest on the Notes semi-annually on June 1 and December 1 of each year, and made our first interest payment on December 1, 2001. The Notes are senior unsecured obligations, rank equal in right of payment with all our existing and future senior unsecured indebtedness. The Notes are convertible, at the option of the holders at any time before the maturity date, into ordinary shares at a conversion rate of 10.8587 shares per \$1,000 principal amount of Notes, subject to adjustment in certain events. The Notes are subject to redemption at any time on or after June 1, 2006, all or in part, at our option, at a redemption price of 100% of the principal amount plus accrued and unpaid interest; and are subject to repurchase, at the holder's option, on June 1, 2004 and June 1, 2006, at a repurchase price equal to 100% of the principal amount plus accrued and unpaid interest, if any, on such repurchase date. We may choose to pay the repurchase price in cash, ordinary shares or a combination of cash and ordinary shares. As of September 30, 2001 all of the Notes were outstanding.

## acquisitions

On November 30, 1999, we completed the purchase of International Telecommunication Data Systems, Inc. ("ITDS") in a stock-for-stock acquisition. The acquisition of ITDS, a leading provider of solutions to communications companies for outsourcing of billing operations, expanded the scope of our CC&B Systems offering and, we believe, further established our leadership in providing total solutions to the communications industry. In connection with the consummation of this transaction, we issued 6,461,376 ordinary shares and granted options to purchase 1,102,955 ordinary shares. The total purchase price of \$189.0 million included issuance of ordinary shares, the grant of options and transaction costs. The acquisition was accounted for using the purchase method of accounting. The fair market value of ITDS' assets and liabilities has been included in our balance sheet and the results of ITDS's operations are included in our consolidated statement of income, commencing on December 1, 1999. The value of acquired technology, which was determined by an independent specialist, included both existing technology and in-process research and development. The valuation of these items was made by applying the income forecast method, which considered the present value of cash flows by product lines. The fair value of existing technology products was valued at \$12.3 million and is being amortized over approximately two years commencing on December 1, 1999. In-process research and development, valued at \$19.9 million, was charged as an expense immediately following the completion of the acquisition since this technology had not reached technological feasibility and had no alternative use. Additional development, coding and testing efforts were required before technological feasibility could be determined. The fair value of customer base was valued at \$0.6 million and the fair value of workforce-in-place was valued at \$5.4 million, both of which are being amortized over five years commencing on December 1, 1999. The excess of the purchase price over the net assets acquired, or goodwill, of \$71.2 million is being amortized over 15 years commencing on December 1, 1999.

On April 5, 2000, we completed the purchase of Solect Technology Group Inc. ("Solect"), in a stock-for-stock acquisition. The acquisition of Solect, a leading provider of billing and customer care software to IP service providers, including wireless and application service providers, or ASPs, expanded our IP service provider customer base for CC&B Systems. Under the terms of our combination agreement with Solect, all then outstanding Solect common shares were exchanged for shares of a newly issued class of exchangeable shares of Solect. The Solect exchangeable shares entitle holders to dividends and other rights economically equivalent to our ordinary shares, including the right, through a voting trust, to vote at our shareholder meetings, and are exchangeable at the option of the holders into our ordinary shares on a one-for-one basis. The total purchase price of \$1,087.7 million included the issuance of 13,846,302 exchangeable shares, the grant of options to purchase 1,653,662 ordinary shares and transaction costs. The acquisition was accounted for using the purchase method of accounting. The fair market value of Solect's assets and liabilities has been included in our balance sheet and the results of Solect's operations are included in our consolidated statement of income, commencing on April 6, 2000. The value of acquired technology, which was determined by an independent specialist, included both existing technology and in-process research and development. The valuation of these items was made by applying the income forecast method, which considered the present value of cash flows by product lines. The fair value of existing technology products was valued at \$18.3 million and is being amortized over two years commencing on April 6, 2000. In-process research and development, valued at \$50.4 million, was charged as an expense immediately following the completion of the acquisition since this technology had not reached technological feasibility and had no alternative use. Additional development, coding and testing efforts were required before technological feasibility could be determined. The fair value of customer

base was valued at \$1.2 million and the fair value of workforce-in-place was valued at \$3.3 million, both of which are being amortized over three years commencing on April 6, 2000. The excess of the purchase price over the net assets acquired, or goodwill, of \$986.2 million is being amortized over five years commencing on April 6, 2000.

## new accounting standards

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS 141"), and No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142").

SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. The adoption of SFAS 141 will have no impact on our business, results of operations, or financial condition.

SFAS 142 is effective for fiscal years beginning after December 15, 2001. Under SFAS 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statement. Other intangible assets will continue to be amortized over their useful lives. According to the adoption requirements of SFAS 142, we have the option of applying the new standard on accounting for goodwill and other intangible assets beginning either in the quarters ended on December 31, 2001 or December 31, 2002. We anticipate adopting this Statement in the quarter ended December 31, 2002. Subsequent to the adoption of SFAS 142, we will perform the first of the required impairment tests of goodwill and intangible assets recorded as of the date of adoption. We have not yet determined what the effect of these tests will be on our earnings and financial position. We recorded \$202.4 million and \$102.8 million of goodwill amortization during fiscal years 2001 and 2000, respectively, and no goodwill amortization during fiscal year 1999.

