Table of Contents

Table of Contents

Table of Contents

Table of Contents

Table of Contents

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EDITED BRIEF

- Q1 2002 UnitedHealth Group Earnings Conference Call

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OVERVIEW:

The company has seen a continued shift towards an optimum mix of business across the five major operating units. The company has achieved an earnings growth of over 30%.

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CONFERENCE CALL PARTICIPANTS

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Bill McKeever (ph) *UBS Warburg*

Tracey (ph) *Uniprise*

Roberta Goodman (ph) *Merrill Lynch*

Charles Baretti (ph) *Goldman Sachs*

Laurie Price (ph) *JP Morgan*

Divesh Calendicar (ph) *Morgan Stanley*

James Wayne (ph) *Salomon Smith Barney*

Eric Vile (ph) *Deutsche Bank*

Josh Raskin (ph) *Lehman Brothers*

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OVERVIEW

The company has seen a continued shift towards an optimum mix of business across the five major operating units. The company has achieved an earnings growth of over 30%.

FINANCIAL DATA

A. **Revenues in 1Q were over $6b.**
B. **Operating income increased to 32% to $482m. Its is a increase of 24% on a comparable reporting basis.**
C. **Cash flow was $502m adjusted for CMF payment timing for Medicare First choice.**
D. **ROE for the company exceeded 30% in 1Q.**

E. **EPS was $0.92, which represents a 44% increase as compared to $0.64 a year ago.**

F. **EPS increased 30% YoverY this quarter after the application of SFAS 142.**

G. **EPS in 2002 is expected to $3.84-3.86, which would be a 38% increase over last year including the impact of SFAS 142 and 25% change on a comparable accounting basis.**

PRESENTATION SUMMARY

I. UNIPRISE

A. **There was an addition of 715,000 net new individuals in 1Q.**

B. **Revenues increased 8% YoverY and 6% sequentially.**

C. **Leverage over fixed and semi-variable cost with operational efficiency gain from new technology contributed to 240 basis points sequentially and 320 basis points YoverY increase in operating margin.**

D. **The segment can control and deliver all the components across the country without significant outsourcing for complete solution.**

E. **This segment represents a legible, predictable and stable growth of business.**

II. UNITED HEALTH CARE SERVICES

A. **Strong earnings characterized 1Q.**

B. **The margins for the segment increased significantly and was successful due to better business mix changes, lower medical cost due to product design and placement, lower operating cost.**

C. **About 240,000 new fee based members were added in 1Qincluding 110,000 converted from fully insured products.**

D. **120,000 small business cases, which were fully insured, were added.**

E. **There were 300,000 net larger case fully insured terminations resulting from dual option fully insured business. These cases have high medical cost to premium ratio. Withdrawing from these has contributed to the overall margin improvement.**

F. **In 1Q, there was a decrease of 110,000 individuals due to First Choice.**

G. **The revenue reduction was $150m in 1Q and the margin was in the 3% range.**

H. **The company would be out from First Choice and would focus on care facilitation for medicare eligible through other products and services.**

I. **Pharmaceutical costs have decreased and are in the low teens and in line with the company’s prediction last year.**

J. **Hospital unit cost increased 5-6% and expected to remain flat on a trend basis.**

K. **There has been a 7% decrease in days per patient and 17% decrease in emergency room visits. It's in parallel with 14% increase in cardiologist business for these patients as well as 82% in cardiac rehab services.**

L. **The increase in utilization has resulted in a 10% decrease in days per patient and a favorable net impact on cost trend.**

M. **There is 6-13% decrease in impatient unit cost. The company sees a 12% decrease in cost for impatient transplant services.**

N. **The company has increase utilization rates of certain services for patients with diabetes. This includes 19% increase in optimology business, 25% increase in peditory business [indiscernible] and 17% increase in DME and supplies. These have contributed to 13% decrease impatient admissions.**

O. **Service operations continue to improve. The ongoing productivity gains, cost savings and service enhancements would accrue in 2003 and beyond.**

P. **The company expects 350,000 net membership in 2002 which includes 200,000 net insured for small business offset by reduction in net insured of about 300,000and 450,000 fee based customers by Dec. 31.**

Q. **Insured business will yield around 13% on net price increases. Medical cost trend would be around 12%. There would be a slowdown in the pharmaceutical cost for the clients in the 10-12% range.**

III. OVATION

A. **Revenues rose $27m sequentially and 15% YoverY. Active ARF medicare supplement program added 74,000 people.**

B. **Revenues from this segment should increase by $10m or more per quarter through the year and margin should expand slightly.**

C. **Margin expansion is expected to be low to mid 5% range for 2002.**

IV. INGENIX

A. **Revenue increased 7% YoverY to $109m. Sequentially revenue was down $28m, which represents a strong 4Q product sale.**

B. **Operating earnings rose to $12m and operating margin was 11% as compared to 10.8% a year ago.**

C. **There was some delay in project launches, which was reflected in lower revenue levels.**

D. **Full year revenue is expected to advance in 2H and exceed $525m, which is a 17-18% increase without any acquisition.**

E. **Operating margin should expand to the upper teens and into the 20% range by 2003.**

V. SPECIALIZED CARE SERVICES

A. **Revenue gains YoverY were to the tune of 20% to $367m. Margins expanded 20 basis points sequentially and 100 basis point YoverY to 18%.**

B. **Margins are expected to be in 18% range and revenues are expected to be $1.5b.**

VI. FINANCIAL REVIEW

A. **Revenue decreased by $300m due to the various actions taken by the company. The revenues increased by 6%.**

B. **Operating profit included a decrease of $2m of investment income as compared to last quarter. There was a $10m sequential increase in depreciation and software amortization due to the technology application.**

C. **Aggregated Operating Margin expanded 8%, which was an increase of 60 basis points sequentially and 120 basis points YoverY improvement.**
D. **The company had targeted margin expansion as one of its goal and has axchieved only modestly from Medical care ratio improvement.**
E. **The company had 13th consecutive quarter of margin expansion as a result of optimizing the revenue mix coupled with operations.**
F. **The cash flow was after paying off claims $180m.**
G. **Share repurchase was to the tune of $424m in 1Q. The company bought over 6m shares.**
H. **Excluding ARP business, receivable decreased sequentially and were down significantly YoverY.**
I. **Medical payables were up to 66 days.**
J. **Medical days dollar payments increased $41m in 1Q, and $127m YoverY despite reduction in the incurred business.**
K. **Aggregate operating cost ratio decreased 10 basis points sequentially and increased 70 basis points YoverY. Ratio was 16.3%, an improvement of 20 basis points sequentially adjusting for the Ovations Pharmacy business.**
L. **Investment income was $62m as compared to $74m a year ago and $64m in the last quarter.**
M. **The capital gains/loss was nil for the company.**

VII. OPERATIONAL REVIEW

A. **The company executed about 4.7m internet based transactions in 1Q which represent 87% advance in 90 days.**
B. **United Care online serves about 140,000 active users and a annual transaction run rate of $8m.**
C. **The consumer portal now serves more than one million households.**
D. **Employer e-service portal serves 70% of Uniprise customers and 40% of United health Care large accounts.**
E. **Weekly internet transaction activity now exceeds half a million(phonetic) and is increasing.**
F. **The company runs on two operating platforms and is merging them.**

VIII. FINANCIAL OUTLOOK

A. **Growth in EPS is expected to be 21%, 32%, and 33% in next years.**
B. **Operating margin will be in the 8% range throughout this year.**
C. **Cash flow would be around $2.1b.**
D. **Current repurchase program allows to buy another 30m shares.**
E. **ROE is likely to move pass 30%.**
F. **Debt to equity ratio would continue at 30% or less.**
G. **The company intend to maintain A rating. Medical days payable are expected to be 64-66 days.**

QUESTIONS AND ANSWERS

Operator

Thank you, Dr. McGuire. At this time, I would like to remind everyone in order to ask a question, please press star, then the number one on your telephone keypad.

Your first question comes from B i l l M c K e e v e r (ph) of UBS Warburg.

Bill McKeever - *UBS Warburg*

Yes, good morning. Congratulations on the quarter. You mentioned in the product area that you're doing some new things there. Are you seeing any interest on the part of customers towards tiering of certain services such as hospital and physician in '03 and beyond?

William McGuire - *United Health Group - Chairman and CEO*

Bill, I think broadly we obviously hear interest or discussion of that from a conceptual standpoint. I think when people see it in action or being seeing it they have perhaps sometimes different experiences or feelings. Let me turn that over to Bob Sheehy and he'll be a little more specific.

Bob Sheehy - *United Health Care*

I believe what you're kind of talking about is kind of a tiered provider network, tiered co-payment process where certain providers may have-there may be an incentive to use certain providers. And we have those products in the market. We're testing those products. But there's isn't really at this point any significant move in the market to go there. We see that is just really one of the types of options, types of solutions that we can bring to the marketplace. And it isn't anything that's having a major impact in terms of market share or market movement right now. But we do offer that.

William McGuire - *United Health Group - Chairman and CEO*

T r a c e y (ph) or C h a n (ph) at Uniprise -- could you all comment on your client base?

Tracey - *Uniprise*

I would agree with Bob. The issue of sharing networks is not a new one and has been in the marketplace for some time. The advent of new technology and the interest in consumer cost sharing has brought more attention to the concept of late. However, there has been more discussion than action and we continue to consider this just one of several options we can provide large employers as they consider cost savings ideas.

William McGuire - *United Health Group - Chairman and CEO*

Thanks, T r a c e y (ph) . As you look out on this question, I think the practical issues will be the ability to in fact implement and conduct the business around the kind of barriers and variables that get produced with multiple tiers in each geographic region and what moves in and out of those and secondly, the concept of what in fact creates the tiers. Is it a quality measure which as everyone knows is yet to be defined and agreed upon as an economic variable? There are things still up in the air. But I think we'll have more to say and more to see on this?

William McGuire - *United Health Group - Chairman and CEO*

Next question?

Operator

Your next question comes from R o b e r t a G o o d m a n (ph) of Merrill Lynch.

Roberta Goodman - *Merrill Lynch*

Hi. I wanted to follow up a little bit on what you were discussing on the slice business and there are really two components to that. One is where the slice business is as a percentage of the risk based enrollment at the UHB now where it was say a year ago and where you would expect it to be out this time next year and then what the impact of that reduction was on the trend and why you would do that.

William McGuire - *United Health Group - Chairman and CEO*

Bob Sheehy?

Bob Sheehy - *United Health Care*

Overall our slice business is a dual option business. We have about 500,000 members that are in that category now. It's performing today at acceptable levels. We're satisfied with the performance but because of the volatility of that market and that segment we watch it carefully and, you know, we'll need to take additional action. So right now it's performing pretty much at levels that we're satisfied with.

The second question in terms of what does that do to our trends. Really, it's a good question. Trend is really impacted by a variety of factors-contracting, mix of services, geographic impact. But that has had a positive impact on our cost-overall cost because of the relative high level of cost within that slice business. I don't have an exact number on it right now but it has a .

William McGuire - *United Health Group - Chairman and CEO*

R o b e r t a (ph) , let me give you a couple of ways to think about the last part of that question as well. One, we know that within any cost trend you would calculation sort of unit costs, you'd calculation utilization and then there would be some other factors that would include demographics, age, sex, mix, et cetera. And those in many cases amount to, you know, a significant or a meaningful piece of the overall trend. Maybe a couple percent out of 13 percent.

So I think you can count on the fact when we get a little more specific into these numbers and have a little more experience to look at the impact that there will be some that has just occurred because of the mix change from what we considered anti selection kind of environment in that regard.

Relative to the contribution of moving away from the slice business to the reduction that you see in the medical care ratio this quarter, it is a piece of it. It is not every bit of it. But I think it's safe to say that it is, you know, at least half of it -- of that reduction. We have gained a little. We're still watching the trend numbers as I indicated to see where we think they're going to come out this year. We clearly see lower pharmacy. But it was a contributor to the lower so-called medical care ratio.

Roberta Goodman - *Merrill Lynch*

OK. And just -- I may have missed this before, but what would have been the slice in a year ago?

William McGuire - *United Health Group - Chairman and CEO*

Bob? What would the slice have been a year ago?

Bob Sheehy - *United Health Care*

It was about 900 or a million -- in that ball park.

Roberta Goodman - *Merrill Lynch*

I think that's a very substantial reduction.

William McGuire - *United Health Group - Chairman and CEO*

Yes, it's very substantial.

Unidentified

Bob, are you talking a year ago March 31st or are you talking about a year ago December?

Bob Sheehy - *United Health Care*

A year ago March.

Roberta Goodman - *Merrill Lynch*

A year ago March. And I guess if you can give me the year end 2000, I'll take that too.

Bob Sheehy - *United Health Care*

Yeah, I don't think we've-we don't have the year end.

William McGuire - *United Health Group - Chairman and CEO*

We'll get back to you with that. I don't think they brought that with them.

Bob Sheehy - *United Health Care*

OK. Thanks much.

Operator

Your next question comes from C h a r l e s B a r e t t i (ph) of Goldman Sachs.

Charles Baretti - *Goldman Sachs*

Thanks, good morning. I have just two brief ones -- one for any additional color you can give behind the guidance for '03 and '04 in terms of commercial enrollment growth. And I know it's too early to give really good guidance but maybe a range for premium yields and cost trends.

William McGuire - *United Health Group - Chairman and CEO*

Yeah, C h a r l e s (ph) . I will field that. I'm not real comfortable getting as specific as you seem to want on that. It's way, way early. We have previously said, and see no real reason to back off on the idea that we can add a million people between United Health Care and Uniprise in the course of a year. So I would throw that out next year and the mix will be some combination.

You know, it might be 75/25 self funded versus insured. But it's way, way too early on that. And right now, you know, we would temper the thoughts on trends in pricing simply to say not a lot different from where we're seeing right now, these lower teen numbers. There are just too many things lurking out there that can push trend numbers or cost numbers up. We see-every quarter we see an increase in the number of people who are enrollees in programs and are becoming patients where heretofore they were enrollees and not using the system. We've talked about that before. That number has actually gone up. That reflects aging.

We see some new technologies and things coming in. We don't know where they're going to go but, you know, you have issues around acute cardiovascular disease, implantable defibrillators. We have new assays for screening tests. We haven't decided where those are going to impact things. So it's just-it's too much to speculate but I would say trends in cost pricing consistent with where we are right now.

Charles Baretti - *Goldman Sachs*

Yes. Along the lines of some of the new technologies you mentioned, are drug coated stents going to have a material savings on readmissions and other hospital costs based on your current population?

William McGuire - *United Health Group - Chairman and CEO*

I think that's theoretic right now. Some would say it is, but I don't know that we see data to support that. It just -- it's too early. And, you know, every time a new technology hits the market at some point it's followed with a study that suggests we may not be right in this. You can see in fact today there are studies being reported about hormonal therapy for women and it's impact on the multitude of diseases that it was theoretically to lower and it's questioned-does that in fact work. We've seen the same thing come out with screening tests now which is a huge issue.

Are we screening so much and really realizing anything? So with the stents I think that it's just too early to tell. We wouldn't expect it to significantly increase costs in any way. So I would say right now it's just even up gain.

Charles Baretti - *Goldman Sachs*

A final question is just on the fee-based business, if you could. Do you have a sense for what the medical cost trend is being experienced by your self-funded employer customers and any actions they might be contemplating now for-ahead of the 2003 period as a way to control the trend?

William McGuire - *United Health Group - Chairman and CEO*

Oh, I think trends for comparable populations are really the same. So I don't think it's a matter of fee-based or not. The differences are in consumption patterns and consumption patterns are often driven by benefit designs and so it would be reflected in what are the particular benefits that the large employers or those using fee-based offer. And sometimes they might be lower.

And I think what they're contemplating is what we've been talking about-continued use of the kind of medical intervention programs we're talking about to coordinate, find problems, efforts to negotiate unit costs and cost sharing which I suggested was probably up two or three percent. Pharmaceutical cost sharing is really up on co-pays only a percent or so, one percentage point so far this year over last year. So you'll see more of that, and some of that will be reflected in the benefit changes. T r a c e y (ph) , do you want to throw out on top of that for the large employers?

Tracey - *Uniprise*

Yeah, I think trends for populations continue to be commensurate with what you're seeing in the insured business. In the large employers the needs around medical costs and their willingness to deploy certain types of medical cost intervention vary by employer. And one of the things that we feel very strongly about is the ability for us to provide a whole host of solutions for large employers control their costs.

Everything from adding or changing benefit designs to adding or changing network designs to deploying specific targeted medical interventions to introducing elements of consumerism and consumer cost sharing. We're well positioned to offer fairly comprehensive and effective tools in each of those areas, and frankly I can't think of a large employer who isn't considering at least one if not more of those at this very moment.

Charles Baretti - *Goldman Sachs*

T r a c e y (ph) , is anybody asking to bring back the G a t e k e e p e r (ph) ?

Tracey - *Uniprise*

No.

Charles Baretti - *Goldman Sachs*

Great. Terrific. Thanks.

Operator

Your next question ...

William McGuire - *United Health Group - Chairman and CEO*

There are employers out there that have lower trends this year or even part of last year than they did the prior year that we're working with. So it varies all over the place depending on the particular population you're dealing with. Next question?

Operator

Your next question comes from Laurie Price (ph) of JP Morgan.

Laurie Price - *JP Morgan*

Hi, Bill. A couple of questions. One, I notice that you had a reasonable pick up in Medicaid membership in the quarter and I was wondering if there's any states where you presently offer Medicaid services where you're reconsidering participation in the program in light of the state deficits or Medicaid cutbacks that may be forthcoming?

William McGuire - *United Health Group - Chairman and CEO*

We are looking at every state individually both up and down. We think over the long run the programs are going to be there and we're just going to try to work with the states to make the thing work better. And -- Richard (ph)? Richard Jones (ph).

Richard Jones - *United Health Care*

I would reiterate that. Just as we look at the book of business across our other lines of business we're looking at this market by market and then categories of programs within markets and making evaluations based on the reimbursement in each one of those. And that's a process that's undergoing right -- currently, and it does -- on a regular basis. And the states are under some pressure. Our state partners need some help.

We-because of the slower economy we're seeing more beneficiaries. And it's giving us an opportunity as we proactively work with them to present our credentials and answer some of their problems as we look at going forward partnerships. And if you'd like some more detail, we're in 12 different states on our Medicaid program and reevaluating as we go forward each one of those.

Laurie Price - *JP Morgan*

But are there any that stand out right now that look like they're a high possibility of, you know, a withdrawal market for you?

Richard Jones - *United Health Care*

At this time, we're in the evaluation phase and we don't see any that rise to that potential currently.

Laurie Price - *JP Morgan*

OK. And just a quick follow up on the coated stent question that Charles (ph) asked. In general, how pervasive is it within your contracts when you charge-or when you have carve outs for new technology? I mean do you typically have carve outs where hospitals automatically get paid for new technology that comes out on the market? You know, is it included in half your contracts? Ninety percent? Do you have any sense of that?

William McGuire - *United Health Group - Chairman and CEO*

I'd be surprised if we have contracts that define things that way. I'll find somebody that can address it. I mean what you're really talking about, at least for us philosophically and certainly for me is we expect physicians to make the appropriate clinical decisions and we want to look and monitor and see that they are doing those. And if coated stents prove to be the modality of choice with proven results we would expect that the clinicians will use those appropriate and I don't think we would say "No, we don't pay for it," or "We do pay for it," when it's prudent. But we'll get a littler more into granularity for contracting. S t e v e R o g e r s (ph) ?

Steve Rogers - *United Health Care*

Our basic methodology is to focus on case rates that include new technology in them. On selective instances we may work with the hospitals to carve those out and in those instances we tend to monitor those new technologies to make sure we incorporate them in into the next contract cycle.

Laurie Price - *JP Morgan*

OK, great. Thank you, and nice quarter.

William McGuire - *United Health Group - Chairman and CEO*

Thank you. Next question?

Operator

Your next question comes from D i v e s h C a l e n d i c a r (ph) of Morgan Stanley.

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Divesh Calendicar - *Morgan Stanley*

I'm sorry. I don't have a question.

Operator

Your next question comes from J a m e s W a y n e (ph) of Salomon Smith Barney.

James Wayne - *Salomon Smith Barney*

Hi, good morning. I had a question for C h a n (ph) . Going into 2002 he had indicated that in the Uniprise business there weren't really that many big whale accounts out there to bid on, and this kind of follows on C h a r l e s ' (ph) question. I'm wondering if you could characterize the opportunity for 1/1/2003? If it's larger or similar to what you saw at this time in '01. And then I have a follow up. Thanks.

Chan - *United Health Care*

Hi, Jim. Yeah, I'd say our early view of 2003 is that A, there seems to be a significant amount of cases that are coming out to bid for the market which is generally very good news for us. And secondly, the case size is similar to what we saw this year. No very large, large significant companies as we had last year when we had two cases that added up to more than half a million members in our January enrollment in 2001.

So we think we're going to have a very strong year next year and I would say that the activity is a little bit earlier. In other words, the proposal activity is coming out to market a little bit earlier but we think that's probably just an advance of three or four weeks of overall proposal activity compared to prior years. But it looks like it will be a strong year.

James Wayne - *Salomon Smith Barney*

Yeah, I didn't mean to suggest this year wasn't strong, because it certainly was. So what you're saying is you expect-you're seeing more cases but roughly the same average case size.

Chan - *United Health Care*

Yeah.

James Wayne - *Salomon Smith Barney*

My follow on is just about -- I was wondering -- it's related to specialized care services and Uniprise revenues. Both were up very strong sequentially. Uniprise was up $38 million sequentially. But on the consolidated income statement, the management services and fees were up $15 million. I was wondering if you could characterize the risk profile of the Uniprise business that was added in light of those two numbers.

Chan - *United Health Care*

Well, I'd say the risk profile is generally services revenue. That was added. We do have a block of revenue that looks as though premium or insured revenue in our books, although it's really rated in such a way that it performs very similarly to our services based business. So the new business is almost exclusively services based. And as we've seen generally over the last couple of years, employers are purchasing products that have looser forms of networks, more like PPO rather than POS or EPO type products. Non gatekeeper products. And these tend to have lower yields on a services basis.

James Wayne - *Salomon Smith Barney*

OK. So is it-it's non-risk business but might be recognized as premium revenue?

Chan - *United Health Care*

The new business that we added generally was services, non risk business.

John Penshorn - *United Health Care*

Jim, this is John Penshorn. There's one other factor at play here which is the sequential decline of $28 million in the E n g e n i c s (ph) revenue stream. One hundred percent of that revenue stream is service revenue and so the growth in C h a n ' s (ph) business and in Ron Colby's services business in F C S (ph) has met with a headwind from the seasonal downtick in E n g e n i c s (ph) .

James Wayne - *Salomon Smith Barney*

OK. That answers it. Thank you.

Operator

Your next question comes from E r i c V i l e (ph) of Deutsche Bank.

Eric Vile - *Deutsche Bank*

Thank you. Really quickly, can you just go back over the enrollment guidance in the United Health Care segment? If I understood correctly, it sounded like the slice business should be sort of at a bottom in terms of the pullbacks here in '02. So can we expect to see some enrollment growth beginning in the second and third quarter within that segment?

William McGuire - *United Health Group - Chairman and CEO*

Yeah, Eric. I think that's right. Plus the continued growth which is actually accelerating in the small business segment. But, Bob, do you want to confirm that?

Bob Sheehy - *United Health Care*

The way we face out to the market is in small business segments, 250, we expect continued strong growth for the year. It's been a very high performing area for us so I expect that to continue. Fee-based business in the larger end of the middle market will continue to be strong for the year and I do expect that because most of the slice based business renews in the first quarter that we will be positive in each quarter here out in the insured business in .

Eric Vile - *Deutsche Bank*

OK. Thank you for that clarification and then just a quick follow up on revenue. It sounds like from your comments, Bill, that Ovations pharmacy service's revenue you expect now to start picking back up as you've had a win on the court front there. Can you give us any specific guidance from a revenue standpoint and where you think that number will move?

William McGuire - *United Health Group - Chairman and CEO*

I think this year we're still thinking a quarter of a billion dollars or so, but-Lois?

Lois Quam - *United Health Care*

As you referenced, we had an issue with PCS that we transitioned the case and we were awarded an injunction by federal court earlier. We anticipate that that-that has had a very favorable impact on the retail pharmacy revenues that will start to play out throughout the rest of the year. We are seeing much improved results consistent with our turn around plan in the other product lines in that business.

We have renewed marketing as we told you we would, and we're seeing a very good response rate to the mailings. The ARP brand and the ARP list proves powerful. So we're looking, and as Bill said, that range and north of that. But I would say that we have only begun to see what the potential of this very strong business is and we continue to see as we put these operational issues related to the turn around behind us the potential for very significant growth.

William McGuire - *United Health Group - Chairman and CEO*

Let's say 250 north.

Eric Vile - *Deutsche Bank*

Two-fifty north is fair, then?

William McGuire - *United Health Group - Chairman and CEO*

Yep.

Eric Vile - *Deutsche Bank*

Great. Thank you.

Operator

Your next question comes from J o s h R a s k i n (ph) of Lehman Brothers.

Josh Raskin - *Lehman Brothers*

Hi, thanks. Congrats on the quarter. Our questions are on the margin improvement. It looks like most of it is coming from the administrative side. And we're just wondering-I know Bill had mentioned specifically some of the Internet initiatives that are being pushed. Did we think about that as actually coming through as a benefit now operationally? I think Steve had said last quarter that you were really just beginning to see the implementation and not really the benefits. Are we finally seeing that at this point in 2002?

William McGuire - *United Health Group - Chairman and CEO*

No. I think it's still in front of us. Steve?

Steve Hemsley - *United Health Care*

Yeah, I'm not willing to declare and put benefits through. I think you're seeing in a range of about $30 million annual in terms of currently our Internet transaction activity. That displaces phone calls, responses to inquiries, some claims processing, things of that nature. That's not an inconsequential number in terms of transactions but we have much higher expectations and we don't really have any of that in our numbers at this point in time and until we really get further up the adoption curve and can really quantify that for you I think we're going to stay in that posture.

Josh Raskin - *Lehman Brothers*

OK, that's helpful. And then just one clarification on the medical payables, the actual balance sheet amount ticked up here a little bit more than modestly. And yet there was less risk based revenue by a couple hundred million dollars in the quarter. And then additionally it sounds like some of the commentary about medical cost trends are that there isn't an expectation that they are significantly rising. So I was just wondering, you know, what caused that boost? Is that conservative or?

William McGuire - *United Health Group - Chairman and CEO*

I think that's a reasonable consideration to our approach, that we said we are not changing and we remain conservative and how we deal with all of this. It's early in the year.

Josh Raskin - *Lehman Brothers*

OK. That's helpful. Thanks, and congrats again.

Operator

Your next question comes from E d C o l e (ph) of SG Cowen.

Ed Cole - *SG Cowen*

Good morning. does the separation of Merck and Medco-Medco being your PBM vendor, have any impact on your contract with them?

William McGuire - *United Health Group - Chairman and CEO*

No. No, we think there will really be no impact whatsoever. We have a very good relationship. We think they are serving us and our clients well. We think we compliment each other in the value that's brought through this and that will -- has been apparent in our trends for pharmaceutical costs relative to competitors and will be apparent again this year and we're quite confident it will be apparent next year.

Ed Cole - *SG Cowen*

All right. And then a quick follow up. As your health plan book of business shifts towards the fee-based side, would you say, Bill, that that is a response to the marketplace demands or a conscious effort on your part to make that business-make that book of business from an earnings standpoint more predictable or a combination thereof?

William McGuire - *United Health Group - Chairman and CEO*

Yeah, I would say it's both. I mean clearly, you know, we've been talking about this now for a number of years. Employers do have views that change based on their particular needs and in some situations a self-funded approach may advantage them versus an insured approach. And so I think they drive some of that. At the same time, it's clearly a conscious effort on our part to not participate in some kinds of business which are just not appropriate we think to our capital and the amount of effort we put into it.

There's no -- there is no hesitation about being in an insured business or with any of these employees and their employers as long as we have a reasonable chance to underwrite versus being selected and that is the problem with the so-called slice business. It's not that we wouldn't do those on an insured basis if we have the whole thing.

Ed Cole - *SG Cowen*

And then finally, very quickly on the care coordination which certainly seems to be gaining traction for you, any chance you can quantify for us either on the medical care ratio-a medical care ratio basis or maybe in terms of medical cost trend what the benefit in the quarter was from the care coordination programs?

William McGuire - *United Health Group - Chairman and CEO*

I think -- I can't. I wish I could, but I think it would be too speculative. The effort to get categorized under the banner of care coordination are really just a piece of a multi-faceted approach to care enhancement and cost savings through better health care. All of these things are really designed with that in hand and I think the efforts of care coordination and facilitating the care, sort of helping to reduce the fragmentation, going out and looking for issues and alerting people to it, helping physicians render their care better to me is meaningful, but on a scientific basis it is just hard to do this early.

I hope we'll have more data for you later on, but you know, every time we would pick some set of circumstances that have an impact we can put some pennies to is but there might be an offset somewhere else. So I would suggest you just look at the totality of the approach and say and say an effective health care system is also going to be one that works well for people, works well for physicians, better for physicians, and manages to be simpler as well as more effective in realizing positive health care outcomes and appropriate costs. And that's a bit -- I think this program is a big part of it.

Ed Cole - *SG Cowen*

Great. Thanks a lot.

William McGuire - *United Health Group - Chairman and CEO*

Thank you.

Operator

Your final question comes from C h e r y l S k o l n i c k (ph) of .

Cheryl Skolnick

Thanks very much and I'm glad to get in under the wire. A very nice quarter and good job. My question relates to your assumptions underlying your guidance going forward about the status of the economy. Bill, last quarter you were very careful to say that you were not anticipating any decline in the economy but also not a terribly robust economy going forward. And so I'm curious about whether or not your view on that has changed and in particular with respect to employers' willingness to both accept and be able to afford the kinds of premium trends that we've been talking about here.

William McGuire - *United Health Group - Chairman and CEO*

Yeah. Cheryl, let me -- I don't think the view has changed relative to the impact of the economy, strong or weak, on what we do. We anticipate for instance that there may -- despite the bulls, be lay offs in the coming quarters in some segments on industries. We feel that in the fourth quarter of last year, post 9/11, the concerns about the economy did push through in some of the medical costs relative to perhaps increased utilization even beyond Cipro and the things we had talked about previously. So I think it remains dicey and a pressure point.

Relative to the premium price increases, that is a bigger issue. And it extends beyond just the economy because I think we'd be challenged even with that. And I'm fairly out front in my belief that this is an issue around consumption, around our inability to define or unwillingness to define what is clearly proven versus what we want. And those are things that are going to have to be grappled with by payers, providers of care, intermediaries, facilitators, all of those. I think people -- you know, the costs are going to be what the costs are. Folks are clearly looking for ways to lower those costs. Some of that is through benefits but there are some hard choices to be made.

You know, we see people-our population is aging, we see significant new technologies. With new technologies come more complex disease, with complex disease comes higher cost. We were just looking at a five-year run sort of, of what's happened to health care costs. I'm looking at some notes from that. Price inflation over the last five years -- well, overall, health care costs about 50 percent or so of the five year increase. Price inflation is 38 percent of the total. Increased consumption, 19 percent. Intensity and mix of services, 17 percent. Pharmaceuticals doubled, driven by some things which, like cholesterol lowering, and you know, we've expanded the indications for that which certainly may be good if used properly.

But we've also had considerable introduction of lifestyle drugs, so to speak, and the consumer marketing . The demographics of the population are clearly changing. We're seeing-you know, we've probably seen a year-and-a-half average age increase in the people we're serving and more complex disease. So I think it's a big challenge. It's a big challenge.

That said, the solutions are going to come from information, the better use of data, services that help people make better choices, seek out the best solutions, tools that allow us to facilitate and coordinate what's going on because we know it is fragmented, we know it is inconsistent. We know it is very complex. And I think that's where the wins will be and I believe we can lower the health care costs. I really do. But it will take some of these steps.

Cheryl Skolnick

Are those discussions that you're beginning to have this year or is it-I mean are you seeing any change in the nature of those discussions? Is it more intense this year for 2003 than it was last year?

William McGuire - *United Health Group - Chairman and CEO*

You know, I would say that the newspapers would tell you it's more intense . I'm not sure that it is-

Cheryl Skolnick

Yeah, neither am I.

William McGuire - *United Health Group - Chairman and CEO*

--significantly more intense. I think it waxes and wanes, you know? Nine-eleven-those unfortunate and tragic events come along and it drops off the radar screen for a little period of time. It's still there, but I don't know that it's a dramatic shift. We're just looking now at different ways to do things in light of sort of a different set of issues.

Cheryl Skolnick

Right. Great. And since everyone else has had an opportunity to comment on C a l p e r s (ph) and its potential impact on the commercial insurance market, would you care to?

William McGuire - *United Health Group - Chairman and CEO*

I think-you know, I don't-we don't look at C a l p e r s (ph) as a meaningful deviation from what's going on. I think C a l p e r s (ph) reflects what's happened in California, the nature of its benefits, the nature of the population C a l p e r s (ph) is trying to serve. We don't directly deal with those with those people. The important thing is they, too, are supporting the idea that costs are higher in California for a variety of reasons including the underlying physician and hospital costs as well as the consumption and the benefit designs they're offering.

Cheryl Skolnick

Great. Thanks so much.

William McGuire - *United Health Group - Chairman and CEO*

Thank you, C h e r y l (ph) . Well, we've used our allotted time. I would like to close and thank you all again for visiting with us. The quarter obviously was quite strong. It continues a series of quite strong quarters which we expect to continue into the future. We have increased our guidance again for this year. As we said, the $3.84 to $3.86 for the full year. On top of that, we obviously expect our businesses to continue strong momentum and to lead into a very strong 2003.

So we'll look forward to visiting with all of you later. And again, thank you. Bye-bye.

Operator

Thank you for participating in today's United Health Group Corporation conference call. You may now disconnect.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

DEL - Q1 2002 Deltic Timber Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 7:00PM GMT

TRANSCRIPT

Operator

Good afternoon. And welcome ladies and gentlemen to the Deltic Timber Corporation first quarter earnings conference call. At this time, I would like to inform you that this conference is being recorded for rebroadcast and that all participants are in a listen-only mode. At the request of the company we will open up the conference for the question and answers after the presentation. I will now turn the conference over to Mr. Ron L. Pearce, President and CEO. Please go ahead sir.

Ron L. Pearce - *Deltic Timber Corp.*

Thank you. Good afternoon. I am glad to welcome you to the Deltic Timber first quarter conference call. And joining today is Mr. Clefton Vaughan Vice President of Financial Administration and Mr. Kenneth D. Mann Manager of Investor Relation. After Kenneth comments, Clefton will go over the financial results that were released yesterday afternoon. I will then comment briefly on our current business climate and the outlook for the reminder of 2002 before opening the lines for questions. Kenneth, go ahead.

KENNETH D. MANN

Thanks Ron. As you know like yesterday Deltic issued its news released regarding earnings for the first quarter of 2002. If you did not receive a copy of this release please contact me after this call. My direct telephone number is 870-881-6432. And now before continuing, I would like to make a statement related to the Safe Harbor provisions for the Private Securities Litigation Reform Act of 1995. Some of the comments made during this conference call would be considered forward-looking statements. These statements will replay the company's current views with regard to future events and financial performance. However, no assurance can be given as those of the ends will cover or that the predictions will be attained. Certain important risks factors that may cause actual results to differ materially from the forward-looking statements are identified in Deltic's 2001 form 10-K on file with the SEC. And now I will turn the call over to Clefton.

Clefton D. Vaughan - *Deltic Timber Corp.*

Thank you Jim. For the first quarter we are reporting net income of $0.8 million or $0.02 per share and that compared to little around a million for our continued operations for the first quarter 2000. And is about even with the last quarter. Woodlands segments contributed $7.2 million operating income and that is compared to $7.9 million this time last year. The 2000 quarter average including the gain of $3.9 million from sales of timberland wood this quarter had a gain of about $300,000. Pine sawtimber harvest levels were 256,200 tones or 43% greater than the first quarter last year. Prices were slightly better $42 a ton. Turning to the mills that segment losses were greatly reduce this quarter. We have lost $1.2 million and that compared to $2.4 million first quarter of last year and $3.1 million last quarter of last year. Our lumber sale was $49.3 million board feet, which is up 63% from $30.2 million feet in the first quarter 2000. And the sales were held back from market conditions and down. Average sales products for the current quarter was $309 with 1000 board feet and improvement at $22 per thousand over this time last year. Real estate segment contributed 600,000 compared to 600,000 this quarter last year. Residential lot sales actually increased by two 26 from 24. However average price was down from 18,300 a lot due entirely do sale mix. We haven't reduced the price of any lots [_____] just take you out through the south. So putting into Del-Tin deltic share of equity and Del-Tin fiber loss was $2.4 million, which is slight less than the first quarter last year loss of $2.5 million. You will remember the plant we have shutdown two of the three months in the first quarter 2001; it operated all this quarter. The capital expenditures for the quarter were $4.1 million and most of this money was spent as we continued building the second if you know about [_____] and continue with the real estate lot development. On the balance sheet, the debt that has been reduced to $6 million from the beginning of the year at $78.1 million that gives a debt-to-capital expenditure showed 30.2%, which our view is one of the lowest leverage rates in our industry. That is right I don't have to add to this. I will turn it back to over to Ron.

