INKTOMI CORP
Form 10-K
December 30, 2002

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 30, 2002

0-24339

(Commission File Number)

INKTOMI CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**94-3238130**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*

4100 East Third Avenue

Foster City, California 94404
(Address of principal executive offices)

(650) 653-2800

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.001 Par Value
(Title of Class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes þ No o

Based on the closing sale price of the Common Stock on the NASDAQ National Market System on November 30, 2002, the aggregate market value of the voting stock held by non-affiliates of the Registrant was $249,014,641. Shares of Common Stock held by each officer and director and by each person known by the Company to own 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of Registrant s Common Stock, $0.001 par value, was 162,754,667 at November 30, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information is incorporated by reference to the Proxy Statement for the Registrant s 2003 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form 10-K.

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This report on Form 10-K and other oral and written statements made by the Company to the public contain and incorporate forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. When used in this report, the words anticipate, believe, expect, intend, may, will and similar expressions identify forward-looking statements. Forward-looking statements in this report include, but are not limited to, those relating to the general direction of our business; our ability to successfully enter new markets; our ability to grow and maintain our Web search services and paid inclusion business models; our ability to continue to support the service provider market; our success generating sales through our partners; our ability to introduce new products and services and enhance existing products and services to meet customer needs; our expected expenses for future periods; our ability to improve our sales and distribution capabilities; our focus on both domestic and international markets; our ability to develop and maintain productive relationships with providers of leading network technologies; our future expenses; the possibility of acquiring complementary businesses, products, services and technologies; results related to mergers, acquisitions and dispositions; and the conditions of markets that impact our business. Although we believe our plans, intentions and expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained in this

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report. Important factors that could cause actual results to differ materially from our forward-looking statements are set forth in this report under the headings Factors Affecting Operating Results, Management s Discussion and Analysis of Financial Condition and Results of Operations and in other reports filed with the Securities and Exchange Commission. These factors are not intended to represent a complete list of the general or specific factors that may affect us. Other factors, including general economic factors and business strategies, may be significant, presently or in the future, and the factors set forth in this report may affect us to a greater extent than indicated. You should not rely on these forward-looking statements, which reflect our position as of the date of this report. We do not assume any obligation to revise forward-looking statements.

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PART I

Item 1. ***Business***
Overview

Inktomi provides World Wide Web search services for Internet portal and search destination sites. Inktomi Web Search provides a customizable, private label solution that offers portals and destination sites the ability to serve differentiated, highly relevant search results. Inktomi Web Search, through its paid inclusion services, also provides content publishers greater access to end users through portal and destination site customers of our search engine services. Web search customers include Microsoft, Overture and HotBot. Paid inclusion customers include Amazon, E-Bay and WalMart.com.

Based in Foster City, Calif., we were incorporated in California in February 1996 and reincorporated in Delaware in February 1998. In this report, Inktomi, the Company, our, us, we and similar expressions refer to Inktomi Corporation and its subsidiaries. Inktomi, Essential to the Internet, Traffic Server, Content Bridge, Search Everywhere, and the tri-colored cube design and other marks are service marks, trademarks and registered trademarks of Inktomi Corporation in the United States and in other countries. All other trademarks, trade names or service marks appearing herein are owned by their respective owners.

Business Background and Strategy

We originally established Inktomi to provide Web search services, entering the market in May 1996 as the first OEM search infrastructure provider. Since 1996, we continued to focus on developing and enhancing this core aspect of our business at the same time as we began to expand our product offerings to provide a range of network infrastructure applications designed to enhance the performance and intelligence of large-scale networks. We expanded our offerings to respond to high initial growth rates in Internet traffic and the resulting need for the build out of networking infrastructure. We also built a worldwide sales organization and a large development and support organization to provide products and services in this area.

As a result of this expanded product offering, we began our 2002 fiscal year with three main product and service offerings: (i) Inktomi *Web search services*, (ii) *content networking products*, comprised of a portfolio of software products designed to address the content and information management and distribution requirements of large enterprises and internet service providers, and (iii) *enterprise search*, comprised of software products designed to enable an enterprise to both crawl and index content within its private intranet and to make this information searchable by its employees and to crawl and index content on a public Internet site and to make this information searchable by customers, prospects and other visitors.

Over the last year, the business climate in general and the service provider market in particular continued to experience dramatic declines. This has adversely impacted our ability to generate revenues and achieve positive earnings. In response to this challenging market environment we determined that we needed to fundamentally restructure our business and sales strategies. As a result of this decision, in July 2002, we commenced a number of initiatives to adjust to this business environment through strong cost cutting measures, consolidating operations and undertaking work force reductions, with the goal of reducing our financial losses and preserving cash resources.

In July 2002, we announced we would be reducing our investment in our content networking products group. As a result, we significantly scaled back the content networking products group and related corporate infrastructure and closed several sales offices around the world. In November 2002, we signed an agreement with Satyam Computer Services, Inc. to take over the support of our remaining content networking software customers and therefore we expect to substantially exit this business by the end of fiscal 2003. Further, in November 2002, we announced an asset sale with Verity, Inc. pursuant to which Verity purchased our enterprise search software business. This asset sale closed on December 16, 2002.

As a result of these restructurings and the asset sale, we are now focused on our Web Search offerings, which utilize the Inktomi Search Engine to provide search results information to our customers, and, through

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our paid inclusion services, also provide content publishers greater access to end users through portal and destination site customers of our search engine services.

Web Search Services

Our Web search services enable our customers to provide a variety of online search services to end-users. We use the Inktomi Search Engine to provide search results information to our customers, who in turn incorporate these results into their online offerings to end users. We provide and manage hardware, software and operational aspects of the Inktomi Search Engine and the associated database of Internet content. We also provide the customer with a programming interface and software tools to enable the customer to custom design its own search service user interface. The user interface communicates with the Inktomi Search Engine via a communication protocol, called the Inktomi Data Protocol. Separating the user interface enables this portion of the service to reside in a different physical location from the Inktomi Search Engine and to run on the customer s choice of computing equipment. In addition, the customer can customize the user interface as to look and feel and functionality and can change the user interface at any time without affecting the operation of the Inktomi Search Engine. This turn-key model allows us to serve multiple customers while continuing to concentrate on developing our core search engine technology. Our Web search customers include Microsoft, Overture and HotBot.

Our Search Engine comprises a crawler, an indexer and search engine servers. The crawler and indexer are software programs that collect and organize information, and store that information on the cluster of search engine servers. The search engine servers are a collection of workstations that are linked together through the use of Inktomi s proprietary software. The search engine servers provide powerful full-text query operations, including full Boolean support, date restrictions and the recognition of multimedia files, various file formats and other embedded objects. Search results are relevance-ranked using state-of-the-art proprietary algorithms.

We generate search service revenues through a variety of contractual arrangements, which include per-query search fees, search service hosting fees, content provider paid inclusion fees, license fees and support fees. Our search services revenues result from the number of end-user searches that are processed by the Inktomi Search Engine and the level of advertising revenue generated by customers.

We have historically generated most search services revenues directly from Internet portal and other online destination site customers. More recently, we have expanded our programs for content providers and other companies who desire to be more easily found on the Internet. Through our paid inclusion programs, content providers submit information often not normally available by traditional web crawling techniques and this information is included in our Web search index. We generate fees when end users query the search index and, depending on the nature of our agreement, click through on the link to the customers web site and, in some customer relationships, also purchase an item from our customer. We are focusing our efforts on expanding these content provider paid inclusion fees.

Our paid inclusion services are comprised of two programs: Inktomi Index Connect and Inktomi Search Submit. Inktomi Index Connect is a pay-for-performance program tailored to large Web sites with more than 1,000 URLs. Inktomi Index Connect subscribers pay fees based on sales leads delivered to their sites from Internet portal searches powered by us. Smaller content providers can join Inktomi Search Submit, a flat-fee, subscription-based service that provides inclusion in the Inktomi Web Search index and an automatic 48-hour refresh of the submitted content. We also will enter into custom Inktomi Index Connect agreements whereby we receive payments based on customer registration or customer sales activity. Paid inclusion customers include Amazon, E-Bay and WalMart.com. We pay certain Internet portal customers, primarily Microsoft, a portion of all paid inclusion revenues generated as they provide access to the click-throughs which enable us to generate the paid inclusion revenues. These payments to Microsoft are recorded as a reduction to Web search revenues generated from Microsoft.

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Sales and Marketing

Our sales strategy is to pursue increased Web search query volume by adding OEM customers and fostering the growth of existing relationships. We currently maintain a small, direct sales force based in the US and Europe. This sales force focuses on portals and other destination sites.

Our strategy also includes expanding our paid inclusion programs. A small, direct sales force works with large content providers that are interested in adding content to our index of Web data. We also have an expansive array of resellers that sell access to our Web search index. The resellers are provided a discount on paid inclusion fees and, in exchange, provide most customer support, billing and administrative services for the customers that they aggregate.

Our software product lines included a large direct sales force to penetrate various targeted market segments through multiple indirect distribution channels. We conducted a variety of programs worldwide to stimulate market demand for our software products, including public relations activities, advertising, trade shows and collateral development. These programs were focused on our target markets and were designed to create awareness and generate sales leads. With the scale down of our content networking products group in July 2002 and the sale of our enterprise search group in December 2002, our direct sales force for software products has been largely eliminated.

Customer Service and Support

We believe that a high level of customer service and support is critical to the successful marketing, sale, and deployment of our products. Web search customer support is integrated into our technical, development and management organizations.

For our software products, we developed a comprehensive service and support organization to manage our service provider customer accounts and enterprise customers. We provide a base level of technical support to our customers through support agreements. In November 2002, we signed an agreement with Satyam Computer Services Ltd. to assign and, in some cases, subcontract the support for remaining content networking software customers. Satyam Computer Services is a provider of professional services employees in offices worldwide. Satyam Computer Services is expected to take over most support obligations beginning in January 2003. In exchange, we pay Satyam Computer Services a one-time fee, provide initial training and transfer certain computer infrastructure components to allow for customer support. In December 2002 we completed the sale of our Enterprise Search Division to Verity, Inc. (see Note 19 to the Financial Statements) and the related support obligations were assumed by Verity, Inc.

Research and Development

We believe that strong product development capabilities are essential to our strategy of enhancing our core technology, developing additional services incorporating that technology, and maintaining the competitiveness of our product and service offerings. We have invested significant time and resources in creating a structured process for undertaking all product development projects. This process involves all functional groups and all levels within Inktomi and is designed to provide the framework for defining and addressing the steps, tasks and activities required to bring product concepts and development projects to market successfully. In addition, we have actively recruited and hired key computer scientists, engineers and software developers with expertise and degrees in the areas of massively parallel computing, mathematics, and computer science. Through this mix of personnel, we strive to create and maintain an environment of rapid innovation and product development.

Our current research and development efforts are focused on adding features and functionality directed to derive additional revenue from our Web search services. We are also focused on continuing to improve the relevance of our Web search service results and the size and freshness of our Web search index. Our research and development expenses totaled $51.3 million, $77.9 million and $59.7 million for the fiscal years ended September 30, 2002, 2001 and 2000, respectively.

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Competition

We compete with a number of companies to provide Internet search and directory services and technology. In the Web services marketplace, our primary competitors include a variety of established and newer companies, including AltaVista, Ask Jeeves, FAST Search and Transfer, Google, Overture, LookSmart, Northern Light, and Yahoo. These companies and other competitors have focused on search result relevance, database size metrics and ease of use to differentiate their services. In addition, several large media and other Internet-based companies have made investments in, or acquired, Internet search engine companies and may seek to develop or customize their products and services to deliver to our target customers.

Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements than we can. In addition, our current and potential competitors may bundle their offerings with other services in a manner that may discourage users from purchasing services offered by us. Also, current and potential competitors have or may have greater name recognition, more extensive customer bases and access to proprietary content. Increased competition could result in price reductions, fewer customer orders, fewer search queries served, reduced gross margins and loss of market share.