## operating results

The following table sets forth for the fiscal years ended September 30, 2001, 2000 and 1999 certain items in our consolidated statements of income reflected as a percentage of total revenue:

	Year ended September 30,				
	2001		2000		1999
	Pro forma (*)	As reported	Pro forma (*)	As reported	
<b>Revenue:</b>					
License	11.2%	11.2%	11.2%	11.2%	11.9%
Service	88.8	88.8	88.8	88.8	88.1
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<b>Operating expenses:</b>					
Cost of license	0.4	0.4	0.5	0.5	0.9
Cost of service	55.3	55.3	57.2	57.2	57.1
Research and development	6.9	6.9	6.7	6.7	6.5
Selling, general and administrative	12.7	12.7	12.3	12.3	12.1
Amortization of goodwill and purchased intangible assets	—	14.3	—	9.9	—
In-process research and development and other indirect acquisition-related costs	—	—	—	6.8	—
	<u>75.3</u>	<u>89.6</u>	<u>76.7</u>	<u>93.4</u>	<u>76.6</u>
Operating income	24.7	10.4	23.3	6.6	23.4
Interest income (expense) and other, net	1.4	1.4	1.0	1.0	(1.0)
Income before income taxes	26.1	11.8	24.3	7.6	22.4
Income taxes	7.8	7.5	7.3	7.1	6.7
<b>Net income</b>	<u>18.3%</u>	<u>4.3%</u>	<u>17.0%</u>	<u>0.5%</u>	<u>15.7%</u>

(\*) We acquired ITDS and Solect in fiscal year 2000. The pro forma financial information regarding our operating results is provided as a complement to results reported in accordance with accounting principles generally accepted in the United States (GAAP). The pro forma financial information excludes (i) amortization of goodwill and purchased intangible assets and all related tax effects attributable to the acquisitions of ITDS and Solect and (ii) for fiscal year 2000 only, purchased in-process research and development charges, other indirect acquisition-related costs, and all related tax effects (clauses (i) and (ii) collectively referred to herein as "ITDS and Solect acquisition-related charges").

## years ended September 30, 2001 and 2000

**Revenue.** Revenue for the year ended September 30, 2001 was \$1,533.9 million, an increase of \$415.6 million, or 37.2%, over fiscal 2000. The increase in revenue was due to the continued growth in the demand for our CC&B Systems solutions in our traditional target markets of high-end and mid-tier communications companies. License revenue increased from \$124.8 million in the year ended September 30, 2000 to \$171.4 million during fiscal 2001, an increase of 37.3%, and service revenue increased 37.1% from \$993.5 million in the year ended September 30, 2000 to \$1,362.5 million in fiscal 2001.

Total CC&B Systems revenue for the year ended September 30, 2001 was \$1,379.7 million, an increase of \$393.1 million, or 39.8%, over fiscal 2000. In the year ended September 30, 2001, the demand for our CC&B Systems was primarily driven by the need for communications companies to upgrade their customer care and billing, CRM and order management systems in response to competition in the subscriber markets, the need to offer convergent and IP services, and the need to improve productivity and operational efficiency.

Revenue from Directory Systems was \$154.2 million for the year ended September 30, 2001, an increase of \$22.5 million, or 17.1%, over fiscal 2000. The increase is attributable primarily to extensions of agreements with and additional services rendered to existing customers.

In the year ended September 30, 2001, revenue from customers in North America, Europe and the rest of the world accounted for 53.8%, 35.8% and 10.4%, respectively, compared to 45.6%, 42.4% and 12.0%, respectively, in fiscal 2000. The growth in North America was attributable primarily to revenue we gained from forming or expanding relationships with new or existing customers in North America in fiscal 2001.

**Cost of License.** Cost of license for fiscal 2001 was \$5.7 million, which is approximately equal to the cost of license in the prior fiscal year. Cost of license includes amortization of purchased computer software and intellectual property rights.

**Cost of Service.** Cost of service for fiscal 2001 was \$847.6 million, an increase of \$207.7 million, or 32.5%, over the cost of service of \$639.9 million for the year ended September 30, 2000. As a percentage of revenue, cost of service decreased to 55.3% in the year ended September 30, 2001 from 57.2% in fiscal 2000. The decrease in cost of service as a percentage of revenue is primarily due to increases in our operational efficiency in the year ended September 30, 2001. In the second half of fiscal 2001, we adopted a plan to increase the efficiency of our operations and lower costs by reducing discretionary expenses. As a result of this plan, we were able to reduce the growth rate of our costs and achieve greater operational efficiency in fiscal 2001.

**Research and Development.** Research and development expense was primarily comprised of compensation expense attributable to research and development activities, either in conjunction with customer projects or as part of our internal product development programs. In the year ended September 30, 2001, research and development expense was \$105.8 million, or 6.9% of revenue, compared with \$74.9 million, or 6.7% of revenue, in the previous fiscal year. The increase represents ongoing expenditures primarily for CC&B Systems.

**Selling, General and Administrative.** Selling, general and administrative expense was primarily comprised of compensation expense and increased by 42.8% to \$195.6 million, or 12.7% of revenue, in the year ended September 30, 2001, from \$137.0 million, or 12.3% of revenue, in fiscal 2000. The increase is attributable primarily to increases in our selling and marketing efforts in the year ended September 30, 2001.

**Amortization of Goodwill and Purchased Intangible Assets.** Amortization of goodwill and purchased intangible assets for the year ended September 30, 2001 was \$220.0 million, compared to \$111.2 million in fiscal 2000. Amortization of goodwill and purchased intangible assets relates to the acquisitions of ITDS and Solect. The increase in amortization of goodwill and purchased intangible assets in fiscal 2001 is due to the full-year amortization period applied in fiscal 2001 compared to a shorter amortization period in fiscal 2000.

**In-process Research and Development and Other Indirect Acquisition-Related Costs.** In-process research and development and other indirect acquisition-related costs were last incurred in fiscal 2000 and consisted of a nonrecurring charge of \$75.6 million related to the acquisitions of ITDS and Solect.

**Operating Income.** Operating income in the year ended September 30, 2001 was \$159.3 million, compared to \$74.1 million in fiscal 2000, an increase of 115%, primarily due to the effect of a non recurring charge for write-off of purchased in-process research and development related to the acquisitions of ITDS and Solect in fiscal 2000. Pro forma operating income for the year ended September 30, 2001, excluding ITDS and Solect acquisition-related charges, was \$379.3 million, or 24.7% of revenue, compared to \$260.9 million, or 23.3% of revenue, for fiscal 2000, an increase of 45.4%.

**Interest Income and Other, Net.** In the year ended September 30, 2001, interest income and other, net, was \$22.3 million, an increase of \$11.6 million over fiscal 2000. The increase in interest income and other, net, is primarily attributable to the increase in our cash equivalents and short-term interest-bearing investments partially offset by overall interest rate declines.