Ron L. Pearce - *Deltic Timber Corp.*

Thank you Clefton. Affecting the current business climate for our company continues to be an interesting exercise each quarter viewed against a backdrop of an improving economy, I would consider the outlook for those Woodlands and Real Estate to be good with lumber continuing to improve. Woodland had a good first quarter with both ton of sawtimber sell and price per ton increasing when compared to the first quarter last year. Though the price per ton was up 2% when compared to the first quarter 2001, it was up $9 per ton or 27% compared to the fourth quarter 2001. We took advantage of improving market and increased our harvest level over the 178, 000 tons from last year. For the second quarter we anticipated the pine sawtimber harvest to be a 175, 000 to 200,000 tones, and we continued to estimate 700,000 to 750,000 tons for the year. But we only sold 328 acres of timberland in the first quarter, we are continuing our program to consider additional sales of timberland identified to be either non-strategic for hire and better use. Several tracks have been identified with something less than the brokerage and some will be put up to bid cycle. The Mills lumber sales volume gross 19 million feet from the first quarter 2001 and 8.7 million feet when compared to the fourth quarter 2001. With an average sales price of $287 per 1000 in the first quarter last year we elected to take some downtime and curtail production at both Mills. This year with conditions improving since beginning of the year, we have continued to concentrate on cost reduction for running both Mills full time. The random links framing composite price was $295 in January, $311 in February, and $338 in March with March resulting in the first month of profitable Mill operations since last June. The most recent composite price printed at $331, which compares favorably to a year ago when it was $317. Finished lumber production and sales volume will continue to be subject to market conditions as estimated to be 50-55 million feet for the second quarter, and 205-215 million feet for the year. Rationale value Real Estate development the residential traffic connectivity remains good. At the end of the first quarter we had 52 lots under contract representing net sales of $4.4 million. In the same time last year we had 66 lots under contract representing $4.1 million in sales. All the lots currently under contract are scheduled to close this year. At this time we have fully residential offering under [______] plan to offer these within the next two quarters. Lot sales projected to be 30-40 this quarter with a 175-200 lots sold for the year. Last, but not least is Del-Tin fiber. We did not see as much improvement in operating results that our medium density fiberboard plant as we have planned on. This was due to a number of reasons including pricing, product sales mix, and sales volumes. For the outlook for the second quarter shows some improvement for the pretax loss declining to $1.2-$1.5 million, we are not satisfied with this forecast. As we have said previously management is currently evaluating all our future options for this joint venture. Esther], I think we can know open the lines for questions.

Operator

Thank you. Question and answer session will began now. If you are using a speakerphone please pick up the handset before pressing any numbers. Should you have question please press 1 and 4 on your push button phone. If you would like to withdraw your question please press 1 and 3. Your question will be taken in the order that is received. Please standby for your first question. Your first question comes from [Richard Diamond]. Please state your affiliation followed by your question.

Richard Diamond

RICHARD DIAMOND]: [Enwood Capital]. I have two questions. One, I want to appreciate your thoughts, firstly, about talk of wall of wood coming down from Canada. If you see any indications of that. And secondly what are you thoughts on wood products demands for the rest of the building season for that [______] wrong or do you believe that housing starts were borrowed earlier in the year. Thank you.

Ron L. Pearce - *Deltic Timber Corp.*

Say on the first one in terms of the wall of wood from Canada this is the time that we have heard quite a bit of over the past year really. Each time we hear it. So far we haven't seen any real indications. I think that we probably will have some type of settlement on the Canadian US lumber problems right now. And I think something probably will happen in the next 30 days. But really we haven't seen any indications that they are going to flood the US with additional lumber and also receiving some thought that railcars and [______] major would not be available to do that. In terms, of the wood products demand I would say that we are clear the demand definitely has improved over the last or really going up back to the first of the year. Housing start remain fairly strong in our area we had good weather conditions and having starts day strong even during some of the winter months. The interest rates have not strongly a real signs of going up drastically and I actually have something that is unforeseen, I think really our thoughts are that it will be another good year for housing.

Richard Diamond

RICHARD DIAMOND]: Thank you very much.

Operator

Thank you. Your next question comes from Richard Straley. Please take your affiliation followed by a question.

Richard Straley - *Stephens Inc.*

Hi Ron Richard Straley with Stephens. On the subject of Del-Tin you mentioned as poor results in the quarter being a function and pricing product mix and sales volume, as I understood you correctly. What about the operations of the plant were there continued problems with [Edix] changer or the quality of the material you are turning now.

Ron L. Pearce - *Deltic Timber Corp.*

Hello Dick. Really in terms of the areas some of the items that I mentioned there the product sales mix and pricing those both impact each other. The plant itself we think now is ready to run of the indication that we have seen we are ready to run. I would say our view is that we would like to have longer rounds of certain five items. We are seeing really in the past 30 days from plants of definite plans of increase in India market there have been some companies that have already announced the price increase the Del-Tin has recently announced the price increase. I think the demand definitely has strengthened. I think I our regional budget we had been backlog to the first of the first of the year. But where we are now the plant is ready to operate. And we hope to have considerably better results here in the second quarter.

Richard Straley - *Stephens Inc.*

Okay. And I relate a question Ron on Real Estate. Do you have any paying conservatives in terms of likelihood of any significantly size commercial sales occurring in the next couple of quarters?

Ron L. Pearce - *Deltic Timber Corp.*

We have a lot of commercial acres out there. As you are aware we really cannot forecast those likely can residential offerings. On the residential offerings we have drawings and builders plan up for lots and had a regional expectation of those being closed foreseeable future. So many of the commercial sales even the ones that we made up to this date they are prospective for quite sometime. And in all of a sudden you know the sale is completed. So we really do not project that in an overall annual budget on what we expect to do.

Richard Straley - *Stephens Inc.*

Okay. Thank you.

Operator

Just to reminder ladies and gentlemen should you have a question please press 1 and 4 on your pushbutton phone. Your next question comes from [Nasia Folk]. Please state your affiliation followed by a question.

BROCK HEIL

BROCK HEIL]: Hi [Brock Heild] Goldman. Just curious when you said we consider any options for Del-Tin. What exact did you have in mind there. What range of possibilities could that encompass?

Ron L. Pearce - *Deltic Timber Corp.*

Well I think really other than that statement currently evaluating all future options. I think that is pretty broad statement. And I do not really think of anything that I would want to add to that right now.

BROCK HEIL

BROCK HEIL]: Okay thank you.

Operator

As there are no further questions I will turn the conference back to Mr. Spears to conclude.

Ron L. Pearce - *Deltic Timber Corp.*

Thank you. I would just like to thank everyone for participating in today's call. If any other information is needed please let us hear from you or any of us, or Ken in particular. I will look forward having you continue to follow Deltic's.

Operator

Ladies and gentlemen that concludes our conference for today. Thank you all for participating and have a nice day. All parties may now disconnect.

THOMSON REUTERS STREETEVENTS

EDITED BRIEF

CCE - Q1 2002 Coca-Cola Enterprises Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 2:00PM GMT

OVERVIEW:

Coca Cola announced 1Q02 results of EPS of $0.02 and EBITDA of $429m. Volume increased 6%, with 5.5% growth in North America, and 7.5% growth in Europe. FY02 earnings guidance increased to $0.83-88 EPS. Executives are upbeat about Coke's ability to capitalize on upward pricing trends and the roll-out and reintroduction of key brands. Q&A focused on changes and future benefits of the rate/volume mix, clarification of financial line items, and prospects for pricing and volume growth in 2002.

OVERVIEW

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FINANCIAL DATA

I. KEY DATA FROM CALL

- 1Q02 EPS totaled $0.02, compared with a net loss of $0.09 EPS in 1Q01.
- Volume increased 6%, with 5.5% growth in North America and 7.5% in Europe.
- 1Q02 EBITDA was $429m, up 11% over 1Q01 EBITDA of $386m.

PRESENTATION SUMMARY

I. 1Q02 OVERVIEW

1Q02 was positive, with volume growth up 5.5% in North America and 7.5% in Europe. North America is significant because it represents strength in key areas. New brand initiatives are strong. Good results in Europe, building on last year's exceptional performance. Seeing benefits of 2001 restructuring. Healthy volume and expense control helped achieve a healthy EBITDA and positive EPS. A single quarter's results don't make a successful year, so we have to manage pricing volume, operating costs and mix to meet financial targets for FY02.

Improved EBITDA reflects strong volume growth and moderate increases in cost of goods and operating expenses.

Consolidated comparable net pricing per case in 1Q02 was flat compared with 1Q01, excluding currency translations. Comparable pricing in North America declined 0.05%, reflecting the timing of planned 2002 price increases. Consolidated cost of goods per case increased 0.05% in 1Q02.

Coca Cola classic grew 3%, benefiting from strong marketing programs. Diet Coke achieved volume growth of 9%. Fanta and Minute Maid, among other Coca Cola brands, added more than 2 points of volume growth in North America in 1Q02.

II. NORTH AMERICA

North American pricing was down 0.5% in quarter. Going forward Coke intends to take pricing in line with industry trends, and should achieve pricing growth in North American markets. The price and volume equation in North America is key. Brands are growing again, products are competitively priced, and the Company believes it can move pricing up in step with the industry. Pricing growth of 2% for remainder of year, in line with cost of goods increases.

III. EUROPE

Europe achieved growth of 3%, and continued pricing growth is likely. Coke is confident it can achieve 2002 FY financial targets. Raised EPS targets to $0.83-$0.88, reflecting favorable interest rate trends. Free cash flow of more than $300m.

Success in Europe shows marketing strength. The World Cup, which attracts more TV viewers than any other sports event in the world, will be important for Coca Cola. The Company will build on growth of Diet Coke in UK with introduction in May of Diet Coke with lemon. Diet Coke with lemon will supply incremental growth in Europe. New Fanta flavors in UK have helped drive Fanta volume up 32%. Powerade is growing successfully throughout Europe.

Continuing to grow cold brands. Coke up 7.5% in UK. Cold Drink division in EU has ongoing potential. Combining growth patterns with 3% pricing growth should result in strong results for this year.

IV. OPERATING PERFORMANCE

Positive volume performance in 1Q02, especially of core brands (Classic and Diet). Classic up almost 3% in quarter, supported by marketing for key events (Olympics, Nascar, Super Bowl, Easter).
Diet Coke grew more than 9%, with volume up 2.5% in the quarter. Diet Coke with lemon continues to bring in new consumers, with strong repeat purchasers. Driving this renewed growth in Coke and Diet Coke is successful execution at the local level and providing good service.
Fanta, Minute Maid etc. added more than 2 points to growth in 1Q02. Dasani was up 60% in quarter and the brand remains strong. Consumer response to advertising has been good for the Dasani brand. Single-serve bottled water represents a significant opportunity in long-term growth and profit. Powerade buying was up more than 25% in the quarter. With additional new packages and brand extension, continued strong growth is expected throughout 2002.

V. NEW BRANDS AND BRAND EXTENSIONS

North American marketing for remainder of year will focus on four points: (1) strength of new brands and products, (2) focus and execution against strong promotions in 1Q02 (NCAA Final Four, Olympics, etc.), (3) more competitive pricing position in market across board, (4) advertising that people relate to.

VI. MAIN SUMMER INITIATIVE

The main summer initiative is the summer music cash promotion, involving instant-win music-related experiences and free drinks, coupons, etc. Increased number of brands included in program. Strong component is ability to tailor program to local retail customers. Coke with food displays will be seen in this program. Two lemonade brands will be rolled out in Apr. 2002. The most significant new introduction is Vanilla Coke. Repositioned Cherry Coke will be reintroduced soon. Combining the power of growing Classic brand, introduction of Vanilla Coke and repositioned Cherry Coke will drive demand for all Coke products.
Powerade and Dasani expansion includes more multi-packs. Nestea Cool lemonade tea will be introduced in 2Q02. Minute Maid sodas will have new graphics and new taste. The combination of an aggressive program of new products and excellent marketing will continue to drive volume and profit growth.

VII. 2002 OUTLOOK

The Company expects FY02 EBITDA growth of 11-14%, resulting in EBITDA of 2.33-2.38bp. FY02 earnings should range from $0.83-0.88 per diluted common share.

QUESTIONS AND ANSWERS

The Q&A portion of this Brief is expected but not currently available.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

- Q1 2002 Westpoint Stevens Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 3:30PM GMT

TRANSCRIPT

Operator

Good afternoon ladies and gentlemen and welcome to the 2002 first quarter earning release conference call. At this time, all participants have been placed in a listen-only mode and we will open the floor for your questions and comments following the presentation. It is now my pleasure to send the floor over to your host, Ms. Lorraine Miller. Ma'am, the floor is yours.

LORRAINE D. MILLER

Good morning everyone and thank you for joining us today April 18, 2002. Participating in today's conference call are Holcombe Green, Chairman and Chief Executive Officer of WestPoint Stevens, Chip Fontenot our President and Chief Operating Officer, LESTER DUPUY SEARS, our Senior Vice President and Chief Financial Officer, Tommy [Lane], Senior Vice President and Treasurer, and Nelson [Griffith], Senior Vice President and Controller. Before we get started, let me remind everyone that any forward-looking statements made in today's conference call are done so under the safe forward provision of SEC 27A of the Securities Act of 1933. Such forward-looking statements involve a number of risks and uncertainties included in today's press release that could cause actual results to different materially with any such statement. I trust that everyone has received the press release this morning, or you can access it on our website www.westpointstevens.com, or you can contact my associate [Judy] Robinson here in New York at 212-930-3824 and we will get a release out to you. I would like to briefly highlight just a few issues from our first quarter release. This morning we reported EPS for the first quarter of 2002 of $0.04; that was versus earnings per share of a loss of $0.10 in 2001 before charges associated with our eight-point plan. This was above our prior guidance of EPS of breakeven to a loss of $0.10. Sales increased in this quarter by 4% to $435 million, which was better than our guidance of down 2% or roughly $410 million. Most of this growth was due to the incremental sales of new license programs that were in line with our expectations. The upside really came from core sales that were roughly flat in the quarter, better than the recent performance of being down about 5%. Of note, excluding Kmart sales our sales in the first quarter would have actually increased at a double-digit rate. Chip is going to discuss in more detail the impact of some changes in product mix and distribution channel issues here in a few minutes. Also during the quarter, we recorded $4 million on a pretax basis in bad debt expense, related to the impact of the Kmart bankruptcy filing in the first quarter. This was in addition to the $11 million pretax charge recorded in the fourth quarter 2001. After this charge, our debt for the first quarter was $60 million, or 14% of sales, ahead of our guidance of $50-55 million and up versus year-ago levels of $50 million, or roughly 12% of sales. Our operating profit was $39 million versus $30 million a year ago, and our operating margin was 8.9% in the quarter, up 180 basis points versus a year ago. The most significant factors behind the margin improvement were low raw material cost, a more favorable product mix, reduced commercial pricing, and cost savings from the restructuring that more than offset the aforementioned bad debt expense. As reported in our press release this morning, we remain comfortable with our prior range of earnings guidance for 2002 of EPS of $0.45-0.50. Sales are still expected to increase 4% for the year assuming additional sales of Ralph Lauren and Disney license products of roughly $70 million and flat core sales growth. Looking specifically at the second quarter for 2002, we are projecting sales of $440 million, which is up 10% from a year ago, EBITDA of $55 million, and EPS at breakeven that would compare to a loss of $0.28 a year ago. Now, I would like to introduce our Chairman and Chief Executive Officer, Mr. Holcombe Green to comment further on our first quarter results and the outlook for the rest of 2002. Holcombe... HOLCOMBE T. GREEN, JR.: Thank you Lorraine and good morning everyone. Well, we are obviously pleased with our first quarter results. This represents the third consecutive quarter of substantial sales increases for WestPoint Stevens and confirms that our strategic plan is working even though retail and industry conditions are still difficult. Sales grew 4% despite Kmart's bankruptcy filing, and more importantly, it shows how we have expanded beyond basic sheets and towels put several resources in place to focus on home fashion accessories. We are starting to see the benefits of this focus in our product mix. In the first quarter, sales of accessories, which is essentially all of the sales excluding sheets, towels, [in] our retail stores increased over 20%. So you can see that we are making great progress in that area. Secondly, the operating profit course increased 30% from last year to $39 million. Lower cotton costs, better operating efficiencies as a result of our eight-point plan, a more favorable product mix, and some moderation in promotional pricing more than offset some bad debt charges and others. We also are continuing our proactive stance with inventory management, which is helping to reduce our working capital intensity and provide liquidity; Dupuy will give you more information on that. We continue to be in compliance with all financial covenants. Finally, we are focused on debt reduction and, as we have said, we expect to generate $70 million of free cash flow that will go toward reducing [______]. Now, I am going to turn it over to Chip so he can comment further. M.L. "CHIP" FONTENOT: Thank you Holcombe. We are very pleased with our sales performance in the first quarter. On our last comments call, we indicated that we were doing a good job of getting our share of business despite difficult industry conditions. Looking at the first quarter, we did see an improvement in department store sales - a distribution channel that had been under pressure for most of last year. Mass merchants with the exception of Kmart and specialty stores continued to perform well in the quarter and our focus on key growth accounts showed our ability to offset planned sales decline at Kmart. I would like to take a moment of shares on recent observations from our home fashions market, which is wrapping up this week. The layout of our showroom and our product displays are no longer focused on solid color sheets and towels. We are not abandoning that important category, we are restating it in display form that demonstrates our broad capabilities and core product. The presentation focuses on our ability to supply any thread count - from 120 to 350 and beyond - with emphasis on color range and service. Beyond this, the majority of the displays demonstrate our ability to design, manufacture, and market accessory products and product categories that offer more margin opportunity for WestPoint Stevens and our retail customer. Summarizing in one sentence, the showroom demonstrates the importance and profitability of product and category extension in today's retail market. I believe that our first quarter performance clearly demonstrates the validity of this direction. Of course, our ability to execute an expanded product offering is due to the successful coordinated efforts of our domestic manufacturing operations and our expanded sourcing initiatives. Our rate of sourcing doubled last year and is on track to increase roughly 50% this year. We continue to focus on those retail partners that are the most important in today's home furnishing market. We are investing more product and ground support energy in our Martex brand. We are particularly excited about expanding our Martex brand with Kohl's, which is one of the fastest growing retailers in the market today. Our Disney brand continues to expand beyond the original placements to customers such as J.C. Penny and Sears. In the department store channel, sales from our license with Ralph Lauren continue to grow through great product design and product extensions. Supporting our growth in all of these areas has been the success of our branding strategy for basic bedding. Bedding includes pillows, mattress pads, blankets, and down comforters. Our product expansion here has contributed to the success of each of our in-house brands and licenses. In summary, our first quarter reflects meaningful progress in product extensions, expansion, and distribution with [______]. Now I would like to turn it over to Dupuy, our Chief Financial Officer.

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

Thanks, Chip. As Lorraine mentioned, we recorded bad debt expense of $4 million pretax in the quarter that was related to our pre-petition receivables exposure at Kmart for January. As we mentioned on our last call, this writeoff has not had a material effect on our liquidity position or our compliance with financial covenants. Turning to the balance sheet, accounts receivable, including our securitization facility, was $305 million; that is $23 million higher than last year, reflecting increased sales overall compared with a year ago and also the inclusion of $18 million in Kmart pre-petition receivables. Days outstanding declined from 56 last year to 55, and that exclude the Kmart on pre-petition receivables. Outstandings under our accounts receivable facility were $146 million, versus $129 million a year ago. Inventories at the end of the quarter were $419 million; that is up 3% versus a year ago and reflects the beginning of our seasonal bill for second quarter and third quarter sales. Quality of our inventories continue to improve, as both age and second-quality inventory levels decline and that resulted in significantly reduced losses from selloffs during the quarter. Total debt, including our trade receivables program, was $1.835 billion versus $1.827 billion a year ago. Borrowing availability at the end of the quarter was $148 million, versus $82 million a year ago. During the quarter, we spent $4 million on capital improvements and we are planning on total capital expenditures for the year of $40-50 million. HOLCOMBE T. GREEN, JR.: Thank you. We'd be happy to take your questions now.

Operator

Thank you ladies and gentlemen. The floor is now open for questions. If you have any questions or comments, please press the number 1, then 4 on your touchtone phone at this time. Pressing 1 and 4 a second time will remove you from the queue should your question be answered. Lastly, we do ask while posing your question, you please pick up your handset if listening on the speakerphone for optimum sound quality. Please hold while we poll for questions. Our first question comes from Eric [_______]. Please state your affiliation then question.

LEWIS SARKIS

LEWIS SARKIS]: It is Lewis Sarkis from Chesapeake Partners. A couple of questions. First of all, in terms of EBITDA is there any special items in there, any pension income? M.L. "CHIP" FONTENOT: No there is not.

LEWIS SARKIS

LEWIS SARKIS]: So no special items at all. You said that your guidance for that was 50-55 for this quarter?

LORRAINE D. MILLER

That was the guidance we have for the first quarter, and it is 60.

LEWIS SARKIS

LEWIS SARKIS]: In terms of sales, you said that you have given estimates of 0-2% including Kmart?

LORRAINE D. MILLER

Are you talking about the first quarter?

LEWIS SARKIS

LEWIS SARKIS]: For the first quarter sales increase, correct.

LORRAINE D. MILLER

The guidance that we had given was down 2% - $ 410 million and we came in up 4%.

LEWIS SARKIS

LEWIS SARKIS]: Okay. Thirdly, what percent now is the foreign sourcing that you all are doing?

LORRAINE D. MILLER

We do not update that on a quarterly basis, but we did mention in the 10-K that sourcing was representing, I believe, 13% of sales at the end of last year.

LEWIS SARKIS

LEWIS SARKIS]: Okay. Finally can you tell in terms of the improvement of the Kohl's account, where they are? What size of a customer at this point, are they in the top five?

LORRAINE D. MILLER

We've disclosed top six customers in our 10-K, and they were not in the top six.

LEWIS SARKIS

LEWIS SARKIS]: Do you expect that they will be by yearend or is that your hope?

LORRAINE D. MILLER

They're one of our top 10 accounts, so it is possible I guess. It depends.

LEWIS SARKIS

LEWIS SARKIS]: Okay and thank you very much. Congratulations. M.L. "CHIP" FONTENOT: Thank you.

LORRAINE D. MILLER

Next question.

Operator

Our next question comes from Jeff Stewart. Please state your affiliation and then your question.

JEFFREY STEWART

Wachovia Securities. A couple of questions. Lorraine, the $60 million you quoted for the quarter, I am assuming that includes that $4 million charge for Kmart, correct?

LORRAINE D. MILLER

That is correct.

JEFFREY STEWART

So if you add that back it would be $64 million. The other question is: can you give us any help at all, going forward, on margins? Holcombe, do you expect any of those things to rise or abate in the next quarter? How should we model this thing on a margin basis, how do you feel about pricing and raw materials and other things for the rest of the year? HOLCOMBE T. GREEN, JR.: I think that we will continue to see what we saw in the first quarter for the balance of the year. That is savings that we got in cotton will continue through the balance of the year. Similarly, the manufacturing savings, which we just started to realize in the fourth quarter last year, will also continue for the full year. So we should see that. We are projecting that margins are going to be in 14-15% range and we are comfortable that we will be able to do that, maybe a little more. The one negative I would say is the rising energy costs could have some impact, but that's fairly negative [______].

JEFFREY STEWART

Okay.

LORRAINE D. MILLER

Jeff, specifically for the second quarter guidance that we gave, you'll notice that the margins are coming down a little bit from the first quarter and that has more to do with the mixed sales, where you will probably see a higher proportion of bath business relative to the first quarter, but as Holcombe said the raw materials cost and the efficiencies should carry through throughout the year.

JEFFREY STEWART

Thank you, that was the direction of my question. And my last question is this: Feeding off of the last question, 13% last year sales is somewhere around $230 million, and a 50% increase goes to almost $350 million - that's like a $170 increase. Is that mostly sheets and accessories? Where do you expect to increase your sourcing?

______

______]: I think that we gave you a bogus number, it is more like around 8%.

JEFFREY STEWART

Around 8%. That for last year?

______

______]: Yes. And it is [_______] to the numbers at the rate that we are going today.

CATH STEWART

CATH STEWART]: Okay and it is more like $150 million?

______

______]: If you are asking about the last year. This year it's running at a rate closer to some of the numbers you threw out.

JEFFREY STEWART

Okay. What areas you are concentrating on for sourcing, is it sheets and towels or is it something else?

______

______]: The product that needs the best. It's an accessory. Finished sheet products, finished towels, and [_______] sheeting. It depends on how we are developing the product and what we need.

JEFFREY STEWART

How is the international market on a sourcing basis, have things settled down a little bit or...what sort of a status is that?

______

______]: If you look at the numbers, you will see imports of towels declining a little bit on a historical basis. Sheeting is still maintaining the percent of market that it's always had. HOLCOMBE T. GREEN, JR.: The imports pretty much across the broad have flattened or declined. Actually there was some a report today from Cotton Inc. that there was a decline probably last year, so...

JEFFREY Stewart

Okay and thank you very much.

Operator

Our next question comes from Pamela Wilson. Please state your affiliation and then your question.

PAMELA WILSON

_______] Company. There is a lot of concern in the market over managing earnings, and your assumption for your return assets and your pension plan's seems relatively high at 10% for your 2001 versus what you actually earned and what the market is likely to produce this year. I wonder if you could tell us first are you continuing to use the 10% return assumption in 2001 and if so, what would be the impact on your EBIT if you used a more reasonable assumption of 7-8%.

LORRAINE D. MILLER

Well I just start of with the comment, Pam, that those assumptions are based on long-term rates of performance are not trying to adjust on year-to-year basis, but Tommy Lane our treasurer may be could speak directly to the question about this year?

TOMMY LANE

TOMMY LANE]: Pam. We are still going to use the 10% return. Over the last several years except for the last year we have experienced greater than a 10% return. To answer your question, if you take it down to each 1% decline and expect returns, it's about $2.5 million of additional expense each year, somewhere in that range.

PAMELA WILSON

Okay. A related question: Your plan at the end of last year was underfunded by $68 million.

TOMMY LANE

TOMMY LANE]: Yes.

PAMELA WILSON

PAMELA WILSON]: At what point in the next two years or whatever do you need to contribute more funds to close the gap with your contribution?

TOMMY LANE

TOMMY LANE]: This year for the 2002 planned year, we do not have to expect to have to contribute any minimum contribution to it; whether we will or not is a different story, but there is no minimum required. For 2003, right now we do not find there is going to be a minimum required contribution, simply because we put a lot of money into the plans over the last 7 or 8 years that was not required at that time. So we will take a look at each year and as we are close to the end of the year to decide to put any money into it, although none's required right now.

PAMELA WILSON

PAMELA WILSON]: The PBGC does not step up and say, 'put in some funds in the next 12-18 months'?

TOMMY LANE

TOMMY LANE]: I am not sure what the PBGC is going to step up and do, but on an actuarial basis, on a required minimum contribution for 2002 we're not required to make a contribution.

PAMELA WILSON

PAMELA WILSON]: Okay, thank you.

LORRAINE D. MILLER

Next question.

Operator

Our next question comes from [Clark Orsky]. Please state your affiliation and then your question.

Clark Orsky

CLARK ORSKY]: [KDP] Investment Advisors. I wonder if you could talk more about the decline in sheets and towels and where you see that going... HOLCOMBE T. GREEN, JR.: Imports or in general?

Clark Orsky

CLARK ORSKY]: In general. HOLCOMBE T. GREEN, JR.: I think from a [_______] perspective, the sheet and towel market has been pretty well and saturated over the last 12 months and has been a big promotional vehicle for a lot of stores. And I think that the emphasis is shifting a little bit away from some of those products towards accessories, basic bedding, and other products. At least we've seen growth in some of those products in our sales mix. And of course Kmart impacted and our sheet and towels sales in the first quarter.

Clark Orsky

CLARK ORSKY]: Okay, but in imports you see that kind of flattening out?

LORRAINE D. MILLER

I do not if you have seen the most recent numbers here, but for the fourth quarter on a trailing 12-month basis in 2001 imports of towels declined - a couple of [ticks here], so it seems that is leveling out here.

Clark Orsky

CLARK ORSKY]: I'm wondering if with cheap cotton we're going to see foreign competitors building inventory or if we're going to see that show up later this year.

LORRAINE D. MILLER

We have got cheap cotton too.

Clark Orsky

CLARK ORSKY]: Are you still planning no downtime for the year? HOLCOMBE T. GREEN, JR.: We do not have any plan for the balance of the year.

Clark Orsky

CLARK ORSKY]: Okay and thanks.

Operator

Our next question comes from Dave [Begros]. Please state your affiliation and then your question.

Daniel _____

DAVE _____]: [_____]. I am just wondering as you could give a little more breakdown on 240 base increase in growth margin, break it down by cost to goods sold, mix, etc.? HOLCOMBE T. GREEN, JR.: We really do not break that out...

LORRAINE D. MILLER

We have talked about that in terms of what is driving the margin improvement, two big issues are the raw material costs and cost savings from restructuring. You can see we talked about the fact that historically accessories have a higher margin and they were clearly a bigger part of our sales so that also helped in the quarter. But we do not break it out specifically.

DAVE _____

DAVE _____]: Okay. And order of magnitude? Is cotton the largest or... HOLCOMBE T. GREEN, JR.]: Cotton would be the biggest and this [segment/saving] should be the next. On the other hand, we had a wage increase that went into effect, so that's a big impact the other way.

DAVE _____

DAVE _____]: Did you run [_____] in the first quarter? HOLCOMBE T. GREEN, JR.]: No.

DAVE _____

DAVE _____]: What was the underabsorption last year in the first quarter? HOLCOMBE T. GREEN, JR.]: $3 million. That's five days, I think.

DAVE _____

DAVE _____]: Second quarter working capital use?

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

Probably go up or use another $20 million or so. We'll bill to probably a peak of $40 million greater than where we are now, and then it will decline towards the end of the year.

DAVE _____

DAVE _____]: Higher than the end of the first quarter?

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

Yes.

DAVE _____

DAVE _____]: Okay. A couple of minor things. What's the tax rate going to be for the full year? It's 36% for this quarter, is that good for the full year?

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

It should be about 36%, Dave.

DAVE _____

DAVE _____]: Okay. Was the Kmart charge in SG&A? [HOLCOMBE T. GREEN, JR.]: Yes it was.

DAVE _____

DAVE _____]: Okay, so we should see it more back around the 65-ish level for the rest of the year per quarter? Depending on sales a little bit, but is that a good run rate now?

LORRAINE D. MILLER

Yes.

DAVE _____

DAVE _____]: Okay, thanks.

LORRAINE D. MILLER

Next question...

Operator

Our next question comes from Michael Zimmerman. Please state your affiliation and then your question.

MICHAEL ZIMMERMAN

SEC] Capital. Could you give us an update in terms of the resumption of shipping to Kmart and to what level you are shipping now?

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

Things have normalized from a shipping point, for one thing.

LORRAINE D. MILLER

We had a brief period when we didn't ship them, right around the time of the bankruptcy.

MICHAEL ZIMMERMAN

Okay. Just to give us a little bit more clarity in terms of what you said on the call, that sales would have been up double digits if...

LORRAINE D. MILLER

excluding Kmart. However, we've mentioned before too that our sales were planned to decline this year with Kmart, and that was a plan that was put in place before the bankruptcy.

Lester Dupuy Sears - *Westpoint Stevens, Inc.*

Also, you have to remember that anything they started buying after their initial bankruptcy statement actually [refinancing] was due to 254 less stores. So that had an impact, just from the planning.

MICHAEL ZIMMERMAN

So will the second quarter benefit relative to what we saw in the first quarter, where you were impacted from [radical] sales from Kmart just for a period of time, and will you pick back up in the second quarter? HOLCOMBE T. GREEN, JR.]: We would still anticipate that Kmart sales will be down from last year in the second quarter. One reason is they have fewer stores. But overall we're looking at big sales outside of Kmart.

MICHAEL ZIMMERMAN

Okay, thanks.

Operator

Our next question comes from Tom [Otto]. Please state your affiliation and then your question.

TOM OTTO

TOM OTTO]: [_____] A couple of questions. First of all, can you give us a breakout on sales in terms of what percentage of sheets and towels?

LORRAINE D. MILLER

We do actually give segmented information in the quarterly report. If you'll bear with us just a second... M.L. "CHIP" FONTENOT]: The [_____] in the 10-Q is not sheets [_____] but bed products as a total group. Bed products overall for the first quarter was roughly 61% sales.

TOM OTTO

TOM OTTO]: So accessories would be 39% of the balance? M.L. "CHIP" FONTENOT]: No. Bath products was running at a rate of about 28% of sales. The remainder still would be our retail stores and our international operations.

LORRAINE D. MILLER

So accessories is going to be broken out primarily in the bedding - sheets and bedding accessories.

TOM OTTO

TOM OTTO]: I guessed you mentioned that sheets and towels were down a little bit, so I'm trying to understand what percentage of your total sales sheets and towels are - as you termed - accessories on the call?

LORRAINE D. MILLER

We don't give that out on a quarterly basis. That number has been increasing and is going to be roughly 35%. That's not an exact figure for the first quarter, we [tend] to give that number more on an annual basis.

TOM OTTO

TOM OTTO]: So that's roughly for accessories.

LORRAINE D. MILLER

Right, and that's going to be up from somewhere around 30%... HOLCOMBE T. GREEN, JR.]: ...or less. This year we are estimating that accessories will be about 35% of 2002 sales.

TOM OTTO

TOM OTTO]: Okay. Just a quick followup on Kmart: they were about 15% of sales in Q1, you said it'll be lower this year. Can you tell us where you think it's going to be or what it was last quarter? 10%?

LORRAINE D. MILLER

We don't disclose on a quarterly basis. Clearly 15% sales, they'll be a company that we would report on when expected results fall below 10%, but are not going to give an estimate at this time.

TOM OTTO

TOM OTTO]: You also mentioned that rising energy costs was also a concern to you. What percentage of your costs are actually energy costs? 2%? [HOLCOMBE T. GREEN, JR.]: Yes, it's fairly minimal.

TOM OTTO

TOM OTTO]: Last question: you mentioned cotton savings were the biggest contributor. Taking a run rate of [220] last quarter, Q4 EBITDA 245, what percent of that increase would be attributed to cotton? HOLCOMBE T. GREEN, JR.]: We don't break that out, but it would be the biggest part of it - that and the cost savings.

TOM OTTO

TOM OTTO]: And the cost savings you mentioned will be somewhere in the $20 million neighborhood?

LORRAINE D. MILLER

Yes, incremental.

TOM OTTO

TOM OTTO]: Great, thank you.

Operator

Our next question comes from Michael Zimmerman. Please state your question.

MICHAEL ZIMMERMAN

Just a followup: can you give us a sense in terms of where you think margins can go in the near term, longer term, and give us a perspective in terms of where you once were and what has changed that would not allow you to get back to those levels? HOLCOMBE T. GREEN, JR.]: Certainly the world has changed from the days when we could enjoy 17% and 18%. If you look over the next few years, we might be pretty happy with a level of around 15%, considering a lot of things. If you say, for example, that we did $2 billion in sales, 15% is $300 million. And that wouldn't be so bad for next year.

MICHAEL ZIMMERMAN

So 15% is a long-term goal? HOLCOMBE T. GREEN, JR.]: Long-term we would hope to do better than that, but it's certainly over the near term where we are headed.

LORRAINE D. MILLER

Clearly there's been increased competition and concentration with our customer base, so what can be offsetting that too is the shift in our products - accessories - will have a favorable impact on that margin [_____]. Maybe we might not be able to get back to the high teens, but something in that 15-17% range is something that we would try to target over the long term.

MICHAEL ZIMMERMAN

But 15% - we're talking in terms of EBIT margins or EBITDA margins?

LORRAINE D. MILLER

MICHAEL ZIMMERMAN

EBITDA, okay. Thanks.

Operator

Our next question comes from Adam [______]. Please state your affiliation and then your question.

Alan ______

ADAM ______]: [______]. I just wanted to clarify on working capital: you're going to use $20 million in the second quarter, and this year you expect it to be flat or down a little? HOLCOMBE T. GREEN, JR.]: By yearend we should be down a little bit.

Alan ______

ADAM ______]: Yearend from where you were year over year? HOLCOMBE T. GREEN, JR.]: That's right.

Alan ______

ADAM ______]: Okay, thank you.

LORRAINE D. MILLER

Next question...

Operator

Our next question comes from Pamela Wilson. Please state your affiliation and then your question.

PAMELA WILSON

______]. Along the lines of your long-term projections or potentials for an EBITDA level of $270-300 million, what do you see is the appropriate capital structure for that level of cash flow and what are your thoughts on how you achieve that capital structure? HOLCOMBE T. GREEN, JR.]: As you know, we have plans to reduce our debt substantially over the next few years. We have excess cash flow of $70 million this year, and it should exceed that next year and the year after that. So we're continuing to look at the capital structure, but we don't - as we said last time - we don't really have anything to comment on at this time with respect to that. We are in great shape with our banks and we have $160 million of availability right now. So we think we are in good shape.

PAMELA WILSON

Don't you have the maturities coming up next year? HOLCOMBE T. GREEN, JR.]: No.

PAMELA WILSON

When does the bank revolver...

LORRAINE D. MILLER

The end of 2004.

Operator

Ms. Miller, there appear to be no further questions in queue. Do you have any closing comments you would like to finish with? HOLCOMBE T. GREEN, JR.]: I thank everyone for participating. I would suggest that if you have questions to give Lorraine Miller a call, and she'd be happy to answer. Thank you very much.