Proprietary Rights

Our success and ability to compete are substantially dependent upon our internally developed technology, which we protect through a combination of patent, copyright, trade secret and trademark law. We generally enter into confidentiality or license agreements with our employees, consultants and corporate partners, and generally control access to and distribution of our software, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Policing unauthorized use of our products is difficult, and we cannot be sure that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

Substantial litigation regarding intellectual property rights exists in the software industry. We expect that software products may be increasingly vulnerable to third-party infringement claims as the number of competitors in our industry segments grows and the functionality of products in different industry segments overlaps. We believe that many companies have filed or intend to file patent applications covering aspects of their technology that they may claim our technology infringes. Some of these companies have sent copies of their patents to Inktomi for informational purposes. We cannot be sure that these parties will not make a claim of infringement against us with respect to our products and technology. Any claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management s attention and resources, and could cause product shipment delays or require us to reengineer our products or enter into royalty or licensing agreements. These royalty or licensing agreements, if required, may not be available on acceptable terms, if at all.

In August, 2001, an amended complaint was filed by Network Caching Technology, L.L.C. in the United States District Court for the Northern District of California against Inktomi as well as other providers of caching technologies including Novell, Inc., Akamai Technologies, Inc., Volera, Inc., and Cacheflow, Inc. Plaintiff alleges that certain products marketed by Inktomi and the other defendants violate one or more patents owned by plaintiff. The complaint seeks compensatory and other damages and injunctive relief. We subsequently filed a response denying the allegations and asserting a number of defenses. We believe these claims are without merit and we intend to vigorously defend against them.

In October 2002, a complaint was served by Teknowledge Corporation in the United States District Court for Delaware against Inktomi, Akamai Technologies, Inc. and Cable & Wireless Services, Inc. The plaintiff alleges that Inktomi products, including Traffic Server, infringe a patent owned by the plaintiff. The complaint seeks compensatory and other damages and injunctive relief. In November 2002, the judge assigned to the case in Delaware transferred jurisdiction of the case to the Northern District of California. Inktomi intends to vigorously defend the against the allegations made by plaintiff.

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Our products and services operate in part by making copies of material available on the Internet and other networks and aggregating this content within centralized or distributed applications. This creates the potential for claims to be made against us (either directly or through contractual indemnification provisions with customers) for defamation, negligence, copyright or trademark infringement, personal injury, invasion of privacy or other legal theories based on the nature, content, copying, collection or use of these materials. These claims have been threatened against us from time to time and have been brought, and sometimes successfully pressed, against online service providers. It is also possible that if any information provided through any our Web search business or facilitated by our software products contains errors, third parties could make claims against us for losses incurred in reliance on this information. Although we carry general liability insurance, our insurance may not cover potential claims of this type or be adequate to protect us from all liability that may be imposed.

Employees

We had 405 full-time employees as of September 30, 2002. In October 2002, we announced a restructuring that resulted in the elimination of 85 full-time employee positions. With the sale of our enterprise search product line in November 2002, we further reduced our size to approximately 200 people. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider relations with our employees to be good.

Current Developments

On December 22, 2002, we entered into a definitive merger agreement with Yahoo! Inc. Under the agreement, a newly incorporated wholly-owned subsidiary of Yahoo! will merge with and into Inktomi, with Inktomi remaining as the surviving legal entity and a wholly-owned subsidiary of Yahoo! Under the terms of the merger agreement, upon completion of the merger, Yahoo! will pay to Inktomi s stockholders $1.65 per share of Inktomi common stock outstanding and will assume any outstanding options to purchase Inktomi common stock.

The merger is subject to a number of conditions including, among others, approval of Inktomi s stockholders and certain regulatory approvals and clearances, including under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended. We currently expect the merger to be completed in the quarter ending March 31, 2003. There can be no assurance that the merger will be consummated. In the event that the proposed merger fails to close, under certain circumstances we will be required to pay Yahoo! a termination fee of $11.2 million.

Item 2. ***Properties***

Our corporate headquarters consist of approximately 130,000 square feet of office space in Foster City, California. In June 2000, we entered into a synthetic lease agreement for this facility and another building on the property totaling approximately 260,000 square feet. This operating lease is commonly referred to as a synthetic lease because it represents a form of off-balance sheet financing pursuant to which an unrelated third-party funds 100% of the costs of the acquisition of the property and leases the asset to Inktomi as leasee. Immediately prior to the closing of the synthetic lease, the agreement was assigned to a third-party lessor under the terms of this synthetic lease finance structure. On August 28, 2002, through the execution of a Termination and Release Agreement, we exercised the purchase option under the synthetic lease and title for the facilities was transferred to Inktomi. In December 2002, we sold the property for proceeds of $41.6 million and leased back the portion we now occupy, which is approximately 130,000 square feet. The lease is for a period of five years renewable at our election for three successive five year periods. The lease may also be terminated at our election after two years in exchange for a fee. Aggregate payments to be made under the lease are approximately $9.8 million over the lease term ending December 19, 2007, net of costs.

In April 2000, we entered into a lease agreement commencing January 1, 2002 for 381,050 square feet of office space in two mid-rise office buildings in Foster City, California, known as Parkside Towers. Payments under the lease commenced on January 1, 2002, when the property was delivered to Inktomi by the developer

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and were to continue over the lease term ending October 31, 2014 for one building and October 31, 2016 for the second building. Aggregate payments to be made under the lease were approximately $324.4 million over the lease term ending October 31, 2016. In September 2002, we executed a Lease Termination Agreement with the landlords of this facility. The total cost of the lease termination, including cash and non-cash items, was approximately $54 million.

In addition, we have sales and development offices, many of which we have abandoned, in several locations: Herndon (Virginia), London, Tokyo, San Francisco, Needham (Massachusetts), Redwood Shores (California), Carlsbad (California), Downers Grove (Illinois) and San Mateo. The Herndon, Virginia lease covers approximately 25,000 square feet and expires in July 2005. The London lease covers approximately 17,500 square feet and expires in September 2015. The Tokyo lease covers approximately 7,000 square feet and expires in March 2003. The San Francisco lease covers approximately 30,000 square feet of office space and expires in December 2002 and July 2004. The Needham, Massachusetts lease covers approximately 15,000 square feet and expires in July 2003. The Redwood Shores lease covers approximately 30,700 square feet of office space and expires in 2010. The Carlsbad (California) lease covers approximately 9,000 square feet of office space and expires in 2005. The Downers Grove (Illinois) lease covers 5,346 square feet of office space and expires in 2005. The San Mateo lease covers 48,666 square feet of office space and expires in 2003.

Item 3. ***Legal Proceedings***

In August, 2001, an amended complaint was filed by Network Caching Technology, L.L.C. in the United States District Court for the Northern District of California against Inktomi as well as other providers of caching technologies including Novell, Inc., Akamai Technologies, Inc., Volera, Inc., and Cacheflow, Inc. Plaintiff alleges that certain products marketed by Inktomi and the other defendants violate one or more patents owned by plaintiff. The complaint seeks compensatory and other damages and injunctive relief. We subsequently filed a response denying the allegations and asserting a number of defenses. We believe these claims are without merit and we intend to vigorously defend against them.

In October 2002, a complaint was served by Teknowledge Corporation in the United States District Court for Delaware against Inktomi, Akamai Technologies, Inc. and Cable & Wireless Services, Inc. The plaintiff alleges that Inktomi products, including Traffic Server, infringe a patent owned by the plaintiff. The complaint seeks compensatory and other damages and injunctive relief. In November 2002, the Judge assigned to the case in Delaware transferred jurisdiction of the case to the Northern District of California. Inktomi intends to vigorously defend the against the allegations made by the plaintiff.

Other than as described above, we are not involved in any legal proceedings at this time that our management currently believes would be material to our business, financial condition or results of operations.

Item 4. ***Submission of Matters to a Vote of Security Holders***

We did not submit any matter to a vote of security holders during the fourth quarter of the fiscal year ended September 30, 2002.

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PART II

Item 5. ***Market for Registrant s Common Stock and Related Stockholder Matters***

Our Common Stock is quoted on the NASDAQ National Market under the symbol INKT . The following table shows the high and low daily closing sale prices per share of our Common Stock as reported on the NASDAQ National Market for the periods indicated:

	High	Low
Fiscal 2001:		
First Quarter	108.94	17.88
Second Quarter	18.63	5.74
Third Quarter	10.96	2.79
Fourth Quarter	9.17	2.25
Fiscal 2002:		
First Quarter	7.71	2.70
Second Quarter	7.31	3.45
Third Quarter	3.82	0.78
Fourth Quarter	1.06	0.25
Fiscal 2003:		
First Quarter (through November 30, 2002)	1.64	0.26

As of November 30, 2002, there were approximately 1,370 holders of our Common Stock. We have never declared or paid any dividends on our capital stock. We currently expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. The covenants under our Loan and Security Agreement with Silicon Valley Bank prohibit us from paying cash dividends.

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

The selected consolidated financial data set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of Inktomi Corporation and the notes thereto included elsewhere in this report. The historical results are not necessarily indicative of results to be expected for any future period.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA

	For the Year Ended September 30,				
	2002(a)	2001(b)	2000	1999	1998
	(In thousands, except per share data)				
Total revenues	$ 112,705	$ 198,562	$224,217	$ 73,503	$ 21,355
Operating loss	(506,639)	(239,989)	(42,465)	(37,619)	(30,428)
Net loss	(500,795)	(296,482)	(27,340)	(33,028)	(29,915)
Basic and diluted net loss per share	(3.51)	(2.36)	(0.24)	(0.32)	(0.38)
Weighted average shares outstanding used in calculating basic and diluted net loss per share	142,693	125,608	113,030	102,033	79,252

(a) Fiscal 2002 includes: $202.6 million impairment charge related to goodwill and other intangibles; $80.0 million charges related to our Parkside lease restructuring and termination; and $103.0 million charge for impairment of property, plant and equipment.

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(b) Fiscal 2001 includes: $44.9 million impairment charge related to goodwill and other intangibles; $19.5 million in acquisition related costs; and a $65.9 million charge for impairment of investments.

CONSOLIDATED BALANCE SHEETS DATA

	September 30,				
	2002	**2001**	**2000**	**1999**	**1998**
			(In thousands)		
Cash and cash equivalents and short-term investments	$ 45,407	$ 84,513	$218,511	$304,214	$54,711
Long term restricted cash		128,957	119,616		
Investments in equity securities	331	1,381	117,898	8,180	
Working capital	(36,377)	7,672	165,328	298,764	40,949
Total assets	145,216	583,123	919,256	385,337	78,946
Debt and capital lease obligations, less current portion	216	5,649	3,748	8,293	9,074
Total stockholders equity	46,634	471,981	803,062	343,867	50,184

Note: All historical information has been restated to reflect the acquisitions of C2B Technologies, Inc. in September 1998, Impulse! Buy Network, Inc. in April 1999, WebSpective Software, Inc. in October 1999, and FastForward Networks, Inc. in October 2000. Each of these acquisitions were accounted for as a pooling of interests.

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

Overview

Prior to July 2002, our business was focused around three main product and service offerings: (i) *Web search services*, comprised of customizable solutions that offer portals and destination sites the ability to serve differentiated, highly relevant search results to their end users and our paid inclusion services, which provide content publishers greater access to end users through portal and destination site customers of our search engine services, (ii) *content networking products*, comprised of a portfolio of software products designed to address the content and information management and distribution requirements of large enterprises, and (iii) *enterprise search*, comprised of software products designed to enable an enterprise to both crawl and index content within its private intranet and to make this information searchable by its employees and to crawl and index content on a public Internet site and to make this information searchable by customers, prospects and other visitors.

