3D ADVISORS

This 3DAdvisors Report Covers:	
	Insider Trading: Insider Trading Behavior
✓	**Accounting**: Quality of Earnings Issues
	Governance: Corporate Governance Issues

Required Swap Collateral May Suggest Credit Issues Mercury Interactive Corp. (NASDAQ:MERQ) Update

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Mercury Interactive is a provider of integrated performance management solutions that enable businesses to test and monitor their Internet applications, helping to improve the performance, availability, reliability and scalability of Websites.

Summary of 3DAdvisors Findings for MERQ

- **Accounting:** Unusual posting of swap collateral suggests hidden credit issues

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Discussion of 3DAdvisors Findings

Accounting: Unusual posting of swap collateral suggests hidden credit issues

Our August 4, 2003 report on Mercury Interactive highlighted the fact that the Company received Interest Rate Swap related earnings boosts both in F/Y 2002 and in Q1 of 2003. A very interesting sidebar to these swap arrangements has caused us to do further digging. The facts show that, in consummating the swaps, MERQ seems to have been required to provide some interesting credit enhancements in order to do the deals with Goldman Sachs Capital Markets (GSCM). GSCM required that MERQ put up an initial $6 million in cash as collateral for the deal. This collateral is carried on MERQ's balance sheet as restricted cash. In addition, MERQ discloses that the swaps may very well require additional collateral, from time to time, depending on market events. Indeed, this was the case earlier in F/Y 2002 when essentially identical swaps (which have since been re-transacted and replaced by the current deal), between MERQ and GSCM, caused the Company to post an additional $6 million over the original $6 million collateral required at the outset of the swap transactions.

These collateral requirements aroused our curiosity. Though we acknowledge that, in an academic sense, posted collateral (for a swap transaction) is not unheard of, we have yet to see disclosure of any such collateral requirement at any of the many companies we have researched, many of which utilize interest rate swaps. Furthermore, our direct contacts with certain companies involved with swap transactions imply that they had not seen collateral issues raised in connection with such activities.

This prompted us to contact certain swap desks to further investigate the matter. The feedback we received supports our suspicions that the collateral requirement imposed upon MERQ, in this case, represented an unusual event. It would be somewhat common for collateral to be required of a company with a less-than-investment grade rating, not for a company on sounder footing. It would also be possible that collateral would be required should the swap contain special features or if the counterparty felt that it already had too much exposure to the company involved. Neither of these latter two cases would apply here.

As we could not reveal the name of the Company to those who we posed our questions to, the question as to which company was involved arose. One contact, which received our communication indirectly, even offered to take a look at the swap agreement for us. Our first impression, that this offer was a conciliatory gesture, gave way to a feeling that the individual was willing to help because they wanted to see the name of the company revealed.

It would seem that there is a possibility that GSCM's due diligence may have picked up something not visible on rating agencies, or Wall Street analysts, radar screens. We also note that Goldman analysts currently do not follow the company.