Operator

Thank you, ladies and gentlemen. A replay will be available using the phone number 973-528-0005 and using PIN #4760 until Friday, 5 PM Eastern Time. This does conclude today's conference call. You may disconnect your phone lines at this time. Have a wonderful day. Thank you for your participation.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SAP.DE - Q1 2002 SAP A.G. ADS Earnings Conference Call

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TRANSCRIPT

Operator

Good day everyone and welcome to today's SAP first quarter results conference call. This call is being recorded. Today's call will be hosted by Henning Kagermann and Hasso Plattner. Gentlemen, you may now begin.

GUNDOLF MORITZ

yeah good morning, good day everybody. Here's Gundolf Moritz. Thank you for joining us to discuss SAP first quarter 2002 results. With me are here Hasso Plattner, Henning Kagermann, Werner Brandt, and joining us from the U.S. is [________________]. Before we begin the call, I will make a few remarks about forward-looking statements. Werner will then go through the financials, and Henning will talk about operational developments in the quarter. After that, we will open the call for your questions. Before we begin our discussions of the results, please note that except for certain information, matters discussed during today's call may contain forward-looking statements, which are subject to various risks and uncertainties that could cause actual results to differ materially from expectations. The factors that could affect the company's future financial results are discussed more fully in the company's most recent filings with Securities and Exchange Commission. Now we will turn it on to Werner.

WERNER BRANDT

Thank you Gundolf, and good morning or good afternoon to everybody. It was a very mixed quarter. We proved our market positioning and continue to gain marketshare in a difficult economic atmosphere, so we are largely pleased with what we have accomplished. In the first quarter, we expanded our capacity of technology closeness, focused on the promising small to medium sized markets, and continued to build the kind of customer relationship that have driven our success so far. Looking now at the first quarter numbers, sales in the first quarter were EUR 1.66 billion, which represents an increase of 9% over the first quarter of 2001. Operating income excluding stock-based compensation and top-tier acquisition related charges improved by 2% up to EUR 237 million. License revenue was down 12% in the first quarter to EUR 402 million. Maintenance revenue grew by 23% up to EUR 597 million. Consulting revenues as you see continue to provide strong results growing by 18% to EUR 539 million, and training revenue stayed stable over the same period of last year at EUR 110 million. Europe, the Middle East, and Africa continued to be a strong region for us, increased sales by 11% to EUR 886 million. Germany remains a good market for us; it's where everything in SAP begins after all, and this quarter sales in Germany was EUR 376 million. Outside of Europe, sales in America contributed EUR 587 million to total revenues while sales in the Asia-Pacific region contributed EUR 185 million. Henning will comment on these regional numbers in a moment. As I have said on previous calls, I and the entire board are focused on improving Sap's margin. We made good progress in this respect over 2001, and we are looking to make further improvements over this year. We expect the progress to become more evident in the second half of fiscal year 2002. The first quarter margin excluding stock-based compensation and top-tier acquisition related charges was 40% reflecting the difficult market environment in which we operate. Looking at all the technology companies around the globe and seeing the difficulties they are having, I am happy with these numbers for now. Sap's year is more weighted towards the end of the fiscal year, so a 40% margin and our first quarter is largely satisfactory when I look at our financial goal for the entire year. We will improve over the year to reach our goal of increasing margins by at least 1 percentage point over the 20% achieved in 2001. Going forward, we will still spend on research and development, technology, and other revenue driving initiatives but will continue to streamline the business and become more efficient over the entire year. At the end of the quarter, headcount at SAP reached 29,156 employees worldwide of which 7,707 were in our R&D Department. R&D is strategically significant to improve Sap's technological openness and these resources adequately reflect our commitment to R&D at SAP. SUC we have already made progress in 2002. Henning will talk about the operational and technical aspect of such momentum, but from my standpoint it appears SAP is and remains in good financial health. So why is SAP is working hard, I want to reiterate something I have been saying for past month. 2002 will be a tough year. The first half will be tougher than the second but is not going to be easy. In any event we are looking to deliver on our stated targets for the end of 2002 and a lot of this progress will come at the end of the year from the solid base we establish now. I look forward to updating you 3 months from now on our progress as a half-year. With that said I'd like to turn over to Henning.

HENNING KAGERMANN

Thank you Werner, hello everyone. Well as Werner just said, the first quarter of 2002 was difficult. And we have been consistent all along in saying that we expected the first half of the year to be weak, so a challenging first quarter was no surprise for us. Looking at the whole software market you will see evidence of this SAP pushed through the first quarter and I think globe is [_______________]. Lets look first at Asia, a region that has been difficult for software companies. We are not immune to the kinds of challenges every software company has been finding in Asia and we had a very tough time in Japan in particular. When you look at Japan, keep in mind that for most Japanese businesses the first quarter just closed and we suspect that many companies decided to spend conservatively as they ended their year. So sales in were 185 million euro and included deals with China Ocean Shipping, Singapore Civil Services, Shionogi, and Crystal Group. In 2001 we have refocused our operations in Asia targeting the fastest growing software markets besides Japan and Australia and we are now looking for that effort to yield improving results over the coming years. The Americas was a challenging area for SAP. No surprise there to any of you. We feel the company simply hasn't returned to inking deals as fast as they did in the past. We won our share of the business and didn't lose deals to the competition but we did see companies in no hurry to spend annual IT budget in the first quarter. The number of contracts we signed was vastly the same as the first quarter last year but the average order value went down significantly. As we get back to business as usual, and performances for the year become more visible, we expect comparative pressure to compare companies to further invest into software. Deals in the first quarter in Americas include companies such as Fleet Capital, Lord Corporation, and Watson Pharmaceuticals. Turning to Europe, we were very happy with our performance in that region in this very tough quarter. Europe continues to be a major strength for us. Some of the oldest SAP customers are located in Europe and as an effect they keep coming to us for more and more, demonstrates the important role that we play in their business. Germany leads the region once again, but SAP signed deals with companies across the continent, companies like Barclays Bank, [_______________], Itellium, Porsche, and Rolls Royce. We are winning the same high percentage of deals we have always won in Europe and expect this to continue throughout 2002. Looking at your solutions sales the initiatives we took over 2001 are really starting to bear fruit. CEOs are looking to SAP not only because of our standalone quality with applications but because we are willing to connect into their existing software infrastructure to make systems at improved company wide efficiencies. Now lets look at our individual solutions where we allocate revenue by customer usage. Performance in these component areas largely reflects the customer and comparative strength we have already touched on. In Supply Chain Management sales were 79 million. We lead in Supply Chain Management market share by a long way. The marketplace, portal market has also gotten tougher in the post dot com area and we sold 44 million. CRM was up by 10% for the quarter to 74 million, and we gained marketshare here. All ERP financials and HR also grew to 172 million as company spent on prudent solutions which give immediate returns. We first broke out component sales in the first quarter of 2001. Given the limited history of component sales, I don't believe that year on year composition have represented of long-term trends. Looking at things from a different angle, 73% of our software business measured by order entry in the first quarter came from our installed base and 27% from new customers. This is in line with what we have experienced over the last years. While these numbers demonstrate the fate of our installed base as in our solutions and our services, they also reflect more and more new companies looking to SAP. So this is where we are after a tough quarter in the challenging market. It was a slow start, but we made some progress. We see no reason to change our expectations, but we are carefully watching the market environment, which is hesitant. We still anticipate revenue for the full year to grow by around 15%, and for the whole of 2002, we also expect an operating margin excluding stock-based compensation and top-tier acquisition related charges to improve at least 1 percentage point over the 20% achieved in 2001. While the first half of 2002 will be tough, we at SAP lead the business software markets now over 30 years, we have experience in this space, and we continue to make strategic moves that will strengthen our leading market position. So operator, please now open up the line for questions and answers.

Operator

Thank you. Today's question and answer session will be conducted electronically. If you wish to post a question at this time, you may do so by pressing the "*" key followed by the digit "1" on your touch-tone phone. Once again that was "*1" to post a question. We will pause for only a moment to assemble our roster. We will take our first question from John Segrich with Goldman Sachs.

John M. Segrich - *Goldman Sachs*

Hi guys! If may be we could focus a little bit on the shortfall which looks like it came out of the U.S. or the America geography, could you give us a little sense on may be the magnitude of the shortfall there and if you could also dig a little bit into the customer behavior?

WERNER BRANDT

Yeah thank you. I would say with the license figure we gave you see that we are still continuing to gain market share, I think that is important to recognize. And if I look to our expectation at the beginning of the year where we said Europe is in line. In Asia we could see that there will be lets say stronger second quarter than the first quarter indicated this. Japan, we missed a few big deals but that was not a surprise because we expect more flow for the second quarter. If I look to North America, I have to say the surprise was a little bit at the end of the quarter. We expected a slight EBITDA conversion rate from horseback deals, but we have not lost deals to competition, and it's still there outside with the customers are shopping around, they are looking, they have the money, but they have also time especially our installed base has good software from SAP and they see that they get the best for their money. Sometimes they start with small implementation so therefore our average order value dropped so down, no larger deals any longer, especially not in the U.S. but overall I have to say we are quite okay with this result because it backs up our full year guidance.

Unidentified

Two additional remarks, this is [_______________] there is a general concern about the United States. We are still facing the aftermath of the new economy and the face of creative accounting is not over. You can read this everyday and this affects specifically our industry, this affects everybody. On top of this we have a little home made problem in the United States in the first quarter since we merged the portals and markets in the first quarter and then decided to merge both of them, the new company back into SAP AG. This didn't help to close all the deals which were on the table in the market and in the portal space. We have no indication that we lost the deals but we didn't move them in and sent out the invoices so that we can acknowledge them as revenues and third point is we announced that we would have a new product in supplier relationship management which only was shipped in the second quarter so again we could not book these revenues and since we have a very tight situation as you all know in the US, even dollar amounts in the 10-20 million range have a significant impact on the complete result.

John M. Segrich - *Goldman Sachs*

If you just take on that one second would you say that most of the deals that slipped were newer customer deals or do you think that customers may be taking a pause in the migration cycle, and may be we migrated some of the easier customers now its going to get more difficult from here now, or is this really economic?

WERNER BRANDT

No it's really economic I think it's across the customer base. It has to do with new customers, its existing customers, some of them continue to migrate, and others are completing their outfield work. So that has not changed. This is an overall attitude amongst install- based customers.

John M. Segrich - *Goldman Sachs*

Okay. Thank you.

Operator

We will take our next question from Robert Schwartz with Thomas Weisel Partners.

ROBERT SCHWARTZ

Thank you very much. Just a couple of questions. US GAP now requires in the consulting revenue that you include T&E expenses as revenue and I am wondering if that has been included in this quarters numbers.

WERNER BRANDT

Which revenue sorry? Would you repeat it again?

ROBERT SCHWARTZ

WERNER BRANDT

So Robert probably we will come back to this very specific question.

ROBERT SCHWARTZ

Let me follow on, it looks that margin on a product was a hair lower than it was last year and I am wondering if anything is happening there given that your guidance to improve ball operating margins.

Unidentified

No its very easy. If we sell a few more millions then the margin looks better.

ROBERT SCHWARTZ

On products...okay so its ..

Unidentified

Just because the fixed cost is still there and so that that is completely related to the relative number in software sales.

ROBERT SCHWARTZ

Right and last question if I may, comment on the strength that you are seeing from your system integrator partner has there been any fundamental change in North America, in the business coming from them?

WERNER BRANDT

No I think we have no signs, I think the month ago was the last contract, was the last of the big 5 integrators but all of them have an alliance contract with us. In this contract we have defined, I cannot disclose this here, but we have defined the areas where we work together, how many [________________] especially in new areas, supply chain management, customer relationship management. There is a focus on regions especially North America but also Europe so that now many of the partners are already trained in the new areas and its now business as usual. So there are no changes that are invoiced, you look to our services business which was very good showing you a lot of projects are underway and all our system integrators take their share and that's the traditional SAP share they see here.

ROBERT SCHWARTZ

If I may just take in one more question. Could you comment on your visibility into Q2 and how it compares to say visibility historically at this point in the quarter?

WERNER BRANDT

It's the same visibility we have said at the beginning of the year to Q1. I think we have a good pipeline, we know what we are doing and we hope that the economy will lets say in the third quarter then start picking up so therefore all our expectation is, as we said, first half will be tougher and the second half will be better and that is not new, that is still there we said at the beginning of the year and that's okay as a guidance.

ROBERT SCHWARTZ

Thank you very much.

WERNER BRANDT

Yeah coming back to the question related to the consulting revenue, consulting business it's Werner Brandt. At SAP we have no change in revenue recognition related to consulting revenue and as in the past we recorded the expenses as revenue if they are billable and chargeable to customers, and we applied this rule since ever and no change in the first quarter.

ROBERT SCHWARTZ

Thank you very much.

Unidentified

Okay thank you next question please.

Operator

We'll go next to Kevin Ashton with Deutsche Bank.

KEVIN ASHTON

Good afternoon gentlemen. Just back to the issue of potential delays, etc., I mean we heard some figures overnight about some other competitors talking of very big push backs into Q2, and I was just wondering if you could in any way quantify the sort of numbers, or the number of deals or whatever that might have pushed over?

HENNING KAGERMANN

No I think we don't want to quantify because you know once we have the deal in the pipeline, it doesn't mean later on that you sign it in the same size that's one of the issues, but it's not only one or two deals but several of those deals and this shows you that this attitude what I said that the customers are really waiting to the last moment especially at the beginning of the year is still there, so that is strong, and we expect this also for the second quarter and as I said but we don't expect it for the second half of the year.

KEVIN ASHTON

But are you see as well just to stick with pipeline for a minute, are you seeing an increase in the pipeline that we are hearing from some quarters, can you detect that?

HENNING KAGERMANN

Yeah but that's knowledge that is not something new, so if you get more visibility over the years, the pipeline is improving and it has to improve there, so that we are seeing but I cannot say that the pipeline looks fundamentally lets say different than in the past.

KEVIN ASHTON

Thanks, I guess one last question if I may, you've mentioned that Europe is strong, and obviously Germany is doing well, I mean from where you all are standing how is that looking as we go forward for the rest of the year? In the past you have mentioned you are relying a lot on Asia-Pacific and the Americas to pick up the growth pattern and obviously they are at the moment, so I mean how do you see the geographic areas developing for the rest of the year?

HENNING KAGERMANN

Europe lets say, we confirm what you said, it's strong. We don't see a major risk that Europe will drop down and some people refer to Germany, but our installed base is so strong that I don't see risk even if the economy slows down a little bit in Europe. I referred to America and Asia because lets say over time these are the growth areas for SAP and what we see is that the potential is there and that we are immersed in most of the deals so customers lets say are looking for SAP software. So what I said beginning of the year is still valid stable, good healthy business in Europe, and over the years picking up in Asia and America.

KEVIN ASHTON

Thank you very much gentlemen.

Unidentified

Thank you, next question please.

Operator

We'll go next to Rick Sherlund with Goldman Sachs.

Rick Sherlund

Thanks. I am wondering if you could comment on any changes you are seeing in the competitive dynamics in the markets. Oracle, PeopleSoft, Siebel, etc., any changes on the margin in competitive dynamics?

Unidentified

There are few observations but they are spotted Rick. I cannot generalize them. We have in the U.S. two large companies brand names who totally walk away from our competitor and concentrate on SAP alone and that was a competition for the last five years. That is a good indication that finally Microsoft is winning against 11i. We have another top 50 brand name in the U.S. continuing with supply chain product only from SAP after another four years of [_________________]. These companies will come forward but we have to wait till they make the announcement. Now this is spotted but it gives me some inspiration that we are on the right track with the products and we have slight disadvantage in that is homemade in our information rollout you might read to your colleagues reports on our competition and I take this opportunity to throw this in. There is the general opinion that mySAP can only run on multiple databases and Oracle is using that as a negative in the competition that they run in all their applications in one single database. Unfortunately, it didn't cross the Atlantic that we announced in 2001 at [_________________] that all my subcomponents were run in one single database, and since November 2001, we physically shipped this. We will make this clear to our sales force in America next week and we will give Oracle a little hint that they don't use that any more in competitive situations because otherwise they will look like fools.

Rick Sherlund

This is the issue of having a common data model under all the applications?

Unidentified

Yeah, we had this, we still have this, and we can run all of mySAP applications in one single database instant.

Rick Sherlund

Right, okay.

Unidentified

And that is what our colleagues from Oracle towed up as their great advantage and when we combined all the new dimension applications and all the 3 type applications, the back office application in mySAP, then for the first 2 years, we run all these 5 or 6 components as components with their own database with one central integration software piece in the middle. So it doesn't change for the user anyway, but I heard now that several people for cost of ownership believe that one single database is cheaper, yes, and we ship the whole system, I repeat this, in one single database.

Rick Sherlund

So could you also comment on what you are seeing in the market in terms customer preferences, it seems that in surveys integration and ERP is showing up much higher in the priority spinning, priority list, can you interpret that?

Unidentified

Again, it is spotted but I visited 6 customers last week in the San Jose area and the number one reason is integration as far as you can see. So that clearly puts the vendors who have the largest footprint of applications in favor. The next sentence is yes, I want to have everything from one vendor and it has to be integrated as long as you are as good as the other ones in functionality. So we have to do both, we have to be in functionality as good as the so called best of breed players or the players who do not cover the whole area of the enterprise hence we have to maintain the integral integration between all the components. If we do this, then customers favor that.

Rick Sherlund

Right, in the ERP, why is ERP showing a pyre on the list, is it people upgrading to mySAP.com, is it the other modules, or are you seeing a renewed interest that you saw in the 90s in back office systems implementations?

WERNER BRANDT

________________] it's Rick. I think it's all of that. It's partially upgrade, yes, because viewing the upgrade there is always normally finding some [________________]. It's to some extend a shift in the industry if I look at especially in Europe we are much stronger in financial services for example than in North America because this is a focused area. These companies start to finance with HR normally as a first step, and as more you enter they will services industry the more you feel ERP is the hot topic which is not contributing so much in the first quarter, but in general term, and then it's Japan. So ERP in Japan is the topic.

Unidentified

I just want to add this also. Again observation from 6 customers I spoke to last week there is one generic theme which also lead to our decision to follow the end markets and portals into a SAP AG. There is only one view of the IT people and the CEO in a company they want to use e-business and front office and back office system in applications in one system. This is not separate anymore so that means companies are not shooting with all what they have for new e-business solutions, they are shooting for integrated solutions from the web page through CRM, into manufacturing, through delivery and then everything has to be visualized and made real in accounting and in cost accounting.

Rick Sherlund

Right. Thank you.

Unidentified

That proportionally, that brings the ERP components back on stage. Two years ago people said we don't need this stuff any more. This is bad. This is a false statement.

Rick Sherlund

All right.

Unidentified

Next question please.

Operator

We will go next to Jason [________________] with Robertson Stephens.

Unidentified

I would like you to please comment on some specifics as to why you believe that second half is going to be stronger? And in fact its only about 2 months away before we are going to be there and could you give us what are some of may be the macroeconomic factors or the behavior of the companies that you are going to be focusing on that are going to give you confidence that this turn in the second half is actually coming to path.

WERNER BRANDT

May I first, it's a basic scenario and we see, as this says no I would say it is the other way round. No indication on evidence that it will not happen, I think it's a better way to answer it and there is a second reason. If you look to the customer behavior was shopping around, signing smaller deals, but heavy at the end, the pressure to do something and installing software. I believe we will again lets say see what we have seen in the last years, all the times, that if it comes to an end of a fiscal year that the customer at the end has pleasure to decide.

Unidentified

Just a quick follow up I mean are we expecting to see this materialize in Q3 or this largely going to be for lack of nothing else, just a traditional Q4 spending search that you are expecting to turn around?

WERNER BRANDT

No. Up to now we expect these to pick up in Q3 and Q4.

Unidentified

Thank you.

Unidentified

Thank you next question please.

Operator

We will go next to Charles Phillips with Morgan Stanley. Mr. Phillips your line is open please go ahead. Mr. Phillips your line is open please go ahead. We will go next to Ross McMillan with Morgan Stanley.

ROSS MCMILLAN

Yes thanks. Can you hear me?

WERNER BRANDT

Yes continue.

ROSS MCMILLAN

Right. I had a couple of questions. Just on that full year confidence again, is there anything specifically there, may be, phase to deal commitments that are being committed for the second half that's giving you any particular above average visibility than you would normally have at this point in the year?

WERNER BRANDT

No Ross that's not the case. There is no particular evidence, its likely look to our, to the environment or pipeline like last year and lets say the same type of visibility would be applied. I think that is fair, last year was a tough year. This year starts to be a tough year so we apply the same rules here.

ROSS MCMILLAN

Great thanks. Just another follow on. Do you think 3 enterprise and the introduction of that in the second quarter will have any impact and particularly do you think there might be any risk of customers posing before there is a full ship release of that?

WERNER BRANDT

I don't think that customers, lets say, will delay decisions because of that. We are giving our customers a very compelling offering. They can stay on the newest release of SAP [_______________], for at least the next 4 years. They can decide to go for SAP at the end of this as a more risk adverse and say okay we are doing smaller steps to migration to mySAP.com and they can go for mySAP.com. So nearly all customer visits [_______________] collection comes up and at the end [_______________] easy. It depends what is the best for the customer? There is no reason to delay or to wait. Its up to his, lets say, situation [_______________] lead to highest and so I don't see any delay but also not a huge push, lets say, into the second half because of SAP at end of what is just normal business....

Unidentified

Yeah I just want to take up on that. Because we differentiate ourselves here from the competition and I have indication through CIO meetings in the United States that our more convenient approach here to allow our customers to decide when they want to move from one release to another and take the advantage of the latest and more modern systems that they really appreciate this and that any kind of push now and strong arming them in a critical situation will not be welcome in the future.

ROSS MCMILLAN

And may be one last one then folding the marketplace in ports of subsidiaries together and then into AG is there any way you can try to quantify the G&A savings that you might get from that and also the timing?

WERNER BRANDT

Yeah the G&A savings are minor. There will be savings that's obvious, but we take them as one of our cost reduction measures. What is much more important to see is we had a major shift in the last six to nine months in the industry, in the market. E-business became standard business, e-business is part of business, and the e-business division in companies is being folded into the normal IT department. That means we have to talk to one CIO and his team. Therefore it doesn't make sense to come with two sales force to the same person. There is a high probability that we can confuse ourselves, and we can confuse the customers. The customers told us that and we found out inside our sales organizations that we confuse each other so therefore we made the decision, it was a tough decision to fold the two sales forces back together, and we see much more synergy here coming that we are better synchronized and fulfill the requirements of our customer base.

ROSS MCMILLAN

Great, thank you very much.

Operator

We'll go next to Jim Mendelson with Soundview.

Jim Mendelson - *SoundView Technology Corp.*

Yes, could you comment and little bit more color on the linearity of license revenue this year versus last year and perhaps give a little bit better sense of scale as to what extent business was deferred in March?

WERNER BRANDT

I can give you one indication but you have to be careful [_______________], if you look say for example to order, and if you are just a little bit, order entry was roughly in line with the last year, so that gives you an indication that that business is out there and that might be that they are from the deferred side, will be a little higher but no significantly.

Jim Mendelson - *SoundView Technology Corp.*

Okay, thank you.

Operator

We'll go next to [_______________] with [_______________].

Unidentified

Yes hello, good afternoon. I have got a couple of questions actually. First one would be business intelligence revenues, you mentioned earlier that you had some problems that got emerged at SAP portals in the markets and the revenue which fell short of at least my expectations was that mostly in the marketplace area or also in the normal as it were of business intelligence area?

WERNER BRANDT

It's probably more in markets. I have only the combined numbers in the pipeline, and you will see a discrepancy that we did not close as much of the pipeline as we should have closed, and if you down from the CEO and stop the sales people and the top product architects that they spend the time on it relatively big merger we were merging here two companies with 850 people and then once we have the merger done that was mid March, we told them now the train is leaving the station again and going somewhere else; this doesn't help. This doesn't help in sales. I cannot say we would have closed all the things, which were marked in the pipeline, but everybody who is in sales knows that a shift in strategy and bringing things together doesn't help. You can look just at the biggest merger of the history of IT business; it's not helping that.

Unidentified

Yes. I also have some statistical question, how many clients do you have at the end of Q1 and how many new clients did you win in Q1?

DAVID J. FITZPATRICK

I think we should go to the next question; we will look through the data and give it later. The next question please.

Operator

We'll go next to Brendan Barnicle with Pacific Crest.

Brendan Barnicle - *Pacific Crest Securities*

Hi guys! Can you comment when you are looking out, you mentioned integration and ERP as strengths for the second half or areas where you might see the makeup. How about some [_________________] on the other, any areas you think particularly well positioned for the second half?

WERNER BRANDT

In general, our supply chain position is strengthening every single day, and I just mentioned before in a four-year contest, where we had parallel installations, we won against our next best competitor here, and the company will continue with SAP. So we have a very good position here, the combination of supply chain, the product we will ship next month, supply or relationship management, and the opportunity we have to build private exchanges and public exchanges makes SAP particularly strong in this area we see also a growing strength in the other combinations of portals and CRM, but we can build on the huge field of CRM with the help of portal technology, so called a collaborated applications of all kind of types, which are applications which accelerate communities, how we work together, etc. So we feel that we are very well positioned there and that will strengthen our position overtime and so that's the product situation. We probably should mention that we introduced [_________________] a low-end product, which can be used in large companies as the local system abroad. Many companies have central systems and serve their major affiliates with mySAP or free type systems, but probably they did not go into the sales offices with the system. We have no answer for that, and we also are slimming our mySAP version down with a single database approach and very low cost of ownership so that we cover now the full range from probably 50 employees in the site to 50,000 or more.

DAVID J. FITZPATRICK

_________________] I'd just try to answer this question with the customer it's always difficult to talk about customer's fault, you have customer hierarchy, mergers, acquisitions sometimes you lose customers if 2 companies merge. Roughly speaking, we have about 18,000 customers. I am giving you a feeling for the number of new customers I gave you the size of contract with new clients, it's about 250-260. That's gives you a feeling of how many new clients we get a quarter.

Brendan Barnicle - *Pacific Crest Securities*

Great, just as another follow-up. In terms of vertical market exposure, are you seeing any vertical markets that are showing any faster recovery than in the other areas or anything that's still particularly weak?

WERNER BRANDT

That's difficult to answer. I don't believe from the customers we are seeing that we can immediately conclude on the sector as a whole. I think we should be careful here [_________________] as a company. Yes, we know which sectors are still let's say weaker like if you look at Telecom etc., but I would not say that we have significant recovery so if I look to all our very new in the first quarter [_________________] for example services industry where we have more in financial services, but I would not make the conclusion that this is expected to end. It might be just by coincident what we saw in the [_________________].

Brendan Barnicle - *Pacific Crest Securities*

Right, thank you.

Unidentified

Next question please.

Operator

We'll go next to Coleen Kaiser with Lehman Brothers.

DAVID J. FITZPATRICK

Hi. I was just wondering if I could get your opinion on just the amount of software inventory that's left in the US market because the hardware vendors in the system integrated they are still talking about a lot of inventory left in the US and just judging from some of your competitors maintenance revenue growth or lack of maintenance revenue growth, how much longer is it going to take in your opinion to get to this inventory?

WERNER BRANDT

You know, it's like there is some inventory left, but I believe what we see is that this is going down significantly so there are a few customers we know we checked some inventory, but most customers and that a positive side especially in the US, are burning this inventory, they are implementing users, and therefore we have these different and especially if you look to North America and in consulting and in new licenses because it shows, yes, there is inventory but it's used now and I think that's a very good indication.

Unidentified

DAVID J. FITZPATRICK

Okay, great. Thank you.

Operator

We'll go next to [_______________] with WR [________________].

Unidentified

Hi. Can you just give me a little bit more detail on what makes you so confident that the second half will improve? Do you see anything specifically?

HENNING KAGERMANN

Hi it's Henning again. I think I have answered exactly this question already in [________________] answer. This was already asked. Especially in this way. We said no particular indication. Last year was tough; beginning of this year is tough. We apply the same rules, lets say, to how we direct all our pipelines and in parallel we see no evidence that the economy should not pick up in the second half.

Unidentified

Okay. Fair enough. Thank you.

Operator

We will go next to David Clayton with Credit Suisse First Boston.

DAVID CLAYTON

Thank you. I want to ask just a couple of questions, quite specific ones. First one was the G&A cost looked high to me. I have been used to that sequentially folding compared to the fourth quarter and I just wondered is there something going on there that I don't fully understand? The second one was could you talk a little bit about hiring plans for the year particularly with respect to services and the consulting group because I guess with the introduction of SAP enterprise that could be quite good for the services business and I wondered whether you have plans to increase demands of in house service results there? And really the third question, just to do with the tax rate, the first quarter underlying tax rate I think looks at around 33% and I am wondering whether there are those system warm up effects there or what we should be modeling in for the rest of the year?

WERNER BRANDT

I can start answering the question of hiring.......

DAVID J. FITZPATRICK

Can you turn off your microphone we have echo. Thank you.

WERNER BRANDT

Okay. Second try was perfect. We will hire carefully. Given the tough market, I think we should really be careful here but we hire in selected areas given the consulting market, our strategy is more to relocate and to retrain some of the resources that we have for new areas. You know that in the traditional areas there is, lets say, especially if you look to the complete eco system outside enough capacity is there in the market. But there is some shortage if it comes to new product, if it comes to experienced consultants in Supply Chain Management etcetera. So what we at SAP are doing is we focus on our complete consulting force independent to whom they report. It could be the global consulting force, could be the local one, sectors, SAP SI, consultants important as markets and we maximize the utilization and if we find that they are underutilized in some areas we use these consultants and we train them in other areas. Therefore I believe it's not necessary to have a massive hiring of consultants. It would be more that we train early enough some of the consultants to meet the demand, which can come through SAP 3 enterprise.

DAVID J. FITZPATRICK

With regard to G&A? You are right, we see an increase here, but this has structural reasons. If you compare quarter over quarter we have acquired as you know TopTier after the first quarter of 2001 and created the sub corpus organization which of course edit cost in the G&A area. We have some acquisitions especially smaller ones in Germany, which edit cost, and of course we have established new legal entities in new countries, that's one side. The other side is that we also shift some responsibilities out of the region into corporate resulting in the fact that the increase by the shift our G&A cost in our external reporting. With regard to the tax expenses if you look to it we have a tax expense of 60 million euro and before tax rate adjusted by [________________] one of 179 million gives you a 33.5%. If we would use our normalized tax rate and we for this year have in mind range of 35% to 37%, so if I would work with 36% then I would come up with 4 million more in tax expenses. And this is mainly, this additional reduction we see here is mainly, driven by tax credit for prior periods in some of our countries. So that's the tax explanation of this relatively low tax rate adjusted for the [_______________] impact.

DAVID CLAYTON

That's very helpful. Thank you very much. _______________] just to clarify Henning's answer. I'm [_______________] to what you're basically saying is that for no headcount increase you can move some employees into being revenue generators.

WERNER BRANDT

Exactly. There will be some hiring but very carefully, but it's more as you said moving them into revenue generating areas, exactly.

Unidentified

And how far this piles up by area here gone up. I jump in the G&A again because we had this question before, we would definitely have an improvement of the ratio with our remerger of portal to market, and actually we would do similar things in areas where we have multiple legal entities as lapse and we will pull those together.

DAVID CLAYTON

Thank you very much.

Unidentified

Next question please.

Operator

We'll go next to [_______________].

Unidentified

Hello. Can you hear me?

WERNER BRANDT

Yes we can.

Unidentified

Okay, couple of questions. This is [_______________] from [_______________]. The first question is can you comment a bit on your deferred revenue line, and the second is can you give us your vision on your relationship with Commerce One now from this point onwards even after the company continues to roll its cost reserves and what this impact will be on your P&L moving forward.

Unidentified

Let me start with Commerce One. We just received the latest version of Commerce One technology for market places and we're preparing together with Commerce One an information release because they will be very positive effects for the customer base. It is a fact that we live in a time where computer based applications seem to have very short peaks. Market places were extremely popular 2 years ago and everybody was running for market places. Now, we live under the impression they're not with the money anymore. The truth is if you smoothen that out, they are very helpful tool. We have very successful market place implementations and I'm confident that this type of application will grow in popularity significantly in the next 18 months, but the fact is that Commerce One has their own set of problems and since we're 20% owner, we automatically participate in those, but as far as the product they have developed, we will talk about this pretty soon and that looks promising.

WERNER BRANDT

Yeah with regards to the deferred revenue, the increase deferred revenue is compared to December 31st by 826 million euro and this is exactly the amount we increased our periodic maintenance accrues due to the fact that we once in a year bill the entire maintenance for the year in January and we have to set it up and deferred.

Unidentified

Okay, thank you. Next question.

Unidentified

Thank you.

Operator

STEVEN ROBERTSON

Thank you. I have a question on the total stock based compensation. It was 45 million euros. Really the question is why was it so high, much higher than I thought it would be and do you have any estimate for where it may be going forward through Q2 to Q4.

WERNER BRANDT

Yeah, I think what we have here is the following. This 45 million you referred to come out of this part of our LTI program which is related to the Goldman Sachs index and these options are in the money and depending on the share price, you have an impact in our P&L, and to predict it, its very difficult because we would have to predict and now tell you what we expect the share price to be, and this is something I would not like to do at the moment.

STEVEN ROBERTSON

Thank you.

Unidentified

What is the final question please?

Operator

We'll go next to [_______________] with Banc of America.

Unidentified

Hi, it's [_______________] here with Banc of America. Just a couple of very brief questions. First of all, you mentioned integration as one of your key strengths. Now I think there are a couple of your competitors trying to replicate that for instance the universal application network from Siebel which is trying to kind of mimic a similar kind of ideology. Do you think that you will have some kind of effect from such competition? And the second question is on your operating costs. You mentioned that you will continue to invest in R&D. I presume mySAP technology will take in some R&D as well, so where would we expect to see the cost ratio reductions?

Unidentified

I think that it is gratifying to see that our competition is following us and since this is a very tough subject I wish them all luck to become successful there for the sake of their customers. So, I don't see any impact with regards to our customers and the integration job we have to do. Actually, the reality is that the various integration initiatives, there are others in the market as well, they all have to come together and work like telephone systems and then the more successful ones will be very likely to become visible and we feel since we have, now, really a 30-year experience in real time integration and integration between complex applications, cementing integrations as [_______________] that we are in a very, very good position here. _______________] seems to want to say something. It seems to be a hot topic.

WERNER BRANDT

I want to add something rather [_______________] can then try. I just have a question I would ask this companies as far as in integrated sale you could use one application?

Unidentified

Yes there is one. One of the key points on Seibel's announcement is that they are addressing a very small part of the integration problem, both on the horizontal part of how many object models they are really aware of when they are really targeting CRM as their only object model and we know today that in order to address integration it is not enough to produce technology, you need to really understand the applications in the business models that you are addressing, and they are aware of one out of six business models and object models in the business. The other one is that they have a very partial integration technology, in the sense; just targeting the first part of it, which is message, based integration, missing the business intelligence knowledge management and portal part of that integration stack. So we are welcoming to the field but its pretty much where we have been in 1998 or 1999.

WERNER BRANDT

Okay. Coming to the cost associated with mySAP technology of cost all the efforts on the development side are included in our R&D expenses and if your question is directed towards increase in profitability where R&D come from, one is increasing our product gross margin and hereby bringing down our support expenses, then of course increasing the profitability of the service business, and thirdly controlling partly our SG&A expenses as just described.

Unidentified

What about sales and marketing? Anything within there?

Unidentified

Sorry?

Unidentified

Any reduction in the sales and marketing cost ratio?

Unidentified

A general comment here. Our drills in marketing we repeat this every quarter, now it has started to work better and better but that we have a harmonized roll out of information and if I think with the systems we have in place today that we are well equipped here but it is a lifelong struggle to reduce cost of sales in marketing.

Unidentified

Okay. Thank you.

WERNER BRANDT

So on with that I think thanks to all of you for joining us in this quarter. See you in a quarter from now. Okay. Bye.

Operator

Once again Ladies and Gentlemen that does conclude today's SAP conference call. Thank you for your participation. You may now disconnect at this time.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

- Q1 2002 Reliance Steel Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 3:00PM GMT

TRANSCRIPT

Operator

Good morning ladies and gentlemen! Welcome to Reliance Steel & Aluminium Company's 2002 first quarter financial results conference call. At this time all participants have been placed on a listen-only mode. We will open the floor for your questions and comments following the presentation. It is now my pleasure to turn the floor over to your host, Mr. David Hannah, Chief Executive Officer of Reliance Steel & Aluminium. Sir, the floor is yours.