In recent periods, the business climate in general and the service provider market in particular, has experienced dramatic declines. This has adversely impacted our ability to generate revenues and achieve positive earnings. Since April 2001, we have undertaken a number of restructurings, particularly workforce reductions and real estate consolidations, to react to market conditions, reducing expenses through strong cost cutting measures, consolidating operations and undertaking work force reductions. In July 2002, our work force reductions were particularly significant in our content networking group, which has historically generated revenues from the now struggling service provider market. In addition to the workforce reductions, we also significantly reduced the resources devoted to this business. Further, in November 2002, we signed an agreement with Satyam Computer Services Ltd. to assign and, in some cases, subcontract the support for our remaining content networking software customers. Satyam is a provider of professional services employees in offices worldwide. Satyam is expected to take over most support obligations beginning in January 2003. In exchange, we pay Satyam a one-time fee, provide initial training and transfer of certain computer infrastructure components to allow for customer support. The cost of the agreement is approximately $1.0 million which will be recognized over the remaining life of existing customer support contracts. We expect revenues and expenses for our content networking product line to eventually decline to zero in fiscal 2003.

Further, in December 2002, we consummated the divestiture of our Enterprise Search division to Verity Inc. in a transaction accounted for as a sale of assets. As part of the sale, Inktomi received $22 million in cash, with an additional $3 million to be paid within 18 months of the closing of this asset sale, subject to certain conditions.

As a result of these restructurings, our current business is focused primarily on providing World Wide Web search services for Internet portal and search destination sites. Inktomi Web Search provides a customizable, private label solution that offers portals and destination sites the ability to serve differentiated, highly relevant search results. Inktomi Web Search, through its paid inclusion services, also provides content publishers greater access to end users through portal and destination site customers of our search engine services.

Web search services revenues are generated through a variety of contractual arrangements, which include general service fees, per-query search fees, database inclusion fees, maintenance fees and search service hosting fees.

General services fees and per-query search fees are based, and recognized, on the query volume in the period or the minimum payments of the respective contract. Database inclusion fees are generated from customers who pay on a click-through basis and customers who pay a flat rate per universal resource locator (URL) to be included in the Inktomi database. Fees based on click-throughs are recognized based on the activity for that period. Fees based on a flat rate per URL are recognized ratably over the term of the contract. Maintenance fees and search services hosting fees are recognized ratably over the term of the contract. For all Web search services, revenue is recognized when persuasive evidence of an arrangement exists, the services have been delivered, performance obligations have been satisfied, no refund obligations exist and collection is reasonably assured.

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Licenses revenues are composed of license and upgrade fees in connection with our software products, which includes our content networking products and our enterprise search products. Our content networking products include our Traffic Server network cache platform, our Content Delivery Suite software solutions, our Media Products, Traffic Core, Traffic Edge, Traffic Controller, Inktomi Media Publisher, and Personal Edge. License fees are generally based on the number of CPUs or nodes running the software, or on network traffic throughput across our products, depending on customer deployment, and are generally recognized upon shipment of the software assuming all other revenue recognition criteria have been met. License fees for our enterprise search products were typically based on the number of documents that can be indexed and searched by a customer.

Maintenance service revenues are generated through maintenance fees related to our software products. Maintenance service fees are recognized ratably over the term of the maintenance agreement.

Other services revenues are composed of revenues generated through consulting and, for some historical periods, through fees generated from our Commerce Engine. Consulting fees are recognized ratably over the service period as the services are performed. We completed the sale of our Commerce Division in March 2001 and therefore, services revenues for year ended September 30, 2002 consisted of only consulting and support fees. Our contracts for the Commerce Engine provided for payments consisting of annual infrastructure service fees, transaction fees from participating online merchants and per-query search fees, and advertising revenues and general service fees from Internet portals and other Web site customers.

In October 1999, we acquired WebSpective Software, Inc., a developer of software solutions for content and application distribution, delivery and management, in a transaction accounted for as a pooling of interests.

In July 2000, we acquired Ultraseek, Inc., a provider of scalable and customizable search and navigation software solutions, in a transaction accounted for under the purchase method of accounting.

In October 2000, we acquired FastForward Networks, Inc., a developer of software solutions for efficiently enabling streaming media over networks, in a transaction accounted for as a pooling of interests.

In December 2000, we acquired various business assets of Adero, Inc. relating to billing, settlement and traffic reporting and licensed other related technologies, in a transaction accounted for under the purchase method of accounting.

In March 2001, we consummated the divestiture of our Commerce Division to e-centives, Inc. in a transaction accounted for as a sale of assets.

In June 2001, we acquired eScene Networks, Inc., a developer of advanced streaming media applications and services, in a transaction accounted for under the purchase method of accounting.

In August 2002, we acquired Quiver Inc., a developer of information categorization and taxonomy solutions, in a transaction accounted for under the purchase method of accounting.

Critical Accounting Policies

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require management to make estimates and assumptions. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, impairment of long-lived assets, allowance for doubtful accounts and contingent liabilities related to lease obligation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe that the following critical accounting policies may involve a higher degree of judgment and complexity.

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Revenue Recognition

Licenses

Licenses revenues are composed of license and upgrade fees in connection with our software products including Traffic Server network cache platform, Content Delivery Suite software solutions, Media Products, Traffic Core, Traffic Edge, Traffic Controller, Inktomi Media Publisher, enterprise search products and Personal Edge. License fees are generally based on the number of CPUs or nodes running the software, or on network traffic throughput across our products, depending on customer deployment, and are generally recognized upon shipment of the software assuming all other revenue recognition criteria have been met.

License fees for our enterprise search products are typically based on the number of documents that can be indexed and searched by a customer. We recognize revenues from software licenses when the licensed product is delivered, collection is reasonably assured, the fee for each element of the transaction is fixed or determinable, persuasive evidence of an arrangement exists, and vendor-specific objective evidence exists to allocate the total fee to any undelivered elements of the arrangement.

We estimate whether collection is reasonably assured based on our knowledge of the customers payment history with us and other sources that may include use of third-party credit rating agencies. Actual collection of amounts from customers will depend on customer specific circumstances and therefore amounts, which we have determined that collection is assured, may ultimately not be collected.

We estimate whether fees are fixed and determinable based on contractual terms of the arrangement. We generally do not offer rights of refund or acceptance provisions. We do not record revenue until the lapse of these provisions, if provided. We assess whether there is sufficient history of collection for any payment terms provided to customers which are longer than what we provide the majority of our customers. We recognize revenue when amounts become due for any amounts considered to be extended payments.

Fees from licenses sold together with support and upgrade rights, consulting and implementation services are generally recognized upon delivery provided that the above criteria have been met, payment of the license fees is not dependent upon the performance of the services and the services are not essential to the functionality of the licensed software. Services are unbundled from these arrangements based on the price sold separately, or in some instances for support and upgrades, substantive renewal rates using the residual method.

We assess numerous factors of services provided with licenses sold in order to determine whether they are essential to the functionality of the software including, but not limited to, our history of providing similar services, whether other vendors can provide similar services, whether core software is being changed and whether customer collection of license fees are contingent upon completion of services. Our assessment of these factors is based on our knowledge of the service market, the software functionality which the customer is purchasing and the contractual terms of the arrangement.

Revenue on upgrade rights is recognized ratably over the term of the agreement and included in licenses revenue.

Web search services

Web search services revenues are generated through a variety of contractual arrangements, which include general service fees, per-query search fees, database inclusion fees, maintenance fees and search service hosting fees. General services fees and per-query search fees are based, and recognized, on the query volume in the period or the minimum payments of the respective contract. Database inclusion fees are generated from customers who pay on a click-through basis, in some cases also acquiring a customer s product, and customers who pay a flat rate per page to be included in the Inktomi database. Fees based on click-throughs are recognized based on the activity for that period. Fees based on a flat rate per universal resource locator (URL) are recognized ratably over the term of the contract. Maintenance fees and search services hosting fees are recognized ratably over the term of the contract.

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For all Web search services, revenue is recognized when persuasive evidence of an arrangement exists, the services have been delivered, performance obligations have been satisfied, no refund obligations exist and collection is reasonably assured.

Maintenance services

Maintenance services revenues are generated through the sale of support services in connection with initial license sales and renewals of support services after the initial service period. Support services generally have a term of one-year and are recognized over the term of the support agreement.

Other services

Other Services revenues are composed of revenues generated through consulting services and commerce revenues, prior to the divestiture of our Commerce Division in March 2001 (see Note 2 to the Financial Statements). Consulting fees are recognized as the services are performed or upon customer acceptance. In instances where the criteria for recognizing license revenues separate from the consulting or implementation revenues have not been met, both the licenses and consulting fees, excluding the maintenance and support elements, are recognized using contract accounting. When management can make reliable estimates on the extent of consulting services required for full functionality, the revenue for the licenses and consulting fees is recognized on a percentage-of-completion based on labor hours incurred compared to total estimated hours. When management cannot make reliable estimates on the extent of consulting services required for full functionality, the revenue for the licenses and consulting is deferred until the consulting services are completed. We classify revenue from these arrangements as licenses and services revenues, respectively, based upon the vendor-specific objective evidence of each element.

Impairment of Long-Lived Assets

We review our long-lived assets, including property, plant and equipment, goodwill and other intangibles, for impairment whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Events or changes in circumstances that we consider as impairment indicators include, but are not limited to the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for our overall business;
- a significant decrease in the market price of a long-lived asset;
- significant adverse economic and industry trends;
- a current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life;
- significant decline in our stock price for a sustained period; and
- our net book value relative to our market capitalization.

Estimates of cash flows related to sublease income and other real estate estimates are based on historical and current information obtained from commercial real estate brokers. This information requires significant judgment and may change in the future.

When we determine that the carrying amount of the long-lived asset may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate commensurate with the risk inherent in our current business model. Significant judgment is required in the development of projected cash flows for these purposes including assumptions regarding the appropriate level of aggregation of cash flows, their term and discount rate as well as the underlying forecasts of expected future revenue and expense. We use established

valuation techniques which rely on these estimates of cash flows which are developed based on our understanding of the underlying cash flows expected from the long-lived asset.

At June 30, 2002, due primarily to the sustained decrease in our market value as well as other factors, we recorded a charge of $200.9 million in addition to the quarterly amortization of $16.7 million to reflect the impairment of intangibles and other assets, primarily related to our goodwill which was created from our purchase of Ultraseek, Inc. See Note 12 to the Financial Statements for further information. Effective October 1, 2002, we will adopt Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* which requires, among other things, that goodwill and other intangibles determined to have an indefinite life are no longer to be amortized but are to be tested for impairment at least annually. In addition, the standard includes provisions upon adoption for assessing the impairment of goodwill at the reporting unit level as compared to the enterprise level under the current rules. We will adopt SFAS 142 as of October 1, 2002 and expect to complete the initial review during our second fiscal quarter ending March 31, 2003.

In October 2001, the Financial Accounting Standards Board (FASB) issued SFAS 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. The objectives of SFAS 144 are to address significant issues relating to the implementation of SFAS 121, *Accounting for the Impairment of Long-lived Assets to be Disposed of*, and to develop a single accounting model, based on the framework established by SFAS 121, for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. Although SFAS 144 supercedes SFAS 121, it retains some fundamental provisions of SFAS 121. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We will adopt SFAS 144 as of October 1, 2002 and do not expect that the implementation will have a significant effect on our financial statements, except for our expected discontinued operations treatment of the sale of our enterprise search division to Verity, Inc. (see Note 19 to the Financial Statements).

Restructurings

We monitor our organizational structure and associated operating expenses periodically. Depending on events and circumstances we may decide to restructure our business to reduce operating costs which may include terminating employees, abandoning lease space and incurring other exit costs. We accrue for the restructuring costs when all of the following occur: (1) management commits to the restructuring plan, (2) the termination benefits are communicated to employees subject to termination or other exit costs are estimated in detail, (3) the plan of termination identifies the number of employees, classification and location, and (4) the period of time to complete the restructuring indicates that significant changes are not likely.