**Income Taxes.** Income taxes in the year ended September 30, 2001 were \$115.2 million on income before income taxes of \$181.6 million. Our effective tax rate in the year ended September 30, 2001 was 63%, resulting from the non-cash amortization of goodwill related to the ITDS and Solect acquisitions, much of which is not tax deductible. In the year ended September 30, 2000, income taxes were \$78.9 million on income before income taxes of \$84.9 million. In the year ended September 30, 2000, the effective tax rate (based on the ratio between income taxes and income before income taxes, excluding nonrecurring charges for write-offs of purchased in-process research and development and other indirect acquisition-related costs) was 49%. The pro forma effective tax rate for fiscal 2001 and 2000, excluding ITDS and Solect acquisition-related charges, was 30%. See discussion below – “effective tax rate”.

**Net Income.** Net income was \$66.4 million in the year ended September 30, 2001, compared to net income of \$6.0 million in the previous fiscal year. Pro forma net income in fiscal 2001, excluding ITDS and Solect acquisition-related charges, increased by 47.8% over fiscal 2000, reaching \$281.1 million, representing 18.3% of revenue.

**Diluted Earnings per Share.** Diluted earnings per share were \$0.29 for the year ended September 30, 2001, compared to \$0.03 in fiscal 2000. Pro forma diluted earnings per share in the year ended September 30, 2001, excluding ITDS and Solect acquisition-related charges, increased by 40.9% from the year ended September 30, 2000, reaching \$1.24 per diluted share.

## years ended September 30, 2000 and 1999

**Revenue.** Revenue for the year ended September 30, 2000 was \$1,118.3 million, an increase of \$491.5 million, or 78.4%, compared to fiscal 1999. Over 70% of the increase in revenue was due to the continued growth in the demand for our CC&B Systems in our traditional target markets of high-end and mid-tier communications companies and less than 30% was attributable to our acquisitions of ITDS and Solect.

License revenue increased from \$74.4 million in fiscal 1999 to \$124.8 million in the year ended September 30, 2000, an increase of 67.8%. Service revenue increased from \$552.5 million in fiscal 1999 to \$993.5 million in fiscal 2000, an increase of \$441.0 million, or 79.8%.

Total CC&B Systems revenue for the year ended September 30, 2000 was \$986.5 million, an increase of \$518.3 million, or 111%, compared to fiscal 1999. The diversity of demand for CC&B Systems was reflected by the broad cross section of new projects we were awarded in fiscal 2000. These projects covered customers in, among other locations, Europe, North America and Latin America, working within a wide range of operating environments, including wireline, wireless and IP. In many cases, we expanded our ongoing relationships with existing customers. In fiscal 2000, the demand for our CC&B Systems was primarily driven by the need for communications companies to upgrade their customer care, billing and order management systems in response to growth in their subscriber base, increased competition in the subscriber markets, and the need to offer convergent and IP services.

Revenue from Directory Systems decreased to \$131.8 million for the year ended September 30, 2000, from \$158.6 million for the prior fiscal year. The decrease in revenue from Directory Systems primarily reflected a reduction in the volume of Directory Systems services required by our existing customers.

In the year ended September 30, 2000, revenue from customers in North America, Europe and the rest of the world accounted for 45.6%, 42.4% and 12.0%, respectively, compared to 36.1%, 41.8% and 22.1%, respectively, in the year ended September 30, 1999. The growth in North America was primarily attributable to revenue we gained from existing ITDS customers and to our forming or expanding relationships with new or existing customers in North America in fiscal 2000.

**Cost of License.** Cost of license for fiscal 2000 was \$5.6 million, an increase of \$0.1 million from cost of license for the prior fiscal year. Cost of license included amortization of purchased computer software and intellectual property rights. The increase in cost of license for fiscal 2000 was primarily attributable to new purchases of computer software in fiscal 2000 and the related amortization.

**Cost of Service.** Cost of service for fiscal 2000 was \$639.9 million, an increase of \$282.1 million, or 78.8%, compared to cost of service of \$357.8 million for the year ended September 30, 1999. Cost of service was predominantly related to salary and employee-related expenses. The absolute increase in cost of service was consistent with the increase in revenue for fiscal 2000, and reflected increased employment levels required to support our growth.

**Research and Development.** Research and development expense was primarily comprised of compensation expense attributable to research and development activities, either in conjunction with customer projects or as part of our internal product development programs. In fiscal 2000, research and development expense was \$74.9 million, or 6.7% of revenue, compared with \$40.9 million, or 6.5% of revenue, in the previous fiscal year. The bulk of the increase in research and development expense represented ongoing expenditures primarily for CC&B Systems, with the balance attributable to Directory Systems.

**Selling, General and Administrative.** Selling, general and administrative expense was primarily comprised of compensation expense and increased by 81.1% to \$137.0 million, or 12.3% of revenue, in fiscal 2000, from \$75.7 million, or 12.1% of revenue, in the year ended September 30, 1999. The increase in selling, general and administrative expense was consistent with the increase in our revenue for fiscal 2000 and with our acquisitions of ITDS and Solect.

**Amortization of Goodwill and Purchased Intangible Assets.** Amortization of goodwill and purchased intangible assets in the year ended September 30, 2000 related to the ITDS and Solect transactions.

**In-process Research and Development and Other Indirect Acquisition-Related Costs.** In-process research and development and other indirect acquisition-related costs in the year ended September 30, 2000 consisted primarily of nonrecurring charges related to the ITDS and Solect transactions of \$19.9 million and \$50.4 million, respectively, for write-offs of purchased in-process research and development.

**Operating Income.** Operating income for the year ended September 30, 2000 was \$74.1 million, as compared with \$147.0 million for the previous fiscal year, a decrease of 49.6%, primarily due to the ITDS and Solect acquisition-related charges. Pro forma operating income for the year ended September 30, 2000, excluding the ITDS and Solect acquisition-related charges, was \$260.9 million, or 23.3% of revenue, as compared with \$147.0 million, or 23.4% of revenue, in the year ended September 30, 1999, an increase of 77.5%.

**Interest Income (Expense) and Other, Net.** Interest income (expense) and other, net, consisted primarily of interest income. In the year ended September 30, 2000, interest income and other, net, was \$10.7 million, an increase of \$16.9 million from the prior fiscal year. The increase in interest income and other, net, was primarily attributable to increases in interest earned on cash equivalents and short-term interest-bearing investments.