David H. Hannah - *Reliance Steel & Aluminum*

Thank you and good morning. Thanks to all of you for taking the time to listen to our report and conference call for the quarter ended March 31st, 2002. Please note that this conference call may contain forward-looking statements relating to future financial results. Actual results may differ materially as a result of factors over which we have no control. These risk factors and additional information are included in our company's report and filed with the Securities and Exchange Commission. For the quarter ended March 31st 2002 net income was $7.5 million, down 41% from net income of $12.8 million for the 2001 first quarter. EPS for the 2002 first quarter was $0.24, up 52% from the $0.15 earned during the first quarter of last year. Weighted average of diluted shares outstanding are 25% higher in 2002 compared to the 2001 first quarter due to the shares issued last July in connection with our secondary equity offering. Sales during the quarter ended March 31st 2002 were $405 million, down 6% from $433 million in last year's first quarter. Karla McDowell, our CFO, will present and discuss additional financial information later on in our conference call. These comparisons are still rather difficult and we did not feel the full effect of the recession during last year's first quarter. Only certain parts of our company began to feel the impact of the depressed business conditions prior to that time. But over geographic and product diversity allowed other parts of our company to continue to perform well primarily because they sold to customers in other markets that were still relatively healthy like Semiconductors, Electronics and Aerospace. Then Semiconductors and Electronics began its steep decline towards the end of the first quarter and into the second quarter last year. Commercial Aerospace [slowed] in the fourth quarter of last year. The numbers are what they are we cannot ignore the fact that they do not measure up to last year's. But we are encouraged. Compared to the prior quarter - the fourth quarter of 2001 - the trend is positive. Sales and net income are up 6% and 71% respectively. The first quarter that just ended reversed the trend of decreasing net income than each of the prior six quarters. Our gross profit margins are still strong, inventories have decreased over $15 million and turns are improving. Receivables are in good shape, expenses are down, and debt-to-total capital was relatively low at 35.8%. When you examine the details of the above comparisons, you find that most of the improvements are because of things that we control and fewer are the result of an economic recovery. The price increases in carbon and steel products are a good thing. However they are not driven by demand side but rather by the tightness on the supply side. Additionally, there was little impact on our results in the first quarter from price changes. Currently we see few signs of economic recovery but at least now there are some small signs of the beginning of a recovery. We feel there is a good foundation in place to support further improvement. Our average sales volume in dollars per business day during the first quarter was up a little over 5% compared to the fourth quarter of 2001. But we are still below our average for all of 2001 by about 6.5%. The improvements are slow but appear to be steady and we expect to remain that way. Except for the aerospace industry, we did not experience any significant decreases in business activity compared to the quarter ended December 31st of last year. Our aerospace business is weakened as we had expected but is still producing good returns. We like our competitive position in this industry. Our sales into the semiconductor market improved marginally and losses narrowed compared to the fourth quarter of last year. The semiconductor, electronics, and telecom parts of our business are the weakest areas. We still expect some recovery in the semiconductor business later in the year but we do not expect anything meaningful to occur until 2003. Anticipating the current business conditions, our business unit managers in our executive management team did an outstanding job. Our expenses, excluding the decrease in amortization and expense related to goodwill, were down about $7 million compared to the first quarter of last year on a same store basis and decreased $1.1 million from the fourth quarter of last year. The expense reduction made last year and during the quarter just ended an proving to be an important part of our financial success. In addition, the de-leveraging of our balance sheet last year resulting from the $150 million equity offering along with cash generated by operations has positioned us very well and strengthened our ability to take advantage of the improvement in business condition and growth opportunity. On April 1st, we acquired the business and net assets of [Central Plains Fuel] Company headquartered in Kansas City, Kansas. We also completed the acquisition of [Olympic Metals Inc.] in Denver, Colorado on April 1st. Central Plains] specializes in the processing and distribution of a full range of carbon steel products from its facilities in Kansas City and Wichita, Kansas to a wide range of customers consisting of original equipment manufacturers, job shops, and fabricators. This brings carbon steel products into a geographic area where we had not previously offered those products. Our existing facilities in Wichita deal only with aerospace aluminium products. Central Plains] is a well-run company with a great reputation in our industry and we look forward to its contribution to our continued success. Olympic Metal Inc.] is a small company dealing mainly in aluminium products and [red] metals. They were attractive to us because of their profitability and because we did not previously sell those products in the Denver market. We expect to grow that business significantly in terms of revenue and profit. It is very difficult to project our financial results in this type of economic environment. There are some good things happening but we are still uncertain about the pace, the stability and the strength of any recovery. Given the current business conditions and anticipating some continued improvement in demand and pricing, our best estimate at this time for next quarter is earnings per diluted share of $0.25 to $0.35. The 2002 first quarter cash dividends of $0.06 per share was paid on March 29th, [and the shareholders' record] on March 8th. We have paid quarterly dividends to our shareholders for 42 consecutive years. We will stick with our strategy that has proven successful in both good and difficult conditions. Our management team is dedicated to the growth and success of the company and we are well positioned to take advantage of the opportunities that present themselves. We like what we are and we thank you for your support. That concludes our initial portion of the presentation. Greg Mollins, our President and Chief Operating Officer, will now review some products and market issues and then Karla will discuss our financial results in a little more detail. After Karla's remarks, we will open the call for questions. Thank you very much.

GREG J. MOLLINS

Thank you Dave and good morning. As Dave pointed out, we are seeing a gradual improvement in our average daily sales. We believe our industry hit bottom in the fourth quarter of last year and we are in the early stages of recovery. Construction, durable goods, and general manufacturing have all improved to some extent. We have yet to notice any improvement in the truck trailer, agricultural, and capital equipment areas. Electronics is showing signs of improvement and aerospace is still in decline. We are proud of the fact that we have been able to maintain our margins in a very difficult economic environment and our inventory turns are improving. We believe that we can increase our inventory by $25-30 million by year-end. From a product point of view, pricing on many of our products is beginning to go up. Because of our relatively small order size - less than $900 - and our unwillingness to participate in contract business that does not meet our profitability target and that is not fully supported by the mill. We view price increases positively and pass them to our customers very quickly. [Covent Steel] which last year represented 53% of our sales has experienced the most dramatic increases, thanks to the reduction of domestic production capacity as well as Section [201] trade rulings, which has reduced the supply of imported steel. The risk here is that given the higher prices and a strong dollar, imports may pick up substantially at some point. _____] products are up $60-80 a ton in the first half of this year with more increases planned for the third quarter. Plate] is up $60 a ton and tubing is tracking the flat rolled increases. Mini-mill products are up $15 a ton and white flange beams are flat. Moving to aluminium, which represented 25% of last year's sales, the [nickel] a pound increase in common alloy coil has helped as well as a $0.03 a pound increase on extruded products. Intruded sheeting plates for aerospace has remained flat in spite of the reduction in demand. As for stainless, base price on 304 coil has remained steady with nickel surcharges up over $0.09 a pound in May. Steel] also remains flat. We viewed the gradual improvement in business conditions as well as price increases on most of our products as positive developments going forward. That concludes my report. I will be happy to answer any questions after Karla's review of the financials.

Karla R. Mcdowell - *Reliance Steel & Aluminum*

Thanks Greg. As Dave mentioned, I will now provide more detailed information regarding our current earnings results. Our first quarter 2002 consolidated sales were $405.5 million, a decrease of 6.3% from our first quarter 2001 sales of $432.9 million. Sales for the current quarter reflect 11.1% increase in our [tons] sold and a 16% decrease in our average selling price per ton. Our [tons] sold increased because of the sales of the companies we acquired in 2001. Our average selling price per ton decreased by 16% because of lower metal costs and decreased sales to the semiconductor, electronic, and aerospace industries as selling prices of the products we sell to these markets are typically higher than most other products we sell. Same store sales for the first quarter of 2002 were $340.8 million, down 17.1% with a 6% decrease in tons sold and a 12% decrease in the average selling price per ton as compared to the same store 2001 first quarter sales. The decrease in our same store tons sold was primarily due to economic slowing experienced throughout 2001 and has continued into 2002. Although sales to semiconductor, electronics, and aerospace industries were strong through most of the first quarter of 2001, they were off significantly in the first quarter of 2002. As Dave mentioned earlier, we see mild signs of improvement with sales for the first quarter of 2002 increasing 6.1% compared to the fourth quarter of 2001. This includes a 6.6% increase in our tons sold. Our average selling price per ton decreased less than 1% in the first quarter of 2002 compared to the fourth quarter of 2001. Our gross margins of $111.5 million in the first quarter of 2002 decreased 7.3% compared to $120.3 million in the 2001 first quarter - a 6.3% decrease in sales. Gross margin as percentage of sales was 27.5% for the 2002 first quarter compared to 27.8% in the 2001 first quarter. The slight change in our gross margin percentage resulted primarily from lower sales of specialty metals to semiconductor, electronics, and aerospace markets in the first quarter of 2002 but typically produced greater gross profit dollars in many other products we sell. We made no LIFO adjustment in the first quarter of 2002. Although we continue to sell lower-cost materials during the first quarter of 2002, as Greg mentioned, price increases have been announced for many carbon steel products. As we begin to receive and then sell these higher priced products, we expect to generate LIFO expense that would offset any LIFO income experienced in the first quarter. The first quarter of 2001 included $1.5 million of LIFO income. Our SG&A expenses increased $2.9 million or 3.4% from $84.8 million in the first quarter of 2001 and $87.7 million in the first quarter of 2002 due to increased sales volume from our 2001 acquisition. On a same store basis, these expenses decreased $6.2 million or 7.6% from the first quarter of 2001. A majority of the same store expense increase resulted from head count reduction made throughout 2001 with reduction of approximately 450 employees from March 31, 2001 to March 31, 2002. Our SG&A expenses as a percentage of sales increased from 19.6% from 2001 first quarter to 21.6% in the 2002 first quarter because of lower prices for our products and lower sales volumes. The 2002 percentage of 21.6% has declined from the fourth quarter 2001 level of 23.2% mainly due to the increased sales volume experienced during the current quarter as compared to the prior quarter and due to additional employee head count reduction of 43 employees during the first quarter of 2002. Although our first quarter operating income margin was 4.3% compared to 6.9% for the first quarter of 2001 this is an improvement from our 3.7% operating margin in the fourth quarter of 2001. Depreciation and amortization expense decreased 11% for the 2002 first quarter mainly due to the change in accounting rules for the amortization of goodwill that was effected for us on January 1, 2002. The first quarter of 2001 included $1.7 million of goodwill amortization expense compared to none in the 2002 first quarter. Our interest expense decreased $2.3 million or 29.8% in the first quarter of 2002 compared to the first quarter of 2001 due to both lower borrowing levels and lower interest rates. We applied the July 2001 equity offering proceeds of approximately $150 million to pay down debt and to fund our 2001 acquisition, which lowered our borrowing level. Our average interest rate in our credit line which was LIFOR-based was 3.1% during the first quarter of 2002 compared to 6.1% in the 2001 first quarter. Our adjusted income tax rate was 39.6% for the 2002 first quarter, up slightly from 39.2% in the 2001 first quarter. The 2002 rate is consistent with the 2001 full-year rate which took into account shifts in our geographic composition both from the 2001 acquisition and from changes in economic conditions. On March 31, 2002 our accounts receivable, day sales outstanding or DSO rate was approximately 46 days, consistent with our DSO rate on March 31, 2001 and up slightly from our DSO rate at year-end 2001 of approximately 45 days. This slight decrease is due to our increased sales during the current quarter as compared to 2001 fourth quarter. We decreased inventory by $16.7 million during the first quarter of 2002 from our 2001 year-end level, mainly due to the improved demand levels during the first quarter of 2002. Our inventory turnover rate was about 4.1 times on March 31, 2002 compared to approximately 4.2 times on March 31, 2001 and 4 times at year-end 2001. We continue to focus on our inventory management and our goals to increase our inventory turn-rate to 4.5-5 times. Our outstanding debts decreased by $13.2 million to $329.1 million on March 31, 2002 from $342.3 million on December 31, 2001. We generated cash flow from operations of $8.4 million during the first quarter of 2002 which included the inventory reduction of $15.7 million offset by an increase in accounts receivable of $25.7 million. The accounts receivable increased resulted from increasing sales during the current year. Capital expenditures for the quarter were $3.9 million. Our net debt-to-capital ratio by quarter end was 35.8% compared to 36.3% at year-end 2001 and 53% on March 31, 2001. With our additional funds on April 1st for the purchases of [Central Plains Field Co.] and [Olympic Metal Inc.] which would increase our net debt-to-capital ratio to 37.1%. We did not repurchase any of our stock during the first quarter of 2002. That concludes my review of this financial information. Thank you for your time this morning.

David H. Hannah - *Reliance Steel & Aluminum*

Okay, John. I think we are ready to take any questions that might be out there.

Operator

Thank you Mr. Hannah. Ladies and gentlemen, the floor is now open for questions. If you have any questions or comments, please press the numbers '1' followed by '4' on your touchtone telephone at this time. Pressing '14' a second time will remove you from the queue should your question be answered. Lastly, we do ask of all those posing their questions that you please pick up your handset if listening on speakerphone for an optimum sound quality. Please hold one moment while we poll for questions. Thank you. Your first question is coming from [Mark Par] of McDonald's and Company. Sir, your line is now live.

Mark Par

MARK PAR]: Thank you. Congratulations on a great quarter. It is always nice to see positive surprises and we are still not out of the recession yet. I have been curious about thing. There have been indications of service owners trying to perform contract business that are not able to and so they are canceling their business. The user has no recourse but perhaps to go look elsewhere for large buyers like yourself. Have you had a chance to look at what was the kind of impact of that activity in the first quarter?

GREGG J. MOLLINS

I do not think that it was significant to our overall company at all.

David H. Hannah - *Reliance Steel & Aluminum*

We are not aware of any big pieces of business that are going to come our way because of the situation that we are talking about.

Mark Par

MARK PAR]: Okay. Given the acceleration of pricing momentum on the [flat rolled] here in the second quarter, is that a possibility or something that you might think it as somewhat likely, may be a modest boost here and there?

David H. Hannah - *Reliance Steel & Aluminum*

Yeah, that is possible. I think may be a greater impact might be in the end-market. If those competitors of ours who have those large contracts need to support those contracts, they might raise their prices into the open market. So they drive day-to-day business away. So they could not maintain the inventory levels needed to support those contract businesses that they have. So I think we will see more activity coming from the day-to-day customer base than we would say those customers that are involved with the customers coming to us.

Mark Par

MARK PAR]: Okay. Just a couple of other quick questions. You said the losses on the semiconductor business were less. Could you talk about what the loss was, on the bail-outs, and also how much did [PDM] contribute to the quarter?

Karla R. Mcdowell - *Reliance Steel & Aluminum*

Their earnings per share for the first quarter of this year was a lot - it was $0.03. If you recall, for the fourth quarter of 2001, they had a $0.05 loss. PDM contributed $0.05 during the first quarter of this year.

Mark Par

MARK PAR]: Okay, terrific. Thank you very much. Congratulations again.

Operator

Thank you. Your next question is coming from [Scott Morrison] of Credit Suisse First Boston. Mr. Morrison, your line is now live.

Scott Morrison - *CS First Boston*

SCOTT MORRISON]: Thanks. Couple of questions. I know you said you are seeing some signs of improvement on the demand side, though still not great. I was wondering if you could talk a little about what you are seeing in terms of inventories either among your competitors, what you hear anecdotally as well as what you are seeing among your customers in terms of the extent of inventory restocking or the desire to restock that is going on at the moment.

David H. Hannah - *Reliance Steel & Aluminum*

As far as what we are seeing in the market place, in particular [flat rolled], it has gotten very tight. In particular in some of the heavier gauges, in hot roll, cold roll, galvanized etc. and some of the lighter [______] material have gotten very tight. So it is tight for us, it is tight for our competition. It is tight in the industry overall. As far as our inventories are concerned, we are scrambling for certain products. We consider our inventories to be too high at this point in time. We are going to make an effort to get them down particularly on the items that are rarely available. As far as our customers are concerned, I think that the OEMs have made a real good effort at reducing their inventories down and they are not in real big hurry to increase those inventories without a meaningful sign of an economic recovery that we have yet not seen.

Scott Morrison - *CS First Boston*

SCOTT MORRISON]: So that would imply obviously that supply side has been a big driver to what is going on in [flat rolled]. Are you suggesting that all of that is actual final demand and it is not restocking on the part of your customers?

David H. Hannah - *Reliance Steel & Aluminum*

I think the majority of that has to do with the demand than the restocking. I think we have gone through that.

GREGG J. MOLLINS

A lot of our customers are, as you know, the [job chops] and the fabricators who do not really have much inventory on an ongoing basis. So they are buying what they need for whatever jobs they might have in their house. I think that order activity has picked up a bit for us. So we are not back at the levels we were last year at this time but we are certainly ahead of where we were late last year.

Scott Morrison - *CS First Boston*

SCOTT MORRISON]: Okay. Then, two other questions. Greg, you had hinted on the import side that substantial increases might be seen somewhere out there. I was wondering if you could talk a little bit about what you are seeing on the offers side and what the timing of the arrivals might be, and if the 201 is public knowledge. Secondly, Dave, on the acquisition side what are you seeing in terms of prices, competition, and what does the pipeline look like?

David H. Hannah - *Reliance Steel & Aluminum*

As far as imports, what we have started seeing is imports coming in at the tail end of the third quarter. From a pricing standpoint, offers are out there anywhere from $300 to $320 a ton on hot rolled coil. So in as much as it gets over $300 and the strength of the dollar, it opens up the door for imports. Third quarter is not even being quoted by the domestic suppliers. So basically it is on allocation. That again opens up the door for [offshore]. We will probably see offshore even more plentiful in the fourth quarter than in the third.

GREGG J. MOLLINS

Regarding acquisitions we have looked at an awful lot of opportunities. Obviously we just finished two. Most of the things we have looked at have not been attractive to us because of the criteria that we have to have in these things. But there is a fair amount of activity still out there. What we have tried to search through is for those quality companies that meet the return targets that we have. Our ideas in those areas have not changed. We are only going to do deals when they are accretive and right out of the box and when we can hit our targets. So we still continue to be picky as people have told us in the past. With regard to the pricing on the acquisition, again, we have not really changed the way we value these things. The two deals we have done have been priced consistently with the way we have priced our deals. As far as competition goes, the two deals that we just did were just us; they were not [shop]; they were not represented by bankers. This is the way most of our acquisitions have been. There are not just many people out there searching around for acquisitions. I think we are the best-positioned with regard to balance-sheet and our capability to acquire companies. So I do not think that the competitive side is something that we worry about too much.

Scott Morrison - *CS First Boston*

SCOTT MORRISON]: Okay, thanks.

Operator

Thank you. Your next question is coming from [Ajit Shah] of Prudential Securities. You line is now live.

AJIT SHAH

AJIT SHAH]: Good morning! I just have a couple of questions. At what price are you selling your hot rolled and your cold finished steel per ton?

David H. Hannah - *Reliance Steel & Aluminum*

It really depends upon our customers and the order size. We do not have "a" published price per ton on any of our products.

AJIT SHAH

AJIT SHAH]: Could you give me an average? Would it be around $375 for the hot rolled and $470 for the cold rolled?

David H. Hannah - *Reliance Steel & Aluminum*

We do not even have that. That is such a difficult question because our order sizes vary so much. We have customers who buy truckload quantities at competitive pricing levels and we have many many - hundreds and thousands of customers - who buy in quantities less than a thousand pounds. There are those quite a bit of quantity extras that are associated with that - deliver expense, warehouse expense etc. going on with this. There is also price discrepancies between prices being quoted in the south east market, for example, as compared to the west coast market. So it is a very difficult question to narrow down.

ALI SHAH

ALI SHAH]: Okay, thank you. Can you tell me how much imported steel is entering the west coast?

David H. Hannah - *Reliance Steel & Aluminum*

Right now, I do not think there is a whole lot of offshore material coming into the west coast primarily because of the 201 rulings. But as I mentioned a little earlier, that trend is going to increase as far as imports coming into the west coast and elsewhere in the mid-to-latter part of the third quarter and going forward.

ALI SHAH

ALI SHAH]: Okay, thank you.

Operator

Thank you. Your next question is coming from [Leen Atley] of Morgan Stanley. Mr. Atley, your line is live.

LEEN ATLEY

LEEN ATLEY]: Thank you. As we have been hearing pricing for [flat rolled] has gotten very strong. I would assume that obviously you are paying up just like everybody else. In the past it was difficult to raise your prices for your buyers as fast as the price you are paying out? Are you seeing any margin squeeze or are you able to pass all your higher pricing through?

David H. Hannah - *Reliance Steel & Aluminum*

I think we have done a real good job in passing those increases through very quickly. Our sales people are out in the street everyday of the week in every market that we are in informing the customers about the price increases. The reason for that is not only the 201 ruling but the loss of [LTV] and [Trico]. Even though they will be coming back, right now they are not back. So we are explaining that. We do not have a lot of contractual business that is not supported by the mill. So we are able to pass those on. Again, I think, it speaks well of our order size. It is not that big a deal for the guys that are buying - $800 order. If they are going to pay $800, they are going to pay $825. The majority of our customers are fabricators - [_____] sheet metal fabricators, [job shops] etc. The end part is if you have $100, you will be lucky to have raw material represent about $20-25 of that.

GREGG J. MOLLINS

The other thing is that a majority of our businesses have their phones ringing today many times late this afternoon from people who want processed material delivered to them tomorrow or the following day. Prices are important, but as Greg pointed out, with the small order size and the small customers who make up the majority of our customer base, we are usually able to pass through the increases. We cannot obviously do that on all of our customers but we are out there trying to sell the increases even before they go into effect. We have had some weird things over the last few years when prices were going down and our margins were rising. The more typical scenario for us is that as prices go up, our margins might get squeezed a little bit initially, and then when prices go down it is the opposite. But we have had some aberrations over the last few years with the weird events with the imports and the demand here at home. So our margins have been pretty much constant.

LEEN ATLEY

LEEN ATLEY]: So you have a very short lead time and you can readjust your pricing to reflect your costs.

David H. Hannah - *Reliance Steel & Aluminum*

That is correct.

GREGG J. MOLLINS

Quite often, we raise prices when the announcement is made. So if [Newcore] - or whoever that might be - makes an announcement today, we will adjust our prices tomorrow to reflect those price increases. As Dave pointed out, that does not mean a hundred percent of our accounts are going to pay that. But a large majority of them do.

LEEN ATLEY

LEEN ATLEY]: If we could turn to aluminium for a second, in the first quarter shipments were down and orders were up, which I guess, is not completely inconsistent [considering] the inflection point in the economy. What are you seeing in terms of your aluminium demand and shipments?

David H. Hannah - *Reliance Steel & Aluminum*

It has improved over the last year. We are seeing good signs. The aluminium market was the most depressed last year - unlike anything that we have seen in many many years. The only exception was aerospace, which maintained a pretty good volume level last year. But we are seeing an improvement in common alloy. You will notice lead times for [_____] have gone way up; depots have been depleted. The same is the case with respect to extruded products. Extruded products constitute a relatively significant part of our overall business and we are seeing a good improvement in demand on that as well. So things are improving in the aluminium business.

LEEN ATLEY

LEEN ATLEY]: So are then you seeing shipments up year-over-year?

David H. Hannah - *Reliance Steel & Aluminum*

Not year-over-year, fourth quarter to first quarter. For most of the first quarter of last year, the semiconductor business was going very very strong. That has not been the case this year by any means.

LEEN ATLEY

LEEN ATLEY]: Would you expect to see business pick up year-over-year in the second quarter?

GREGG J. MOLLINS

I do not think the second quarter of 2002 will be above the second quarter of 2001.

David H. Hannah - *Reliance Steel & Aluminum*

I think we are moving in the right direction. So far, in each of the months this year, our average daily sales have improved. But we are still not anywhere near where we were a year ago and I do not think we will catch that in the second quarter. As Greg mentioned, we still have some pretty strong businesses in the second quarter. Semiconductor and electronics have not slowed completely. It has certainly started to slow near the end of the first quarter and aerospace was actually gaining strength at that point in time. Unfortunately, both those scenarios have changed.

LEEN ATLEY

LEEN ATLEY]: Great, thank you.

Operator

Thank you. If there are any remaining questions or comments, please press the numbers '1' followed by the '4' on your touchtone telephone at this time. Mr. Hanna and Co., I am not showing any further questions in our queue. Do have any closing comments you would like to finish this quarter off with?

David H. Hannah - *Reliance Steel & Aluminum*

No. Thank you again for joining us. We look forward to talking to you again two months from now. Thank you very much.

Operator

Thank you, ladies and gentlemen. This does conclude Reliance Steel & Aluminium Company's 2002 first quarter financial results conference call. You may disconnect your phone lines at this time. Have a great day! Thank you for your participation.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

- Q1 2002 Plum Creek Timber Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 9:00PM GMT

TRANSCRIPT

Operator

Good day ladies and gentlemen. Welcome to the Plum Creek's first quarter conference call. At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions will follow at that time. As a reminder, this conference is being recorded. I would like to introduce your host for tonight's conference, Mr. John Hobbs of Plum Creek. Go ahead Mr. Hobbs.

John Hobbs

Good afternoon ladies and gentlemen and welcome to the first quarter conference call for Plum Creek. I am John Hobbs, Director of Investor Relations for the company. Today, we have on the line Rick Holley, President and CEO and Bill Brown our Executive Vice President and CFO. This call is open to all investors and members of the media. However, the Q&A portion of the call is intended for analysts and portfolio managers. We ask that any other participants please follow up any questions by calling our investor relations line at 1800-858-5347. Before we begin, I'd like to take this time to remind everyone that certain of our statements today will be forward-looking involving known and unknown risks, uncertainties, and other factors that may cause actual results or performance to differ from those expressed or implied. These risks and factors are routinely detailed in our filings with the Securities and Exchange Commission. I'll now turn the call over to Rick.

Rick R. Holley - *Plum Creek Timber Co. Inc*

Good afternoon. First of all, Bill will cover our first quarter results and after he concludes, I will spend some time discussing current business conditions and our outlook for the second quarter in the full year of 2002. Following our prepared remarks, we'll call for questions and answers. Bill?

William R. Brown - *Plum Creek Timber Co. Inc*

As you've seen, we reported earnings of 30 cents per share in the first quarter better than expected. During the quarter, we closed $23 million in real estate sales significantly higher than our original expectations of $5 million to $10 million. Several transactions closed earlier than initially planned resulting in approximately 5 cents of incremental earnings in the first quarter. These transactions were originally scheduled to close in the second quarter, so this represents a timing difference rather than a fundamental change in the business. We think the first quarter marked the bottom of the log market. By the end of the quarter, sawlog prices had flattened out or begun to rise in 5 of our 6 regions while pulpwood prices appear to have stabilized in 4 of our 6 regions. Our Northern resources segment posted operating income of $20 million, $1 million improvement compared to the fourth quarter of 2001 all of which was driven by 4% reduction in log and haul costs. Volumes were down about 4% while we reported flat quarter-over-quarter prices. Northwest softwoods saw timber dominates the product mix of the Northern resources segment typically accounting for over 60% of the volume and over 70% of the revenues for the segment. The flat quarter-over-quarter price comparison masks the price recovery we started we see at the end of the quarter in the Northwest region. Northwest region sawlog prices were over $10 per ton or 17% higher in March than the first quarter average. Pulp markets continue to be poor throughout the North. Incremental sawmill production has increased chip supply and reduced demand for pulpwood. At the same time, pulp and paper mills continue to face challenging markets providing little opportunity for upward pressure on pulpwood prices. Our pulpwood supply agreement in the Northeast region provides some stability in pricing and volume for our pulpwood in the northern resources segment. In our Southern resources segment, sawlog prices started to show some signs of recovery. Operating profit for this segment was $55 million, up approximately $9 million from the pro forma fourth quarter results due to a slightly stronger mix of sawlog to pulpwood and a $2 per ton or 6% improvement in sawlog pricing. Volumes in the South were seasonally down about 7% from the fourth quarter. As we moved into the first quarter, our customers [_________________] was low due to cautious buying in the fourth quarter of 2001. Warm weather and strong housing demand led to high sawlog demand. As a result, sawlog prices halted their declines and averaged flat to up quarter over quarter across the South with one exception. The Atlantic coast region showed little signs of recovery due to an extended drought that has kept timber availability unusually high. The southern pulpwood market is poor. Fiber availability is generally good across the south and stepped up lumber production added incremental chip volume to a well-supplied fiber market. We reported flat pulpwood pricing for the quarter compared to the fourth quarter of last year. Our manufacturing segment continues to be profitable posting earnings of $2 million up $1 million from the fourth quarter. Sales volumes were better than expected as distribution and retail home center demand continued at a healthy pace due in part to the mild winter which allowed unseasonably high levels of construction activity. Prices for Plum Creek specialty product mix tend to be more stable than those for commodity lumber and plywood. That why our lumber and plywood prices moved less than 4% quarter to quarter while the random length framing lumber index was up 14% and the random length structural panel index was up 11%. Our new stand MDF line continued moving up the start up curve consistent with our initial investment assumptions but behind our goals for the quarter. Our total MDF business was a cash contributor to the first quarter, and we expect significant improvement in the second quarter when the new MDF line will be a positive contributor to both earnings and cash flow. Finally, our real estate segment posted sales of $23 million an operating profit of $12 million, significantly above our range of expectations. We closed several large transactions that were originally scheduled for the second quarter. So a strong performance here is simply a timing difference. We continue to see terrific interest in our properties from individuals, developers, and conservation buyers. We ended the quarter with $285 million in cash, net debt of just over $1.4 billion. Our ratio of net debt to total enterprise value at the end of the quarter was approximately 21%. Now I hand the call over to Rick to review current business conditions and our outlook for the quarter and year.

Rick R. Holley - *Plum Creek Timber Co. Inc*

As our numbers suggest business conditions are firming and we see some signs of improvement in both demand and prices for our timber. However, this statement cannot be applied to all of our products and all the markets we serve. Sawlog markets are improving modestly while pulpwood markets remain weak. Housing starts and permits are up year over year and new and existing home sales are very strong. We think the strong permit and home sales numbers are encouraging and suggest continued demand strength in the months ahead. Taken together, the signs of sustained recovery in the timber business are very encouraging. We are receiving reports of lumber and plywood mills adding shift and even a few reports that mills reopening. No such operational signs are apparent yet in the pulp and paper markets. Log buyers there continue to be cautious and are not aggressively building log inventories. Currently sawlog prices are higher than first quarter averages in all but one of our 6 regions. As a result, we are looking for improved sawlog prices in the second quarter, particularly in the North, where current prices are as much as 17% higher than first quarter levels. Pulpwood markets continue to be poor especially soft wood pulpwood. Pulpwood price recovery remains uncertain. We see positive market signals such as announced pulp and paper price increases, favorable pulp and paper inventory changes, and favorable year over year shipment data. They all point to the potential recovery for pulpwood demands, but it simply too early to tell. We expect our customers to move cautiously and pulpwood prices to hold at current levels during the second quarter. Post merger, we continue to find opportunities to improve the results from our businesses. One example is in the south logs are sold on a stumpage, pay-as-cut, or delivered basis. Previous to the merger, The Timber Company did primarily stumpage sales. Plum Creek was a primarily delivered log seller. In the first quarter of this year, we increased the delivered log component of our southern harvest by nearly 200,000 tons versus the fourth quarter of 2001. This is a 17% increase in delivered logs. Delivered logs now represent about 43 or did represent about 43% of our first quarter southern harvest. We view a delivered log sales program as one of the key marketing tools we employ to position timber sales for maximum return. By controlling the [_______________] and delivery of our logs, we are able to capture additional value by ensuring that each log is delivered to the mill that values it the most. During weaker markets, we found some customers willing to pay more for logs that are sorted to match up well with their equipment in customer base. With these delivered sales, we are able to position the company both as a very reliable supplier, but also a capture additional margin. Turning now to our manufacturing operations, as Bill indicated, business conditions are improving. Strong housing related demand and improving industrial markets are translating into higher prices for our products, which as you know are sold primarily to the home center in industrial market segments. March prices for lumbar, plywood, and MDF were all higher than first quarter averages. Our coal-bed methane project in Virginia, and West Virginia continues to make progress. Initial data from our first 10 test wells is very encouraging. Our 2002 capital plan calls for as many 70 production wells in 2 separate fields, and we expect to begin producing gas by the third quarter of this year. While we don expect material income in 2002, this investment will establish proven and probable reserves providing us with information, which will help establish the total value of this business opportunity. We continue to evaluate this project and will determine how to best realize the value. At this time we had made no further capital commitments beyond this year. In late March, the US Department of Commerce announced a final duty amount of 29% in accountability duty and antidumping cases against Canadian softwood lumbar imports. Imposition of the duty is subject to a finding by the International Trade Commission that the US lumbar industry was injured by Canadian lumbar imports. The ITC is expected to rule in early May with the effective date of any duties imposed in the latter part of May. We expect some pricing volatility in framing and dimension lumbar markets until this rule becomes effective. We do believe that the duty will provide some additional support for US lumbar and timber prices. Finally, we continue to evaluate acquisitions and other growth opportunities. Over the next couple of years, we believe that there will be a number of attractive opportunities for Plum Creek to grow its land and timber portfolio, but rest assured we will continue to apply the same disciplined analysis that has led to our history of accretive acquisitions. And we are confident with our equity currency and conservative balance sheet that we will have the financial flexibility to consummate any acquisition we find attractive. Now lets talk about the outlook. As I mentioned there are a number of initial signs of improvement in both our markets and the general economy. However, we remain cautious in our outlook. During the second quarter, we expect to see a typical seasonal reduction in our harvest levels in the North while we expect our southern harvest to increase slightly from first quarter levels. Our annual harvest will remain, as we mentioned at the end of last year, between 18 and 19 million tons for this year. Sawlog prices should move up in the North during the second quarter while we expect our Southern sawlog and Southern pulpwood prices to remain at their current levels. Our planned closings of real estate in the second quarter should result in revenues between $8 million and $12 million. We still expect to close between $75 million and $100 million of real estate transactions this year. Manufacturing volumes should increase modestly as seasonal demand picks up and the new MDF line increases its output. We expect prices for plywood and MDF to improve in the second quarter due to the strong housing market and improving industrial demand. We believe that lumbar prices will hold steady for the time being due to uncertainty surrounding the Canadian duties and potential supply increases. For the second quarter, we expect to report earnings between 22 and 27 cents per share, and I remain comfortable with our earlier guidance of $1.20 to $1.35 per share for the full year. We have supplied supplemental data on our website which is www.plumcreek.com to aid all of your net analytical work. If you have any follow up questions, please feel free to contact John Hobbs in Seattle. I know it is late in the day in East Coast and everyone has been very busy, so we will turn it over to questions and please limit your questions to 2 per person. Thank you. Lisa?

Operator

Yes thank you Mr. Hobbs. If you have a question at this time, please press the 1 key on your touch-tone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the # key. And our first question if from Richard Holohan.

Richard Holohan - *Salomon Smith Barney*

Hi good afternoon.

Unidentified

Good afternoon.

Richard Holohan - *Salomon Smith Barney*

Quick question on interest expense, it moved down a little bit from the fourth quarter of 2001, is 26 million around the right run rate for the year?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah this is Bill. That's about right.

Richard Holohan - *Salomon Smith Barney*

Okay. And you gave, I think I heard you say that Northern sawlogs, the realizations were up about 10% in March versus the first quarter average. Is that correct?

William R. Brown - *Plum Creek Timber Co. Inc*

That's correct.

Richard Holohan - *Salomon Smith Barney*

And that would put it around 69 bucks a ton?

William R. Brown - *Plum Creek Timber Co. Inc*

That pretty close.

Richard Holohan - *Salomon Smith Barney*

Okay and do you have those data for the other products that you have, Northern pulp, Southern saw, and Southern pulp?

William R. Brown - *Plum Creek Timber Co. Inc*

By March, you mean by month?

Richard Holohan - *Salomon Smith Barney*

Yeah, March versus the first quarter, just an idea of where things are versus the quarter trend?

William R. Brown - *Plum Creek Timber Co. Inc*

Well they are pretty flat for the first couple. If that your question?

Richard Holohan - *Salomon Smith Barney*

Okay.

William R. Brown - *Plum Creek Timber Co. Inc*

We saw the biggest pick up in the last month.

Richard Holohan - *Salomon Smith Barney*

So, I am sorry, just where March realizations would stand relative to the first quarter average? Not month by month, but just the sort of where they stand now versus where they, just to get an idea of what the trend has been during the quarter?

William R. Brown - *Plum Creek Timber Co. Inc*

March in the Northwest region for softwood was between $72 and $73. So you see that kind of increase over the Q1 average which is like $62. Hardwood, saw timber was between $82 and $83 versus the average of about $66 to $67 for the Northwest region.

Richard Holohan - *Salomon Smith Barney*

Okay.

William R. Brown - *Plum Creek Timber Co. Inc*

And the Northeast region, since you asked for the entire segment, softwood saw timber in March was about $58 versus about 57 for the average and then hardwood was about $82 from March $89 for the whole quarter.

Richard Holohan - *Salomon Smith Barney*

This is all the Northern resources segment?

William R. Brown - *Plum Creek Timber Co. Inc*

Northern resources segment. Yes.

Richard Holohan - *Salomon Smith Barney*

And then for southern segment, just on average?

William R. Brown - *Plum Creek Timber Co. Inc*

We didn't do that kind of pickup in the southern segment.

Richard Holohan - *Salomon Smith Barney*

So more or less flat through the quarter?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah Richard I think this, you will see it pretty flat. May be there is 50 cents in between each of the regions on an average in the Southern segment it should be pretty flat quarter over quarter.

Richard Holohan - *Salomon Smith Barney*

Got you. Okay. Terrific. Thank you.

Operator

Next question is from Rich Schneider.

Richard S. Schneider - *UBS Warburg (US)*

Yeah I was wondering if you felt that you could have little more confidence that the rise that you are seeing taking place with log prices, and I know sort of it's modest in scope except what you talked about for the Northwest, is just a seasonal upturn in pricing reflecting the activity in housing market or do you think because of what you are seeing out there, you feel that there may be some sustainability to this?

Rick R. Holley - *Plum Creek Timber Co. Inc*

Rich this is Rick Holley. I think that we will see this staying through the rest of the year. We are not going to see prices, I don think shoot up, but I think we will see a modest improvement through the rest of the year. We have a strong economy, certainly the housing and the repair remodel markets are very strong. I guess the real question here is what happens to pulpwood prices and you are probably better judge of that since you study and follow the pulp and paper business more closely, but if we see improvement in industrial demand and we see the economies in Europe improve, and we see any weakness at all weakening of the US dollar, I think you will see the pulp and paper businesses improve and therefore pulpwood process should improve as well.