Any resulting restructuring accrual includes numerous estimates made by management. Estimates of exit costs are developed based on our knowledge of the activity being effected and existing commitments and the cost to exit those commitments. Lease abandonment estimates include estimates of sublease income which are based on historical and current information often obtained from commercial real estate brokers. This information requires significant judgment and may change in the future, which may impact the restructuring accrual. For instance, subsequent to an accrual of lease abandonment we may negotiate a lease termination payment with the landlord which is different than the initial accrual. We monitor our initial estimates periodically and will record an adjustment for any significant changes in estimates.

In June 2002, the FASB issued SFAS 146, *Accounting for Exit or Disposal Activities*. SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002 and early application is encouraged. The

provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS 146. We will adopt FSAS 146 for exit or disposal activities that are initiated after December 31, 2002. The effect on adoption of SFAS 146 will change on a prospective basis the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Management regularly reviews the adequacy of the allowance after considering the size of the accounts receivable balance, historical bad debts, customer s expected ability to pay and our collection history with each customer. Management reviews significant individual invoices that are past due to determine whether an allowance should be made based on the factors described above. The allowance for doubtful accounts represents our best estimate, but changes in circumstances discussed above may result in a change to the amount of the allowance.

Recently Issued Accounting Pronouncements

In November 2001, the FASB Emerging Issues Task Force (EITF) reached a consensus on EITF Issue 01-09, *Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products*, which is a codification of EITF 00-14, 00-22 and 00-25. This issue presumes that consideration from a vendor to a customer or reseller of the vendor s products to be a reduction of the selling prices of the vendor s products and, therefore, should be characterized as a reduction of revenue when recognized in the vendor s income statement and could lead to negative revenue under certain circumstances. Revenue reduction is required unless consideration relates to a separate identifiable benefit and the benefit s fair value can be established. We implemented EITF 01-09 during the fiscal year ended September 30, 2002. The adoption of EITF 01-09 did not have a significant impact on the financial position or results of operations for the fiscal 2001 and 2000.

In July 2001, the FASB issued SFAS 142, *Goodwill and Other Intangible Assets*, which is effective for fiscal years beginning after December 15, 2001. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. The impairment review required under SFAS 142 will involve a two-step process as follows:

Step 1 we will compare the fair value of our reporting units to the carrying value, including goodwill of each of those units. For each reporting unit where the carrying value, including goodwill, exceeds the unit s fair value, we will move on to step 2. If a unit s fair value exceeds the carrying value, no further work is performed and no impairment charge is necessary.

Step 2 we will perform an allocation of the fair value of the reporting unit to its identifiable tangible and non-goodwill intangible assets and liabilities. This will derive an implied fair value for the reporting unit s goodwill. We will then compare the implied fair value of the reporting unit s goodwill with the carrying amount of the reporting unit s goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess.

We will adopt SFAS 142 as of October 1, 2002 and expect to complete the initial review during our second quarter ending March 31, 2003.

In October 2001, the FASB issued SFAS 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. The objectives of SFAS 144 are to address significant issues relating to the implementation of SFAS 121, *Accounting for the Impairment of Long-lived Assets to be Disposed of*, and to develop a single accounting model, based on the framework established by SFAS 121, for long-lived assets to be disposed of by

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sale, whether previously held and used or newly acquired. Additionally, SFAS 144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. Although SFAS 144 supercedes SFAS 121, it retains some fundamental provisions of SFAS 121. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We will adopt SFAS 144 as of October 1, 2002 and do not expect that the implementation will have a significant effect on our financial statements, except for our expected discontinued operations treatment of the sale of our enterprise search division to Verity, Inc. (see Note 19 to the Financial Statements).

In June 2002, the FASB issued SFAS 146, *Accounting for Exit or Disposal Activities*. SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002 and early application is encouraged. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS 146. We will adopt SFAS 146 for exit or disposal activities that are initiated after December 31, 2002. The effect on adoption of SFAS 146 will change on a prospective basis the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred.

In November 2002, FASB issued FASB Interpretation No. 45 (FIN 45), *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor s year-end. We are currently assessing what the impact of the guidance would have on our financial statements.

In November 2002, the EITF reached a consensus on issue No. 00-21 *Accounting for Revenue Arrangements with Multiple Deliverables* (EITF 00-21) on a model to be used to determine when a revenue arrangement with multiple deliverables should be divided into separate units of accounting and, if separation is appropriate, how the arrangement consideration should be allocated to the identified accounting units. The EITF also reached a consensus that this guidance should be effective all revenue arrangements entered into in fiscal periods beginning after June 15, 2003, which for us would be the quarter ending September 30, 2003. We are currently assessing what the impact of the guidance would have on our financial statements.

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Results of Operations

The following table sets forth our results of operations expressed as a percentage of revenues. Our historical operating results are not necessarily indicative of the results for any future period.

	For the Year Ended September 30,		
	2002	**2001**	**2000**
Revenues			
Licenses	37%	54%	61%
Web search services	42%	26%	23%
Maintenance services	15%	11%	6%
Other services	6%	9%	10%
Total revenues	100%	100%	100%
Cost of revenues			
Licenses	3%	4%	3%
Web search services	13%	12%	10%
Maintenance services	4%	3%	2%
Other services	5%	6%	4%
Total cost of revenues	25%	25%	19%
Gross Profit	75%	75%	81%
Operating expenses			
Sales and marketing	61%	70%	54%
Research and development	46%	40%	27%
General and administrative	13%	12%	9%
Amortization of intangibles and other assets	44%	35%	6%
Impairment of intangibles and other assets	180%	23%	
Restructuring	18%	6%	
Parkside lease restructuring and termination	71%		
Impairment of building, property and equipment	91%		
Purchased in-process research and development			2%
Acquisition-related costs		10%	2%
Total operating expenses	524%	196%	100%
Operating loss	(450)%	(121)%	(19)%
Impairment of investments		(33)	
Other income, net	6%	5%	8%
Pretax loss	(444)%	(149)%	(11)%
Income tax provision	(1)%		(1)%
Net loss	(445)%	(149)%	(12)%

Fiscal Years Ended September 30, 2002 and 2001

Revenues

Revenues totaled $112.7 million in fiscal 2002, a decrease of $85.9 million or 43% from revenues of $198.6 million in fiscal 2001. All of our business experienced declines in revenue, however most of the decline is attributable to decreased license sales in our software products. For fiscal 2002, one customer, America Online (AOL) represented 22% of total revenues, while no single customer represented over 10% of total

revenues in fiscal 2001. For fiscal 2002, AOL represented 33.2% of total license revenues, 13.9% of total

services revenues and 17.5% of total Web search services revenues. For fiscal 2002, Microsoft represented 20.8% of total Web search services revenues. For fiscal 2001, AOL represented 6.7% of total license revenues, 6.0% of total services revenues and 15.5% of total Web search services revenues. For fiscal 2001, Microsoft represented 23.1% of total Web search services revenues.

We market and sell our products to customers located in the United States and abroad, both through our direct sales force and through our channel partners. Historically, the percentage of sales to customers located outside of the United States has varied substantially. We expect this variation to continue for the foreseeable future. We have generated most of our revenues through direct sales efforts, except in Asia where our revenues have been principally generated through our channel partners.

License revenues totaled $41.2 million in fiscal 2002, representing a decrease of $65.5 million or 61% from license revenues of $106.7 million in fiscal 2001. The decrease was primarily due to lower demand for our content networking products across all market segments. As a result of this continued decline in demand, we announced in July 2002 a restructuring in which we decided to focus our efforts on the Web search services and enterprise search software markets and to reduce our investment in our content networking products group while continuing to maintain support for our content networking software customers and partners. Subsequently in November 2002, we also announced that we had entered into an agreement with Verity Inc. under which Verity will purchase our enterprise search software business. The transaction was consummated in December 2002. As a result, we expect license revenues to continue to decline to insignificant amounts going forward. We recognized $12.4 million, $18.7 million and $2.7 million of Enterprise Search license revenues in fiscal years 2002, 2001 and 2000, respectively.

Web search services revenues totaled $47.1 million in fiscal 2002, representing a decrease of $4.2 million or 8% from Web search services revenues of $51.3 million in fiscal 2001. The decrease was primarily due to weakness in our traditional Web search services, which decreased $20.6 million in fiscal 2002, the result of many smaller or poorly funded companies not being able raise sufficient funds to continue to purchase our services. This decrease in our traditional Web search services was partially offset by the growth of our paid inclusion fee services of $16.4 million or 544% in fiscal 2002 as compared to fiscal 2001. Also, upon expiration in August 2002, AOL, one of our major portal customers, did not renew their Web search services agreement. We expect that this will significantly decrease our traditional Web search business revenues in fiscal 2003. In the future, we expect revenues from paid inclusion fee business to continue to become a greater percentage of our total Web search services revenues. Also going forward, we expect Microsoft, another major portal customer, to contribute a majority of web search service and total company revenues. Web search revenues from Microsoft totaled $9.8 million in fiscal year 2002 representing 20.8% of total Web search revenue for this period. Query volume from Microsoft s MSN Network were also indirectly responsible for $12.7 million of paid inclusion revenue in fiscal year 2002. Total revenue, direct and indirect, generated through Microsoft s MSN Network was $22.5 million in fiscal year 2002.

Maintenance services revenues totaled $18.3 million in fiscal 2002, representing a decrease of $3.4 million or 16% over maintenance services revenues of $21.7 million in fiscal 2001. The decrease was primarily the result of a decline in our content networking support revenues of $6.1 million, offset by growth in our enterprise search support revenues of $2.7 million. Our emphasis on Web search markets will reduce future services revenues as current maintenance agreements expire. At September 30, 2002, deferred maintenance revenue was $9.9 million, the majority of which we expect to be recognized or sold over our 2003 fiscal year.

Other services revenues totaled $6.1 million in fiscal 2002, representing a decrease of $12.7 million or 68% over services revenues of $18.9 million in fiscal 2001. The decrease was the result of a decline in our consulting revenues of $5.8 million and a decline in our Commerce Division revenues of $7.0 million (which we sold in March 2001). We expect other services revenue to be insignificant going forward.

During fiscal 2002 and 2001, we recognized revenues of approximately $4.5 million and $29.5 million, respectively, on contracts, development, and licensing arrangements with customers in which we were equity shareholders at September 30, 2002 and 2001, respectively. Prices and fees on these contracts and arrangements were comparable to those given to other similarly situated customers.

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Cost of Revenues

Cost of revenues totaled $28.5 million in fiscal 2002, representing a decrease of $20.7 million or 42% from cost of revenues of $49.2 million in fiscal 2001.

Licenses cost of revenues generally consists of royalties or license fees associated with licensed technologies used in our software applications. License cost of revenues were $3.6 million in fiscal 2002, representing a decrease of $2.7 million or 43% from licenses cost of revenues of $6.3 million in fiscal 2001. The decrease in license cost of revenues was due primarily to decreased license sales in fiscal 2002. Licenses cost of revenues does not necessarily fluctuate proportionately with licenses revenue due to guaranteed minimum royalty obligations we have with certain licensed technologies.

Web search cost of revenues generally consist of expenses related to the operation of our Web search business, primarily depreciation, and network and hosting charges as well as licensed technology fees. Web search services cost of revenues were $15.3 million in fiscal 2002, representing a decrease of $9.4 million or 38% from Web search services cost of revenues of $24.7 million in fiscal 2001. The decrease was primarily the result of decreased network and hosting costs of $5.4 million and decreased depreciation of $2.5 million.

Maintenance services cost of revenues generally consists of expenses associated with our technical support department. Maintenance services cost of revenues were $4.2 million in fiscal 2002, representing a decrease of $1.7 million or 29% from services cost of revenues of $5.9 million in fiscal 2001. The decrease was primarily due to reduced headcount in our technical support department.