**Income Taxes.** Income taxes in fiscal 2000 were \$78.9 million on income before income taxes of \$84.9 million. Our effective tax rate in fiscal 2000 (based on the ratio between income taxes and income before income taxes, excluding nonrecurring charges for write-offs of purchased in-process research and development and other indirect acquisition-related costs) was 49%, resulting from the non-cash amortization of goodwill related to the acquisitions of ITDS and Solect, much of which was not tax deductible. The pro forma effective tax rate for the year ended September 30, 2000, excluding the ITDS and Solect acquisition-related charges, was 30%. In fiscal 1999 income taxes were \$42.2 million on income before income taxes of \$140.8 million. Our effective tax rate in fiscal 1999 was 30%. See discussion below – “effective tax rate”.

**Net Income.** Net income was \$6.0 million in the year ended September 30, 2000, as compared to \$98.5 million in the previous fiscal year. Net income was 0.5% of revenue for fiscal 2000, as compared to 15.7% for fiscal 1999. Pro forma net income in fiscal 2000, excluding the ITDS and Solect acquisition-related charges, increased by 93.0% from fiscal 1999, reaching \$190.1 million, representing 17.0% of revenue.

**Diluted Earnings per Share.** Diluted earnings per share were \$0.03 for the year ended September 30, 2000, as compared with \$0.49 in fiscal 1999. Pro forma diluted earnings per share in the year ended September 30, 2000, excluding the ITDS and Solect acquisition-related charges, increased by 79.6% from the year ended September 30, 1999, reaching \$0.88 per diluted share.

## liquidity and capital resources

Cash, cash equivalents and short-term interest-bearing investments totaled \$1,110.1 million as of September 30, 2001, compared to \$402.3 million as of September 30, 2000. The increase is primarily attributable to net proceeds from the issuance of the Notes and cash flows from operations. Net cash provided by operating activities amounted to \$338.0 million and \$287.6 million for fiscal 2001 and 2000, respectively. The increase in cash flows from operations was due to increased net income before depreciation and amortization offset by increases in working capital, principally from accounts receivable. A significant portion of our cash flow from operations during the year ended September 30, 2001 was used to invest in cash equivalents and short-term interest-bearing investments. We currently intend to retain our future operating cash flows to support the further expansion of our business.

As of September 30, 2001, we had positive working capital of \$1,059.9 million, compared to positive working capital of \$319.0 million as of September 30, 2000. The increase is attributable primarily to cash generated from the issuance of the Notes and operating activities. We believe that current cash balances, cash generated from operations and our current lines of credit will provide sufficient resources to meet our needs in the near future.

All of the Notes were outstanding as of September 30, 2001, representing an aggregate principal amount of \$500.0 million plus accumulated interest. See discussion above – “convertible notes”.

As of September 30, 2001, we had short-term general revolving lines of credit totaling \$40.0 million, none of which were outstanding. In addition, as of September 30, 2001, we had credit facilities totaling \$22.6 million limited for the use of letters of credit and bank guaranties from various banks. We had utilized approximately \$22.9 million from these credit facilities and from compensating cash balances to support outstanding letters of credit and bank guarantees as of September 30, 2001.

Subsequent to the balance sheet date, we entered into an additional credit facility limited for the use of letters of credit and bank guaranties totaling \$20.0 million from a commercial bank.

We had outstanding long-term obligations of \$35.2 million in connection with leasing arrangements as of September 30, 2001.

Currently, our capital expenditures consist primarily of computer equipment and vehicles and are funded principally by operating cash flows and capital leasing arrangements. We do not anticipate any change to this policy in the foreseeable future.

## net deferred tax assets

As of September 30, 2001, deferred tax assets of \$27.9 million, derived primarily from carry-forward net operating losses relating to Solect pre-acquisition losses, were offset by valuation allowances due to the uncertainty of realizing any tax benefit for such losses. When realization of the tax benefits associated with such net operating losses is deemed probable, the valuation allowance will be released, resulting primarily in an offsetting reduction of the goodwill recorded in the Solect acquisition.

## effective tax rate

Our overall effective tax rate has historically been approximately 30% due to the corporate income tax rates in the various countries in which we operate and the relative magnitude of our business in those countries. Our consolidated effective tax rate for the year ended September 30, 2001 was 63%, compared to 49% (based on the ratio between income taxes and income before income taxes, excluding nonrecurring charges for write-offs of purchased in-process research and development and other indirect acquisition-related costs) in the year ended September 30, 2000. This higher effective tax rate was attributable to amortization of goodwill related to our acquisitions of ITDS and Solect, much of which is not tax deductible. Excluding the impact of the ITDS and Solect acquisition-related charges, the effective tax rate for the years ended September 30, 2001 and 2000 was 30%.

## currency fluctuations

Approximately 90% of our revenue is in U.S. dollars or linked to the dollar and therefore the dollar is our functional currency. Approximately 60% of our operating expenses (excluding amortization for goodwill and intangible assets) are paid in dollars or linked to dollars. Other significant currencies in which we receive revenue or pay expenses are Australian dollars, British pounds, Canadian dollars, the European Monetary Union currency ("euro") and Israeli shekels. Historically the effect of fluctuations in currency exchange rates has had a minimal impact on our operations. If we expand our operations outside of the United States, our exposure to fluctuations in currency exchange rates could increase. In managing our foreign exchange risk, we enter from time to time into various foreign exchange contracts. As of September 30, 2001, we had hedged most of our significant exposures in currencies other than the dollar.

## foreign currency risk

We enter into foreign exchange forward contracts to hedge most of our foreign currency exposure. We use such contracts to hedge exposure to changes in foreign currency exchange rates associated with revenue denominated in a foreign currency, primarily British pounds and the euro, and anticipated costs to be incurred in a foreign currency, primarily Australian dollars, Canadian dollars and Israeli shekels. We seek to minimize the risk that the anticipated cash flow from sales of our products and services and cash flow required for our expenses denominated in a currency other than our functional currency will be affected by changes in exchange rates. See note 22 to our consolidated financial statements. The following table summarizes our foreign currency forward exchange agreements as of September 30, 2001. The table (all dollar amounts in millions) presents

the notional amounts by expected (contractual) maturity dates, and fair value of the total derivative instruments as of September 30, 2001. Notional values are calculated based on forward rates as of September 30, 2001, dollar translated.