Richard S. Schneider - *UBS Warburg (US)*

Okay. Since you brought up pulpwood prices, have you ever looked at, and I was thinking about this when you made the comments about pulpwood on the call, have you a fit relationship between pulpwood prices and waste paper prices because they have started to show some pickup here?

William R. Brown - *Plum Creek Timber Co. Inc*

We haven studied that in depth. We know there is a correlation and again, as Rick mentioned in his comments, we are seeing some positive numbers that I am sure you are aware of. We just haven seen it translate yet into pulpwood prices in sort of systemic way. You know, the isolated transactions that are hopeful, but we don see it across the board yet.

Richard S. Schneider - *UBS Warburg (US)*

Okay. And just last question, could you give us an update on where things stand on the real estate activity with the new structure you put in place to increase sales?

Rick R. Holley - *Plum Creek Timber Co. Inc*

I guess, this is Rick Holley again. The new structure you are referring to is really the hiring the earlier this year of Tom Lindquist to run our real estate group, and Tom is in the process of doing a number of things. One is he is putting in a new business plan together for the real estate business. He is looking at his team and bringing in some new team members and really, kind of, getting his hands around, which we all are, with the real estate opportunities are on the 4.7 million acres that we now have from the merger with The Timber Company. Again as you recall, we knew quite a bit about the old Plum Creek lands, and we knew less about The Timber Company lands and increasingly we see a lot of opportunities, and when we find us some fascinating opportunities from conservation buyers, and although we have done some of that in the past, you know, we think that there is a huge amount of interest there that may fit some of the opportunities we have very well. So, you know, as we said earlier, we got a $75 million to $100 million number for the real estate business which we feel very comfortable in and certainly to a comfortable numbers like that could be sustained over the next several years. I am very excited about Tom being on board and the team that he will bring on board and just the whole new look at what we are doing in that whole area.

Richard S. Schneider - *UBS Warburg (US)*

Will there be a time when you are going to talk more fully about, you know, your plan in this area?

Rick R. Holley - *Plum Creek Timber Co. Inc*

Well, what we plan to do, and I think we are scheduled for sometime this summer is we are bring a little road show to both New York and go to Boston and meet with all of you in New York or anybody we can in Boston as well to start, and we are going to bring our operating guy Mike Covey along, Bill Brown will certainly be there, and also Tom Lindquist, and we are going to talk to you guys about the new Plum Creek and the different parts of the business and how we are thinking about them. So we are going to do that sometime midsummer, certainly before everybody goes on vacation.

Richard S. Schneider - *UBS Warburg (US)*

Thanks a lot.

Operator

Next question is from Matt Berler. Mr. Berler go ahead.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Hi, I am sorry about that.

Unidentified

Hi Matt.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Hi guys. I wanted to just ask you about your harvest volumes, look like they were up substantially year-over-year, and while I was looking for some increase year over year particularly in the Southern area, it looks like the Northern area was a surprise, is this just an instance of where you decide to make hay when the market was strong?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah, this is Bill. There are a few cases where you are exactly right, and as Rick indicated in part of his comments too, there were some opportunities with delivered logs that, I think, prior to this hadn't been exploited and among seen some attractive pricing opportunities, we also were widening the number of customers that we normally would sell to, so we are getting a little more depth in the market that way, but yes, of course a year ago, it was two different companies as you know.

Rick R. Holley - *Plum Creek Timber Co. Inc*

Yeah, the other thing Matt is we saw very strong markets in the Pacific Northwest, so we basically took it down into that and moved some volume up and in Oregon and Washington to capture higher prices, and we also moved some volume up in Montana for fear that in the summer if the forest services are successful in selling any of those salvage sales they could weaken the market a bit, so we want to capture what we thought were more attractive markets today.

Matthew K. Berler - *Morgan Stanley Dean Witter*

So as you, I think you said Rick in your concluding comments, you still think 18-19 million tons is the right full-year range for harvest, and we should not be pumping up our expectations because of unusually strong or strong than expected first quarter, I wondered if you could just help us on a couple of financial items, the $7 million other costs and elimination line, was that where you backed out the gains in inventories and then what was the 2 million of other operating income in the quarter with that segment line?

William R. Brown - *Plum Creek Timber Co. Inc*

This is Bill, two million of other is the royalties from Gas, mineral leases, and so forth.

Matthew K. Berler - *Morgan Stanley Dean Witter*

That�a pretty good ongoing number to use.

William R. Brown - *Plum Creek Timber Co. Inc*

Yes.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Okay.

William R. Brown - *Plum Creek Timber Co. Inc*

I think for the year we gave guidance of 8 million to 10 million in that, that�consistent with that.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Okay.

William R. Brown - *Plum Creek Timber Co. Inc*

Seven million is like I understand is the profit in inventory and corporate. Combined. So it�elimination of the profit inventory in that and it�also the corporate overhead expense. That�, on a sort of combined basis, that�the number.

Operator

Next question is from Mark Weintraub.

Mark Weintraub - *Goldman Sachs*

Thanks. I apologize if you have mentioned this in the first couple of minutes, which I missed, but can we get some more details on the real estate sales that you made in terms of where they were perhaps in acreage?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah the acreage was about 12000 acres, and they were a combination of lands, both in the Northern and Northwest and also the South, about equally split, and you probably say some, there was probably a third conservation type buyers and 2/3 other type of buyers.

Mark Weintraub - *Goldman Sachs*

Okay, and is it similar types of properties that you expect to be selling in the balance of the year with those types of very nice evaluations?

William R. Brown - *Plum Creek Timber Co. Inc*

Yes. And I don't know if you heard this part of the call Mark, but we gave guidance that we would do between $75 million and $100 million of real estate sales through the year.

Mark Weintraub - *Goldman Sachs*

I got that. Thanks very much.

Operator

Next question is from Steve Chercover.

Steven Chercover - *D.A. Davidson*

Good afternoon. Two questions. Is 75 million still a good annual number for capex, this year and next?

Rick R. Holley - *Plum Creek Timber Co. Inc*

I think our run rate on capex should be around 70 or 75 million, but as you know we are going to spend $15 million this year on the coal-bed methane project which will be capitalized.

William R. Brown - *Plum Creek Timber Co. Inc*

This year, this is Bill, this year's coal should probably do a 100 million largely because of that coal bed methane, 15 million, that's the extra big piece.

Steven Chercover - *D.A. Davidson*

Got it, and secondly and I am not sure if I should have known this but what's going to be the split between return of capital and capital gain on your distribution this year and next please?

Rick R. Holley - *Plum Creek Timber Co. Inc*

I think, we have said there is primarily capital gains, so you might call it of 50-50 this year, and I think as time goes on that will change a bit but probably this year you can call at 50-50. It will all be capital gains. Last year we had ordinary income because of the special dividend related to the purge in [_______________] profit, and we shouldn't, certainly wouldn't have that this year. So it should be all capital gains and no ordinary income.

Steven Chercover - *D.A. Davidson*

And 50-50 split this year and then becoming increasingly capital gain next year?

Unidentified

That correct.

Steven Chercover - *D.A. Davidson*

Got it. Thanks.

Operator

Next question from Mark [________________].

Unidentified

Good afternoon.

Unidentified

Hi mark!

Unidentified

Hi, can you just give us a sense or kind of what seems to be going on in the timberland market generally right now. It seems like there is awful lot of industry players and may be some other long-term investors who are selling timberland right now?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah, this is Bill. What we are seeing is there is some rebalancing of portfolios and you are right, there are a lot of sellers out there but also a lot of buyers. Certainly within the sort of institutional owners, the so-called timberland investment management organizations. And of course I think everybody here understands the larger public companies, many of which are also trying to sell timberland. So the fact is it a pretty busy market, particularly in smaller pieces as people are trying to capture those higher values. And interestingly at least in my view from what we have seen, timberland buyers really haven suffered compared to some of the prices we have seen or the drops in prices for log and stumpage. So there is still a fairly long-term bullish view on the value of timberland.

Unidentified

All right. Another question. I saw about 4 or 5 months ago I think it was, OG paper was going to stop pulling chips out of the sort of the Upper Tennessee Valley, and I am just curious about how much volume it really took in terms of these chip exports to Japan out of the Southern states and whether that really had much of an effect on the market?

Rick R. Holley - *Plum Creek Timber Co. Inc*

Yeah, this is Rick Holley. Several Japanese customers were buying chips both in the Northwest and also in the South and certainly in the South they had almost no impact on the market, on the margin, certainly well less than 1%. In the Northwest it was a little greater impact because they took a lot of chips both from the coast of Oregon and also Washington, so [________________] chips in this market still, so had a bigger impact here but not noticeable in price, just a little bit too many chips around; they had no impact on the sales at all.

Unidentified

And finally, you talked about selling to the conservation buyers, but have you guys done anything with just conservation easements on timberland that you are pretty confident is just going to remain working timberland, is there an opportunity there?

Rick R. Holley - *Plum Creek Timber Co. Inc*

Yeah, we have done and we will continue to look at those. We did an easement in the South, actually in Florida, one of the transactions that closed in the first quarter where as we still have the rights to manage the timber and we give up the rights for development, and the land that we studied and said is never to be developed anyway and most of you know, last year we did a transaction which was closing in pieces with the State of Montana and the US government in Western Montana where in we are going to get paid $30 million to agree to do two things to allow access to our lands to the public, which we already do for free, and also not to develop these lands, but we can still grow and manage tress on them and cut tress over time. And again, we studied this property for 5 years and there is no development coming there so we got paid $30 million for doing some, you know basically found money. And the important thing about that when you do a conservation easement all the lands around that that aren't under the conservation easement, suddenly become more valuable.

Unidentified

Can you give us any idea of like how you going about trying to value those easements?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah, this is Bill. You know, some of it's really traditional in terms that we have to create a development scenario, working with basically the appraisal community because often this is with the public and you will come up with that traditional thing. The other thing public access and those kinds of more esoteric values, you often have to go to, kind of, national comps, you have to pretty creative in how you value that. Fortunately, there are some emerging methodologies in this sort of field that put values on things like public access and wildlife habitat and that's great for landowners like Plum Creek which traditionally couldn't take advantage of that kind of thinking. So we are getting paid for things that are traditional.

Unidentified

Okay, great. Thanks Bill.

Operator

Matthew K. Berler - *Morgan Stanley Dean Witter*

Hi guys. I just wondered if you could give us any guidance at all on how to look at the basis in your real estate that you are selling? It looks like the margin in the first quarter was something like 52%-53%, is there any way to, kind of, look out over the year at the 75-100 million a full-year real estate sale that will probably have a margin of x?

William R. Brown - *Plum Creek Timber Co. Inc*

Yeah, I☒ use 40% for that x. That☒our best view today. That 40% is the cost basis, so it☒really kind of a 60% margin.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Yeah, okay that makes more sense.

William R. Brown - *Plum Creek Timber Co. Inc*

And that☒consistent with the first quarter number you just quoted.

Matthew K. Berler - *Morgan Stanley Dean Witter*

Very good. Okay, thanks.

Operator

There are no further questions at this time. Mr. Hobbs, I would like to turn the program back to you.

John Hobbs

Thank you so much everybody for your time and attention today.

Operator

Ladies and gentlemen, thank you. This concludes today☒conference. You may disconnect at this time. Have a nice day.

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EDITED TRANSCRIPT

- Q1 2002 Genzyme Transgenics Earnings Conference Call

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CORPORATE PARTICIPANTS

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John Green *Genzyme Transgenics Corporation - Senior VP of Finance and CFO*

Tom Newberry *Genzyme Transgenics Corporation - Vice President of Corporate Communications*

CONFERENCE CALL PARTICIPANTS

Yarrin Werber (ph) *Erin*

William Yates (ph) *Yates Capital Management*

Matthew Alino (ph) *Salomon Smith Barney*

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Genzyme Transgenics First Quarter Results Conference call. During the presentation, all participants will be in a listen-only mode. Afterwards, a question-and-answer session. if you have a question, please press the one followed by the four on your telephone. As a reminder, this conference is being recorded Thursday, April 18, 2002.

I would now like to turn the conference over to Dr. Geoffrey Cox, Chairman, President, and CEO for Genzyme Transgenics. Thanks. Please go ahead, sir.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Thank you and good morning everyone and welcome to the conference call and web cast to discuss the first quarter 2002 for Genzyme Transgenics Corporation, NASDAQ symbol GZTC.

I am Geoffrey Cox, Chairman, President, and CEO of GTC. With me today is Jack Green, our CFO and Tom Newberry, our Vice President of Corporate Communications. Our results for the first quarter were released earlier this morning. I hope that you have had the opportunity to review this release prior to our call. Jack will briefly review our financial results and expectations. I will then provide an update on some of GTC's corporate activities and the company's progress with its external programs and proprietary products. We will then entertain questions.

Let me just go through the Safe Harbor provision under the SEC Safe Harbor provisions. Please note that certain comments today about our expectations, achievements are forward-looking statements based on management's current anticipations. the Safe Harbor statement noted in our most recent Form 10-K filed with the SEC, particularly Exhibit 99 titled, "Important Factors Regarding Forward-looking Statements."

As you know, due to the risks inherent in our business, which I've described in detail in the Form 10-K, are actual results and may differ materially from our current expectations. So, now may I hand over to Jack Green and I'll ask him to review our financial results and provide an update on our expectations for future results. Jack.

John Green - *Genzyme Transgenics Corporation - Senior VP of Finance and CFO*

Thank you, Geoff. GTC's total net loss of the quarter was $4.6 million f o r (ph) cents per share compared to a net loss of $3.6 million f o r (ph) 12 cents per share for the First Quarter of 2001. Excluding the impact of the gain from the sale of Primedica Corporation, a net loss in the First Quarter of 2001 was 20 cents per share, compared with the 15-cent loss per share in the current quarter.

We continue to expect a full year net loss of between 77 and 87 cents per share. Our revenues for the First Quarter were $3.8 million compared to $2.9 million for the First Quarter of 2001. This 31 percent increase is consistent with our expectation for an overall increase in revenue for 2002 of 20 -- 30 percent over the full year 2001 revenues 16 -- $18 million.

Due to the nature of our milestone-based research and development revenues, it's normal to see a variation from quarter to quarter. Total operating expenses decreased $600,000 to $9 million in the First Quarter of 2002 as compared to the First Quarter of 2001. In the quarter, we spent approximately $1.1 million in the development of antithrombin III, which was a reduction of approximately $1.7 million from the First Quarter of 2001.

You will recall the GTC reacquired full rights to AT III from Genzyme in 2001 in consideration of a percentage of future product sales. We are moving AT III forward in the hereditary deficiency indication. There was also a reduction in other research and development expenses of approximately $800,000 quarter to quarter, as resources were allocated to external programs.

Accordingly, we incurred approximately $1.5 million higher spending in other external programs due to higher activity on those programs. And, finally, SG&A expenses also increased approximately $400,000, primarily due to increased information technology investment to support our growth and to higher legal expenses to support our .

Our cash position and balance sheet remains strong. We used about $7.3 million in the quarter to end up at $83.1 million of cash and marketable securities. This cash is somewhat higher than our historical quarterly average. This is due primarily to timing issues related to the expenses supporting work towards R&D on the capital expenditures. We continue to expect to use approximately $30 million for the year to support our development program for AT III, investments in our development, r e a d i n g (ph) capacity and purification capabilities.

Our long-term debt increased to about $6.4 million, while our current liabilities decreased by about $8 million. This is due primarily to the refinancing of a t u r n a l o n g (ph) that matured in the quarter associated with the financing of our production facilities. The original loan was with Fleet Bank and had been guaranteed by Genzyme Corporation. The new loan, through Silicon Valley Bank, provides for $5.5 million and $5.1 million of new borrowing capacity to fund capital additions. This new loan carries a floating rate at prime, currently about 4.75 percent, and has a five-year term.

Approximately $900,000 of the expanded credit line was used in the first quarter to finance capital expenditures, including a new b a r n (ph) . $4.2 million r e n e w a b l e r e m a i n s f o r (ph) future borrowing. The new loan, this new loan was established using our independent assets and credit history with no guarantee from Genzyme Corporation. Finally, Silicon Valley has a first lien on all assets, except intellectual property, which is fairly standard for this type of findings.

On April 5th, we announced a stock buyback from Genzyme Corporation. This was a second quarter event. Therefore, the buyback is not reflected financial statements for the first quarter or in the reported shares outstanding. The shares outstanding were approximately $30 million at the end of the quarter and are expected to drop to about $27.4 million in the second quarter due to our reacquisition of 2,820,000 shares of GZTC stock. Genzyme financed half of this transaction, approximately $4.8 million, through a loan at , or plus one percent.

We will repay half of the principal in April 2005 and the other half in April 2006. This note has a subordinated lien on all assets, except intellectual property. The remaining $4.8 million was paid in cash and will be reported in our Second Quarter financial results. Genzyme has agreed to a two-year lockup on the remaining shares, eliminating what otherwise may be perceived as an overhang on the stock for that period. And Genzyme now owns approximately 18 percent of our shares outstanding.

In summary, we have made good progress this quarter in meeting the financial expectations to support our growth and independence. continues to operate on a financial . We've made good progress in the quarter and increasing our revenues in line with expectations for the year. we refinanced that attractive terms and, finally, we've successfully negotiated stock buyback on terms that we believe are attractive to our investors. Geoff.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Thank you, Jack. Firstly, I'd like to take some time to tell you about our proposal announced yesterday to change our name to GTC B i o t h e r a p e u t i c s (ph) , Inc. For some time it's been clear that a name change would be helpful to both investors and the general public in establishing clarity to GTC's strategic and financial independence. By retaining the familiar initials GTC, by which many people know us, we retain our linkage to our customer base and our strong position as a leader in this sector of the industry. The use of B i o t h e r a p e u t i c s (ph) recognizes our participation in the broad field in which we operate and supports our intention to focus on the commercial development of a broad range of protein-based products.

In other words, to clearly transition from a products-based company. This proposal will be subject to the approval of our shareholders at our Annual Meeting in May and if, as we hope, this proposal is approved, we will be changing our ticker symbol to GTCB. I also want to provide some background to the share buyback Genzyme, which Jack has just reviewed in the financial section. GC did not initiate this transaction.

However, we came to the conclusion that this supported out plans to establish financial and strategic independence and, importantly, we felt that the terms of the transaction were in the best interests of our shareholders.

In particular, the share price of the buyback, together with the availability of partial financing of the t r a n s a t t r a c t e d t e r m s (ph) . The lockup arrangements we were able to negotiate were also beneficial in removing what may be otherwise have been perceived as an overhang for the stock. Genzyme's objective was to reduce ownership in GTC to a point where they would not require to consolidate a portion of GTC losses.

In line with Genzyme's changing ownership, Henri Termeer has resigned from our Board and at Genzyme's request Henry Blair will not be standing for reelection at our Annual Meeting. Both Henri Termeer and Henry Blair have been instrumental in establishing GTC as an independent corporation and their support and insight over the years has been greatly valued and appreciated. My personal appreciation and thanks is extended to them both.

Over the coming months, I expect s o m e (ph) Board members to GTC as replacements for these positions. It's only been a short time since we reported our year end results. We are making good progress in the development of both our proprietary products and our external programs. Our lead program AT III continues the pharmacokinetic study begun in the fourth quarter of last year. Enrollment in this study is nearly complete and we continue to expect to report the results of this study in the Third Quarter.

As previously stated, we expect to begin an efficacy trial and the registry deficiency indication for AT III later this year. This efficacy trial is expected to last about a year, with a filing for approval in 2004 in Europe initially. We are continuing with our dialogue with the regulatory agencies, both in and the USA regarding our clinical plans and protocols.

This programs will require external partners who value the leadership establishing this technology. We are also d e v e l o p i n g p l a n s (ph) with our partner R e z e n i a s (ph) for the next stage of our H S A (ph) program. R e z e n i a s (ph) completed their exercise of an option to obtain Japanese marketing rights for this product. R e z e n i a s (ph) now has H S A (ph) marketing rights in North America, Europe, and Asia, including Japan.

Our plan this year for H S A (ph) is to move this program from b e n c h s c a l e (ph) work to clinical production, using our proposed commercial scale process. As discussed in previous calls, our malaria vaccine program is an interesting application of our technology f o r a r e l a t i v e l y (ph) small volume product, which is difficult to express. This program is based on the development of Merozoite Surface Protein 1 or MSP-1. It is a protein-based vaccine candidate. The production of this protein has yet to be demonstrated in a commercially relevant way in any other technology.

As you may recall, we're in the process of discussing with the US government agencies and nonprofit organizations the potential of funding development of transgenic goats, along with the purification and formulation processes capable of supporting a clinical grade study of this vaccine candidate and we are continuing these discussions and we're encouraged by their progress.

Our external programs are continuing to make good progress. There are currently 12 of these programs, allowing the company to participate in many therapeutic areas with multiple shots on goal, moving into the clinic and working towards commercialization.

In our year-end report last month, we talked about eight of these programs with either transgenic animals in evaluation or accepted founders. We have now brought one more program, our second undisclosed program with Elon, to the status of transgenic animals in evaluation. We now have nine programs that are either evaluating transgenic animals or have reached accepted status. And I'll briefly review the status of each of these external programs. The terms we used to describe the status of the program are as follows. Where it's development, this is where initial project planning and development of appropriate molecular biology and c e l l l i n e (ph) development is occurring.

For transgenic animals, this is where animals with their transgenic profile have been born and evaluations regards genetic profile, productivity, and protein characterization, as well as additional program development, are in progress. And, where there are selected founders this is where one or more transgenic animals have been accepted by the partner and started a line that can be evaluated for preclinical and clinical evaluation of the product.

Let me start off with D 3 7 (ph) , which in the monoclonal antibody with Abbott. This is for the treatment of rheumatoid arthritis and Crohn's Disease. Abbott recently filed for approval for this product with the FDA, as expected, based on the c h o d u r i d e (ph) product. Discussions about the further development of p a n d e r l i n e (ph) continue to be encouraging.

Now, with o u r g e n i c s I L H (ph) , it's a monoclonal antibody human antibody to i n t e r l e u k i n 8 (ph) and it's being explored as a therapy for psoriasis and in oncology. This program is in the evaluation process. Our next program is Alexion. Alexion continues to study the 5 G 1 . 1 (ph) fully humanized monoclonal antibody in a variety of indications, including rheumatoid arthritis and nephritis. Alexion is beginning a P h a s e 2 B (ph) study in rheumatoid arthritis using product derived from c h o l i n e s (ph) . This program has transgenic animals in evaluation.

The next two programs are with BMS, Bristol-Myers. The CTLA4Ig project has selected immunoglobulin protein. Transgenic evaluation continues in the second undisclosed program. For the Centocor Remicade program, Remicade is a T N F (ph) antagonist antibody approved from a c h o (ph) system for Crohn's Disease and rheumatoid arthritis. This project has transgenic animals in evaluation and we are in a continuing dialogue with Centocor regarding their plans for future production.

For the second Centocor program, this is a protein which remains undisclosed and we cannot discuss anything further about this program. The next program is the monoclonal antibody with Elan, which is Antegren. This is an antibody which is being s l a t e d (ph) for multiple sclerosis and this has s e l e c t e d (ph) a animal.

Our second program with Elan, which remains undisclosed, has progressed to having transgenic animals in evaluation. The next program is ImmunoGen and we're working with ImmunoGen to develop goats that express huN901 in their milk. This antibody is being studied for use in small-cell lung cancer as part of ImmunoGen's tumor activated prodrug strategy. This program is evaluating transgenic animals. The next program is the PRO542 Progenics fusion protein that is a potential treatment for HIV and AIDS. This program is evaluating transgenic animals for the selection of p a n d e r (ph) animals. And our next program is the M e r r i m a c (ph) , which was Atlantic B i P h a r m a c e u t i c a l s (ph) , the A B 1 . 0 0 1 (ph) .

We have a program with this company for a protein that has demonstrated therapeutic potential for myasthenia gravis. This, like our internal molecule programs, is a protein that may be partly enabled by our technology without being in the monoclonal antibody or immunoglobulin fusion protein class of molecules. This program has made good progress towards completing its development stage. I am also encouraged by our progress in the tracking of new external programs. We've always been engaged in discussions with multiple potential partners across a range of proteins. two of these current discussions to a stage where we are performing sponsored research evaluation f o r (ph) product designs using transgenic expression as one of the tools of development.

So much of our programs, these potential partners represent a wide cross-section from early stage companies to well-established industry leaders. This progress is very supportive of our objective to add two new commercial development programs to our portfolio this year. So, somehow I think our progress towards our 2002 objectives we are on track to report on the recombinant AT III hereditary deficiency T K (ph) study in Q3. We continue to expect to begin the AT III efficacy trial before the end of this year in 2002. We are planning to initiate reduction of clinical grade H S A (ph) this year.

Our external programs are continuing to make progress and our objective is to enable one of our partners to begin clinical grade production of product this year. Our marketing discussions are progressing on obtaining two new program partnerships and, in addition, we continue in discussions to attract a partner to the AT III program. We're continuing to follow a financially prudent strategy by managing our burn to $30 million, or approximately $30 million, for this year.

So, thank you for listening to our prepared remarks and I will now ask the operator to please open the call to questions. Thank you very much.

QUESTIONS AND ANSWERS

Operator

Ladies and gentleman, if you would like to register a question, please press the one followed by the four on your telephone. You will hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the one followed by the three. using phones, please lift your handset before entering your request. please press the one followed by the four. Our first question will come from Y a r r i n (ph) W e r b e r (ph) with E r i n (ph) . Please go ahead.

Yarrin Werber - *Erin*

A question. Two questions. Number one, could you elaborate, you mentioned potentially going into clinical production by year end, could you explain what does that involve in terms of manufacturing and is that all product and what are your plans for that? And, secondly, what kind of potential Board members would you look to, to have what kind of backgrounds, to replace the two?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Yeah, let me, you're talking about the H S A (ph) program in your first question, is that correct?

Yarrin Werber - *Erin*

Right.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

OK. Well, our plans are we have developed a process called the H S A (ph) purification at bench scale and clearly what we now need to do is to prepare material under clinical grade conditions to enable preclinical work to commence on this product, but using our commercial scale process and that's what we're planning to do. So, this is in the kilo type of scale. This has not been the hundred of kilos or anything of that time. But, nonetheless, we clearly in order to be able to initiate preclinical work we need to be able to use the process which we plan to use commercially and that is what we're expecting to initiate before the end of the . Does that answer your first question?

Yarrin Werber - *Erin*

Yeah. Absolutely.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

The second part of the question is that this is a relatively recent event and therefore I'm still getting my thoughts together on this from this particular perspective. But, certainly I'm looking for people who have good industry experience, people who understand how to transition companies from development stage companies to being commercial enterprises and product companies and I think that in this part of the world, in the Northeast, there are a large number of people who we have the opportunity to approach in that respect. I don't have any immediate candidates, but those are certainly the sort of people, people have got good experience in the industry, who could help the company and help me too to be able to progress the company in the future.

Yarrin Werber - *Erin*

OK, great. And then perhaps another question. We bought in New York for a second farm. Could you elaborate on your timing for that and when you're going to begin construction and potentially when is that going to be online?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, yes, the idea -- we bought that site, I think we have, which I've heard discussed in the previous call, this is in upstate New York. We have developed that site at this moment, but the object of that is to provide the of our herds and also capacity, which is obviously important. Our expectations are that we will probably start investing on that site either later this year or next year, probably next year, and to start to provide the type of barns and infrastructure which are necessary to be able to support this type of technology. So, at this moment, we're not spending significant money on that side of this juncture, other than preparing ourselves, so to speak.

Yarrin Werber - *Erin*

OK. And then the final question. mentioning starting at t o w a r d s (ph) the end of two trials this year. Is that going to be mostly done in Europe and could you elaborate on the plans there?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Sure. At the moment, we're in discussions with European agencies and also with the FDA about what their requirements are going to be for these trials and what I'm particularly anxious to make sure that we do take the time on the front end with the agencies to insure that any trial, any protocol which we use in these types of studies, will be an appropriate basis for an approvable submission. That's very important for us, of course.

So, we are taking our time to have those discussions and to make sure we do the groundwork in advance of that. I think the trial will be carried out principally in Europe, but we certainly are also looking to potentially have sites in the US. I think that will be helpful also for any future US submissions. We're currently in the process of developing patient register of patients with hereditary deficiency.

Remember, the basis of this type of trial is that having identified these patients you look to recruit them into this trial when they're undergoing some particular trauma, whether it's an operation of some kind or whether the patient may be pregnant and in delivery, and at that juncture those patients can be brought into our trials.

So, there's a lot of groundwork which we're doing in order to prepare ourselves this. The numbers of patients at this moment are a little uncertain and that's what we're also trying to pin down with the agencies at this moment to make sure we have those figures correct, as well. So, but we feel those discussions are progressing in good shape and we feel comfortable with our plans which we've disclosed to enter the efficacy trial before the end of this year.

Yarrin Werber - *Erin*

OK. Thank you.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Thank you.

Operator

Our next question will come from William Y a t e s (ph) of Y a t e s (ph) Capital Management. Please go ahead.

William Yates - *Yates Capital Management*

Yes, I have about three questions. Last time I met with you, you were quite hopeful that the Bill Gates Foundation would endorse your vaccine.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Yes.

William Yates - *Yates Capital Management*

Where does that stand?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, as I said, we are in fact continuing in a dialogue with the Gates Foundation. We're also talking to the NIH and those conversations are actually all proceeding quite well. So, there's no change as far as that's concerned and clearly when one's dealing with nonprofit organizations it's always a little difficult to define the timelines when those will be brought to successful conclusion. But, certainly, that dialogue is still very positive one and continuing.

William Yates - *Yates Capital Management*

Well, good. How much institutional ownership do you think you have?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Actually, I will ask Tom Newberry to help me with that.

Tom Newberry - *Genzyme Transgenics Corporation - Vice President of Corporate Communications*

Bill, we're still at approximately 50 percent. Of course, the major impact on that is the shares we bought back from Genzyme, which would take us down to 46 -- 47 percent, something of that nature, institutional ownership.

William Yates - *Yates Capital Management*

OK. And, finally, when do you think you're going to become profitable?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, that's a question that is often asked. I think that the p r i o r i t y (ph) at this moment is really to make sure we make the investment in AT III to be successful with that program. That is going to be very important to us in terms of advancing towards profitability. I think now is the appropriate time for us to invest in that program.

We now have timelines which we believe give us a position where we have the potential for filing for that program in 2004 and I think that that's the milestone which we are focused on at this moment and if we are successful with that submission and approval I think that's going to be the very important step on our road to profitability. But, beyond that I don't want to speculate in terms of any particular year at this point.

William Yates - *Yates Capital Management*

OK. Thank you.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Thank you very much.

Operator

Ladies and gentlemen, again, if you do have a question, please press the one followed by the four at this time. Our next question will come from Matthew A l a n i n o (ph) with Salomon Smith Barney. Please go ahead.

Matthew Alino - *Salomon Smith Barney*

Yes, good morning.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Good morning.

Matthew Alino - *Salomon Smith Barney*

On the D2E7 founder line, I know that Abbott came out about a week or so ago and said they hoped to have approval on D2E7; I think twelve months was the timeframe. Can you establish for me what would be the timeframe if D2E7 got approved by the FDA? What would be the timeline for Abbott to decide to start doing clinical trials utilizing a transgenic molecule in D2E7?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

I think it's an excellent question, but unfortunately it's one on which I can't truly speculate at this point in time. Obviously, though, as timelines, o u r (ph) timelines which are defined by Abbott. We do have a good, ongoing discussions with Abbott about their plans. Clearly, their first objective is to get approval for the existing product and clearly have the opportunity to to participate in the future production of D2E7 program in the commercial environment.

I actually cannot say much more than that at this point in time and I think if I did actually have the information, I probably wouldn't be able to disclose it in any detail, obviously, as a matter of confidentiality with Abbott. But, other to say that we are in good ongoing discussions, I don't think I can say any more than that.

Matthew Alino - *Salomon Smith Barney*

OK. Maybe something more general in nature. When you're at the point of founder line and you're able to produce a molecule, what timeframe can purified product be available in bulk from the point of having a founder line?

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, when you have a founder line you've obviously got to breed that line out. The gestation period for a goat is five months. But, those animals which are born also then have to become fertile and then be bred out, as well. The normal way in which we would approach this is to be working with the milk product during the actual evaluation stage in order to be able to initiate the development of processes. Remember, with many of our partners, we do the initial purification through to a concentrate, clarified milk concentrate, and our partners actually do the purification process.

But, usually those things are run in parallel in order to better define the process prior to actually making the final decisions on whether we have a founder animal or not and obviously the characterization of protein which is developed from that is also an important part of that evaluation process. And, that's why sometimes these things take some time before we're able to report on the establishment of a founder line. There are ways, of course, not only of breeding the individual goats, but there are also ways of being able to do in vitro fertilization from transgenic animals in order to be able to increase the rate at which that herd can be established.

So, I think that it's perhaps a long answer to your question , but I think in terms of at least a year to eighteen months for us to be able to have a of goats on the ground that start to provide commercial quantities of material once we've established the founder herd.

Matthew Alino - *Salomon Smith Barney*

Two more questions and that'll be it. One, once a drug just generally is approved and one of your partners wants to move that and start utilizing the molecule, clinical trial I guess needs to be done utilizing that molecule. How long of a time period does it take before there is an acceptance of that molecule, generally speaking? And, I want you to be specific.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, you know, I think it's a fine question and that's obviously something which we're very interested in moving our partners toward that particular process. I can't give you absolute statements about how that process will go, because obviously that's also subject to discussions and negotiations between our partners and the agencies. But, our sense is that those types of crossover trials would be focused very much on safety trials. It is not our expectation, from the information that we have at this juncture, that the agency would expect phase I, phase II, phase III trials to be begun.

But, clearly, comparability is important for the agency and safety would be an important part of that, as well. The numbers of patients that would be involved in such a trial, which would determine the timelines of that, are probably going to be somewhat product-dependent and that's why it's a little difficult to and articulate the numbers of patients. The b e n e f i t (ph) of those patients would determine the speed at which those trials could be done.

So, I think this is something which we're also interested in trying to move into rather than speculation into the reality of one our partners moving this program into the clinical stage and that's obviously one of our objectives here, as well.

Matthew Alino - *Salomon Smith Barney*

This question has to do with the amount of cash that you have and the burn rate. Correct me if I'm wrong, but I think some of the money is used e i t h e r (ph) to acquire the stock was utilized through a credit facility and, if I'm wrong I'm wrong, just let me know about that. $30 million burn equates to an additional $22 million or so for the next three quarters, which would bring you down to somewhere in the range of $58 million in cash through the end of the year.

If you maintain that same burn rate, you know, literally, you're out of cash in two years, at the end of this year. I'm concerned about moving towards profitability or at least break even. It seems like all the timelines have that there's a major concern about that.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

Well, obviously, it's a fair question. I think that what we believe and what we stated is that we can manage our cash effectively during the period where we bring AT III through the regulatory process and we can get the company to the next level, which is having a product in submission to the regulatory agencies with our existing cash and I think that's a very important milestone for any company. I'm not sure that the timelines for our products are any different from most companies are in development. These aren't programs which, you know, can be moved forward in any quicker period. I think we're very conscious of the need to move those forward as soon as possible.

But, we feel quite comfortable the cash that we have and our ability today to deliver on our programs with our existing cash and we will very carefully continue to manage the company in a prudent fashion to insure that we achieve that objective. And, I would just like to, in relation to your first part of your question, just to ask Jack to comment, if you can help me on that.

John Green - *Genzyme Transgenics Corporation - Senior VP of Finance and CFO*

Yes, if I understood the question correctly; we spent approximately million in cash in the buyback and also took on $4.8 million of debt in the buyback. So, essentially, Genzyme financed half of the approximately $9.6 million in total consideration. Now, the cash that we had used in that buyback is part of the $30 million. It's functioned into the $30 million annual burn number that we have projected for the year.

Matthew Alino - *Salomon Smith Barney*

OK. Thank you.

Operator

I'm showing no additional questions at this time. Please continue with your presentation or any closing remarks.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

All right. Well thank you very much, indeed, everyone for joining us in this review of our financial results for our First Quarter 2002. We expect to be able to discuss our second quarter results on Thursday, July the 18th, 2002 and we look forward to speaking with you again at that juncture and I would also like to remind everyone that our Annual Meeting is on May the 22nd and I think, Tom, our proxy recently -- is about to be published. Is that correct?

Tom Newberry - *Genzyme Transgenics Corporation - Vice President of Corporate Communications*

Our definitive proxy has been filed and we're in the process of doing the mailings.

Geoffrey Cox - *Genzyme Transgenics Corporation - Chairman, President, and CEO*

So, thank you very much indeed everyone. We look forward to speaking to you in the future.

Operator

Ladies and gentlemen, that does conclude our conference call for today. We thank you for your participation and ask that you please disconnect your lines.

THOMSON REUTERS

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EDITED BRIEF

SLM - Q1 2002 USA Education Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 4:00PM GMT

OVERVIEW:

On a GAAP basis, earnings for 1Q02 were $422m or $2.63 per share vs. $30m or $0.16 per share in 1Q01. Remains comfortable with consensus estimates for 2Q02 and the remainder of 2002. Q&A focus: Loans.