Other services cost of revenues generally consists of expenses associated with our consulting services as well as depreciation and network and hosting charges associated with the operation of our former Commerce business. Other services cost of revenues were $5.5 million in fiscal 2002, representing a decrease of $6.9 million or 56% from services cost of revenues of $12.3 million in fiscal 2001. The decrease was primarily the result of decreased consulting services expenses of $4.9 million and decreased Commerce related expenses of $3.2 million.

Expenses

Operating expenses include sales and marketing expenses, research and development expenses, general and administrative expenses, amortization of goodwill and other intangibles, impairment of goodwill and other intangibles, impairment of intangibles and other assets, restructuring costs, lease termination costs, impairment of fixed assets, purchased in-process research and development, and acquisition-related costs. Research and development, sales and marketing and general and administrative expenses primarily consist of personnel and related costs.

In connection with stock option grants and our business acquisitions, certain options granted have been considered to be compensatory. Compensation associated with such options was $5.1 million in fiscal 2002, representing a decrease of $0.5 million or 8% as compared to fiscal 2001. The decrease is a result of a decreased number of employees in fiscal 2002. As of September 30, 2002, we had unamortized deferred compensation of $2.0 million, which will be charged to operations as the underlying options vest.

Over the next fiscal year, expenses are expected to decrease due to our workforce reductions, lease terminations, fixed assets impairments and our narrower business focus on Web search products and services.

Sales and Marketing Expenses

Sales and marketing expenses consist of personnel and related costs for our direct sales force and marketing staff and marketing programs, including trade shows and advertising. Sales and marketing expenses were $68.9 million in fiscal 2002, a decrease of $70.2 million or 50% over fiscal 2001. Of the $70.2 million decrease, approximately $41.6 million was due to reduced sales and marketing headcount, $8.7 million resulted from lower commissions on reduced sales, $8.5 million resulted from reduced marketing programs, $8.1 million resulted from reduced bad debt expense and $3.3 million resulted from miscellaneous other

savings. The reduction in bad debt expense in fiscal 2002 was the result of improved collections, a change in the remaining revenue mix and lower revenue.

Research and Development Expenses

Research and development expenses consist primarily of personnel and related costs for our development efforts. Research and development expenses were $51.3 million in fiscal 2002, a decrease of $26.6 million or 34% over fiscal 2001. This decrease was primarily due to decreased headcount in fiscal 2002 as a result of the restructurings highlighted in Note 13 to the Financial Statements. Our current research and development efforts are focused on adding features and functionality directed to derive additional revenue from our Web search services. We are also focused on continuing to improve the relevance of our Web search service results and the size and freshness of our Web search index.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel and related costs for general corporate functions, including finance, accounting, purchasing, human resources, facilities and legal. General and administrative expenses totaled $15.0 million in fiscal 2002, representing a decrease of $9.6 million or 39% over fiscal 2001. Of the $9.6 million decrease, approximately $2.6 million was due to reduced bad debt expense, $2.2 million from reduced general and administrative headcount, $2.0 million from reduced outside consulting expense, $1.3 million from reduced facilities expense, $1.1 million due to reduced depreciation expense, and $0.4 million to other miscellaneous expenses. The reduction in bad debt expense in fiscal 2002 was the result of improved collections, a change in the remaining revenue mix and lower revenue.

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles primarily relates to amortization of goodwill acquired through our purchase acquisitions of Ultraseek Corporation and eScene, and through our asset purchase from Adero. Amortization of intangibles and other assets totaled $50.2 million in fiscal 2002, a decrease of $20.2 million or 29% from $70.4 million in fiscal 2001. The decrease was primarily due to our impairment of Ultraseek goodwill in the quarter ended June 30, 2002.

Impairment of Goodwill and Other Intangibles

During fiscal 2002 we recorded $202.6 million in charges to reflect the impairment of goodwill and other intangibles, compared to $44.9 million in fiscal 2001.

On June 30, 2002, we recorded a charge of $200.9 million to reflect the impairment of goodwill and other intangibles created from the purchase of Ultraseek ($192.4 million) and eScene ($8.5 million). In fiscal 2000, we integrated Ultraseek s product offerings and operations into our entire organization and, therefore, the associated goodwill from this purchase transaction was accounted for as enterprise goodwill. In the quarter ended June 30, 2002, we experienced a sustained decline in our market capitalization to amounts well below our net book value. In addition, other factors occurred in the quarter ended June 30, 2002 that led us to assess whether an enterprise goodwill impairment charge was appropriate. In particular, America Online, one of our largest customers announced in April 2002, that it would not renew its web search contract with us upon expiration in August 2002. In addition, we were experiencing continued negative cash flows during the third quarter ended June 30, 2002. These factors affected our overall enterprise value leading to further decreases in the market capitalization. Because of these factors we conducted an enterprise goodwill impairment analysis and recorded a charge at June 30, 2002 related to the goodwill created from the purchase of Ultraseek and eScene.

In December 2001, we evaluated the remaining intangible assets associated with our asset purchase from Adero and recorded a $1.8 million charge to write-off the remaining net book value as there will be no further revenue streams related to these assets.

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During fiscal 2001, we recorded a non-cash charge of $44.9 million to reflect the impairment of goodwill and other intangibles, primarily related to our goodwill associated with our investment in AirFlash and with the assets acquired from Adero. Our private equity investment in AirFlash was determined to be impaired due to continuing sustained operating losses and no success by AirFlash of obtaining additional funding. No cash flows were anticipated from our investment in AirFlash therefore the associated goodwill was fully impaired. Our goodwill related to the assets acquired from Adero was determined to be impaired as we licensed the remaining technology to a third party during 2001 and estimated discounted cashflows were below the carrying value of the goodwill. An impairment charge was recorded to adjust the carrying value of the Adero goodwill down to the estimated fair value, which was based on the estimated discounted cash flows.

Restructuring Costs

Fiscal 2002

For fiscal 2002, we accrued $19.9 million for restructuring. At September 30, 2002, $7.4 million for restructuring remained outstanding as an accrued liability on our balance sheet.

Fiscal 2002 Fourth Quarter Restructuring:

In July 2002, we announced plans to focus our business on web search and enterprise retrieval markets. As a result, we significantly scaled back the content networking products group and related corporate infrastructure and eliminated 290 positions and closed several sales offices around the world. As a result of this restructuring, we incurred a charge of $15.4 million made up of $11.9 million of severance and related expenses and $3.5 million in costs associated with office consolidations. Approximately $8.3 million of the charge was paid in the quarter ended September 30, 2002 and the remainder will be paid over the next twelve months.

As a result of the restructuring, we expected to reduce compensation related expenses by approximately $10.0 million per quarter. We also expected to reduce facility related operating expenses in the amount of $0.7 million for the quarter ended December 31, 2002 and $0.3 million per quarter thereafter, through the end of the lease term which will be through the end of fiscal 2003. In the remaining portion of fiscal 2002, we realized the expected benefits of these restructuring efforts.

Fiscal 2002 Third Quarter Restructuring:

In April 2002, we completed a restructuring and a workforce reduction of approximately 50 employees to reduce our operating expenses. All of our functional areas were affected by the reduction. As a result of this workforce reduction, we incurred a charge of $2.2 million. During the quarter ended September 30, 2002, a $0.3 million adjustment was made to reduce the charge for severance and related expenses. As of September 30, 2002, approximately $0.3 million of this restructuring accrual remained outstanding as an accrued liability on our balance sheet. The remaining payments will be made over the next six months.

As a result of the restructuring, we expected to reduce compensation related expenses by approximately $1.6 million per quarter. We also expected to reduce facility related operating expenses in the amount of $0.3 million per quarter through the end of the remaining lease term. In the remaining portion of fiscal 2002, we realized the expected benefits of these restructuring efforts.

Fiscal 2002 First Quarter Restructuring:

In the quarter ended December 31, 2001, we announced and substantially completed a restructuring and a workforce reduction of approximately 115 employees to reduce our operating expenses. All of our functional areas were affected by the reduction. As a result of this workforce reduction, we incurred a charge of $2.7 million. As of September 30, 2002, none of this restructuring accrual remained outstanding as an accrued liability on our balance sheet.

As a result of the restructuring we expected to reduce compensation related expenses of approximately $3.3 million per quarter. We also expected to reduce facility related operating expenses through the end of the

related lease term and depreciation, through the end of the related useful lives, in the respective amounts of $0.2 million and $0.1 million per quarter. In the remaining portion of fiscal 2002, we realized the expected benefits from this restructuring effort.

Fiscal 2001

For fiscal 2001, we accrued $11.6 million for restructuring charges. At September 30, 2002, $1.1 million for restructuring remained outstanding as an accrued liability on our balance sheet.

Fiscal 2001 Fourth Quarter Restructuring:

In the quarter ended September 30, 2001, we instituted a restructuring and a workforce reduction of approximately 35 employees to reduce our operating expenses. The reduction in workforce primarily affected our employees working on wireless related products. As a result of this restructuring, we incurred a charge of approximately $6.6 million in the quarter ended September 30, 2001. This charge included costs associated with underutilized space and office consolidations related primarily to approximately eight sales offices in North America and the United Kingdom. During the quarter ended September 30, 2002, a $0.2 million adjustment was made to reduce the charge for severance and related expenses. As of September 30, 2002, approximately $1.1 million of this restructuring accrual remained outstanding as an accrued liability on our balance sheet, which will be paid over the next twelve months.

As a result of the restructuring we expected to reduce compensation related expenses of approximately $1.7 million per quarter. We also expected to reduce facility related operating expenses in the amount of $1.7 million for the quarter ended December 31, 2001 and $0.5 million per quarter thereafter, through the end of the lease terms which are through fiscal 2003. We realized the expected benefits from this restructuring effort.

Fiscal 2001 Third Quarter Restructuring:

In the quarter ended June 30, 2001, we announced and substantially completed a restructuring and a workforce reduction of approximately 200 employees to reduce our operating expenses. All of our functional areas were affected by the reduction. Included in the restructuring charge was $0.6 million for professional fees related primarily to job consultation services for displaced employees. As a result of this workforce reduction, we incurred a charge of $5.0 million. As of September 30, 2002, no amount remained outstanding as an accrued liability on our balance sheet.

As a result of the restructuring we expected to reduce compensation related expenses of approximately $6.9 million per quarter. We realized the expected benefits from this restructuring effort.

Parkside Lease Restructuring and Termination

In April 2000, we entered into a lease agreement commencing January 1, 2002 for 381,050 square feet of office space in two mid-rise office buildings in Foster City, California, known as Parkside Towers. Payments under the lease commenced on January 1, 2002, when the property was delivered to Inktomi by the developer and continue over the lease term ending October 31, 2014 for one building and October 31, 2016 for the second building.

In the quarter ending March 31, 2002, we completed our assessment of our current and future anticipated needs for operating facilities and adopted a plan to consolidate our operating facilities. In accordance with this plan, we recorded a lease termination charge of $74.6 million during the quarter ended March 31, 2002 related to the abandonment of our lease for 381,050 square feet of office space described above. Of the $74.6 million charge, $62.3 related to the expected loss on future subleases and $12.3 related to asset write-offs. Lease abandonment costs for this facility were estimated to include the remaining lease liabilities through the term of the lease, impairment of leasehold improvements, estimated future leasehold improvements and brokerage fees offset by estimated sublease income. Estimates related to sublease costs and income are based on

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assumptions regarding the period required to locate sub-lessees and sublease rates which were derived from market trend information provided by commercial real estate brokers (see Note 14 to the Financial Statements for further detail).