	For the year ended		As of
	September 30,		September 30,
	2002	2003	2001
	Notional amount		Fair Value
	translated to US dollar		of Derivative
<b>Forward contracts hedging:</b>			
Revenue	\$ 17.6	\$ 8.2	\$ (0.5)
Costs	(213.5)	(3.5)	(10.8)
	<u>\$ (195.9)</u>	<u>\$ 4.7</u>	<u>\$ (11.3)</u>

## interest rate risk

Our interest expenses and income are sensitive to changes in interest rates, as all of our cash reserves and borrowings are subject to interest rate changes. Excess liquidity is invested in short-term interest-bearing investments. Such short-term interest-bearing investments consist primarily of federal agency securities and corporate bonds and currently bear minimal interest rate risk. As of September 30, 2001, we had nothing outstanding on either our revolving lines of credit or our short-term credit facilities, and \$35.2 million recorded as long-term lease obligations, which in the aggregate bear minimal interest rate risk.

## subsequent events

On November 28, 2001, we completed our acquisition from Nortel Networks Corporation of substantially all of the assets of its Clarify business ("Clarify"), a leading provider of CRM software to communications companies and other enterprise sectors, for approximately \$200.0 million in cash. We believe that this acquisition positions us as a leading provider of CRM to the communications industry and reinforces our leadership in delivering a comprehensive portfolio of BSS products and applications.

The transaction will be accounted for by the purchase accounting method, as required by SFAS 141 (see discussion above – "new accounting standards"). We expect to incur a nonrecurring acquisition-related charge in the first quarter of fiscal 2002 to account for certain costs relating to the acquisition, primarily the write-off of purchased in-process research and development.

On November 6, 2001, we announced that our board of directors approved a share repurchase program authorizing the repurchase of up to 11.0 million of our ordinary shares, or approximately 5% of our currently outstanding ordinary shares. According to the program, shares may be repurchased from time to time over the next twelve months on the open market, in privately negotiated transactions or otherwise, all in accordance with any applicable laws, and at prices per share as we deem appropriate. If any repurchases are made, we intend to fund the repurchases with available funds.

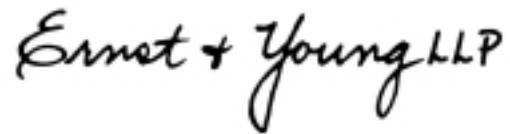
As part of our plan to achieve increased operational efficiency and to reduce costs, we have decided to combine our Stamford, Connecticut data center with one we operate in Champaign, Illinois, and thereupon to close our Stamford facility. As a direct result of this plan, we expect to incur a nonrecurring charge of between \$10.0 million to \$15.0 million, primarily for the write-off of leasehold improvements and rent obligations, during the first quarter of fiscal 2002.

To the board of directors and shareholders  
Amdocs Limited

We have audited the accompanying consolidated balance sheets of Amdocs Limited as of September 30, 2001 and 2000, and the related consolidated statements of income, changes in shareholders' equity (deficit) and cash flows for each of the three years in the period ended September 30, 2001. 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 consolidated financial position of Amdocs Limited as of September 30, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States.

A handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

Ernst & Young LLP  
New York, New York  
November 1, 2001

	As of September 30,	
	2001	2000
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 872,998	\$ 402,300
Short-term interest-bearing investments	237,069	—
Accounts receivable, including unbilled of \$23,272 and \$4,203, less allowances of \$3,219 and \$6,868, in 2001 and 2000, respectively (*)	384,851	263,100
Deferred income taxes and taxes receivable	38,916	35,179
Prepaid expenses and other current assets	38,045	34,327
<b>Total current assets</b>	<b>1,571,879</b>	<b>734,906</b>
Equipment, vehicles and leasehold improvements, net	173,695	128,081
Deferred income taxes	19,722	13,900
Goodwill and other intangible assets, net	788,187	1,011,053
Other noncurrent assets	70,953	47,145
<b>Total assets</b>	<b>\$2,624,436</b>	<b>\$1,935,085</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 166,527	\$ 128,249
Accrued personnel costs	103,990	70,196
Short-term financing arrangements	—	20,000
Deferred revenue	140,033	133,546
Short-term portion of capital lease obligations	10,400	8,713
Deferred income taxes and taxes payable	91,026	55,197
<b>Total current liabilities</b>	<b>511,976</b>	<b>415,901</b>
Convertible notes and long-term portion of capital lease obligations	524,779	23,417
Deferred income taxes	7,410	11,191
Other noncurrent liabilities	68,180	53,804
<b>Total liabilities</b>	<b>1,112,345</b>	<b>504,313</b>
<b>Shareholders' equity:</b>		
Preferred Shares - Authorized 25,000 shares; £0.01 par value; 0 shares issued and outstanding	—	—
Ordinary Shares - Authorized 550,000 shares; £0.01 par value; 222,628 and 221,165 outstanding in 2001 and 2000, respectively	3,560	3,539
Additional paid-in capital	1,806,290	1,784,816
Accumulated other comprehensive income (loss)	(6,382)	1,159
Unearned compensation	(185)	(1,164)
Accumulated deficit	(291,192)	(357,578)
<b>Total shareholders' equity</b>	<b>1,512,091</b>	<b>1,430,772</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$2,624,436</b>	<b>\$1,935,085</b>

(\*) See note 4.