CORPORATE PARTICIPANTS

JEFF HEINZ *USA Education Earnings - ASSISTANT VICE PRESIDENT, INVESTOR RELATIONS*

ALBERT L. LORD *USA Education Earnings - CHIEF EXECUTIVE OFFICER*

THOMAS J. FITZPATRICK *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

JACK F. REMONDI *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

CONFERENCE CALL PARTICIPANTS

Operator

STEVEN ICEMAN (ph)

HOWARD SHAPIRO *GOLDMAN, SACHS & COMPANY*

MICHAEL R. HUGHES *MERRILL LYNCH & CO., INC*

PETER MONTEGO (ph) *TUDOR INVESTMENT*

GARY GORDEN *UBS WARBURG*

BRUCE HARTING *LEHMAN BROTHERS, INC.*

ROGER LISTER (ph) *MORGAN STANLEY DEAN WITTER & CO.*

CHIP ROUI (ph) *SLOPE WISEMAN (PHONETIC)*

MAT SNOWLING (ph) *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

OVERVIEW

On a GAAP basis, earnings for 1Q02 were $422m or $2.63 per share vs. $30m or $0.16 per share in 1Q01. Remains comfortable with consensus estimates for 2Q02 and the remainder of 2002. Q&A focus: Loans.

FINANCIAL DATA

A. **1Q02 core cash basis earnings per share increased 25% over 1Q01 to $1.05 (Phonetic).**

B. **Core cash basis net interest income equaled $334m for 1Q02 compared to $96m for 1Q01.**

C. **1Q02 loan originations through the preferred channel totaled $3.8b, a 23% increase over 1Q01.**

D. **Other income for 1Q02 equaled $121m compared to $112m in 1Q01 and $111m in 4Q01.**

E. **Operating expenses for 1Q02 was $161m compared to $170m in 1Q01.**

F. **Earned $129m in floor (Phonetic) income net of hedging costs in 1Q02.**

G. **Tangible capital increased to 1.7% of managed assets vs. 1.4% at year-end.**

PRESENTATION SUMMARY

I. 1Q02 OPERATING RESULTS

A. **Fixed interest rate index issue in January.**

B. **During the quarter market share growth was strong.**

C. **Fee income was strong.**

D. **The company is going back to the old name i.e. Sallie Mae or SLM, Inc.**

E. **Generated strong growth in loan origination during 1Q02.**

F. **Preferred channel origination for 1Q02 was $3.8b, up a healthy 23% vs. 1Q01.**

G. **USA Education's school base strategy continues to drive the preferred channel originations.**

H. **Has seen significant increases in its originations at numerous college campuses including Duke University, Eastern Michigan, Loyola, Ohio Northern, UCLA, and University of Pacific (Phonetic).**

I. **71 schools have decided to return to (Indiscernible) program with Sallie Mae.**

J. **Has 32 new direct lending schools that are using USA Education's (Indiscernible) process for other alternate loan programs.**

K. **The new school campuses give an opportunity to demonstrate both the service levels and operational efficiencies in technology.**

L. **Identified out of that population the key prospects for 2002 and beyond to continue the focus on converting these direct planning (Phonetic) schools back to (Indiscernible).**

M. **On loan consolidations, addressing from an operations perspective, the company is in its year two of its marketing campaigns that have several components.**

N. **Has staffed and equipped the loan servicing centers to manage incoming consolidation request as well as handling the company's own direct mail campaign, which is targeted at borrowers than its own base that have a strong likelihood of consolidating.**

O. **Increased the marketing to third party borrowers who are right for consolidation as well.**

P. **Has amply armored itself to both monitor and counter the impact of rate changes to the portfolio.**

Q. **To put this in a little perspective, last July there was a 220 basis points rate reduction benefiting present borrowers, and the net reduction to the portfolio in 2001 was $1.3b of net pay-offs.**

R. **That 220 basis points refinancing opportunity was further enhanced by an 80 basis points teaser rate but that the Dept. of Ed offered through Oct. 2001, which made that total rate reduction to the borrower even more appealing at 300 basis points, a quite significant and certainly a huge opportunity.**

S. **In July 2002 borrowers are going to have another nice refinancing opportunity probably closer to 180 basis points.**

T. **Certainly it is substantially less imposing than the 220-300 basis points that were dealt with in the previous year's academic cycle.**

U. **Expects direct lending consolidation trends to soften as evidenced by the 1Q02 numbers.**

V. **Anticipates that the (indiscernible) market including Sallie Mae will continue its act of consolidation drive through June 30.**

W. Sallie Mae is well equipped to protect the asset base, which will be protected, and consolidation expectations have already been built into the financial plans for 2002, which are on target through 1Q02.

X. In addition to the core business of loan originations continued to develop fee-income businesses, with a dual emphasis on Guarantor's services operation and collection portfolio.

Y. Pleased with the contribution these businesses have made to 1Q02 results.

Z. The Guarantor's services and collection revenues for 1Q02 totaled $79m, up $24m from 1Q01.

AA. Collection revenues accounted for the majority of this increase.

AB. Furthermore sales and marketing efforts in selling the USA funds guarantees generated to 7% growth in USA funds volume for 1Q02.

AC. More importantly the preferred channel originations had achieved an 18% growth in attaching (Phonetic) a funds guarantee to that drive.

AD. This drive (Indiscernible) the importance of the preferred channel partner and relationships.

AE. On schedule in terms of working to position collections as a key part of the business strategies.

AF. Recent acquisitions of Pioneer Credit Recovery and General Revenue Corporation - the two highly successful loan collection experts have allowed Sallie Mae to aggressively pursue market share in the student loan collections business.

AG. Pioneer Recovery specializes in working with guarantors and has been the number 1 ranked collection agency with the Department of Education since 1997.

AH. General Revenue Corporation specializes in campus-based collections that compliments the product suite offered to schools by Sallie Mae's 200+ higher education sales force personnel.

AI. Sallie Mae is effectively managing operating expenses.

AJ. Operating expenses for 1Q02 totaled $161m, a decrease of approximately $9m from 1Q01 operating expenses of $170m.

AK. This decrease reflects the continued integration activities, and it does include the new expenses associated with the recent acquisition of both General Revenue Corporation and Pioneer, which were not part of 4Q01 operating costs.

AL. Continues to execute on business plan with measurable success.

AM. Excited about the results for 1Q02 and the momentum that it is taking into 2Q02.

AN. Anticipates that financing for higher education will continue to play a critical role as Americans look to fulfill their educational dreams.

AO. Although college is getting more expensive, Sallie Mae is experiencing record college enrollments.

AP. Sallie Mae is ready for the upcoming academic year.

II. FINANCIAL HIGHLIGHTS FOR 1Q02

A. Continues to meet the expectations with respect to loan growth, fee-based income, and operating efficiency, which combined to drive the profitability.

B. For 1Q02 core cash basis earnings per share increased 25% over 1Q01 to $1.05 (Phonetic).

C. Core cash basis net interest income equaled $334m for 1Q02 compared to $296m for 1Q01.

D. The 13% increase driven by (Indiscernible) had 6% increase in the average managed student loans, and a 14 basis point increase in the student loan spread.

E. Net interest income decreased from the 4Q01due principally to the fewer number of days in 1Q02.

F. The increased in Sallie Mae's student loans spread from 1Q01 in the stability from the 4Q01 is the result of the financing activities in 2001 and 2002.

G. It took advantage of favorable market conditions that generated both long and short-term improvements in the student loans spread.

H. Going forward, still expects the student loan spread to remain stable in the mid 180s.

I. For 1Q02 loan originations through the preferred channel totaled $3.8b, a 23% increase over 1Q01.

J. During 1Q02 purchased $4.5b in student loans, an 18% increase over 1Q01.

K. Other income for 1Q02 equaled $121m compared to $112m in 1Q01 and $111m in 4Q01.

L. The increase from 4Q01 was primarily due to growth in the Guarantor services operations and in particular the collections business.

M. Offsetting these factors were several items including the decrease in other income from the sale of the Student Information software business.

N. Operating expenses for 1Q02 was $161m compared to $170m in 4Q01.

O. The decrease in operating expenses for the quarter was due in part to the sale of the Student Information software operations, continuing commitment to improve operating efficiency, and seasonal factors.

P. This reduction occurred despite the increase in operating expenses associated with the acquisitions in the collections business.

Q. During 1Q02 the company purchased 200,000 shares net of option related activity and issuance (Phonetic) related to acquisitions.

R. At March 31st, equity forward purchase commitments totaled 9.7m shares at an average price of $75.54.

S. During 1Q02 the company earned $129m in floor (Phonetic) income net of hedging costs.

T. Of this $33m was used to repurchase existing hedge transactions and the balance was retained to build capital.

U. As mentioned in the past floor (Phonetic) income is real cash income, however, since it varies with interest rate cycles it was excluded from the core cash basis earnings.

V. The company continues to anticipate (Indiscernible) income will total roughly $240m for 1H02.

W. The company's plan in 2002 was to retain poor (Indiscernible) income and reduce share repurchase activity in order to build capital more rapidly.

X. At 03/31/02, total equity was $1.9b, an increase of $282m over year-end.

Y. Tangible capital increased to 1.7% of managed assets vs. 1.4% at year-end.

Z. At 03/31/02, 94% of managed student loans were federally guaranteed.

AA. Due to the guaranteed nature of these assets, credit losses are (Indiscernible).

AB. For 1Q02, net charge-offs were $5.2m or an annualized 0.03% of the average managed federal student loan portfolio or 3 basis points.

AC. **Private non-insured loan portfolio totaled $5.1b on 03/31/02.**

AD. **In 1Q02, net charge-offs for the private loan portfolio equaled $12.2m or an annualized 1.7% of the non-federally insured portfolio when repayment.**

AE. **Total allowance and the loan losses were equal to 2.6% of the managed student loan portfolio at 03/31/02.**

AF. **The allowance allocated for the private loan portfolio was 4.3%.**

AG. **The credit performance of federal and private loan portfolios continues to meet the expectations.**

AH. **Continues to make progress towards the wind down of the GSC (Phonetic) in 2006.**

AI. **Securitized $3.5b in student loans towards this goal, in issue of $1.6b in term holding company debt.**

AJ. **This includes $850m of five year fixed rate debt issued on 04/03/02.**

AK. **This last transaction was significant for a variety of reasons:**
1. The maturity date of the bonds extended past the anticipated wind down date of the GSC (Phonetic), the first such issuance.
2. The deal was extremely well received by investors.

AL. **The high quality of assets along with the predictable growth in earnings continues to attract investors divest their interest in both securitization and holding company securities' offerings.**

AM. **On a GAAP basis, earnings for 1Q02 were $422m or $2.63 per share vs. $30m or $0.16 per share in 1Q01.**

AN. **Included in these results is an SFAS 133 mark-to-market gain of $288m in 1Q02, and a mark-to-market loss of $168m in 1Q01.**

AO. **These 133 results are driven by the mark-to-market derivative contracts that provided economic hedge of embedded interest rate options in the student loan portfolio.**

AP. **Remains comfortable with consensus estimates for 2Q02 and the remainder of 2002.**

QUESTIONS AND ANSWERS

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

Hai, good afternoon. On the consolidation loans, can you just discuss the economics of the consolidation loans versus the regular student loans? In other words, the 105 basis points fee (Phoentic) versus 30 and then what is the yield? And is the 105 basis points expensed immediately or is that amortized over the life of the loan?

Unidentified

On the economic side of the equation, consolidation loans do have different terms to the lender than to Stafford loans. In today's rate environment and the interest rate set on consolidation loans through June 30th, the economic had spin on spread is equivalent to what we would earn on Stafford loans. So, there is really no net with all the items that you mentioned, we are about even. The 105 basis points that you mentioned is an annualized fee that is paid each quarter to the Department of Education on outstanding consolidation loans. On a post July 1st basis, we would expect that based on current interest rate environment and other issues affecting these loans that the economics difference between a Stafford loan and a consolidation loan would be in the 30 basis point range (negative).

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

How did you get the 30 basis points?

Unidentified

There are a variety of factors that come into that. I think we can probably describe those off line in more detail, because there is also more than half a dozen items.

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

Okay

Operator

Your next question comes from Steven I c e m a n (ph) - .

STEVEN ICEMAN

Hai, the guarantee collection revenue item, what was the component guarantee collection and to compete you just bought new. What are your expectations for the collection fee revenue item over the next six months?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

This is Kim. I think the guidance we gave on the last quarter on the collection companies that we acquired that are looking to have those new collection companies there at least six to sevent cents into our earnings per share and with some efficiencies internally, we are probably going to get another two pennies out of that for those two operating units, Pioneer and G R C (ph) . In the 79 million dollars of guarantor services and collections in total, approximately 55 percent of that is just into collection business itself and that breaks down that 79 million for you.

STEVEN ICEMAN

Okay, thank you. I just explain, given that you bought these companies, how was it that the operating expenses went down? You got revenue combine the company and net expenses are down sequentially, which seems to be a bit odd?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

Well we did benefit from the face out of of Salle Mae solutions, which were in our operating expense numbers both in quarter four and first quarter of 2001. Coupled by the fact that some of the efficiencies that we were expecting out of integration, which were trailing in quarter three and quarter four and if we recall days, we had just a robust quarter three of new origination volume that did slow down some of the efficiencies we are looking to do in our servicing centers. We are on a low right now and the seasonality of both reduced labor because we are in for the l o s s (ph) period for new originations. This is probably the softest quarter for our servicing centers. That certainly assisted along with some of the technology assistance. This finally started taking place in late December or early January. We didn't get the entire impact in fourth quarter as we only received maybe one-quarter value in quarter four. We received three months' value in the first quarter of 2002. The efficiencies, which we were expecting and anticipating, we probably were about four or five months behind (indiscernible) of getting those costs reduced to 2001 and they came in very neatly in first quarter of 2002.

STEVEN ICEMAN

Okay, thank you.

Operator

Your next question is from Howard Shapiro - Goldman, Sachs & Company.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Hi, yeah, two questions please. I know you addressed this issue in last quarter's call but I want you to just refresh us. As you continue to securitize loans, your actual capital need to decline, but yet you are planning to build capital. Can you just with us about some of the uses of this capital that you anticipate? And Jack just a question for you. Kind of based on what you are saying with the 30 basis point net cost, if everybody who is eligible to consolidate tomorrow, what would the impact on earnings be to your best estimate?

Thanks

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

On the first side on our capital issue, we look at our capital requirements. We are really looking at that as a percentage of our managed assets, which do take into account, both securitized loans as well as loans that are on balance sheet. When we look at where we stand today, we are principally trying to drive that ratio up pretty close to where we are right now. In my prepared remarks, I had indicated that our tangible capital ratio had improved from 1.4 percent at year-end to 1.7 percent. We started some growth that will take place in that ratio in the balance of 2002, but we were really able to capture a good part of that in 1Q02 due to the retention of poor income on that side. This has become a more important issue for us as we begin to wind down at the GSE and principally as we begin to issue debt at the holding company level, although, it certainly points you towards 850 million dollars deal we did in April as an example of the strong investor reception we would have initially in debt securities principally driven by the quality of our assets. On the consolidation side of the equation, the numbers here, we know that portfolio of Stafford loans that's close to 40 billion dollars in size. The level of consolidation activity that takes place is a far smaller percentage of that overall volume. It has been and we would certainly expect that to continue. On 07/01/02, although the interest rate will decline for our new consolidation loans and it is also important to recognize that the interest rates for Stafford loans will also decline. Based on current rates, they will both decline to 4.2 percent. So borrower who does nothing captures the lower interest rate benefit for the next 12 months. I think that capturing of that benefit will help us demand for consolidation activity. The other thing to be remembered is that once they get consolidated, they cannot consolidate again. So, it's a one-time kind of opportunity. I would mention on this is that When a borrower does consolidate, their repayment term extends and most people with an installment debt don't end up repaying loans and so the net interest cost that a student could end up paying over the life of the loan could actually be more expensive proposition (ph) for them that if they just stay in the Stafford category.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Okay and thank you. If I can squeeze one more clarification and Kim, I think, you said half of the 79 million dollars in guarantor fee income was from the collection business. In your press release, you mentioned 12 million dollars on Pioneer and GRC. Did you already own some other collection businesses?

Unidentified

This is Howard, correct? When we went through the acquisition of the USA group, they had in place a company Education Default Services Inc., (E D S I) (ph) , which was their collection company that they had extended two years earlier and they were actually the master servicer for the USA funds collection services, which they service and collect close to 4 billion dollars of defaulted loans from USA funds. That was already a part of the build up of the collection businesses that were furthering along today.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Okay. Great. Thanks.

Unidentified

You are welcome.

Operator

Your next question comes from Michael R. Hughes - Merrill Lynch & Co., Inc.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

Thank you. On the other income, the non-guarantor fee income, it looks like there was a pretty good drop off there. I know the software company came out of that, but I don't imagine that given the selling price that was big . I was wondering if you could what else is in there and what might have caused the drop if there was indeed a drop?

Unidentified

The revenue actually wasn't as small as the profit margin on that business. So, definitely it was a fairly significant item. We also sold off a small interest we had in a Canadian student loan service company that generated revenues as well and then there is some other one-time items that really took place in 1Q01 and it's just the elimination of those items coming through or showing up in the comparison.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

So, is that 41.5 a relatively clean number now therefore?

Unidentified

I would expect that that is a relatively clean number though it probably will trend upward over the balance of 2002.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

And there is some seasonal good things or h i k e r (ph) in 1Q02? Is there not?

Unidentified

There are some seasonal items that take place on the guarantor services side and the insurance side of the equation based on when terms of repayment and flow back and it comes in 3Q02 vs. 1Q02.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

So it is more in 3Q02 and 1Q02, 2Q02, and 4Q02 are more equal. Is it?

Unidentified

Yes.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

Okay. Thank you.

Operator

Your next question comes from Peter Montego (ph) - Tudor Investment (ph)

PETER MONTEGO - *TUDOR INVESTMENT*

Good afternoon. Thank you all for your time. On the capital issue debt, since you are at or approximately near the targeted 17 as a percentage of managed assets level in tangible basis, would it be reasonable to expect not withstanding the acceleration of the wind down? Would it be reasonable to expect share repurchase activity to a sort of re-accelerate in the back half of the year or is that not a reasonable assumption in light of the profitable loan growth opportunity presented by the potential increase in the student loan effects (ph) next year?

Unidentified

We would expect that this 2.5 percent share repurchase level that we guided to in the fourth quarter conference call will continue for the balance of 2002 and that repurchase activity would return to more historically normal levels in 2003. So I don't think you would gain acceleration in the balance of this year.

PETER MONTEGO - *TUDOR INVESTMENT*

And am I right that this 17 (ph) tangible capital managed assets is sort of in your mind the optimal level and the level that you are going to manage to going forward?

Unidentified

What we were trying to accomplish here is that the company first of all has generated significant amount of capital each year based on its return on equity, a good portion of which we have always retained to build capital on an absolute dollar basis YoverY with the balance sheet. We managed that as the company grows. Those would continue. During the time frame that we have been a buyer of our stock with a 5 percent levels, our tangible capital ratios also were improving and I would expect to see that in 2003, if we were to return to 5 percent levels our tangible capital ratios would continue to improve to set a slower pace.

PETER MONTEGO - *TUDOR INVESTMENT*

Got it. Thank you.

Operator

Your next question comes from Gary Gorden - UBS Warburg

GARY GORDEN - *UBS WARBURG*

Okay. Thanks. Two questions. One, Jack you mentioned that you had buybacks some of the contracts. What is the economics of this and how does this affect the earnings going forward? If I could ask Kim (ph) i0n light of the news that Fleet (ph) looks like to trying to exit the servicing business, what sort of changes if any in competition, from your bank competitors if you have seen over the last year or two?

Unidentified

On the first part Gary, the 33 million dollars we spent for buyback hedges. We are buying back a variety of hedges just four contracts. That income typically would be earned back into earnings over five year period of time.

GARY GORDEN - *UBS WARBURG*

Okay.

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

And Gary if I can answer your question on the Fleet's (ph) , perhaps change of appetite for some of the non-core businesses in the education, finance is one. We have not seen much of Fleet in the market that we are operating in. Their business is not growing in education and finance. Our competitors remain to be the direct loan program. They seem to still want to stay in the business. Fleet has kept their presence mostly in the New England. We have been able to compete aggressively in the New England as we have in all the other markets in the US and we are not surprised by the news that we have read and you have read together. We are just anxious to continue with our growth in competing against all those lenders in the stock (ph) marketplace. It's not surprising and they haven't posed a threat to us in the markets we have been competing with today.

GARY GORDEN - *UBS WARBURG*

Okay. Thank you.

Operator

Your next question comes from Bruce Harting - Lehman Brothers, Inc.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

I am just following on Gary's and you know is this prescarcity will see more of this bank exiting. And another question was could you just comment on the government direct lending program in the schools that you mentioned that you acquired in the beginning of the call? Can you give us any feedback that you hear in the marketplace about the satisfaction and dissatisfaction on those market share gains?

Unidentified

Let me just quickly comment on Fleet (ph) or other in the program. We are not sure that certain Fleet (ph) is exiting the business. I know they had an article regarding selling some of their service contracts, one with a direct loan program, but we didn't read into that they were really departing from the program. We know that Amex (ph) departed last year. We also know as information is visible but there are less private sector players in the program today than they were perhaps ten years ago. Now withstanding that those who are standing in are making a concerted (ph) effort of right value and levels of service to keep the program at a level of expectation and performance about the direct loan program. On the direct loan program in the schools, we are both entertaining and winning on. There is no question that technology plays a vital role in the school choice of both leading the direct loan program to go back to . In addition to the other values that they receive from the platforms that we have invested on in our servicing centers, which is both helping and assisting both the parents and the students through their faster processes or their application of processing. We are very pleased with what we have entertained to-date and both having 71 schools move over to over the last three years, we also have an inventory of 20-30 schools that were entertaining today, who are next driving to 2002 and 2003. What we hear from the direct lending schools is that there is no longer seems or appears to be a threat that they have to stay in the program. I think that they realized that the options they have are one to look at the program today and they will be making their choice based on what value they are going to get out of the private sector vs. what they are staying in the government loan program. It is a fairly simple equation and I think we are not experiencing the same imposing threats of behavior perhaps what we saw two or three years earlier.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

Do you have the latest market share number for the direct program?

Unidentified

I believe the direct lending program represents about 29 percent of the total title for borrowings, which is a little over 11.5 billion dollars.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

Thanks.

Operator

Your next question comes from Roger Lister (ph) - Morgan Stanley Dean Witter & Co.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

Thank you. Even the consolidation and low rates, what's happening to the prepayment fees in the securitizations? How is that holding up against your typical 7 percent assumption?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

This is Jack. The data on each of the securitization transaction is actually published on our website for each individual unit. The prepayment u n i t (ph) varies depending upon the characteristics of the underlying loans and they are in the stage of repayment versus in schools' statistics. It can vary significantly from Quarter to Quarter. At this stage of the game, we haven't seen any significant issues in that front, no long-term trends in that particular area.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

And maybe on a different topic in terms of the non-Federal Government lending, are you seeing the delinquency performance? Are there signs of any improvement with the economy starting to show signs of recovery?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

On that portfolio, the delinquency rates on the private non-Federal insured loan portfolio have actually declined each month of this year, which is historically a seasonal high of delinquencies for consumer credit is in first quarter of the year. We have actually seen them drop off since December. So, very nice performance in that area. As I said earlier, the credit performance of both the Federal and private portfolio is right in line with what we would have expected.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

So, your outlook going forward continues to be pretty favorable. Are you looking to take some advantage of that going forward?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

Yes.

Operator

Your next question comes from Chip R o u i (ph) - Slope W i s e m a n (ph) .

CHIP ROUI - *SLOPE WISEMAN (PHONETIC)*

Hai, I was wondering if you could briefly talk about the eventual pacing of the 529 plans and the impact on any reduced loan activity would be over the longer term?

CHIP ROUI - *SLOPE WISEMAN (PHONETIC)*

Okay. Thank you.

Operator

Your next question comes from Mat S n o w l i n g (ph) - Friedman, Billings, Ramsey & Co. Inc.

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

Can you comment on the t h r e a t (ph) you are seeing from some of these new consolidators or vendors in the market? Does that threat diminish once the rate is re-set in July?

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

So I am just clear though.

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

July, is that due to the increased potential?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

Yes.

Operator

At this time I would like to remind everyone in order to ask a question please press star and then the number one on your telephone key pad. At this time there are no further questions.

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

That will conclude the call and thank you very much.

Operator

Thank you for participating in today's conference call. This call will be available for replay beginning at 3 PM Eastern standard time today through 11:59 PM Eastern standard time.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SLM - Q1 2002 USA Education Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 4:00PM GMT

OVERVIEW:

On a GAAP basis, earnings for 1Q02 were $422m or $2.63 per share vs. $30m or $0.16 per share in 1Q01. Remains comfortable with consensus estimates for 2Q02 and the remainder of 2002. Q&A focus: Loans.

CORPORATE PARTICIPANTS

JEFF HEINZ *USA Education Earnings - ASSISTANT VICE PRESIDENT, INVESTOR RELATIONS*

ALBERT L. LORD *USA Education Earnings - CHIEF EXECUTIVE OFFICER*

THOMAS J. FITZPATRICK *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

JACK F. REMONDI *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

CONFERENCE CALL PARTICIPANTS

Operator

STEVEN ICEMAN (ph)

HOWARD SHAPIRO *GOLDMAN, SACHS & COMPANY*

MICHAEL R. HUGHES *MERRILL LYNCH & CO., INC*

PETER MONTEGO (ph) *TUDOR INVESTMENT*

GARY GORDEN *UBS WARBURG*

BRUCE HARTING *LEHMAN BROTHERS, INC.*

ROGER LISTER (ph) *MORGAN STANLEY DEAN WITTER & CO.*

CHIP ROUI (ph) *SLOPE WISEMAN (PHONETIC)*

MAT SNOWLING (ph) *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

PRESENTATION

Operator

Thanks for joining our USA Education 2002 first quarter earnings conference call. During the conference call, we may discuss we may discuss predictions and expectations and forward-looking statements. Actual results in the future may differ from those discussed here perhaps materially based on a variety of factors. This, you should refer to the discussed to those factors in the company's Form 10-K and the other filing with the Securities and Exchange Commission.

The itinerary for the call will be as follows:

ALBERT L. LORD will revise an overview of first quarter results.

THOMAS J. FITZPATRICK will discuss the operations of the company.

JACK F. REMONDI will discuss the quarter's financial highlights and provide an outlook for the remainder of 2002. Then we will open up calls for Q&A.

ALBERT L. LORD - *USA Education Earnings - CHIEF EXECUTIVE OFFICER*

Good day. This is our first opportunity in 2002 to talk to you about what's going on in case I forget to say it was a good quarter. It's as I guess I can ensure one said that the beat continues to go on. We are meeting or beating all of our growth targets. Our growth trends both the ones you can see and some maybe that are a little more subtle are better even than I expected. Before I talk about those quarterly results, I just wanted to mention two things, at least two things that transpired in the quarter that really relate much more to future results than to the immediate quarters. Our confidence in our outlook has created the opportunity for us to accelerate our GSE E x i t (ph) by 2-4 years from Sept. 08 to Sept. 06, we began acceleration as you will hear from JACK a little later and we will continue that acceleration. We are fixed what we refer to as our index rate issue in the quarter. It was fixed in Jan. and that fix vastly at least my ability to see how far our success can extend.

During the quarter, our market share growth was strong, it is strong and it will be strong. I think importantly, we continued to lay a broad and strong foundation for future growth. Our margins held up. They held up quite nicely and they also looked good going forward. Fee income was strong. I think we have announced to acquisition of two collection companies we think the best in our business, which I hope makes us the best in our business by name of Pioneer and GRC. Those two companies came on line in the first quarter. That transition took place without a hedge and is already creating growth for us both on the top line and much more importantly, on the bottom line and I expect, you heard about this business last quarter, you are hearing about it now, and you are going to hear about it, I can tell you in the future. Slowly but surely, we are getting our operating cost back in line. There is no magic to this quarter's cost reductions. We are just paying closer attention to it. In fact, we did sufficiently well and I am almost satisfied with the reduction. As you are well aware, I hope by now that almost everything we do most and generally in a hurry. I will say that there is exception. We have introduced today as USA Education. We are going back to our old Sallie Mae or SLM, Inc. I think we have already made that announcement as well. My favorite sequence of three initials USA, this when combined with USA Education has caused too much confusion around too many of our investors. Before I ramp up and

to THOMAS J. FITZPATRICK, just wanted to comment a little bit on yesterday, which was a 5 million share trading day for Sallie Mae, which is pretty unusual and did not result in a higher stock price which is unfortunate. I think at one point during the day, we were down about 6 percent. It was a day that surprise us and like everything else, we grew around here. We would like to try to turn surprises and challenges into learning opportunities. We clearly our shareholder communications are not perfect.

Yesterday, we believed a story from a very knowledgeable analyst, triggered some excitement in our marketplace. The analyst informed investors of the annual consolidation refinancing opportunity that comes to our borrowers once a year in July. Apparently he had been unaware of that event. Obviously, others had been unaware of that event. The analyst deemed the event a financial risk also a difficult one to quantify. He also found the event to be something that was noteworthy. Obviously, some shareholders found his story noteworthy. Let me explain to you that we are very much aware of the event. We have for years. I don't want to say it is not a material financial risk because no one knows what material means any more. But, I will tell you this we don't deem it to be a major financial risk. Consolidation is a standard feature of our program. We manage it every year. We manage it every day of the year. We have quantified the risk and let me for one of a more specific financial term calls it a bump in our road. Let me tell you that last year's bump in the road relating to this activity was a larger bump. The cost of this event is contemplated in all our planning. Any earnings guidance that we have ever given you and contemplated it, any earnings guidance that you get out of the day's call or future calls will contemplate w r o n g (ph) consolidation activity as well as any other activity that is a standard part of our operating results. But, as I said, we learned a communication for us and we did not disarm the perception that this was a risk, anywhere near as well as we disarm the risk itself. The analyst who wrote this article and I actually think there might have been another one today. The one who wrote the article yesterday is certainly among the thoughtful analyst with whom I have ever done business. I have known him for quite a few years. He is a good guy. I have read his stuff with respect to us and others and that he and others didn't this event coming or recognize the fact that we have already d e a l t (ph) it. It is an issue of our communications, not his or anyone else's.

To the shareholders who are on this call, I think you are the only boss that I have to the exception of the one at home. In this role, I am your subordinate and hopefully a trusted subordinate. I will give you the answer that I most appreciate for my trusted subordinates. This is not an issue. It's very much under control and you don't need to worry about it, which gets me very close to ramping up here. I will tell you this with respect to this quarter that has now ended. It was a good quarter. It's meeting t h o u g h (ph) at least to you and to me, it is not so much what we did but what it means to the future. I am very pleased with what we have achieved, but I am much more pleased with the outlook for the company. I have a variety and a number of trusted subordinates. I am going to turn this to over of them. THOMAS J. FITZPATRICK who I can assure you is h a r d l y (ph) subordinate.

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

Thank you ALBERT L. LORD and good afternoon.

Like ALBERT L. LORD, I am quite pleased with the operating results for the first quarter. We continue to execute on our strategy and to focus on those initiatives they are going to allow us to grow our business. Let me just highlight a few key items.

We generated strong growth in our loan originations during the first quarter. Our preferred channel originations for the quarter were 3.8 billion dollars, up a healthy 23 percent compared to the year-ago quarter. Our school base strategy continues to drive our preferred channel originations. We have seen significant increases in our originations at numerous college campuses including Duke University, Eastern Michigan, Loyola, Ohio Northern, UCLA, and University of Pacific (ph) , just to name a few. Adding to our growth in loan originations were direct lending wins. For to-date, 71 schools have decided to return to program with Sallie Mae. Most notable to-date, in the recent quarters are Rice University and William Patterson College in New Jersey. No doubt, our investment in technology has been a key factor in convincing these schools to move out of direct lending as evidenced by the fact that 3 out of every 4 school returning to the program with Sallie mae have elected to use one of our Internet-based loan delivery systems, Laureate or NetWizard. Additionally and a very pleasing news, we have 32 new direct lending schools that are not part of the 71 population that I referred to earlier, that are using our Laureate process for other alternate loan programs.

these new school campuses and gives an opportunity to demonstrate both our service levels and our operational efficiencies in technology and we have identified out of that population, the key prospects for 2002 and beyond to continue our focus in converting these direct lending schools back to .

Let me say a few words about loan consolidations, which as Alb. mentioned is not new issue for us. I would like to address the consolidations from an operations perspective and share with you how we handle rate that might pose a risk to our portfolio. We are in year two of marketing campaigns that have several components. We have staffed and equipped our loan servicing centers to manage incoming consolidation request as well as handling our own direct mail campaign, which is targeted at borrowers than our own base, which have a strong likelihood of consolidating. We have also increased our marketing to third party borrowers who are right for consolidation as well. We have amply armored ourselves to both monitor and counter the impact of rate changes to our portfolio. And to put this in a little perspective if you will, last July there was a 220 basis points rate reduction benefiting present borrowers and the net reduction to our portfolio in 2001 was 1.3 billion dollars of net pay-offs. That 220 basis points refinancing opportunity was further enhanced by an 80 basis points teaser rate but that the offered through Oct. 2001, which made that total rate reduction to the borrower even more appealing at 300 basis points, a quite significant and certainly a huge opportunity. In July of this year, borrowers are going to have another nice refinancing opportunity probably closer to 180 basis points. Certainly, it is substantially less imposing than the 220-300 basis points that we were dealt with in the previous year's academic cycle. We expected direct lending consolidation trends to soften as evidenced by the first quarter numbers. We also anticipate that the (indiscernible) market including Sallie Mae will continue its act of consolidation drive through 06/30/2002 and we are well equipped to protect our asset base, which will protect and our consolidation expectations have already been built into the financial plans for the year, which are on target through the first quarter. In addition to our core business of loan originations, we continued to develop fee-income businesses with a dual emphasis on our guarantor services operation and collection portfolio. We are pleased with the contribution these businesses have made to our first quarter results. Our guarantor services and collection revenues for the first quarter of 2002 totaled 79 million dollars, up 24 million dollars from the year-ago quarter. Collection revenues accounted for the majority of this increase and further more, our sales and marketing efforts in selling the our USA Funds Guarantees generated a 7 percent growth in USA funds volume for the first quarter. More importantly, our preferred channel originations had achieved an 18 percent growth in attaching (ph) a funds guarantee to that drive. This drives the importance of the preferred channel partnering relationships.

We spoke a little bit about growing our collection businesses in our last call and I wanted to let you know that we are on schedule in terms of working to position collections as a key part of our business strategies. The recent acquisitions of Pioneer Credit Recovery and General Revenue Corporation - the two highly successful loan collection experts have allowed Sallie Mae to aggressively pursue market share in the student loan collections business. Pioneer Recovery specializes in working with guarantors and has been the number 1 ranked collection agency with the Department of Education since 1997. General Revenue Corporation specializes in campus-based collections, which compliments the product suite offered to schools by our 200 plus higher education sales force personnel. We are in early stages of implementing some cost selling (ph) strategies, which link our traditional preferred channel and contract guarantor products with our collection services. In our initial discussions with schools, it has been positive. They are certainly strong links between student loan originations and collections on school campuses. Finally, I am pleased to report to all of you that we are effectively managing our operating expenses. Our operating expenses for the first quarter totaled 161 million dollars, a decrease of approximately 9 million dollars from our prior quarter operating expenses of 170 million dollars. This decrease reflects our continued integration activities and it does include the new expenses associated with the recent acquisition of both General Revenue Corporation and Pioneer, which were not part of our fourth quarter operating costs.

In summary, we continue to execute on our business plan with measurable success. We are excited about the results for the quarter and the momentum that we are taking into the next quarter. We anticipate the financing for higher education that will continue to play a critical role as Americans look to fulfill their educational dreams. Although college is getting more expensive, we are experiencing record college enrollments. Students and families do understand the value of college education and naturally, they are looking to take advantage of the federal-aid and loan programs and we are certainly poised and ready for the upcoming academic year.

And now let me turn the discussion over to Jack F. Remondi, our Chief Financial Officer.

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

Thanks Tim. I would like to start today by discussing into more deeply of some of the financial highlights of the quarter and recognize that another solid quarter of growth for the company.

We continued to meet our expectations with respect to loan growth, fee-based income, and operating efficiency, which combined to drive our profitability. For the quarter, core cash basis earnings per share increased 25 percent over the year-ago quarter to 1 dollar and 5 cents. Core cash basis net interest income equaled 334 million dollars for the quarter compared to 96 million dollars for the year-ago quarter. The 13 percent increase driven by 6 percent increase in the average managed student loans and a basis point increase in the student loan spread. Net interest income decreased from the fourth quarter of 2001 due principally to the fewer number of days in the first quarter. The increased in our student loans spread from the first quarter of 2001 in the stability from the fourth quarter is the result of the financing activities in 2001 and 2002. It took advantage of favorable market conditions that generated both long- and short-term improvements in the student loans spread. Going forward, we still expect the student loan spread to remain stable in the mid 180s. For the quarter, loan originations throughout the preferred channel totaled 3.8 billion dollars, a 23 percent increase over the same quarter last year. During the quarter, we purchased 4.5 billion dollars in student loans, an 18 percent increase over the year-ago quarter. Other income for the first quarter equaled 121 million dollars compared to 112 million dollars in the year-ago period and 111 million dollars in the previous quarter. The increase from the prior quarter was primarily due to growth in the guarantor services operations and in particular, the collections business. Offsetting these factors were several items including the decrease in other income from the sale of our Student Information Software business. Operating expenses for the quarter were 161 million dollars compared to 170 million dollars in the prior quarter. The decrease in operating expenses for the quarter was due in part to the sale of our Student Information Software operations, our continuing commitment to improve operating efficiency, and seasonal factors. This reduction occurred despite the increase in operating expenses associated with our acquisitions in the collections business.