On September 5, 2002, we executed a Lease Termination Agreement providing for the termination of Parkside Towers. In exchange for the termination of the lease, we agreed to pay the landlords certain consideration including the following: (i) immediate surrender of the cash security deposit of approximately $1.5 million, (ii) consent for the landlords to immediately draw on a letter of credit with Silicon Valley Bank in the amount of approximately $16.5 million, (iii) immediate cash payment of $12.0 million, a portion of which covered August rent and the pro-rated rent for the month of September through the effective date of the Lease Termination Agreement, (iv) issuance of a $21.5 million promissory note, including $0.2 million imputed interest, of which $5 million is payable on October 1, 2002 and $16.5 million is paid the earlier of the sale of the Bayside facilities or January 21, 2003, (v) payment of 50% of any amounts in excess of $50 million that Inktomi realize upon the sale of the Bayside facilities, (vi) issuance of five million shares of our common stock valued at $2.3 million, (vii) the transfer of two HVAC chillers, (viii) the relinquishment of Inktomi s claim to undispursed portions of the landlords obligations to contribute funds for tenant improvements in the amount of $441,223, (ix) the granting of registration rights related to the 5 million shares of common stock issued to the Parkside landlords, and (x) the granting of deeds of trust for the Bayside facilities to the landlords to secure the $21.5 million promissory note.

Total value of the lease termination, including cash and non-cash items, was $54.0 million. As a result, we recorded a charge of $5.4 million in the fiscal 2002 fourth quarter representing the cost in excess of the remaining lease restructuring accrual initially recorded in the quarter ended March 31, 2002.

As part of the lease termination transaction, the landlords of the Parkside facility (and their affiliates) agreed, at Inktomi s election, to purchase the Bayside facilities (see Note 11 to the Financial Statements) for $37.5 million. Inktomi s right to require the landlords to purchase the Bayside facilities commenced on November 1, 2002 and ended on January 21, 2003. In December 2002, we sold the building to a third party for $41.5 million.

Impairment of Fixed Assets

Fiscal 2002

In August 2000, we entered into an operating lease agreement for the land and facilities of our corporate headquarters, known as Bayside, in Foster City, California. This operating lease is commonly referred to as a synthetic lease because it represents a form of off-balance sheet financing under which an unrelated third-party funds 100% of the costs of the acquisition of the property and leases the asset to Inktomi as lessee. Under the lease terms, we were required to pay lease payments for five years to the lessor. The payments were calculated based on a floating interest rate applied against a $114 million principal value. The agreement was assigned to a third party lessor under the terms of a lease finance structure. This structure also required the creation and maintenance of a cash collateral account that limited the liquidity of $119.6 million of our cash, which was classified as long-term on our balance sheet. During the term of the lease, we had a purchase option to buy the building for $114 million plus breakup fees or to extend the lease. If we elected not to purchase the building or extend the lease term, we had guaranteed to compensate the lessor for the difference between the market value of the building and $114 million, limited upwards to a maximum amount of $101 million (residual value guarantee).

Due to the declining commercial real estate market in the Bay Area, we believed that it was probable at the end of the lease term in August 2005 that the market value of our Bayside corporate headquarters would be less than the $114 million residual value guarantee. Therefore, we accrued for this loss on a straight-line basis from April 1, 2002 to the end of the lease term. Accordingly, we had recorded $2.2 million in fiscal 2002 as the total estimated future probable loss amounted to $18.8 million. This loss was based on the difference between the residual value guarantee amount and the estimated value of our Bayside corporate headquarters at the end of the lease term determined through the use of estimated future sublease income provided by commercial real estate brokers.

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In August 2002, through the execution of a Termination and Release Agreement, we exercised the purchase option under our operating lease arrangement for the Bayside corporate headquarters and title for such facilities was transferred to Inktomi on such date. We paid $114 million to Deutsche Bank and its affiliates, the holders of the synthetic lease, for the purchase of the Bayside corporate headquarters.

At the purchase date we valued the Bayside corporate headquarters at $44.8 million based on established valuation techniques. As a result of this valuation, we incurred a charge of $67.0 million in the quarter ended September 30, 2002. We also wrote down to zero the net book value of the Bayside leasehold improvements which totaled $15.5 million during the quarter ended September 30, 2002. In December 2002, we sold the Bayside property to a third party for $41.5 million, with the additional loss on the sale to be recorded in the quarter ending December 31, 2002.

In September 2002, we incurred an additional $10.5 million non-cash asset impairment primarily related to computer equipment and furniture and fixtures held in use as the expected cash flows were less than the carrying value of these assets. Factors which triggered our assessment for impairment included continued negative cash flows from operations, continued operating losses and carrying values which exceeded market values. These assets were written down to their estimated fair value based on information obtained from recent sales of similar assets. After the asset write-offs, we expect depreciation expenses to reduce by $2.1 million per quarter beginning in the quarter following the impairment.

Primarily as a result of our July 2002 restructuring (see Note 13 to the Financial Statements), we incurred an $8.7 million non-cash asset impairment related to abandoned assets of our Web search group and content networking products group.

As a result of our December 2001 restructuring (see Note 13 to the Financial Statements), we incurred a $1.3 million asset impairment charge. The $1.3 million write-down represents computer equipment consisting of $0.5 million of abandoned assets in the London office that was downsized in the restructuring and $0.8 million of abandoned assets related to Content Bridge services that were discontinued as a product line in the quarter ended December 31, 2001.

Fiscal 2001

As a result of our September 2001 restructuring (see Note 13 to the Financial Statements), we incurred a $0.7 million non-cash asset impairment charge.

As a result of our June 2001 restructuring (see Note 13 to the Financial Statements), we incurred a $0.2 million non-cash asset impairment charge.

During fiscal 2001, we recorded a non-cash charge of $44.9 million to reflect the impairment of goodwill and other intangibles, primarily related to our goodwill associated with our investment in AirFlash and with the assets acquired from Adero. Our private equity investment in AirFlash was determined to be impaired due to continuing sustained operating losses and no success by AirFlash of obtaining additional funding. No cash flows were anticipated from our investment in AirFlash therefore the associated goodwill was fully impaired. Our goodwill related to the assets acquired from Adero was determined to be impaired as we licensed the remaining technology to a third party during 2001 and estimated discounted cashflows were below the carrying value of the goodwill. An impairment charge was recorded to adjust the carrying value of the Adero goodwill down to the estimated fair value, which was based on the estimated discounted cash flows.

Purchased In-Process Research and Development

A portion of the purchase prices we paid for Ultraseek and various assets of Adero have been identified as developed technology and in-process research and development (IPRD). We identified and valued the developed technology and IPRD by conducting extensive interviews, analyzing data provided by the acquired companies concerning developmental products, considering the stage of development of such products and the time and resources needed to complete them, and assessing the expected income generating ability of the products, target markets and associated risks. The income approach, which includes an analysis of the markets, cash flows, and risks associated with achieving such cash flows, was the primary technique utilized in

valuing the developed technology and IPRD. Based on our analysis of these variables, we recorded a one-time purchased IPRD charge of $0.4 million in fiscal 2001 associated with our purchase of various assets of Adero, and a one-time purchased IPRD charge of $4.4 million in fiscal 2000 associated with our Ultraseek acquisition because technological feasibility had not been established and no future alternative uses existed.

Acquisition-Related Costs

As a result of our FastForward acquisition in October 2000 we recorded acquisition-related costs of $19.5 million in fiscal 2001, primarily for investment banking fees, accounting, legal and other professional expenses. As of September 30, 2002, no accrued liabilities relating to FastForward acquisition related costs remained outstanding.

Impairment of Investments

In late 1999 and early 2000, we made numerous equity investments in both public and private companies for strategic purposes. Our approach was to invest in companies that were working to expand the markets that we believed to be strategically beneficial to us. Market conditions for technology companies began to deteriorate in late 2000 and this deterioration continued during the first half of 2001. During our quarter ended June 30, 2001, we determined that there was an other-than-temporary decline, or impairment, in value of most of our strategic investments in the amount of $65.9 million. The $65.9 million impairment charge consists of $39.7 million related to four public company investments and $26.2 million related to nine private company investments. We considered the prolonged decline in overall technology market conditions as well as factors such as liquidity and market acceptance on a company specific basis.

Other Income, Net

Other income, net generally includes interest on our cash and cash equivalents and short-term investments, less expenses related to our debt and capital lease obligations and gains and losses on disposal of assets and sale of investments. Other income, net, also included $0.4 million of rent from other tenants in our Bayside corporate headquarters after the building was purchased in August 2002. Other income, net, totaled $6.6 million of income in fiscal 2002, a decrease of $3.7 million or 36% over fiscal 2001. The decrease in other income, net, was primarily due to a decrease in interest income of $10.6 million, offset by decreased realized losses on investments of $2.2 million, a $2.8 million gain relating principally to the settlement of accruals from previous one-time charges, and a $0.8 million reversal of an accrual related to our former Commerce division in fiscal 2002. Please refer to Note 2 to the Financial Statements for further detail.

Fiscal Years Ended September 30, 2001 and 2000

Revenues

Revenues totaled $198.6 million in fiscal 2001, a decrease of $25.7 million or 11% from revenues of $224.2 million in fiscal 2000. No single customer represented over 10% of total revenues in either fiscal 2001 or 2000. We market and sell our products to customers located in the United States and abroad, both through our direct sales force and through our channel partners. Historically, the percentage of sales to customers located outside of the United States has varied substantially, reflecting the early stage build-out of our international operations. We have generated most of our revenues through direct sales efforts, except in Asia where our revenues have been principally generated through our channel partners.

License revenues totaled $106.7 million in fiscal 2001, representing a decrease of $29.1 million or 21% from license revenues of $135.8 million in fiscal 2000. A majority of our license revenues had been generated from Internet service providers. In previous fiscal years, service providers were investing substantial amounts of capital to build out their networks to address Internet opportunities. In fiscal 2001, this segment substantially curtailed spending in response to the challenging economic environment. The year to year decrease in license revenue was partially offset by the inclusion of revenue derived from the licensing of our enterprise search product that we launched in earnest in fiscal 2000. Enterprise search license revenues grew from $2.7 million in fiscal 2000 to $20.0 million in fiscal 2001.

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Maintenance Services revenues totaled $21.7 million in fiscal 2001, representing an increase of $9.1 million or 72% over maintenance services revenues of $12.6 million in fiscal 2000. The increase was the result of an increase in our content networking support revenues of $4.7 million and an increase in our enterprise search support revenues of $4.4. The increase in our content networking support revenues was primarily due to an increase in our support revenues generated from service provider customers who purchased support for our products over the last several fiscal years.

Other Services revenues totaled $18.9 million in fiscal 2001, representing a decrease of $4.8 million or 20% over services revenues of $23.7 million in fiscal 2000. The decrease was the result of a decline in our Commerce Division revenues of $8.5 million (which we sold in March 2001), offset by an increase in our consulting revenues of $3.7 million.

Web search services revenues totaled $51.3 million in fiscal 2001, representing a decrease of $0.8 million or 2% from Web search services revenues of $52.1 million in fiscal 2000. The decrease was due a decrease in our general Web search business of $3.8 million where many smaller or poorly funded companies could not raise sufficient funds to continue to purchase our services, partially offset by growth in our database inclusion fee business of $3.0 million.

During fiscal 2001 and 2000, we recognized revenues of approximately $29.5 million and $31.3 million, respectively, on contracts, development, and licensing arrangements with customers in which we were equity shareholders at September 30, 2001 and 2000, respectively. Prices on these contracts and arrangements were comparable to those given to other similarly situated customers.

Cost of Revenues

Licenses cost of revenues generally consists of royalties or license fees associated with licensed technologies used in our software applications. License cost of revenues were $6.3 million in fiscal 2001, representing a decrease of $0.2 million or 3% from licenses cost of revenues of $6.4 million in fiscal 2000. The decrease in license cost of revenues was due primarily to decreased license sales in fiscal 2001. Licenses cost of revenues does not necessarily fluctuate proportionately with licenses revenue due to guaranteed minimum royalty obligations we have with certain licensed technologies.

Web search cost of revenues generally consist of expenses related to the operation of our Web search business, primarily depreciation, and network and hosting charges as well as licensed technology fees. Web search services cost of revenues were $24.7 million in fiscal 2001, representing an increase of $2.9 million or 13% from Web search services cost of revenues of $21.8 million in fiscal 2000. The increase was primarily the result of increased network and hosting costs.