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

**Amdocs Limited** consolidated statements of income (in thousands, except per share data)

	Year ended September 30,		
	2001	2000	1999
<b>Revenue:</b>			
License (*)	\$ 171,430	\$ 124,822	\$ 74,387
Service (*)	1,362,480	993,498	552,468
	<u>1,533,910</u>	<u>1,118,320</u>	<u>626,855</u>
<b>Operating expenses:</b>			
Cost of license	5,651	5,624	5,515
Cost of service (*)	847,591	639,900	357,809
Research and development	105,807	74,852	40,874
Selling, general and administrative (*)	195,592	137,004	75,659
Amortization of goodwill and purchased intangible assets	219,988	111,199	—
In-process research and development and other indirect acquisition-related costs	—	75,617	—
	<u>1,374,629</u>	<u>1,044,196</u>	<u>479,857</u>
Operating income	159,281	74,124	146,998
Other income (expense) and other, net (*)	22,286	10,734	(6,223)
Income before income taxes	181,567	84,858	140,775
Income taxes	115,181	78,880	42,232
<b>Net income</b>	<u>\$ 66,386</u>	<u>\$ 5,978</u>	<u>\$ 98,543</u>
<b>Basic earnings per share</b>	<u>\$ 0.30</u>	<u>\$ 0.03</u>	<u>\$ 0.50</u>
<b>Diluted earnings per share</b>	<u>\$ 0.29</u>	<u>\$ 0.03</u>	<u>\$ 0.49</u>
<b>Basic weighted average number of shares outstanding</b>	<u>222,002</u>	<u>212,005</u>	<u>197,436</u>
<b>Diluted weighted average number of shares outstanding</b>	<u>226,832</u>	<u>216,935</u>	<u>200,262</u>

(\*) See note 4.

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

**Amdocs Limited** consolidated statements of changes in shareholders' equity (deficit) (in thousands)

	Ordinary Shares		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Accumulated Deficit	Total Shareholders' Equity (Deficit)
	Shares	Amount					
Balance as of October 1, 1998	196,800	\$3,149	\$447,503	\$(1,495)	\$(8,947)	\$(462,099)	\$(21,889)
Comprehensive income:							
Net income	—	—	—	—	—	98,543	98,543
Decrease in unrealized loss on derivative instruments, net of \$145 tax	—	—	—	338	—	—	338
Comprehensive income							98,881
Issuance of Ordinary Shares, net	2,000	32	41,352	—	—	—	41,384
Stock options granted, net of forfeitures	—	—	244	—	(163)	—	81
Amortization of unearned compensation	—	—	—	—	5,280	—	5,280
Balance as of September 30, 1999	198,800	3,181	489,099	(1,157)	(3,830)	(363,556)	123,737
Comprehensive income:							
Net income	—	—	—	—	—	5,978	5,978
Decrease in unrealized loss on derivative instruments, net of \$1,000 tax	—	—	—	2,333	—	—	2,333
Increase in unrealized loss on cash equivalents income, net of \$(7) tax	—	—	—	(17)	—	—	(17)
Comprehensive income							8,294
Employee stock options exercised	2,058	33	21,327	—	—	—	21,360
Tax benefit of stock options exercised	—	—	10,825	—	—	—	10,825
Issuance of Ordinary Shares related to acquisitions, net	20,307	325	1,263,330	—	—	—	1,263,655
Stock options granted	—	—	235	—	—	—	235
Amortization of unearned compensation	—	—	—	—	2,666	—	2,666
Balance as of September 30, 2000	221,165	3,539	1,784,816	1,159	(1,164)	(357,578)	1,430,772
Comprehensive income:							
Net income	—	—	—	—	—	66,386	66,386
Decrease in unrealized gain on derivatives, net of \$(3,891) tax	—	—	—	(9,078)	—	—	(9,078)
Increase in unrealized income on cash equivalents and short-term interest-bearing investments, net of \$659 tax	—	—	—	1,537	—	—	1,537
Comprehensive income							58,845
Employee stock options exercised	1,463	21	13,946	—	—	—	13,967
Tax benefit of stock options exercised	—	—	7,345	—	—	—	7,345
Stock options granted	—	—	183	—	—	—	183
Amortization of unearned compensation	—	—	—	—	979	—	979
Balance as of September 30, 2001	<u>222,628</u>	<u>\$3,560</u>	<u>\$1,806,290</u>	<u>\$(6,382)</u>	<u>\$(185)</u>	<u>\$(291,192)</u>	<u>\$1,512,091</u>

As of September 30, 2001, 2000 and 1999, accumulated other comprehensive income (loss) is comprised of unrealized gain (loss) on derivatives, net of tax, of \$(7,902), \$1,176 and \$(1,157) and unrealized gain (loss) on cash equivalents and short-term interest-bearing investments, net of tax, of \$1,520, \$(17) and \$0, as of September 30, 2001, 2000 and 1999, respectively.

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

	Year ended September 30,		
	2001	2000	1999
<b>Cash Flow from Operating Activities:</b>			
Net Income	\$ 66,386	\$ 5,978	\$ 98,543
Reconciliation of net income to net cash provided by operating activities:			
Depreciation and amortization	282,625	155,359	30,601
Adjustment to the basis of investments	6,750	—	—
In-process research and development expenses	—	70,319	—
Loss on sale of equipment	593	148	549
Deferred income taxes	5,018	(1,196)	(4,026)
Tax benefit of stock options exercised	7,345	10,825	—
Unrealized income (loss) on other comprehensive income	(10,773)	3,309	483
Net changes in operating assets and liabilities, net of amounts acquired:			
Accounts receivable	(121,751)	(29,763)	(69,354)
Prepaid expenses and other current assets	(3,718)	(12,408)	(4,400)
Other noncurrent assets	(7,826)	(10,861)	(10,350)
Accounts payable and accrued expenses	71,772	38,852	22,893
Deferred revenue	6,487	24,313	75,448
Income taxes payable	20,703	16,071	2,177
Other noncurrent liabilities	14,376	16,642	9,739
Net cash provided by operating activities	<u>337,987</u>	<u>287,588</u>	<u>152,303</u>
<b>Cash Flow from Investing Activities:</b>			
Proceeds from sale of equipment, vehicles and leasehold improvements	2,062	1,280	1,461
Payments for purchase of equipment, vehicles, leasehold improvements and other	(91,891)	(62,740)	(43,180)
Purchase of short-term interest-bearing investments, net	(237,069)	—	—
Investment in noncurrent assets	(12,291)	(9,000)	—
Net cash acquired in acquisitions	—	67,791	—
Net cash used in investing activities	<u>(339,189)</u>	<u>(2,669)</u>	<u>(41,719)</u>
<b>Cash Flow from Financing Activities:</b>			
Net proceeds from issuance of Ordinary Shares	—	—	42,535
Proceeds from employee stock options exercised	13,967	21,360	—
Payments under short-term finance arrangements	(20,000)	(284,464)	(395,345)
Borrowings under short-term finance arrangements	—	301,933	306,161
Net proceeds from issue of long-term convertible notes	488,000	—	—
Principal payments on capital lease obligations	(10,067)	(6,622)	(4,150)
Net cash provided by (used in) financing activities	<u>471,900</u>	<u>32,207</u>	<u>(50,799)</u>
Net increase in cash and cash equivalents	470,698	317,126	59,785
Cash and cash equivalents at beginning of year	402,300	85,174	25,389
Cash and cash equivalents at end of year	<u>\$ 872,998</u>	<u>\$402,300</u>	<u>\$ 85,174</u>