During the quarter, the company purchased 200,000 shares net of option-related activity in issuance related to acquisitions. At 03/31/2002, equity forward purchase commitments totaled 9.7 million shares at an average price of 75 dollars and 54 cents. During the quarter, the company earned 129 million dollars in p o o r (ph) income net of hedging costs. Of this, 33 million dollars was used to repurchase existing hedge transactions and the balance was retained to build capital. As we have pointed out in the past, p o o r (ph) income is real cash income, however, since it varies with interest rate cycles, we excluded it from our core cash basis earnings.

We continue to anticipate that income will total roughly 240 million dollars for the first half of the year. As we stated inJanuary our plan in 2002 was to retain poor income and reduce share repurchase activity in order to build capital more rapidly. At March 31st total equity was 1.9 billion an increase of 282 million over year-end.

In addition company's tangible capital increased to 1.7 percent of managed assets versus 1.4 percent at year-end. At March 31st, 94 percent of managed student loans were federally guaranteed. Due to the guaranteed nature of these assets, credit losses are .

For the first quarter net charge-offs were 5.2 million or an annualized 0.03 percent of the average managed federal student loan portfolio or three basis points. At March 31st our private non-insured loan portfolio totaled 5.1 billion dollars. In the first quarter net charge-offs for the private loan portfolio equaled 12.2 million dollars or an annualized 1.7 percent of the non-federally insured portfolio when repayment. At March 31st our total allowance for the loan losses were equal to 2.6 percent of the managed student loan portfolio. The allowance allocated for the private loan portfolio was 4.3 percent.

Most importantly, the credit performance of our federal and private loan portfolios continues to meet our expectations. We continue to make progress towards the wind down of the G S C (ph) in 2006. Towards this goal we securitized 3.5 billion dollars in student loans towards this goal, in issue of 1.6 billion dollars in term holding company debt. This includes 850 million of five year fixed rate debt issued on April 3rd.

This last transaction was significant for a variety of reasons. First, the maturity date of the bonds extended past the anticipated wind down date of the G S C (ph) , our first such issuance. The second, the deal was extremely well received by investors. The high quality of our assets along with the predictable growth in our earnings continues to attract investors divest their interest in both securitization and holding company securities' offerings.

On a GAAP basis, earnings for the first quarter were 422 million dollars or 2 dollars and 63 cents per share. This compares to the 30 million dollars or 16 cents per share in the first quarter of 2001. Included in these results is an SFAS 133 mark-to-market gain of 288 million in the first quarter of 2002, and a mark-to-market loss of 168 milion in the first quarter of 2001.

These 133 results are driven by the mark-to-market derivative contracts that provided economic hedge of embedded interest rate options in the student loan portfolio. These embedded options are however not commited to the value or earnings under SFAS 133. If this embedded options were valued in the respective quarters the gain and loss would have been offset.

In conclusion we are extremely pleased with the first quarter results and excited about the opportunitites for the balance of the year. We remain comfortable with consensus estimates for the second quarter and the remainder of 2002.

As our results continue to demonstrate continued emphasis on our campus-based strategy integrating our fee-based initiatives and focusing on efficiency will generate solid predictable earnings per share growth.

This concludes our prepared remarks and will now open the line for questions.

Operator

At this time I would like to remind everyone, in order to ask a question, please press star, then the number one on your telephone key pad. We will pause just a moment to compile the Q&A r o s t e r (ph) .

Your first question comes from Mark Alpert - Deutsche Banc Alex. Brown Inc.

QUESTIONS AND ANSWERS

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

Hai, good afternoon. On the consolidation loans, can you just discuss the economics of the consolidation loans versus the regular student loans? In other words, the 105 basis points fee (Phoentic) versus 30 and then what is the yield? And is the 105 basis points expensed immediately or is that amortized over the life of the loan?

Unidentified

On the economic side of the equation, consolidation loans do have different terms to the lender than to Stafford loans. In today's rate environment and the interest rate set on consolidation loans through June 30th, the economic had spin on spread is equivalent to what we would earn on

Stafford loans. So, there is really no net with all the items that you mentioned, we are about even. The 105 basis points that you mentioned is an annualized fee that is paid each quarter to the Department of Education on outstanding consolidation loans. On a post July 1st basis, we would expect that based on current interest rate environment and other issues affecting these loans that the economics difference between a Stafford loan and a consolidation loan would be in the 30 basis point range (negative).

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

How did you get the 30 basis points?

Unidentified

There are a variety of factors that come into that. I think we can probably describe those off line in more detail, because there is also more than half a dozen items.

MARK ALPERT - *DEUTSCHE BANC ALEX. BROWN INC.*

Okay

Operator

Your next question comes from Steven Iceman (ph) - .

STEVEN ICEMAN

Hai, the guarantee collection revenue item, what was the component guarantee collection and to compete you just bought new. What are your expectations for the collection fee revenue item over the next six months?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

This is Kim. I think the guidance we gave on the last quarter on the collection companies that we acquired that are looking to have those new collection companies there at least six to sevent cents into our earnings per share and with some efficiencies internally, we are probably going to get another two pennies out of that for those two operating units, Pioneer and GRC (ph). In the 79 million dollars of guarantor services and collections in total, approximately 55 percent of that is just into collection business itself and that breaks down that 79 million for you.

STEVEN ICEMAN

Okay, thank you. I just explain, given that you bought these companies, how was it that the operating expenses went down? You got revenue combine the company and net expenses are down sequentially, which seems to be a bit odd?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

Well we did benefit from the face out of of Salle Mae solutions, which were in our operating expense numbers both in quarter four and first quarter of 2001. Coupled by the fact that some of the efficiencies that we were expecting out of integration, which were trailing in quarter three and quarter four and if we recall days, we had just a robust quarter three of new origination volume that did slow down some of the efficiencies we are looking to do in our servicing centers. We are on a low right now and the seasonality of both reduced labor because we are in for the loss (ph) period for new originations. This is probably the softest quarter for our servicing centers. That certainly assisted along with some of the technology assistance. This finally started taking place in late December or early January. We didn't get the entire impact in fourth quarter as we only received maybe one-quarter value in quarter four. We received three months' value in the first quarter of 2002. The efficiencies, which we were expecting and anticipating, we probably were about four or five months behind (indiscernible) of getting those costs reduced to 2001 and they came in very neatly in first quarter of 2002.

STEVEN ICEMAN

Okay, thank you.

Operator

Your next question is from Howard Shapiro - Goldman, Sachs & Company.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Hi, yeah, two questions please. I know you addressed this issue in last quarter's call but I want you to just refresh us. As you continue to securitize loans, your actual capital need to decline, but yet you are planning to build capital. Can you just with us about some of the uses of this capital that you anticipate? And Jack just a question for you. Kind of based on what you are saying with the 30 basis point net cost, if everybody who is eligible to consolidate tomorrow, what would the impact on earnings be to your best estimate?

Thanks

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

On the first side on our capital issue, we look at our capital requirements. We are really looking at that as a percentage of our managed assets, which do take into account, both securitized loans as well as loans that are on balance sheet. When we look at where we stand today, we are principally trying to drive that ratio up pretty close to where we are right now. In my prepared remarks, I had indicated that our tangible capital ratio had improved from 1.4 percent at year-end to 1.7 percent. We started some growth that will take place in that ratio in the balance of 2002, but we were really able to capture a good part of that in 1Q02 due to the retention of poor income on that side. This has become a more important issue for us as we begin to wind down at the GSE and principally as we begin to issue debt at the holding company level, although, it certainly points you towards 850 million dollars deal we did in April as an example of the strong investor reception we would have initially in debt securities principally driven by the quality of our assets. On the consolidation side of the equation, the numbers here, we know that portfolio of Stafford loans that's close to 40 billion dollars in size. The level of consolidation activity that takes place is a far smaller percentage of that overall volume. It has been and we would certainly expect that to continue. On 07/01/02, although the interest rate will decline for our new consolidation loans and it is also important to recognize that the interest rates for Stafford loans will also decline. Based on current rates, they will both decline to 4.2 percent. So borrower who does nothing captures the lower interest rate benefit for the next 12 months. I think that capturing of that benefit will help us demand for consolidation activity. The other thing to be remembered is that once they get consolidated, they cannot consolidate again. So, it's a one-time kind of opportunity. I would mention on this is that When a borrower does consolidate, their repayment term extends and most people with an installment debt don't end up repaying loans and so the net interest cost that a student could end up paying over the life of the loan could actually be more expensive proposition (ph) for them that if they just stay in the Stafford category.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Okay and thank you. If I can squeeze one more clarification and Kim, I think, you said half of the 79 million dollars in guarantor fee income was from the collection business. In your press release, you mentioned 12 million dollars on Pioneer and GRC. Did you already own some other collection businesses?

Unidentified

This is Howard, correct? When we went through the acquisition of the USA group, they had in place a company Education Default Services Inc., (E D S I) (ph) , which was their collection company that they had extended two years earlier and they were actually the master servicer for the USA funds collection services, which they service and collect close to 4 billion dollars of defaulted loans from USA funds. That was already a part of the build up of the collection businesses that were furthering along today.

HOWARD SHAPIRO - *GOLDMAN, SACHS & COMPANY*

Okay. Great. Thanks.

Unidentified

You are welcome.

Operator

Your next question comes from Michael R. Hughes - Merrill Lynch & Co., Inc.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

Thank you. On the other income, the non-guarantor fee income, it looks like there was a pretty good drop off there. I know the software company came out of that, but I don't imagine that given the selling price that was big . I was wondering if you could what else is in there and what might have caused the drop if there was indeed a drop?

Unidentified

The revenue actually wasn't as small as the profit margin on that business. So, definitely it was a fairly significant item. We also sold off a small interest we had in a Canadian student loan service company that generated revenues as well and then there is some other one-time items that really took place in 1Q01 and it's just the elimination of those items coming through or showing up in the comparison.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

So, is that 41.5 a relatively clean number now therefore?

Unidentified

I would expect that that is a relatively clean number though it probably will trend upward over the balance of 2002.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

And there is some seasonal good things or h i k e r (ph) in 1Q02? Is there not?

Unidentified

There are some seasonal items that take place on the guarantor services side and the insurance side of the equation based on when terms of repayment and flow back and it comes in 3Q02 vs. 1Q02.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

So it is more in 3Q02 and 1Q02, 2Q02, and 4Q02 are more equal. Is it?

Unidentified

Yes.

MICHAEL R. HUGHES - *MERRILL LYNCH & CO., INC*

Okay. Thank you.

Operator

Your next question comes from Peter Montego (ph) - Tudor Investment (ph)

PETER MONTEGO - *TUDOR INVESTMENT*

Good afternoon. Thank you all for your time. On the capital issue debt, since you are at or approximately near the targeted 17 as a percentage of managed assets level in tangible basis, would it be reasonable to expect not withstanding the acceleration of the wind down? Would it be reasonable to expect share repurchase activity to a sort of re-accelerate in the back half of the year or is that not a reasonable assumption in light of the profitable loan growth opportunity presented by the potential increase in the student loan effects (ph) next year?

Unidentified

We would expect that this 2.5 percent share repurchase level that we guided to in the fourth quarter conference call will continue for the balance of 2002 and that repurchase activity would return to more historically normal levels in 2003. So I don't think you would gain acceleration in the balance of this year.

PETER MONTEGO - *TUDOR INVESTMENT*

And am I right that this 17 (ph) tangible capital managed assets is sort of in your mind the optimal level and the level that you are going to manage to going forward?

Unidentified

What we were trying to accomplish here is that the company first of all has generated significant amount of capital each year based on its return on equity, a good portion of which we have always retained to build capital on an absolute dollar basis YoverY with the balance sheet. We managed that as the company grows. Those would continue. During the time frame that we have been a buyer of our stock with a 5 percent levels, our tangible capital ratios also were improving and I would expect to see that in 2003, if we were to return to 5 percent levels our tangible capital ratios would continue to improve to set a slower pace.

PETER MONTEGO - *TUDOR INVESTMENT*

Got it. Thank you.

Operator

Your next question comes from Gary Gorden - UBS Warburg

GARY GORDEN - *UBS WARBURG*

Okay. Thanks. Two questions. One, Jack you mentioned that you had buybacks some of the contracts. What is the economics of this and how does this affect the earnings going forward? If I could ask Kim (ph) i0n light of the news that Fleet (ph) looks like to trying to exit the servicing business, what sort of changes if any in competition, from your bank competitors if you have seen over the last year or two?

Unidentified

On the first part Gary, the 33 million dollars we spent for buyback hedges. We are buying back a variety of hedges just four contracts. That income typically would be earned back into earnings over five year period of time.

GARY GORDEN - *UBS WARBURG*

Okay.

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

And Gary if I can answer your question on the Fleet's (ph), perhaps change of appetite for some of the non-core businesses in the education, finance is one. We have not seen much of Fleet in the market that we are operating in. Their business is not growing in education and finance. Our competitors remain to be the direct loan program. They seem to still want to stay in the business. Fleet has kept their presence mostly in the New England. We have been able to compete aggressively in the New England as we have in all the other markets in the US and we are not surprised by the news that we have read and you have read together. We are just anxious to continue with our growth in competing against all those lenders in the stock (ph) marketplace. It's not surprising and they haven't posed a threat to us in the markets we have been competing with today.

GARY GORDEN - *UBS WARBURG*

Okay. Thank you.

Operator

Your next question comes from Bruce Harting - Lehman Brothers, Inc.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

I am just following on Gary's and you know is this prescarcity will see more of this bank exiting. And another question was could you just comment on the government direct lending program in the schools that you mentioned that you acquired in the beginning of the call? Can you give us any feedback that you hear in the marketplace about the satisfaction and dissatisfaction on those market share gains?

Unidentified

Let me just quickly comment on F l e e t (ph) or other in the program. We are not sure that certain F l e e t (ph) is exiting the business. I know they had an article regarding selling some of their service contracts, one with a direct loan program, but we didn't read into that they were really departing from the program. We know that A m e x (ph) departed last year. We also know as information is visible but there are less private sector players in the program today than they were perhaps ten years ago. Now withstanding that those who are standing in are making a c o n c e r t e d (ph) effort of right value and levels of service to keep the program at a level of expectation and performance about the direct loan program. On the direct loan program in the schools, we are both entertaining and winning on. There is no question that technology plays a vital role in the school choice of both leading the direct loan program to go back to . In addition to the other values that they receive from the platforms that we have invested on in our servicing centers, which is both helping and assisting both the parents and the students through their faster processes or their application of processing. We are very pleased with what we have entertained to-date and both having 71 schools move over to over the last three years, we also have an inventory of 20-30 schools that were entertaining today, who are next driving to 2002 and 2003. What we hear from the direct lending schools is that there is no longer seems or appears to be a threat that they have to stay in the program. I think that they realized that the options they have are one to look at the program today and they will be making their choice based on what value they are going to get out of the private sector vs. what they are staying in the government loan program. It is a fairly simple equation and I think we are not experiencing the same imposing threats of behavior perhaps what we saw two or three years earlier.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

Do you have the latest market share number for the direct program?

Unidentified

I believe the direct lending program represents about 29 percent of the total title for borrowings, which is a little over 11.5 billion dollars.

BRUCE HARTING - *LEHMAN BROTHERS, INC.*

Thanks.

Operator

Your next question comes from Roger L i s t e r (ph) - Morgan Stanley Dean Witter & Co.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

Thank you. Even the consolidation and low rates, what's happening to the prepayment fees in the securitizations? How is that holding up against your typical 7 percent assumption?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

This is Jack. The data on each of the securitization transaction is actually published on our website for each individual unit. The prepayment u n i t (ph) varies depending upon the characteristics of the underlying loans and they are in the stage of repayment versus in schools' statistics. It can vary significantly from Quarter to Quarter. At this stage of the game, we haven't seen any significant issues in that front, no long-term trends in that particular area.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

And maybe on a different topic in terms of the non-Federal Government lending, are you seeing the delinquency performance? Are there signs of any improvement with the economy starting to show signs of recovery?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

On that portfolio, the delinquency rates on the private non-Federal insured loan portfolio have actually declined each month of this year, which is historically a seasonal high of delinquencies for consumer credit is in first quarter of the year. We have actually seen them drop off since December. So, very nice performance in that area. As I said earlier, the credit performance of both the Federal and private portfolio is right in line with what we would have expected.

ROGER LISTER - *MORGAN STANLEY DEAN WITTER & CO.*

So, your outlook going forward continues to be pretty favorable. Are you looking to take some advantage of that going forward?

JACK F. REMONDI - *USA Education Earnings - EXECUTIVE VICE PRESIDENT*

Yes.

Operator

Your next question comes from Chip Roui (ph) - Slope Wiseman (ph).

CHIP ROUI - *SLOPE WISEMAN (PHONETIC)*

Hai, I was wondering if you could briefly talk about the eventual pacing of the 529 plans and the impact on any reduced loan activity would be over the longer term?

CHIP ROUI - *SLOPE WISEMAN (PHONETIC)*

Okay. Thank you.

Operator

Your next question comes from Mat Snowling (ph) - Friedman, Billings, Ramsey & Co. Inc.

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

Can you comment on the threat (ph) you are seeing from some of these new consolidators or vendors in the market? Does that threat diminish once the rate is re-set in July?

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

So I am just clear though.

MAT SNOWLING - *FRIEDMAN, BILLINGS, RAMSEY & CO. INC.*

July, is that due to the increased potential?

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

Yes.

Operator

At this time I would like to remind everyone in order to ask a question please press star and then the number one on your telephone key pad. At this time there are no further questions.

THOMAS J. FITZPATRICK - *USA Education Earnings - PRESIDENT & CHIEF OPERATING OFFICER*

That will conclude the call and thank you very much.

Operator

Thank you for participating in today's conference call. This call will be available for replay beginning at 3 PM Eastern standard time today through 11:59 PM Eastern standard time.

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MEG - Q1 2002 Media General Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 3:00PM GMT

CORPORATE PARTICIPANTS

Luanne Nabhan (ph) *Media General - Vice President, Corporate Communications*

J. Stewart Bryan (ph) *Media General - Chairman and Chief Executive Officer*

Michael Morton (ph) *Media General - Vice President and Chief Financial Officer*

Reid Ashe (ph) *Media General - President and Chief Operating Officer*

CONFERENCE CALL PARTICIPANTS

Ed Aturrino (ph) *Dressinger Klinesworth*

Mario Gabelley (ph) *Gabelley & Company*

Charlie Carter (ph) *Credit Suisse First Boston*

Chuck Wittmer (ph) *Eagle Capital Partners*

Ellen Gibbs (ph) *CRI Partners*

PRESENTATION

Operator

Please stand by. We're about to begin. Good morning ladies and gentlemen and welcome to Media General's First Quarter Conference Call. I would like to remind all participants that this call is being recorded and that a replay will be available approximately two hours upon the conclusion of the call.

All participants will be on a listen-only mode during the presentation portion of the call, which will be followed then opportunities to ask questions by pressing star, one, on your touch-tone phone. Again, star, one, if you would like to ask a question.

At this time I would like to turn the conference over to Ms. Luanne Nabhan, Media General's Vice President of Corporate Communications. Please go ahead ma'am.

Luanne Nabhan - *Media General - Vice President, Corporate Communications*

Thank you A b e (ph) . Good morning everyone. Welcome to our conference call and Webcast. Media General issued two news releases this morning. One announced first quarter earnings, the other March revenues. Both have been posted to our Web site if you need copies.

Our speakers today will be Stewart Bryan, Chairman and Chief Executive Officer, Marshall Morton, Vice Chairman and Chief Financial Officer, and Reid Ashe, President and Chief Operating Officer. Their comments will be posted to our Web site immediately following this call.

Today's presentation does contain forward-looking statements. These are subject to various risks and uncertainties and should be understood in the context of the company's publicly available reports filed with the SEC. Media General's future performance could differ materially from its current expectations.

At this time, I'll turn it over to Stewart.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Thank you Luanne and good morning ladies and gentlemen and thank you for your interest in our company and its first quarter performance.

For the first three months of this year, Media General earned 26 cents a share before a one-time charge to account for the impairment of certain intangible assets in accordance with a new accounting standard. We're very pleased with the performance of our operating units. The results there are significantly better than we anticipated at the start of the year and we will discuss that in more detail in a moment.

Several items other than core operations contributed to our net income before the charge. Acquisition intangible amortization was $12 million less than last year. Interest expense was down about a half million dollars. These two benefits in turn were offset by the under-performance of our investments in the Denver Post and SP Newsprint.

Equity income from our 20 percent interest in the Denver Post was down $5.3 million from last year. This decrease was mostly because in '01s first quarter, we had the benefit of a one-time gain from the startup of the JOA.

In addition, our one-third interest in SP Newsprint contributed $7.7 million less than it did in last year's first quarter, almost entirely because of low newsprint prices. While revenue in our three divisions was a mixed bag, all three of them performed very well. Our publishing division profit, not including Denver, was almost $1 million better than last year's first quarter. That increase is attributable entirely to strong cost management.

The broadcast division's profit exceeded last year by $3.7 million, the result of higher than expected revenues and good cost management. Our interactive media division also performed better than last year for two reasons, lower equity investment losses and new revenue initiatives. Broadcast time sales for the quarter increased $4.2 million.

We realized $3.4 million more in billings from strong Olympics advertising on our five NBC stations. In fact, olympic billings doubled our forecast.

We believe this higher spending was a combination of two things, strong patriotism and advertiser response to a rebound in the economy. We have also seen an overall strengthening in many important broadcast categories, particularly automotive, which was 17 percent ahead of last year for the quarter.

We continue to outpace the national averages for time sales. Through February of this year, the TB Bureau reports an increase in industry time sales of 5.4 percent. Our stations increase during the same time was 8.9 percent.

We believe this better-than-peer performance reflects three qualities: (1) our ability to effectively manage and price our spot inventory; (2) a strong national rep effort in our dedicated offices in New York and Atlanta; and (3) our success in developing new business and garnering higher shares from existing clients in our markets.

We do continue to see broadcast advertisers place their orders unusually late, compared to past practices, which makes forecasting challenging and more difficult. While publishing division revenues were below last year's first quarter, the declines in February and March were some of the smallest of the previous 12 months, at 3.5 percent and 3.7 percent, respectively. The first quarter of this year was certainly better directionally than the fourth quarter of last year.

Classified advertising is still down from '01, mostly because of continued weakness in the employment category. Improved automotive linage partially offset this and retail revenue has been trending up, although we see some advertisers continuing to hold back schedules in some markets. We got an unexpected boost in national revenue from ads placed in Tampa related to the proxy battle over Hewlett-Packard's merger with Compaq.

On the cost side, strong expense management company-wide enhanced our profits in the first quarter. Publishing division expenses were eight percent lower than last year and broadcast division expenses were about one percent lower. Total operating expenses were three percent below last year, and we held corporate expense even.

Overall, we continue to have about five percent fewer employees than we did at the end of the year 2000, when we began our cost reduction and containment program in response to the advertising downturn. And I might say we are pleased that we have not had to resort to any layoffs in the downturn.

Let me now ask Marshall to discuss further details around financial performance.

Michael Morton - *Media General - Vice President and Chief Financial Officer*

Thank you Stewart. My comments will focus on our results for the quarter compared to last year's first quarter.

I'd like to begin by noting that we've expanded the format of our earnings press release tables. We are now providing a GAAP income statement supplemented by detailed segment data. This is in response to questions from investors, particularly about EBITDA and segment cash flow. We hope this fuller approach will better meet your needs. Please let us know.

Starting with our publishing segment, total revenues decreased six percent. Many advertisers remain cautious about the size of the schedules they're buying. Classified revenues declined 12 percent, mostly from weak employment advertising. Employment linage in Richmond, Tampa and Winston-Salem was down 36, 40 and 48 percent, respectively. Increases in automotive and real estate in some markets partially offset the impact.

Retail advertising decreased three percent. A strong ROP schedule in our metro papers by Eckerd partially offset the decline. In addition, to give you some perspective, last year the Tampa Tribune had significant dollars from Super Bowl advertising.

National advertising increased seven percent, with gains in the telecom, financial and automotive categories. Preprints were about even with last year. Circulation revenue declined two percent, excluding the effect of the conversion to independent contractors in Tampa. Last year, the Tampa Tribune sold 100,000 copies related to the Super Bowl.

Total operating expenses for the publishing division declined eight percent and more than offset lower revenues. Salary expense was down two percent, while benefit costs were up about 10 percent. Other spending was down 11 percent, due to a variety of cost cutting measures.

Newsprint expense decreased 28 percent. Consumption was down seven percent and newsprint prices were down 23 percent. Our average price per ton was $415 in this year's first quarter compared with $537 last year.

As a result of the outstanding expense management, publishing division profit, excluding Denver, was up 3.4 percent. The publishing segment results we report externally include the results of our 20 percent interest in the Denver Post. In this year's first quarter, we posted a $569 thousand loss from Denver, compared with income of 4.7 million in last year's first quarter. Most of last year's income was from a one-time gain related to the JOA conversion.

Publishing segment operating ash flow was up slightly. Now let's look at the broadcast division. Total revenues increased five and a half percent. Total time sales increased seven percent. Local revenues were up six percent. This reflected gains in the automotive, services, specialty store and grocery categories.

National revenues were up eight percent, mostly from WFLA, with strength in the automotive, corporate, telecommunications and entertainment categories. Political revenues increased $273 thousand. Total broadcast expenses were just under one percent lower than last year. Payroll was down slightly, while benefit costs increased.

Most of the revenue increase flowed through to the bottom line because of ongoing expense management. Segment profit increased 47 percent. Segment operating cash flow increased 26 percent, and the margin improved to 27 percent, compared to 22 percent in the first quarter of last year.

Now let's discuss the interactive media division. Total revenue of $2.6 million was 17 percent higher than last year. Classified revenue, our largest online category, increased 183 percent, mostly as a result of classified up-sells in several markets. While the segment showed a loss of $1 million, that performance was 40 percent better than last year, mostly from lower losses from equity subs.

Now let's focus on changes in consolidated, below-the-line items. Interest expense was four percent than in the first quarter of 2000, due to lower debt outstanding, offset slightly by a small rate increase. This year's investment loss at SP Newsprint contrasts sharply with last year's strong profitability and is due to lower newsprint selling prices.

Now last year we didn't get a lot of questions about why we're continuing our investment in SP, but understandably, we have been getting some lately with the downturn in newsprint pricing. Over the long term, SP has been a strong investment for us and we believe it will continue to be a strategic investment in the future. I'd like to highlight a few reasons.

Our number two machine in Dublin is the second most productive machine in the world, exceeded only by a much newer, wider machine in Germany. Our Dublin plant was designed to handle - to produce 1,300 tons a day. We're now running at 1,700 tons a day. These facts - both those last two facts have a dramatic impact on our costs.

Ranked against other machines that were put in service in the '90s as ours were, our number two machine outperforms them by 25 percent in productivity. A co-generation investment that we've currently got underway on the West Coast will have a dramatic impact on our costs.

West Coast energy costs are the largest cost difference between the two mills, West Coast and East Coast, and had those costs been identical, we would have had a break even performance for the southeast for the quarter.

We've just signed a very competitive six-year labor agreement with our unionized employees and all of this puts us in terrific position when more normal pricing returns.

Then moving on to other items, acquisition intangibles amortization was lower by $12 million, or 81 percent, due to the adoption of SFAS 142. For the first quarter of 2001, had the new rule been in effect, our pre-tax amortization expense would have been lower by the same amount. This translates to 37 cents per share after tax and you'll see approximately that same difference in each of our next three quarters.

In addition to eliminating a major portion of amortization, the adoption of SFAS 142 requires companies to reassess the value of existing good will and identified intangibles like FCC licenses on an annual basis to ensure that their value has not been impaired.

As a result of our initial impairment testing, Media General has written off some existing intangibles to reflect the lower level of cash flows currently being generated by some of our recently-acquired broadcast properties.

This is a cumulative accounting catch-up and will not be part of ongoing earnings. The charge was $126 million, or $5.47 per diluted share. Corporate expense was about the same level as last year. The largest components of the change in the other category were reductions in license fees from SP newsprint and the absence of a gain on the sale of land in the 2002 quarter.

The effective tax rate for the first quarter of '02 was 38 percent, compared with 41 percent for the first quarter of 2001. The reduction was largely attributable to the adoption of SFAS 142. EBITDA for the first quarter was $40 million, compared with $49 million in the 2001 period.

After-tax cash flow, that's income before the cumulative effect change plus depreciation and amortization, was $23 million, compared with $33 million from the same period of last year. Free cash flow, that's after-tax cash flow minus cap ex, was $12 million, compared with $23 million in the first quarter of '01.

Total capital spending in the first quarter was $10 million. By division, publishing spent just over a million dollars, broadcast, 8.7, Interactive Media, just over - just under $150 thousand, and corporate, $450 thousand. For the full year of 2001, we continue to expect capital spending of just under $60 million.

Debt at the end of the first quarter was $751 million and stood at 42 percent of total capital. Today, we're at $745 million.

Now I'll turn it over to Reid, who will provide more highlights from our operations.

Reid Ashe - *Media General - President and Chief Operating Officer*

Thanks Marshall. Let's begin by discussing two of the successful revenue growth initiatives that we have under way.

Those are sales across multiple media in the same market, and sales across multiple publications in our newspaper clusters. In both cases, we're leveraging our market knowledge and customer relationships, we're offering customers the convenience of one order and one bill, and we're giving our sale staff more things that they can sell.

Multi-media, or converged sales, began last year in Tampa, where we operate The Tampa Tribune, WFLA-TV and TBO.com. By selling multi-media advertising packages or simply encouraging advertisers to throw an additional medium into their mix, we estimate we gained about a two percent lift in total revenue last year. We expect that benefit to grow this year by about two-thirds.

In Tampa and five smaller markets, we can sell all three media. Everywhere that we operate a newspaper or a TV station, we have our traditional medium plus the Internet. Convergence sales outside Tampa are just beginning this year and the early results are encouraging.

We think the greatest short-term potential is in classified advertising on the Internet. Almost exactly a year ago, we began offering classified advertisers in The Tampa Tribune the option to add TBO.com at a small additional fee. Eighty-five percent of advertisers opted in, producing 1.1 million in incremental revenue in the program's first nine months.

On March 7 of this year, we launched the same program in Richmond. Advertisers' participation rate here is running at 78 percent, rivaling Tampa's 85 percent. We expect to offer the Internet option at almost all of our newspapers by the end of this year.

The second major new revenue initiative is cross-selling in our newspaper clusters. The best example of this is in our North Carolina Community Newspaper cluster, where we launched the program last August, selling advertising across five daily newspapers and several other publications.

By the end of last year, we were generating about $100 thousand per month from these efforts. This has now risen to the range of 170 to 180 thousand per month. At this rate, our North Carolina group is enjoying about a five percent revenue lift from this new initiative, at virtually no additional cost.

We are now implementing cross-selling in all three of our Virginia newspaper clusters. Now because of the nature of these markets, we don't think they have quite the potential of our North Carolina cluster. Nevertheless, incremental revenue at negligible cost is a welcome thing.

Now let me comment on a few other significant operating matters. Our broadcast business, the Olympics, as expected, heavily influenced the February sweeps. Our NBC station in Tampa recorded the highest 6:00 p.m. news ratings of any station in the market in recent history, and one of the 10 highest ratings for 11:00 p.m. news of any NBC station in the country.

Because the Olympics had such a dramatic impact on the February sweep, the majority of media buyers aren't using it. Instead, we continue to rely on our strong November ratings and those have translated into revenue gains averaging eight percent this March compared to the same month last year.

Our broadcast business also will benefit this year from political advertising. Even with campaign finance reform, we still expect to have a good year. Significant political activity will occur in every state where we operate. There will be seven gubernatorial races, including Florida's, eight Senate races, and all congressional seats and various local elections.

Construction of the new building for our station in Charleston, South Carolina is complete now. Our news and technical departments are rehearsing with their new equipment and will move in right after the May ratings period ends. The rest of the staff moved in last weekend.

We are on track to meet the May deadline for digital television. We are at full power in Tampa, Spartanburg, Florence/Myrtle Beach and Charleston, and we will have full power in Birmingham later this year. All of our other stations will be at low power by May 1, except for our four satellite stations, which have a waiver until 2006.

By the end of this year, we will have invested $21 million in digital conversions, and we estimate we'll spend another 52 million over the next few years to get all stations to full power by 2006.

Now I'll hand it back to Stewart.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Thank you Reid. I've got a couple more comments before we move to the Q&A. Let me first update you on our view of the FCC's review of the newspaper broadcast cross-ownership rule. We were gratified to hear Chairman Powell say at the NAB meeting in Las Vegas last week that he expects to rule on the issue this year.

Media General is taking an active role in the process. We believe we have made a compelling presentation to the FCC, and we are pleased to have their interest. On April 22, we will host two FCC commissioners and other staff at our Tampa News Center. This follows a visit on January 19 by the FCC's chief economist.

It is very important, we think, for the Commission to see real-life convergence and the enhanced local news product that we're continuing to develop in Tampa. We remain hopeful that the Commission will make a decision by early autumn.

Next, let me discuss our expectations for the second quarter. Our near-term outlook is somewhat cautious for our publishing division. While we're pleased with the signs we've seen, it is too early to announce a trend.

In our broadcast business, we feel more confident that we are seeing a recovery for both local and national spot business in the majority of our markets. Broadcast sales for the second quarter are pacing 12 percent ahead of last year with the strongest month forecast to be June.

Our publishing division expects second quarter revenues to be about 1.5 percent below last year's same period, and the broadcast division expects an increase of about 8.5 percent. Analyst estimates for the second quarter currently range from 54 cents to 60 cents a share, and the consensus is 57 cents a share.]

We are comfortable with these estimates. For the full year, the analyst estimates range from $2.14 to $2.24 and we are comfortable with the lower end of that range.

I'd like to close by reminding everyone that our annual meeting will be held on May 24, here in Richmond. If your schedules permit, we'd be glad to have you attend. Also, we will be at the mid-year media review. Our presentation is on June 19 at 11:00 a.m. and we hope to see a lot of you there.

Well, that ladies and gentlemen, concludes our formal remarks and we'll be pleased to take your questions and hopefully we can answer them.

QUESTIONS AND ANSWERS

Operator

Thank you Mr. Bryan. Once again, to signal for a question, please press the star key followed by the digit one on your touch-tone phone. That's star one for questions. We'll pause for a moment to give everyone a chance to signal.

The first question will come from E d A t u r r i n o (ph) . He's with Dresdner Kleinwort.

Ed Aturrino - *Dressinger Klinesworth*

Good morning. Two questions. Did you discuss - would you discuss your cost trends, particularly in TV given the ramp up, it looks like a ramp up, in revenues? And do you want to give a guesstimate on how much political money might flow into your pockets this year, given the races, particularly in Florida and North Carolina?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well E d (ph) , let me just say in general that the cost trends are quite good across Media General and that is no different from what we expect throughout our three divisions. Political spending we forecasted this moment to reach just under $15 million for the year versus a little under $2 million last year.

It's going to be a very robust year as we pointed out to you. Now as far as on the cost trends, Marshall, can you - what - can you point at anything more about what I've said?

Michael Morton - *Media General - Vice President and Chief Financial Officer*

We're just pushing very hard on maintaining our costs. The margins in broadcast particularly have moved up ahead of our budget because of the stronger .

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

I would say this E d (ph) , and ask Reid to comment on it because we were in western Salem, Marshall, Reid and I, and Luanne, what Monday, Tuesday of this week, where we had a publishing division group meeting.

A very good meeting where we discuss things and Reid pointed out in a little informal talk at lunch that day about our approach to the employees that we are doing without at this moment, when we stopped hiring people in the fall of 2000.

And pointed out that while we've never said we've got a permanent reduction in these people, that we are looking at things in a different way. Now I didn't mean to - do you remember what you said?

Reid Ashe - *Media General - President and Chief Operating Officer*

Well, we just - we told people of the things we quit doing when we were forced to cut costs, we're not going to restore anything just because we used to do it. However, we invite people to present us with investment opportunities.

If they can - if they can present to us an investment that will increase the audience, and therefore revenue, then we will - and can give us a way to track it and measure it, then we will - we will welcome that and fund them to the extent that it seems prudent.

Ed Aturrino - *Dressinger Klinesworth*

Are you OK on the programming side? Do you have any syndication stuff popping up in the fall or is that pretty well set?

Michael Morton - *Media General - Vice President and Chief Financial Officer*

I would have to check on that for you. I'm not aware of anything that's going to - that's going to push our cost structure in a significantly different direction.

Ed Aturrino - *Dressinger Klinesworth*

Okie doke. Thanks very much.

Operator

Next question will come from Charlie Carter (ph). He's at Credit Suisse First Boston. Mr. Carter (ph), your line is open. Mr. Carter (ph)? He'll have to probably re-signal. We'll go to Mario Gabelley (ph), Gabelley & Company (ph).

Mario Gabelley - *Gabelley & Company*

I hadn't - Stewart and everyone, I hadn't listened in for a while. I've got to tell you, this is the best and it kind of makes in hog heaven in terms of listening to the way you handled the quarter, so I have to commend you.

Just to put a little meat and bones, a couple of things. How did the Denver Post actually do at their level at the EBITDA line or were there revenues Steward or if you can? As opposed to kind of - and secondly, just refresh for us some of what the arrangements are with regards to liquifying that asset?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well frankly Mario (ph), it's good to hear your voice, especially when you say something nice to us.

Mario Gabelley - *Gabelley & Company*

Oh Stewart, I tell you the way it is, not the way you want to hear it.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well, I do. I thank you very much and I know I'm speaking for Marshall and Reid and Luanne when you say that. I don't think I can give you operating results from the Denver Post.