Maintenance services cost of revenues generally consists of expenses associated with our technical support department. Maintenance services cost of revenues were $5.9 million in fiscal 2001, representing an increase of $2.1 million or 54% from services cost of revenues of $3.9 million in fiscal 2000. The increase was primarily due to increased headcount in our tech support department.

Other services cost of revenues generally consists of expenses associated with our consulting services as well as depreciation and network and hosting charges associated with the operation of our former Commerce business. Other services cost of revenues were $12.3 million in fiscal 2001, representing an increase of $2.2 million or 22% from services cost of revenues of $10.1 million in fiscal 2000. The increase was primarily the result of increased consulting services expenses.

Expenses

Operating expenses include sales and marketing expenses, research and development expenses, general and administrative expenses, amortization of goodwill and other intangibles, impairment of goodwill and other intangibles, impairment of intangibles and other assets, restructuring costs, lease termination costs, impairment of fixed assets, purchased in-process research and development, and acquisition-related costs. Research and development, sales and marketing and general and administrative expenses primarily consist of personnel and related costs.

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Sales and Marketing Expenses

Sales and marketing expenses consist of personnel and related costs for our direct sales force and marketing staff and marketing programs, including trade shows and advertising. Sales and marketing expenses were $139.1 million in fiscal 2001, an increase of $16.0 million or 13% over fiscal 2000. This increase was primarily due to an increase in headcount in the first half of fiscal 2001, offset partially by workforce reductions implemented in April and September 2001.

Research and Development Expenses

Research and development expenses consist primarily of personnel and related costs for our development efforts. Research and development expenses were $77.9 million in fiscal 2001, an increase of $18.2 million or 30% over fiscal 2000. This increase was primarily due to an increase in headcount in the first half of fiscal 2001, offset partially by workforce reductions implemented in April and September 2001.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel and related costs for general corporate functions, including finance, accounting, purchasing, human resources, facilities and legal. General and administrative expenses totaled $24.6 million in fiscal 2001, an increase of $5.5 million or 29% over fiscal 2000. This increase was primarily related to an increase in headcount and consulting expenses.

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles primarily relates to amortization of goodwill acquired through our purchase acquisitions of Ultraseek Corporation and eScene and through our asset purchase from Adero. Amortization of intangibles and other assets totaled $70.4 million in fiscal 2001, an increase of $57.2 million or 434% over fiscal 2000. The increase was primarily due to amortization of goodwill associated with our acquisition of Ultraseek in the fourth quarter of fiscal 2000 and our Adero and eScene acquisitions consummated in fiscal 2001.

Impairment of Goodwill and Other Intangibles

During fiscal 2001, we recorded a non-cash charge of $44.9 million to reflect the impairment of goodwill and other intangibles, primarily related to our goodwill associated with our investment in AirFlash and with the assets acquired from Adero. Our private equity investment in AirFlash was determined to be impaired due to continuing sustained operating losses and no success by AirFlash of obtaining additional funding. No cash flows were anticipated from our investment in AirFlash therefore the associated goodwill was fully impaired. Our goodwill related to the assets acquired from Adero was determined to be impaired as we licensed the remaining technology to a third party during 2001 and estimated discounted cashflows were below the carrying value of the goodwill. An impairment charge was recorded to adjust the carrying value of the Adero goodwill down to the estimated fair value, which was based on the estimated discounted cash flows.

Restructuring Costs

In fiscal 2001, in light of a challenging operating and business environment, we implemented two restructurings and workforce reductions, totaling approximately 235 employee positions, to reduce our operating expenses. As a result of these workforce reductions, we incurred restructuring charges of $11.6 million in fiscal 2001. The restructuring charge included approximately $6.2 million of severance related amounts, $4.8 million of committed excess facilities and $0.6 million of professional fees.

Purchased In-Process Research and Development

A portion of the purchase prices we paid for Ultraseek and various assets of Adero have been identified as developed technology and in-process research and development (IPRD). We identified and valued the developed technology and IPRD by conducting extensive interviews, analyzing data provided by the acquired

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companies concerning developmental products, considering the stage of development of such products and the time and resources needed to complete them, and assessing the expected income generating ability of the products, target markets and associated risks. The income approach, which includes an analysis of the markets, cash flows, and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and IPRD. Based on our analysis of these variables, we recorded a one-time purchased IPRD charge of $0.4 million in fiscal 2001 associated with our purchase of various assets of Adero, and a one-time purchased IPRD charge of $4.4 million in fiscal 2000 associated with our Ultraseek acquisition because technological feasibility had not been established and no future alternative uses existed.

Acquisition-Related Costs

As a result of our FastForward acquisition in October 2000 and our WebSpective acquisition in October 1999, we recorded acquisition-related cots of $19.5 million and $4.0 million in fiscal 2001 and 2000, respectively, primarily for investment banking fees, accounting, legal and other professional expenses.

Impairment of Investments

In late 1999 and early 2000, we made numerous equity investments in both public and private companies for strategic purposes. Our approach was to invest in companies that were working to expand the markets that we believed to be strategically beneficial to us. Market conditions for technology companies began to deteriorate in late 2000 and this deterioration continued during the first half of 2001. During our quarter ended June 30, 2001, we determined that there was an other-than-temporary decline, or impairment, in value of most of our strategic investments in the amount of $65.9 million. The $65.9 million impairment charge consists of $39.7 million related to four public company investments and $26.2 million related to nine private company investments. We considered the prolonged decline in overall technology market conditions as well as factors such as liquidity and market acceptance on a company specific basis.

Other Income, Net

Other income, net includes interest on our cash and cash equivalents, short-term investments and our long-term restricted cash, less expenses related to our debt and capital lease obligations and loss on disposal of assets. Other income, net, totaled $10.3 million of income in fiscal 2001, a decrease of $6.6 million or 39% over fiscal 2000. The decrease in other income, net was primarily the result of net realized losses on the sale of investments in fiscal 2001. We incurred net realized losses on the sale of investments of $2.9 million in fiscal 2001, as compared to net realized gains of $1.9 million in fiscal 2000. Interest income decreased from $15.9 million in fiscal 2000 to $15.4 million in fiscal 2001. We incurred foreign exchange losses of $0.6 million in fiscal 2001, as compared to foreign exchange gains of $0.1 million in fiscal 2000. Please refer to Note 2 to the Financial Statements for further detail.

Liquidity and Capital Resources

Cash and cash equivalents and short-term investments totaled $45.4 million at September 30, 2002, a decrease of $39.1 million or 46% from $84.5 million at September 30, 2001. The decrease primarily came from cash used in operating activities.

We used $116.9 million in cash from operations during fiscal 2002 as compared to cash used in operations of $74.9 million during the prior year. The change was primarily due to the increase in net loss of $204.3 million, offset by an increase in non-cash charges of $162.4 million.

Cash provided by investing activities was $32.0 million in fiscal 2002, as compared to cash provided by investing of $47.8 million in the prior year. The change was primarily the result of $79.1 million less in net proceeds from the sale of short-term investments, net of reinvestments, $114.0 million used in the purchase of our Bayside headquarters, $11.6 million of other increased cash items partially offset by the release of restricted cash balances of $129.0 million compared to cash restrictions in the prior year of $9.3 million, and $33.3 million less cash used to purchase property, plant, and equipment, and to fund company acquisitions.

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Cash provided by financing activities was $83.7 million in fiscal 2002, an increase of $79.2 million from the prior year, primarily due to $52.8 million of net proceeds from the issuance of 13.2 million shares of Common Stock in November 2002, and $23.1 million of increased cash proceeds net of repayments of notes payable.

From time to time, we have used debt and leases to partially finance capital purchases. At September 30, 2002, we had $31.4 million in total loans and capitalized lease obligations outstanding. Our underlying assets collateralize the loans, and the underlying equipment obtained through the lease agreements collateralizes each capitalized lease.

Approximately $8.8 million of our debt at September 30, 2002 was in the form of bank loans, of which $3.8 million was a term loan and $5.0 million were borrowings under a line of credit the size of which is based on accounts receivable balances. The loans are subject to specific financial covenants that are reported to the bank monthly. The covenants (i) require minimum unrestricted cash, cash equivalents and short term investments of $27.5 million, (ii) provide that we cannot incur GAAP loss of more than $137.0 million, $10.3 million, $7.6 million, $4.7 million, $1.3 million for the quarters ended September 30, 2002, March 31, 2003, June 30, 2003 and September 30, 2003 respectively, and (iii) require that we maintain all US bank deposits at the bank. We were in compliance with these covenants at September 30, 2002.

Any one or more of the following events would constitute a default under the bank facility: payment default, covenant default, the occurrence of a material adverse change, default under certain other agreements, subordinated debt and judgments, misrepresentations regarding information we have disclosed to the bank, and insolvency. Upon the occurrence of a default the bank may declare all obligations due and payable immediately, settle or adjust disputes and claims directly with account debtors for amounts that the bank considers advisable, make such payments as necessary to protect its security interest in the collateral, apply company balances held by the bank to the obligations, and sell the collateral.

We violated the minimum cash balance covenants for the months ending October and November 2002. The bank waived the covenant violations in December 2002. The Company is currently negotiating to restructure its loan covenants, as it is probable that it will be in violation of the maximum GAAP loss covenants for the quarter ended December 31, 2002. In December 2002, the bank prospectively waived this GAAP loss covenant for the quarter ended December 31, 2002. Accordingly, we have classified all amounts due as current under this facility at September 30, 2002. If we were required to repay the amounts borrowed under these loan arrangements, it would reduce the amount of cash we have available for our operations.

In September 2002, we executed a Lease Termination Agreement on our Parkside facilities. The total value of the lease termination, including cash and non-cash items, was $54.0 million, with $17.9 million of unrestricted cash paid in the September quarter and additional $21.5 million provided in the form of a promissory note, of which $5 million is payable on October 1, 2002 and $16.5 million is paid the earlier of the sale of the Bayside facilities or January 21, 2003. Non cash items transferred to the lease provider included certain previously purchased assets, five million shares of our common stock, and permission to draw down a letter of credit provided as a security deposit on the facility that was partially collateralized by restricted cash investments. The promissory note was paid in full in the December 2002 quarter.

In August 2000, we entered into a synthetic lease agreement for our corporate headquarters in Foster City, California. This operating lease is commonly referred to as a synthetic lease because it represents a form of off-balance sheet financing which an unrelated third-party funds 100% of the costs of the acquisition of the property and leases the asset to Inktomi as leasee. This structure required the creation and maintenance of a cash collateral account that limited the liquidity of $119.6 million of our cash, which was classified as long-term on our balance sheet. On August 28, 2002, through the execution of a Termination and Release Agreement, we exercised the purchase option under our lease and title for the facilities was transferred to Inktomi in exchange for $114.0 million. In December 2002, we sold the property for $41.5 million and leased back the portion we now occupy.

At September 30, 2002, we had negative working capital of $36.4 million, down from $7.7 million at September 30, 2001. Our current significant capital commitments consist of commitments under operating

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leases of $37.7 million as well as our agreement to pay cash consideration of $21.5 million in connection with our Parkside lease termination. The $21.5 million cash consideration was paid by December 20, 2002.

Significant Contractual Cash Obligations At September 30, 2002 (in millions)	Payments Due by Period			
	Total	Less than 1 year	1-3 years	After 3 years
Operating leases	$37.7	$ 7.4	$12.1	$18.2
Payment for Parkside lease termination	$21.5	$21.5		
Total significant contractual cash obligations	$59.2	$28.9	$12.1	$18.2

On December 20, 2002, we completed the sale of our Bayside corporate headquarters and also entered into a five-year lease with the facilities new owner for the portion of the property that we occupy for an aggregate lease commitment of approximately $2 million per year for a total of $9.8 million, net of costs. The lease may also be terminated at our election after two years in exchange for a fee.

In December 2002, we sold our Enterprise Search division for $25.0 million, with $22.0 million paid to us in the period and an additional $3.0 million, potentially offset by any claims that may arise during the interim period, to be paid in June 2004.