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

	Year ended September 30,		
	2001	2000	1999
<b>Supplementary Cash Flow Information</b>			
Interest and Income Taxes Paid			
Cash paid for:			
Income taxes, net of refunds	\$ 77,429	\$ 49,262	\$ 38,369
Interest	2,901	2,614	6,393

## non-cash investing and financing activities

Capital lease obligations of \$13,116, \$15,732 and \$14,853 were incurred during the years ended September 30, 2001, 2000 and 1999, respectively, when the Company (as defined below) entered into lease agreements for vehicles.

In fiscal 2000, the Company issued 6,461 Ordinary Shares and options to acquire 1,103 Ordinary Shares in connection with the acquisition of ITDS (as defined below). The Company issued 13,846 exchangeable shares and options to acquire 1,654 Ordinary Shares in connection with the acquisition of Solect (as defined below). See note 3.

As of September 30, 1999, the Company incurred stock issuance costs of \$1,153, which had not been paid as of that date. Such costs were paid during fiscal year 2000.

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

## note 1- nature of entity

Amdocs Limited (the "Company") is a leading provider of software products and services to the communications industry. The Company and its subsidiaries operate in one business segment, providing business support systems and related services for the communications industry. The Company designs, develops, markets, supports and operates information system solutions for communications companies throughout the world.

The Company is a Guernsey corporation, which directly or indirectly holds several wholly-owned subsidiaries in the Asia-Pacific region, Australia, Europe, Israel, Latin America and North America. The Company's customers are mainly in North America, Europe, Latin America and the Asia-Pacific region. During fiscal 2001, the Company derived approximately 54 percent of its revenue from North America. The Company's main production and operating facilities are located in Israel, the United States, Ireland, Canada and Cyprus.

## note 2 - summary of significant accounting policies

### **Basis of Presentation**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States.

### **Consolidation**

The financial statements include the accounts of the Company and all its subsidiaries, which are wholly-owned. All significant intercompany transactions and balances have been eliminated in consolidation.

### **Functional Currency**

The U.S. dollar is the functional currency for the Company and its subsidiaries, as the U.S. dollar is the predominant currency of the Company's revenue and expenses.

### **Cash and Cash Equivalents**

Cash and cash equivalents consist of cash and short-term interest-bearing investments with insignificant interest rate risk and original maturities of 90 days or less.

### **Investments**

From time to time the Company invests in short-term interest-bearing investments. The Company classifies all of its short-term interest-bearing investments as available-for-sale securities. Such short-term interest-bearing investments consist primarily of federal agency securities and corporate bonds, which are stated at market value. Unrealized gains and losses are comprised of the difference between market value and amortized costs of such securities and are reflected, net of tax, as other comprehensive income (loss) in shareholders' equity. Realized gains and losses on short-term interest-bearing investments are included in earnings and are derived using the specific identification method for determining the cost of securities.

The Company also has certain investments in non-publicly traded companies. These investments are included in other noncurrent assets in the Company's balance sheet and are generally carried at cost. The Company monitors these investments for impairment and makes appropriate reductions in carrying values if necessary.

#### **Equipment, Vehicles and Leasehold Improvements**

Equipment, vehicles and leasehold improvements are stated at cost. Assets under capital leases are recorded at the present value of the future minimum lease payments at the date of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the asset, which ranges from 2 to 10 years and includes the amortization of assets under capitalized leases. Leasehold improvements are amortized over the shorter of the estimated useful lives or the term of the lease. Management reviews property and equipment and other long-lived assets on a periodic basis to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

#### **Goodwill and Other Intangible Assets**

The total purchase price of product line or business acquisitions accounted for using the purchase method is allocated first to identifiable assets and liabilities based on estimated fair values. The excess of the purchase price over the fair value of net assets of purchased businesses is recorded as goodwill. Goodwill is amortized on a straight-line basis over its estimated useful life.

Other intangible assets consist of purchased computer software, intellectual property rights, core technology, workforce-in-place and customer base.

Purchased computer software is reported at the lower of amortized cost or net realizable value, and is amortized over its estimated useful life based on pro-rata amount of the future revenue expected to be realized from the software. This accounting policy results in amortization of purchased computer software on a basis faster than the straight-line method.

Intellectual property rights, core technology, workforce-in-place and customer base acquired by the Company are amortized over their estimated useful lives on a straight-line basis. Periodically, the Company considers whether there are indicators of impairment that would require the evaluation of the net realizable value of goodwill and other intangible assets in comparison to their carrying value. Any impairment would be recognized when the expected future operating cash flows derived from such intangible assets is less than their carrying value.

#### **Comprehensive Income**

The Company accounts for comprehensive income under the provisions of Statement of Financial Standards (SFAS) No. 130, "Reporting Comprehensive Income", which established standards for the reporting and display of comprehensive income and its components. Comprehensive income represents the change in shareholders' equity during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity except those resulting from investments by owners and distributions to owners.

### **Income Taxes**

The Company records deferred income taxes to reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for tax purposes. Deferred taxes are computed based on tax rates anticipated to be in effect (under applicable laws at the time the financial statements are prepared) when the deferred taxes are expected to be paid or realized. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefit, or that future deductibility is uncertain. In the event that a valuation allowance relating to business acquisitions is subsequently reduced, the adjustment will reduce the original amount allocated to goodwill.

Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences, if not related to an asset or liability for financial reporting, and also include anticipated withholding taxes due on subsidiaries' earnings when paid as dividends to the Company.

### **Revenue Recognition**

The Company usually sells its software as part of an overall solution offered to a customer, in which significant customization and modification to the Company's software generally required. As a result, revenue generally is recognized over the course of these long-term projects in conformity with Accounting Research Bulletin (ARB) No. 45 "Long Term Construction Type Contracts", Statement of Position (SOP) 81-1 "Accounting for Performance of Construction Type and Certain Production Type Contracts" and SOP 97-2 "Software Revenue Recognition". Initial license fee for software revenue is recognized as work is performed, under the percentage of completion method of accounting. Subsequent license fee revenue is recognized upon completion of the specified conditions in each contract. Service revenue that involves significant ongoing obligations, including fees for customization, implementation and modification, is recognized as work is performed, under the percentage of completion method of accounting. Software revenue that does not require significant customization and modification, is recognized upon delivery, in accordance with the principles emphasized in Staff Accounting Bulletins (SAB) 101 "Revenue Recognition in Financial Statements" and SOP 97-2. In outsourcing contracts, revenue from operation and maintenance of customers' billing systems is recognized in the period in which the bills are produced. Revenue from ongoing support is recognized as work is performed. Revenue from third-party hardware and software sales is recognized upon delivery, and recorded at gross or net amount according to the criteria established in Emerging Issues Task Force (EITF) 99-19 "Recording Revenue Gross as a Principal versus Net as an Agent" and SAB 101. Maintenance revenue is recognized ratably over the term of the maintenance agreement, which in most cases is one year or less. Losses are recognized on contracts in the period in which the liability is identified. As a result of a substantial portion of our revenue being subject to the percentage of completion accounting policies, the Company's annual and quarterly operating results may be significantly affected by the size and timing of customer projects and the Company's progress in completing such projects.

Deferred revenue represents billings to customers for licenses, services and third-party products for which revenue has not been recognized. Unbilled accounts receivable include all amounts that had not been billed as of the balance sheet date due to their not being billable under contractual or other arrangements with customers.

Included in service revenue are sales of third-party products. Revenue from sales of such products includes third-party computer hardware and computer software products and was less than 10 percent of total revenue in each of fiscal 2001, 2000 and 1999.

#### **Cost of License and Cost of Service**

Cost of license and service consists of all costs associated with providing services to customers, including warranty expense. Estimated costs related to warranty obligations are initially provided at the time the product is delivered and are revised to reflect subsequent changes in circumstances and estimates. Cost of license includes royalty payments to software suppliers, amortization of purchased computer software and intellectual property rights.

Included in cost of service are costs of third-party products associated with reselling third-party computer hardware and computer software products to customers, when revenue from third-party products is recognized at gross amount. Customers purchasing third-party products from the Company generally do so in conjunction with the purchase of services.

#### **Research and Development**

Research and development expenditures consist of costs incurred in the development of new software modules and product offerings, either in conjunction with customer projects or as part of the Company's internal product development programs. Research and development costs, which are in conjunction with a customer project, are expensed as incurred.

Based on the Company's product development process, technological feasibility, as defined in SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", is established upon completion of a detailed program design or, in the absence thereof, completion of a working model. Costs incurred by the Company after achieving technological feasibility and before the product is ready for customer release have been insignificant.

#### **Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees". Pursuant to this accounting standard, the Company records deferred compensation for share options granted to employees at the date of grant based on the difference between the exercise price of the options and the market value of the underlying shares at that date. Deferred compensation is amortized to compensation expense over the vesting period of the underlying options. No compensation expense is recorded for stock options that are granted to employees and directors at an exercise price equal to the fair market value of the Ordinary Shares at the time of the grant. See note 19 for pro forma disclosures required in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation". Compensation expenses that are deductible in a tax return in a period different from the one in which they are reported as expenses in measuring net income are temporary differences that result in deferred taxes. To the extent that compensation is not recorded for stock-based compensation, the benefit of the related tax deduction is recorded as an increase to additional paid-in capital in the period of the tax reduction.

### **Fair Value of Financial Instruments**

The financial instruments of the Company consist mainly of cash and cash equivalents, short-term interest-bearing investments, accounts receivable, short-term financing arrangements, forward exchange contracts, lease obligations and convertible notes. In view of their nature, the fair value of the financial instruments, excluding the convertible notes, included in the accounts of the Company does not significantly vary from their carrying amount. The fair values of the Company's foreign currency exchange contracts are estimated based on quoted market prices of comparable contracts.

### **Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of trade receivables. The Company invests its excess cash primarily in highly liquid U.S. dollar-denominated securities with major U.S. and U.K. institutions. The Company does not expect any credit losses in respect of these items. The Company's revenue is generated primarily in North America and Europe and to a lesser extent in the Asia-Pacific region and Latin America. Most customers are among the largest communications and directory publishing companies in the world (or are owned by them). The Company performs ongoing credit analyses of its customer base and generally does not require collateral.

### **Earnings per Share**

The Company accounts for earnings per share based on SFAS No. 128 "Earnings per Share". SFAS No. 128 requires companies to compute earnings per share under two different methods, basic and diluted earnings per share, and to disclose the methodology used for the calculations. Basic earnings per share is calculated using the weighted average number of shares outstanding during the period. Diluted earnings per share is computed on the basis of the weighted average number of shares outstanding and the effect of the dilutive outstanding stock options using the treasury stock method and the effect of the dilutive outstanding convertible notes using the if-converted method.

### **Derivatives and Hedging**

The Company accounts for derivatives and hedging based on SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 requires the Company to recognize all derivatives on the balance sheet at fair value. If the derivative meets the definition of a hedge and is so designated, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is recognized in earnings.

### **Reclassifications**

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

### **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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. The Company's most significant estimates are related to contract accounting estimates used to recognize revenue under the percentage of completion method of accounting. Actual results could differ from those estimates.