In December 2001, our Board of Directors approved a $5 million revolving line of credit to our Chief Executive Officer. In December 2001, we provided loans to our Chief Executive Officer totaling $4.7 million of which $2.7 million was repaid prior to December 31, 2001. During the quarter ended March 31, 2002, we provided loans to our Chief Executive Officer totaling $0.9 million of which $0.1 was repaid prior to March 31, 2002. During the quarter ended June 30, 2002, we provided loans to our Chief Executive Officer totaling $2.1 million. As of September 30, 2002, total loans outstanding and total accrued interest to our Chief Executive Officer were approximately $4.9 million and $160,000, respectively. These loans are unsecured and are represented by full recourse promissory notes accruing interest at the rate of 6% per annum. Each loan, plus any accrued unpaid interest, will become due the earlier of either two years from the grant date of the individual loan or the date that our Chief Executive Officer leaves the Company. All after tax proceeds of compensatory bonuses and 50% of after tax proceeds from sales of Company stock must be used to pay down the loans outstanding. The first loans will become due in December 2003.

Our capital and liquidity requirements depend on numerous factors, including market acceptance of our products and services, economic conditions impacting our revenue generation, the resources we devote to developing, marketing, selling and supporting our products and services, the timing and extent of establishing and consolidating international operations, the resources we commit to facilities, the extent and timing our investments, the value of our investments in equity securities and real estate, acquisition costs, and the ability to raise capital and other factors. For the years ended September 30, 2002, 2001 and 2000, the Company has incurred losses from operations of $506.6 million, $240.0 million and $42.5 million, respectively, and negative cash flows from operations for the years ended September 30, 2002 and 2001 of $116.9 million and $74.9, respectively. We have historically relied upon proceeds from equity offerings to fund operations. During 2002, we undertook restructurings to reduce costs and to reduce cash outflows from operations. As described in Note 19 to the Financial Statements, subsequent to September 30, 2002 the Company completed the sale of the Enterprise Search Division for net proceeds of $25.0 million and the sale of its corporate headquarters for net proceeds of $41.6 million. As further described in Note 19 to the Financial Statements the Company also implemented subsequent to September 30, 2002 a restructuring plan in order to reduce the operating expenses on an ongoing basis. These activities generated cash flows needed for our operations. Management believes it has adequate cash resources to fund operations for at least until December 2003 with these additional subsequent cash flows and continued efforts on pursuing increased revenues and monitoring expenses.

Other Matters

At a meeting held on December 10, 2002, our Audit Committee approved future non-audit tax services, including tax planning and tax compliance, to be performed by PricewaterhouseCoopers in fiscal 2003. The Audit Committee also approved other non-audit services to be performed by PricewaterhouseCoopers in fiscal

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2003, including transaction services such as pre- and post-acquisition activities and due diligence, where the aggregate fees for such services did not exceed $50,000. The Chairman of the Audit Committee has been delegated the authority to approve these other non-audit services to the extent they exceed $50,000.

Factors Affecting Operating Results

Interested persons should carefully consider the risks described below in evaluating us. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impair our business operations. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our common stock could decline.

If we do not increase our revenues, we will fail to achieve or sustain operating profitability.

We are not currently profitable, and our revenues have declined in recent periods. To achieve and sustain operating profitability on a quarterly and annual basis, we will need to increase our revenue associated with our Web search services. We plan to continue to invest in technology and marketing to develop and improve our products and services and increase market share, but these investments and expenditures may not result in increased revenues. In the future, our revenues may continue to decline, remain flat, or grow at a slow rate, particularly in light of the current market environment.

In the absence of substantial and sustained revenue growth, we cannot predict when or if we will become profitable. If we fail to achieve profitability or display significant progress towards profitability, our stock price may fall due to a lower perceived value, customers may defer or delay purchases based on our financial condition, our relationships with our partners and distributors may suffer, and we may breach financial covenants in our financial arrangements.

Our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are fixed in the short term. Despite our recent workforce reductions, we expect to continue to make appropriate investments to develop and market products for the information retrieval markets, improve our customer support capabilities, develop new distribution channels, and fund of research and development. These investments and expenditures may not result in increased revenues in the near term, if at all.

Recent restructuring efforts have resulted in our recognizing substantial charges. These restructuring efforts may not improve our operating results or financial condition and there exists uncertainty as to whether these actions will be successful.

In order to reduce our recurring losses, we have taken a number of actions to reduce our expenses. In fiscal year 2002 and continuing in October 2002, we implemented restructuring initiatives where we consolidated operations, closed certain branch offices, reduced headcount across all business units, sold certain assets and reduced our content networking products group. In the event these restructurings were implemented too late or at insufficient levels, our expenses will be too great over coming periods to achieve profitability. In addition, there is a risk that these cost-cutting actions will impair our ability to effectively develop and market products and services and remain competitive in the industries in which we compete. In the future, we may undertake additional expense reducing actions that may involve one-time expenditures related to severance, facilities or real estate. The impact of these one-time expenses on our financial statements may adversely impact our perceived value.

If customers choose not to use or promote our Web search services, our revenue will decrease and our growth opportunities will suffer.

Revenues from our Web search services result primarily from the number of end-user searches processed by our Search Engine. Our agreements with customers do not require them to direct end-users to our search services or to use our search services exclusively or at all. Accordingly, revenues from search services are highly dependent upon the willingness of customers to promote and use the search services we provide, the ability of our customers to attract end-users to their online services, the volume of end-user searches that are

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processed by our Web search services, and the ability of customers to monetize traffic from their Web site search pages. Some of our customers have selected competing search and directory services to operate in combination with our services, which has reduced the number of queries available for us to serve and may erode future revenue growth opportunities. The technological barriers for customers to implement additional services or to replace our services are not substantial.

The declining market for Internet portals has limited the market opportunities for our Web search services business and has adversely affected demand for our services. Consequently, our Web search revenues are largely dependent upon a relatively small number of large portal customers.

Many of our smaller search services customers have elected not to renew their contracts and our market opportunity from portals has become more limited. Many smaller and medium size portals are not profitable, suffer from declining revenue growth and have limited access to capital to fund operational needs, which has resulted in consolidation in the portal industry. In addition, many portals are terminating their operations. As a result, our Web search revenues have become increasingly dependent on a relatively few number of major customers. Economic conditions may lead such customers to stop paying for Web search services, to only pay for such services at highly reduced rates or to leave our services in favor of competitors offering Web search services bundled with other offerings. In order for us to increase revenues from our Web search services business, we will need to attract new customers, develop and deliver new search services, products and features to existing and future customers, establish deeper strategic relationships with our customers, and increase the adoption of our Index Connect and Search Submit search marketing solutions for content publishers.

A large percentage of our current revenue is dependent on one customer and if this customer stops utilizing our search services, our revenues will decline.

Our Web search revenue is dependent upon the distribution channel provided through the portal customers serving our search queries. Should any significant portal customer reduce or stop utilizing our search services our search marketing solutions revenue would decline. Currently, Microsoft is our largest portal customer, accounting for $9.8 million in Web search services revenue for the fiscal year ended September 30, 2002 and representing 20.8% of total Web search services revenue for this period. Microsoft s Web search services agreement with us expires in April 2003 and we do not know whether Microsoft intends to renew this agreement upon its expiration or, if this agreement is renewed, whether it will be renewed on the same terms and conditions as currently exist. Should Microsoft cease to be a customer, our business and financial condition would be materially and adversely affected. In addition, AOL, one of our largest portal customers, did not renew its Web search services agreement with us when it expired in August 2002. For the fiscal year ended September 30, 2002, AOL represented $8.3 million in Web search services revenue representing 17.5% of total Web search services revenue for this period. Revenues from our Web search services decreased as a result of the loss of AOL as a customer.

The shift in our focus away from the content networking market could have a material adverse effect on our operating results.

Our shift in strategy away from content networking will likely reduce the average size of our software transactions and corresponding services revenue. We expect revenues from content networking to be insignificant going forward. In order to maintain existing revenue levels or achieve any revenue growth, we will need to significantly increase revenue from our existing Web search services business. Since the quarter ended December 2000, we have experienced a decline in licenses revenue from sales of our content networking software products. In July 2002, we announced a shift in our strategy to reduce our investment in our content networking products group and focus our business on the Web search services and enterprise search software markets. In December 2002, we consummated the sale of our enterprise search business. We may not be able to increase our Web search revenues in amounts sufficient to offset lost revenues from our content networking business. Although we intend to continue to support customers who purchased our content networking software products and partners marketing such products, such customers and partners may view our strategic shift as a breach of certain obligations we have to them. If these customers and partners were to bring or

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threaten legal action against us, defending these actions could be costly to defend, time-consuming and distracting to our management team.

We operate in a highly competitive and rapidly changing market, and our inability to compete successfully against new entrants and established companies could result in a loss of market share, fewer customer orders, price reductions, reduced gross margins and otherwise adversely harm our financial results.

We compete in markets that are new, intensely competitive, highly fragmented and rapidly changing. We have experienced and expect to continue to experience increased competition from current and potential competitors, many of which are bringing new solutions to market, establishing technology alliances and OEM relationships with larger companies, and focusing on specific segments of our target markets. In some cases, our competitors are implementing aggressive pricing and other strategies that are focused in the short term on building customer bases, name recognition in the market and capturing market share. This may cause some price pressure on our products and services in the future. We compete with a number of companies to provide Internet search and directory services and technology. In the Web services marketplace, our primary competitors include a variety of established and newer companies, including AltaVista, Ask Jeeves, FAST Search and Transfer, Google, Overture, Look-Smart, and Northern Light. These companies and other competitors have focused on search result relevance, database size metrics and ease of use to differentiate their services. In addition, several large media and other Internet-based companies have made investments in, or acquired, Internet search engine companies and may seek to develop or customize their products and services to deliver to our target customers.

Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements than we can. In addition, our current and potential competitors may bundle their products with other software services, or hardware, including operating systems, browsers and network hardware in a manner that may discourage users from purchasing services offered by us. Also, current and potential competitors have or may have greater name recognition, more extensive customer bases and access to proprietary content. Increased competition could result in price reductions, fewer customer orders, fewer search queries served, reduced gross margins and loss of market share.

We may lose customers and our business will suffer if we do not develop, license or acquire new services, products or technologies or deliver enhancements to existing products and services on a timely and cost-effective basis.

The markets that we target for our Web search services are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. The introduction of services embodying new technologies and the emergence of new industry standards could render our existing services obsolete. Our future success and revenue growth will depend upon our ability to develop, acquire and introduce a variety of new services and service enhancements to address the increasingly sophisticated needs of our customers. We have experienced delays in releasing new services and product enhancements and may experience similar delays in the future. Material delays in introducing new services and enhancements may cause customers to forego purchases of our services or to purchase those of our competitors**.**

If the use of the internet, intranets, extranets, corporate portals and web portals does not grow as anticipated, our business opportunities would be seriously limited.

Sales of our products and services are dependent upon the development and expand use of corporate intranets, extranets, portals and Websites. Global acceptance and use of these mediums may not continue to develop at recent historical rates. The lack of growing use or initial adoption of these mediums by our targeted customers and their end user customers would impair demand for our products and services and would adversely affect our ability to sell our products and services. Demand and market acceptance for our products and services aimed at servicing intranets, extranets, portals and Websites are subject to a high level of uncertainty and there exist few proven services and products. Our paid inclusion business model relies on the

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willingness of retailers and service providers to allocate marketing funds to online programs. Our business would be adversely impacted if online marketing programs become an unpopular business tool.

If we do not continue to improve the effectiveness and breadth of our sales personnel, we will have difficulty acquiring and retaining customers.

Our products and services often require sophisticated sales efforts targeted at a limited number of key people within a prospective customer s organization. Because the market for our products and services is relatively new, many prospective customers are unfamiliar with the services we offer. As a result, our sales effort