I can say this, last year there was a one-time payment made in by the DW Scripps (ph) Company that is what allowed us to have a good performance there last year. I think it's safe to say that we are - we have not seen the improvements in the bottom line there that we anticipate seeing.

I would - I thought last year we would have seen them by the first quarter, but I know from talking to Dean (ph) and the other people there that they're very happy. The initial reluctance of advertisers to use both of their newspapers at increased advertising rates has been dissipating and they are feeling good about the future.

Marshall, what can you add that makes - added to that payment last year?

Reid Ashe - *Media General - President and Chief Operating Officer*

I think you've covered it. Now that we are only a 20 percent holder of the amount of the information we put in our own financial statement has diminished of course.

Mario Gabelley - *Gabelley & Company*

Yeah, no problem. We'll get it out of S c r i p p s (ph) .

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Yeah.

Mario Gabelley - *Gabelley & Company*

That's fine. Tell us about the exit strategy on that, if any? What the - just any changes in the ...

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

There are no - there are no changes in it. We have a formula M a r i o (ph) that starts taking effect year after next, where we have the ability to ask D e a n (ph) to buy us out and we have the ability to tell him we'd like to buy him out.

I can't remember without getting the document in front of me who goes first, but over the course of two years, it's a typical arrangement like this where we each get to pick someone to evaluate and those two get to pick a third one ...

Mario Gabelley - *Gabelley & Company*

Yeah. No problem. There are no changes in that Stewart?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

There's no change in that and it does - it goes from about '04 to '05.

Mario Gabelley - *Gabelley & Company*

OK. This is, I guess, for all three of you. Given where your stock is and given, you know, that it's getting closer to the hundred dollars plus that we put on the values, where are you in thinking about reducing your debt by selling some kind of an equity or something like that? We were very much in the forefront of asking you to buy stock back rather than making acquisitions and now we'd like to hear the other side of that.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well, the other side of it M a r i o (ph) , is we've stuck by the same course on that as well. We're waiting to see the FCC remove the cross ownership prohibition, which we think is going to happen. We think the record, it clearly supports the total removal of that prohibition.

At that time, we've never - we've said from the time we lost S p a r t a n (ph) that we're holding the five TV stations outside of the southeast as trading for future television stations that we might want to acquire in the southeast. I think we have to wait until autumn to see what the FCC has done and I think you will see a flurry of some activity as people attempt to make trades so that they can cluster their hard assets.

We think that is going to happen. We also continue to look at possible newspaper acquisitions in the southeast. There are not that many available now, but I think we're aware of what might be available in conversations with people and are well known by those people. Marshall, what would you ...

Michael Morton - *Media General - Vice President and Chief Financial Officer*

Just on the part of availability M a r i o (ph) , we've got the shelf offering available as well as the unused credit agreement money, so we're ready to go when we see something that would generate a need.

Mario Gabelley - *Gabelley & Company*

Well, again, you know, looking at what the value of your enterprise, we're delighted you faced the reality and wrote off some of the high costs of the acquisitions and keeping it powder dry makes sense. Thank you.

Reid Ashe - *Media General - President and Chief Operating Officer*

Thank you.

Operator

We'll now try again with C h a r l i e C a r t e r (ph) at Credit Suisse First Boston.

Charlie Carter - *Credit Suisse First Boston*

Hi. This is C h a r l i e C a r t e r (ph) filling in for B i l l (ph) . I apologize for the, I guess, the technical issues that we had earlier, but the question was, and I apologize if this has already been asked, is you all had, I guess, said that broadcast revenues would be up north of eight percent in Q2.

And also, you know, some of your peers and you all alluded to as well, that a lot of near airtime buying still is the case for most, I guess on the print side and on the broadcast side, so is there any other commentary or color you can add to, I guess, your competence and I guess strong pacings going forward in the second quarter?

And then also, a question on the political, you know, it's been better than expected so far in the year and just any other, you know, anecdotal, I guess, commentary on where you think that's going to go. OK. Thanks.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

C h a r l i e (ph) , let me take a try at it and I'm sure Reid can fit in more, but the political, there hasn't been much political activity thus far. I mean, that's going to come later this year. But as far as what we're doing to - in our broadcast division, where we're outperforming our peers, basically is both national and local, but I think it's - the local is where we have our own initiatives, which we are employing across the board.

Automotive has come back quite strongly from a national standpoint in broadcast and the Olympics, as we told you, were double what we had forecast that revenue to be. Reid, can you talk about any particular initiatives that might give a flavor?

Reid Ashe - *Media General - President and Chief Operating Officer*

Well, I think the big story is threefold that our broadcast division has grown rapidly by acquisition and has worked very hard to improve the stations acquired. And an important thing right now is we're reaping the benefits of investments we've made in the past and increasing the ratings, increasing the audience and giving our sales people more gross routing points that they can sell.

They also - we also think they're managing their inventory better. They have changed their national representation structure to a more effective form, so just a variety of things coming together there. Yes, you're right. Newspapers have always sold at the last minute. You never know until Wednesday what your Sunday paper is going to look like.

And television is - has been moving in that direction to adjust more just in times where we think - a couple of months ago, we were worried about second quarter broadcast revenue, but the closer we get to it, the better it looks. And now we're able to forecast a nice gain.

The flip side of that is that we have more than usual uncertainty about the second half. But with trends - but we're sort of - we have some faith in the trends.

Charlie Carter - *Credit Suisse First Boston*

OK. Thank you.

Operator

We'll now go to C h u c k W i t t m e r (ph) . He's with E a g l e C a p i t a l P a r t n e r s (ph) .

Chuck Wittmer - *Eagle Capital Partners*

Hi. Yes, I'd like to second M a r i o ' s (ph) comments. I think you're doing a good job in the self-operating environment. A few questions and I apologize. I know you already mentioned it. If you could just go over the cap ex by division?

And then I want to make sure I understood your debt pay down was 745, because I thought your target this quarter was like 764 and you only did 12 million of free cash flow. Could you go over what took your debt down to that level? And then also, if you could just give a little flavor in the publishing area on your advertising by the different categories?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

C h u c k (ph) , thank you for your comments. Marshall can address the first three parts of that cap ex, debt pay down and free cash flow and I know Reid can give you a bit of the flavor and I can enjoy the answers along with you.

Chuck Wittmer - *Eagle Capital Partners*

Thank you.

Michael Morton - *Media General - Vice President and Chief Financial Officer*

We're back down to 27 million in debt during the quarter C h u c k (ph) .

Chuck Wittmer - *Eagle Capital Partners*

How much?

Michael Morton - *Media General - Vice President and Chief Financial Officer*

And I think we had a mass problem with you the last call too where you were leaving something out and I just - I don't remember what that was, but we had 46 million of fund sources and only used 19 million.

Chuck Wittmer - *Eagle Capital Partners*

OK.

Michael Morton - *Media General - Vice President and Chief Financial Officer*

Cap ex was 10 in the quarter and dividends were four were the big pieces. I'll be glad to run over this with you afterwards, but in any event, we had 27 million of free cash in the quarter and then paid down a few more dollars after the end of it. Our cap ex in the quarter, I told you are around $10 million.

The biggest piece, the biggest one piece, was finishing up the NBC Station, new station in Charleston. That was over $3 million. Also, we spent another $2 million on digital conversion in the broadcast division. We bought some buildings and did some other things, but that - but the two biggest pieces were both in broadcasting.

We had a newsroom renovation in one of our - , in our i n a u d i b l e (ph) in Roanoke. The heavy, heavy spending was in broadcast, about $8 million of it.

Reid Ashe - *Media General - President and Chief Operating Officer*

You asked about newspaper categories. Classified was down 12 percent, retail down three percent and national, up seven percent. Pre-prints were flat and circulation revenue is down two percent after correcting for the carrier conversion in Tampa.

Chuck Wittmer - *Eagle Capital Partners*

OK. Thank you.

Operator

Once again, if you would like to ask a question, it's star one on your touch-tone phone. Star one to signal if you'd like to ask a question.

We'll now go to E l l e n G i b b s (ph) . She's with CRI Partners.

Ellen Gibbs - *CRI Partners*

Hi Mr. Stewart. Terrific results. I have two quick questions. One, on the newspaper side in publishing, what are you looking - what should we be looking for? What are you seeing in terms of some kind of turnaround? You seem a little less optimistic about that versus broadcast side.

And secondly, on the cross ownership, are there still a lot of talk about limits on markets? I mean, we haven't heard too much about that recently, but I just wondered if you're picking that up as you're talking to the FCC people? Fell off, yeah.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

You fell off a little on that FCC question and I didn't quite hear what it was, but think about it, and let me just speak to you on the newspaper side and then I'll ask you to repeat that question.

Ellen Gibbs - *CRI Partners*

OK.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

What we have said since last fall was we thought we had reached the bottom and we know now that we've reached the bottom and we've rattled along on that bottom and in this first quarter, we've seen some nice changes and changes and attitudes from retail and from classified with all categories except employment. And did I mis-speak that part Reid?

When I say all categories of classified except one, I think. Automotive has been especially nice, but that's been stronger in broadcast than newspaper. However, I think we've said this before. I don't ever anticipate classified coming back to the glory days of the '99, '98, '99 and 2000.

The anomaly is not what is going on now, the anomaly is what was going on then with all of the dot coms hiring, with unemployment, with economy booming and unemployment at the lowest phase, I think, since World War II. So I don't - I don't think we should be looking at employment linage as a measure here. I think we should be looking at it back around the in the early '90s, the late '80s, as being the norm.

But I think we're seeing a lot of good things happening in the mindset of people who place advertising. The one thing that is continuing to happen is that we are seeing consolidations in certain retail operations. We're seeing some failures in retail operations and we're going to see some more mergers and acquisitions and you can't - you can't do this, I mean you can't look at it from a national level or even a regional level.

You have to look at each individual marketplace and judge that one. But we feel good about it, but we're just not saying that it's - that we've seen the start of a trend for sure. Now what did you ask me on the FCC?

Ellen Gibbs - *CRI Partners*

There had been some talk earlier about limits, that would cut the - the restrictions would be lifted only up to certain level markets and that would penalize the smaller markets. There's been less talk of that now and I just wonder what you're hearing?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well, what we're hearing, of course as you know, there was - there is one announced, I think, hearing is the right word, that is going on before the FCC and it's been - it was announced last spring and early summer that they were going to hold a hearing on the cross ownership prohibition.

The other issues that had come up before the FCC since had been where courts have thrown back two of the decisions they made and said justify this or change it, those are on the other issues that are before them. We have always wanted them not to be clouded with all of these other issues, but to approach the cross ownership prohibition issue as a distinct case.

becoming somewhat muddied with these other things having been thrown back out. We had earlier thought based on statements by Chairman Powell and the other folks there that they would make a decision by early summer. Now it looks like it will be the fall.

They are - it is not a precise schedule that anybody's following, but we're very pleased with the fact that the Commissioners and their staff have come to see us in Tampa and to watch and see what we are doing. And it's not just the FCC Commissioners, we've had Congressmen and others come down there.

And I think it's fair to say that when they see what we're doing and they see that the quality of local journalism is improved by this process, they go away enlightened beyond the way they felt when they arrived. And so we're still optimistic that it will be removed across the board and that's what we think the record proves needs to be done.

Ellen Gibbs - *CRI Partners*

Thank you.

Michael Morton - *Media General - Vice President and Chief Financial Officer*

I think that was one thing on - going back to C h u c k W i t t m e r ' s (ph) question. C h u c k (ph) , I think the biggest difference in our numbers is that you're not looking at other balance sheet accounts, which will bring up substantial funds in the quarter and whereas always, the first quarter will free up a lot of accounts receivable, because they've run up strongly in December and then pay down during the first quarter.

That added $14 million to cash flow. So I think that to funds available so I think that's probably the biggest difference between your number and what actually happened to debt pay down.

Operator

Our next question is a follow-up. It comes from E d A t u r r i n o (ph) .

Ed Aturrino - *Dressinger Klinesworth*

Hi.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Yes sir.

Ed Aturrino - *Dressinger Klinesworth*

There's been a lot of political posturing about the FCC rules, haulings and and making a lot of noise, I guess. Those are quieted down. Do you think this might delay any actions on the part of Mr. Powell, post-election, maybe into 2003?

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

E d (ph) , there's certainly that danger and things certainly have slowed down there. But I mean the record is there, the record - if you read what has been put in front of the FCC, and I'm especially proud of our filings, but because I think that we have really spelled it out with actual examples of why the removal of the cross ownership prohibition is needed if strong local journalism is going to survive and prosper, especially in medium and small markets throughout this country.

It's not so much trying to protect individual voices in a community, it's trying to protect a voice or two voices in a community against national groups like - well, on AOL.com or Disney, Bill Gates, people who want to come in and take off certain amounts of things that can be nationally programmed and we just say that local journalism is going to suffer and that's where the competition is coming from and you need to make stronger - you need to make local players stronger so that they can fight national trends.

And so, again, could it be delayed further? Yes it could, but I can't predict what Washington agencies or congressmen do.

Ed Aturrino - *Dressinger Klinesworth*

Nobody can. I think it'll happen but it sounds like they're just getting into a little snit down there.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Yes.

Ed Aturrino - *Dressinger Klinesworth*

Thanks.

Operator

Mr. Bryan, we have no remaining questions. I'll turn it back to you for any closing comments, sir.

J. Stewart Bryan - *Media General - Chairman and Chief Executive Officer*

Well, thanks very much and ladies and gentlemen, thank you again for your interest in us and Luanne is eager to follow up with any questions that you all have that come to mind during the course of the day. Thank you very much and we'll see you soon. Bye.

Operator

Thank you. That does conclude our conference call. We do appreciate your participation. At this time, you may disconnect. Thank you.

THOMSON REUTERS STREETEVENTS

EDITED BRIEF

- Q1 2002 US Airways Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 5:00PM GMT

OVERVIEW:

US Airways Group reports $269m loss in 1Q02. Q&A focuses on cash balance, revenues, and unit costs.

CORPORATE PARTICIPANTS

Kimberly Holland (ph) *US Airways - Director of Investor Relations*

David Siegel *US Airways - President and CEO*

Neil Cohen *US Airways - Executive Vice President and CFO*

B. Ben Baldanza *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Al Krellen (ph) *US Airways Corporation*

CONFERENCE CALL PARTICIPANTS

Doug Lentay (ph) *Morgan Stanley Fixed Income Research*

Jim Higgins (ph) *Credit Suisse First Boston*

Glenn Engel (ph) *Goldman Sachs*

Gary Chase (ph) *Lehman Brothers*

Brian Harris (ph) *Salomon Smith Barney*

Kevin Murphy (ph) *Morgan Stanley*

Helene Becker (ph) *Buckingham Research Group*

Jamie Baker (ph) *JPMorgan*

Sam Buttrick (ph) *UBS Warburg*

OVERVIEW

US Airways Group reports $269m loss in 1Q02. Q&A focuses on cash balance, revenues, and unit costs.

PRESENTATION SUMMARY

I. OPERATIONAL OVERVIEW - DAVID SIEGEL

A. **Approximately 80% of the 144 airports the company serves is in Mississippi.**

B. **Topped the industry survey as a top rank network carrier for 2000 and No.2 overall in the airline quality ranking.**

C. **Significantly improved the performance in 1Q02 vs. 1Q01.**

D. **The company's losses reflect a weak economic environment, a significant drop in demand and yield resulting from the events of Sept. 11, and intense competition from low-cost carriers and regional jet operators from the East Coast.**

E. **US Airways must restructure to lower its unit costs, optimize the revenue potential of its East Coast presence, and improve its overall balance sheet position.**

II. FINANCIAL RESULTS - NEAL COHEN

A. **Reported a net loss of $269m for 1Q02 on a revenues of $1.7b compared to a net loss of $171m on revenues of $2.2b for 1Q01.**

B. **On a diluted per share basis, the net loss in 1Q02 amounted to $3.97 vs. $2.55 in 1Q01.**

C. **Results for 1Q02 included a tax benefit of $149m.**

D. **Recent economic stimulus by deflation enabled the company to recover additional federal income tax that was previously paid.**

E. **Recorded a full valuation allowance for book purposes in 2001, the company realized an additional book tax benefit in 1Q02.**

F. **In addition to the tax benefit, 1Q02 results included a $17m credit related to a change in accounting policy for engine maintenance at one of the company's express subsidiary.**

G. **1Q01 results included a $22m ($14m after-tax) impairment charge related to the early retirement of certain 737 -200 aircraft and a $7m after-tax credit resulting from US Airways' accounting adoption SFAS 133, Accounting for Derivative Instruments and Hedging Activities.**

H. **Excluding accounting changes in both years and the unusual item in 2001, the pretax loss for 1Q02 was $435m that equates to $6.42 per share and that is compared to a pretax loss of $248m that equates to $3.69 per share in 1Q01.**

I. **1Q02 revenue of $1.7b was down 24% from last year.**

J. **ASMs declined 19% while passenger unit revenues declined 11%.**

III. EXPENSES FOR 1Q02 - NEAL COHEN

A. **1Q02 operating expenses were $2.1b down 15% excluding the 2001 impairment charge.**

B. **Unit cost for the airline increased by 1% with 19% decline in ASM.**

C. **Commissions also declined substantially due to reduction in commission rate, lower sales, and favorable channel shift to the Internet.**

D. **Personnel costs were only down 5%.**

E. **While US airways' headcount has declined 23%, to 33,900 employees increased (Indiscernible) and benefit costs partly offset the cost savings of lower headcount.**

F. **Excluding fuel, unit costs increased by 6%.**

G. **In terms of fuel, fuel expense declined by $131m or 42%.**

H. **Hedged fuel consumption at a level that translated to a reported price of $0.68 per gallon including taxes.**

I. **Total balance sheet debt outstanding including capital lease obligation in 1Q02 was $3.7b.**

J. **The company's cash balance in 1Q02 was $561m.**

K. **On an operating basis, the company continues to consume cash in 1Q.**

L. **Operating cash flow for 1Q02 was negative $3.5m per day. Expecting operating cash flow for 2Q02 to turn positive and we view the company's cash position as stable.**

M. **The company is entering into a seasonal year when cash typically accumulates and anticipates improved cash position in the coming months.**

N. **The company's cash position has a one time benefit from a $169m tax refund received in April 2002.**

O. **There will be pressure on the company's cash position later in 3Q02 and 4Q02 without taking into account the restructuring plan.**

P. **The company retired to remaining 22 F-100 and 14 MD-80 that was announced last fall.**

Q. **The company also sold 97 surplus aircrafts and took delivery of four A-321 aircrafts.**

R. **At the end of the quarter, the company had an operating fleet of 310 aircrafts.**

S. **The company is scheduled to take delivery of five additional A-321 during the remainder of the year.**

T. **Secured financing on all of these aircrafts.**

IV. GUIDANCE FOR 2Q02 - NEAL COHEN

A. **Expects the company's capacity to be 20% lower on the YoverY basis.**

B. **Load factors to be up slightly and revenue per seat to be down 5-7%.**

C. **Unit costs including fuel are anticipated to increase 2-4% over 2Q01.**

D. **Hedged 45% of fuel that translates into a projected price per gallon for the hedged fuel at $0.64 including tax.**

E. **Additionally, the company has locked-in prices for approximately 24% of the projected needs in the 3Q at $0.68.**

F. **Unit costs excluding fuel are expected to increase 6-8% over 2Q01.**

V. FINANCIAL PERFORMANCE - (BEN BALDANZA)

A. **1Q02 mainline passenger revenue was $1.31b, 28% below 1Q01.**

B. **Traffic was down 16% while capacity dropped 19%.**

C. **Load factor of 68.5% was up 2.3 points YoverY and passenger yield was down 14% resulting in 11% decline in passenger revenue per available seat mile (ASM).**

D. **This unit revenue performances is disappointing given the reported decline of 7.6% in 1Q01.**

E. **The impacts of Sep. 11 on general demand but especially business demand, an increased competition from low-cost carriers and regional jet operators on the East Coast drove this unit revenue performance.**

F. **Throughout the quarter, passenger loads built steadily continuing the recovery from the events of last Sep.**

G. **Load factor was down 0.2 points in Jan., up 2.6 points in Feb., and up 4.6 points in Mar. to an all time record of 78%, helped by an early holiday.**

H. **Yield performance maintained a fairly steady 14% decline YoverY, resulting in a steady improvement in YoverY unit revenue from down 14.2% in Jan. to down 8.8% in March.**

I. **Bookings taken inside 7 days of travel were down approximately 20% YoverY in line with decreasing capacity.**

J. **Revenue build in the same window was down 36% indicating a 16% drop in yield.**

K. **Revenue for wholly owned and regional jet express operations was up 0.4% YoverY in 1Q02.**

L. **Revenue for wholly owned and regional jet express capacity was up 25% YoverY driven by a 47% increase in regional jet capacity while unit revenue fell 19%.**

M. **Ended 4Q01 with 67 regional jets in fleet and added the final three, allowed under the current agreement with the pilots on Feb. 3.**

N. **Total group cargo revenue in 1Q02 was down 28% YoverY due to significant reductions in domestic and Atlantic service as well as FAA restrictions on mail carriage.**

O. **Freight-related revenues were down 15% YoverY and mail was down 54% vs. 1Q01.**

P. **Domestic fleet RTMs were up 16% vs. 1Q01 while other US majors were down 8% YoverY.**

Q. **On the Atlantic, US Airways cargo RTMs were down 9% YoverY while other major US carriers were down 19%.**

R. **Online sales were 20% of total sales on the distribution front, up 7.3 points from 1Q01.**

S. **Sales on usairways.com were just under 9% of total sales and Internet agency sales reached 11%.**

T. **In March, usairways.com reached an all time high of over $17m in revenues for one week.**

U. **Travel agency penetration was 66% in 1Q02 down 4.5 points from 1Q01.**

V. **By the end of 1Q02, the company was serving 34 destinations with 76% of the previous departures and by the end of 2Q02 will be serving 2 more destinations with 83% of the previous departures.**

W. **Reinstating most of the transatlantic service, 1Q02 capacity was down 20% YoverY and capacity will be down about 16% in 2Q02.**

X. **Transatlantic unit revenue was up 4% YoverY and for the quarter.**

Y. **The company had the largest YoverY increase and load factor in the 1Q02, up 7.2 points to 74.5%.**

Z. **Caribbean destinations is currently under review with service potentially starting in 4Q02 and beyond.**

AA. **Expecting system capacity to be down about 20% YoverY in 2Q02.**

AB. **For the full year 2002, capacity will be down approximately 11%.**

AC. **Load factor for 2Q02 should be at least 2 points higher than last year; however, there is little evidence of improvement in the business travel picture and the adding back capacity at an increasing rate indicating that yields will continue to be under pressure.**

AD. **Low-cost carriers presence in the east of the Mississippi continues to grow with low-cost carriers accounting for 22% of the capacity within this region in 1Q02, up 4.5 points from 2001.**

AE. **US airways capacity share in this region has declined 2.4 points over the same period to 18%.**

VI. OPERATIONAL PERFORMANCE - ALAN CRELLIN

A. **Implemented a very focused airport monitoring system, adding additional lanes at security checkpoints in 16 airports to facilitate more efficient passenger screening.**

B. **The expansions at 8 airports have already been completed and expect work at the remaining 8 facilities to be completed shortly.**

C. **Reducing airport processing time for customers at the ticket counters by installing more sales service electronic ticketing kiosk throughout the system and have accelerated their deployment.**

D. **In the process of expanding kiosks at 25 more locations and will have 251 kiosks at 48 airports operating by early this summer.**

E. **Starting May, the company will expand flights between Philadelphia and 5 of the US airways key business destinations.**

QUESTIONS AND ANSWERS 1

Operator

Thank you. The floor is now open for questions. If you do have a question or a comment, please press one followed by four on your touch-tone telephone at this time. If at any point you find you question has been answered, you may remove yourself from the queue by pressing the pound key. Again, if you have a question or a comment, please press one followed by four on your touch-tone telephone at this time. Please hold while we poll for questions.

Thank you. Our first question is coming from Doug Lentay (ph) . Please state your affiliation.

Doug Lentay - *Morgan Stanley Fixed Income Research*

Yes, Doug Lentay (ph) , Morgan Stanley Fixed Income Research. A question on the cash balance? Can you tell us what percentage, if any, if that cash balance is restricted? And, whether the credit card companies have imposed any limitations?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Doug (ph) , this is Neil. The $561 million number I quote has no restricted cash.

Doug Lentay - *Morgan Stanley Fixed Income Research*

And then a follow-up on that. Does that cash balance include the cash proceeds from the sale of the 97 aircraft? And if so, what would the amount be, net of that sale proceeds?

Neil Cohen - *US Airways - Executive Vice President and CFO*

We sold - we're in the process of disposing of those aircraft. I think we disposed of a portion of them in the first quarter. I think it was about $25 million in first quarter proceeds associated with those aircraft.

Doug Lentay - *Morgan Stanley Fixed Income Research*

And what sort of remaining proceeds do you expect? A similar range of magnitude, 25 to $50 million perhaps?

Unidentified

You know I'll have to get back to you on that. I think it will be - as we go through and close those transactions, they'll be closed in April and May. And I would expect them to be probably in about the 25 to $50 million range in the second quarter.

Doug Lentay - *Morgan Stanley Fixed Income Research*

Great - thanks very much.

Operator

Thank you.

Our next question is coming from Jim Higgins (ph) . Please state your affiliation.

Jim Higgins - *Credit Suisse First Boston*

Yes, Jim Higgins (ph) with Credit Suisse First Boston.

Can you give us any update on your pilots' discussions regarding adding regional jets or at least any sense of timing when we might hear something?

David Siegel - *US Airways - President and CEO*

Sure, Jim (ph) , how are you doing?

Jim Higgins - *Credit Suisse First Boston*

Hi, Jerry (ph) , how are you?

David Siegel - *US Airways - President and CEO*

Good.

As you saw - oh, you thought it was Jerry (ph) , sorry.

Jim Higgins - *Credit Suisse First Boston*

Oh, I'm sorry. That's OK, go ahead.

David Siegel - *US Airways - President and CEO*

Dave Siegel, .

Jim Higgins - *Credit Suisse First Boston*

Oh, hi Dave, how are you?

David Siegel - *US Airways - President and CEO*

Good, thanks.

As you know, we've reached a tentative agreement on a mini deal for 7 0 (ph) aircraft.

Jim Higgins - *Credit Suisse First Boston*

Right.

David Siegel - *US Airways - President and CEO*

And we're going to hear one way or the other - I'd say the next 24, 48 hours on that issue.

Jim Higgins - *Credit Suisse First Boston*

OK.

And those aircraft - it's sort of hard to tell with what's been in the press so far - will they all be flown by P o t o m a c a i r (ph) ? Or is there some - or some of them may be, some of them may not? I mean how does that piece work?

David Siegel - *US Airways - President and CEO*

Yeah, we're evaluating now whether all or none or some will be flown in P o t o m a c a i r (ph) .

Jim Higgins - *Credit Suisse First Boston*

OK.

So it's zero to 100 percent is the range, then?

David Siegel - *US Airways - President and CEO*

Right. It's because of a variety of factors, aircraft availability and ability to get, you know, those deliveries within a reasonable timeframe. So we've got a window of opportunity we think to acquire and deploy aircraft, and we're going to look at, you know, some combination of inside and out. But it could range anywhere from zero to 100 percent.

Jim Higgins - *Credit Suisse First Boston*

Great - thank you very much.

Operator

Thank you.

Our next question is coming from Glenn Engel (ph) . Please state your affiliation.

Glenn Engel - *Goldman Sachs*

Glenn Engel (ph) , Goldman Sachs - good afternoon.

Unidentified

Hi Glenn (ph) .

Glenn Engel - *Goldman Sachs*

Can you talk about - both domestically and internationally there was - the last call you talked about alliances and all that and what your thinking is there?

Unidentified

Sure, Glenn (ph) , how are you doing?

Glenn Engel - *Goldman Sachs*

OK.

Unidentified

As you know, we've got a very powerful East Coast franchise. One that has caught the attention of international and domestic carriers alike. We are a very exciting unique piece of a puzzle to complete, a global network. And we continue to have discussions both with domestic partners, international partners. I'd say those discussions are progressing very well for the company.

I don't think we're prepared to comment in any more detail than that, but we are very optimistic that we will be able to achieve something in that arena within a reasonable period of time.

Glenn Engel - *Goldman Sachs*

Secondly, I think Delta made some comments the other day about the impact of both being a Northeastern carrier and more short haul was hurting them more. Do you have any numbers to second that?

Unidentified

Sure, I'll make a quick comment and then let Ben (ph) elaborate.

Clearly, when you look at our reduction capacity of 19 percent to achieve similar unit revenue declines and load (ph) factors, as the rest of the industry, I think that reduction in capacity is reflective of that issue.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Hello, Jim (ph), this is Ben (ph) - or Glenn (ph), I'm sorry.

As I mentioned in my talk earlier, we are seeing continued weakness, especially in closer end (ph) bookings of business travel. And we know that in our network that we're seeing continued pressure from drive competition at disproportionate rates versus a lot of our competitors.

So we see that, we think is driving clearly some of the unit revenue performance in the 11 percent decline quarter over quarter that we've seen - or year over year, I mean, for the first quarter. And we're trying to attack that every way we can with a combination of Al (ph) making sure the airports work well, and us making sure that we're working with our corporate customers, our frequent flier database and frequent flier customers, and making sure that customers want to fly rather than drive.

Glenn Engel - *Goldman Sachs*

And, finally, can you go through the - if I look at the labor cost reduction and look at the headcount reduction, it implies that the costs per employee went up 19 percent. Can you go through on how come that number is so large?

Neil Cohen - *US Airways - Executive Vice President and CFO*

You know - this is Neil Cohen. You know benefits were up - let me just sort of say that the main driver for our personal costs being down, obviously, was the, you know, substantial decrease in flying. But that was also offset by pension expense increases, employee increases, as well as contractually defined increases and with regard to some of our sort of current parody plus one (ph) formula.

Glenn Engel - *Goldman Sachs*

And the next two, do you get hit by it again by the parody plus (ph) with increases in May and then following again in October?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Yes we do.

Glenn Engel - *Goldman Sachs*

Thanks.

Operator

Thank you.

Our next question is coming from Gary Chase (ph). Please state your affiliation.

Gary Chase - *Lehman Brothers*

It's Gary Chase (ph) with Lehman Brothers.

I just was curious, Neil, you had guided - we were kind of trying to catch a lot of numbers at once. I think you had guided to c h a s m e x f u e l (ph) of between six and eight percent for the second quarter. Are - that obviously assumes the p a r o d y p l u s o n e (ph) adjustments that G l e n n (ph) was just asking about?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Yes. I think one thing that would also be helpful for - given the tax issue that I talked about in the first quarter, is we'd like to sort of - we expect to have a book tax rate for the balance of the year between 15 and 20 percent. So that would be helpful for people in looking at it given sort of the annualized effect of the tax changes put in place in the first quarter.

Gary Chase - *Lehman Brothers*

OK.

A quick question for B e n (ph) . I'm just curious. You know, you embarked on this network restructuring a while ago. You know, are things living up to your expectations in terms of mix, or, you know, are you getting - can you see the improvements that you thought you were going to get? And, also, if you could specifically comment on the Caribbean and the Atlantic and domestic unit revenue, if you don't mind.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Well, G a r y (ph) , overall the mix is not where we want it to be, certainly. Again, due to fewer business-paying passengers on the airplane or business fare paying passengers on the airplane. But as a result of changes we made with the removal of M e t r o J e t (ph) and with the - adding some frequencies in key business markets, and some success we're having in the corporate sales arena, I do see the right direction happening in our mix, but not at the pace we would like to see. And certainly we would like to see that accelerate.

The Caribbean continues to be fairly strong for us, and that is mostly the result of having less lower cost competition in the Caribbean. Although, I'll point out that we know J e t B l u e (ph) is scheduling to enter the JFK San Juan market shortly. The Caribbean, quarter over quarter - I mean year-over-year unit revenue is down about 10 percent, but that's on a capacity gross of over 23 percent. So we're quite happy with that result.

In the transatlantic, our capacity was down 21 percent year over year for the first quarter, 21.7 percent. And unit revenue was actually up 2.3 percent. That's a result of stronger load factor and some good yield management strategies that have resulted in a little bit better mix in the first quarter year over year.

So, in summary, G a r y (ph) , what I would say is that we're happy with the direction, but not happy with the slope of the curve.

Gary Chase - *Lehman Brothers*

OK.

And - sorry to hop around here. One last question. Just, you know, we had some government aid that I think you were expecting. Is that still, you know, 50-$60 million? Is that what we should be thinking or...

Neil Cohen - *US Airways - Executive Vice President and CFO*

This is Neil. Yeah, that's correct.

Gary Chase - *Lehman Brothers*

OK, 50-$60 million. OK, thanks a lot, guys.

Operator

Thank you.

Our next question is coming from Brian Harris (ph). Please state your affiliation.

Brian Harris - *Salomon Smith Barney*

Hi, it's Brian Harris (ph) at Salomon Smith Barney.

A question for Ben (ph). Let me make sure I got this right. I think you said prior to your bringing down capacity and closing down Metro Jet (ph) and so forth, you were competing on 38 percent of your network versus the low-fare carriers. And now you're at 34 percent.

That doesn't sound like much of a change given you're taken 20 percent of your capacity out. And, you know, obviously Metro Jet (ph) and point-to-point markets and so forth, where I would imagine you would have had, you know, the bulk of your low-cost carrier competition. Can you comment a little bit about that issue?

Unidentified

Yes I will. Your numbers, you heard the numbers right, about 38 percent of our revenue stream is exposed to low-cost carrier pricing activity. Now we estimate that number to be about 34 percent. That's the net of two effects, one obviously larger than the other. The biggest effect is the pull-down of MetroJet, which importantly meant the reduction of much of our service in Baltimore, which as you know is where Southwest has a large operation. Currently today we actually don't compete head-to-head with Southwest on any single route in our system, as a result of the pull-down of MetroJet.

On the offset of that, is the fact that growth in JetBlue, AirTran and other carriers, and Southwest's expansion in connecting yields have offset that some, so the net is, we're a little bit less exposed to low-cost competition, but we see that as sort of a short-term blip from the big pull-down in MetroJet, and that number's going to continue to rise as we see it.

Brian Harris - *Salomon Smith Barney*

OK. Can you comment then a little bit about like the percentage of your traffic right now, which is local versus connect versus say a year ago?

Unidentified

Well, as I think you know Brian (ph) we, in our hubs of Charlotte and Pittsburgh, there are significantly more connecting opportunities than local opportunities. So, we continue to be more of a connecting carrier than a local carrier, although with the pull-down of a lot of our point-to-point service which was exclusively, or mostly, local service, we're actually a little bit more connect than local now, than we were a year ago.

But again, that's because today we are a much more traditionally structured airline, with virtually all of our flights flying into or out of a hub, with the notable exception of the US Airways Shuttle product. So generally, we've gotten a little bit more connect and a little bit less local because we've pulled down the point-to-points. But overall we expect that to improve the unit revenue performance given where the point-to-point performance was.

Brian Harris - *Salomon Smith Barney*

OK, I understand. Just one quick comment here, question just for Dave. Do you have a timetable when the new plan will be, you know, fleshed out and we'll get some, you know, details and so forth?

David Siegel - *US Airways - President and CEO*

Well we are, we are in the process of working that plan pretty aggressively right now. We will have a first draft of that plan late this month or very early May, and we'll be sharing that first with our key stakeholders. We expect that the month of May is really a process by which we spend a lot of time with all key stakeholders drafting and redrafting that plan with their input.

Brian Harris - *Salomon Smith Barney*

OK, thank you.

Operator

Thank you. Our next question is coming from Kevin Murphy (ph) . Please state your affiliation.

Kevin Murphy - *Morgan Stanley*

Kevin Murphy (ph) from Morgan Stanley. Have a question on the type of concessions that you seek from labor. In the past, I think it's almost 100 percent of the time, when a carrier's been in difficulties and they get concessions, the concessions are only temporary, and when you look at the magnitude of losses that you're generating, it looks as though you have to totally revamp your business strategy on a permanent basis. What are the chances of you being able to do that, and moving beyond just temporary concessions to boost your liquidity and really changing your business model permanently?

Unidentified

Kevin (ph) how you doing?

Kevin Murphy - *Morgan Stanley*

Good.

Unidentified

Long time no talk. We are in the process of developing this plan that's going to include all stakeholders, not just labor. And so when we talk about fixing our business problem, we are as you say, focused on doing that on a permanent basis to make sure that this is a company that's successful over the long-term. So we're fully committed to that, and that's what our focus is. There's no question we've a very strong franchise on the east, and we have an opportunity to be successful over the long-term if we can have a cost structure that's consistent with the revenue production while at the same time we're clearly going to focus on things like the regional jets, and alliance partnerships to maximize the revenue opportunity. So we're going to include all stakeholders in that process to get the right cost structure. I wouldn't focus on any particular individual stakeholder. We're obviously working with our employees, we're going to include management in that, we're going to include our suppliers and other stakeholders in that process, so it's a total solution and it's a long-term solution that we're looking for.

Kevin Murphy - *Morgan Stanley*

You say you have a strong franchise on the east coast. What is the basis for this claim?

Unidentified

A number of things. One basis is that every domestic and international airline would love to be our partner. So I think the market's telling us that. But clearly if you look at our market position, as I said earlier, in the 144 airports that we serve east of the Mississippi, in 80 percent of those, if you measure us on a traffic basis we're either number one or number two. That's clearly a strength, and the east of the Mississippi is where 70 percent of the population and 90 of the wealth is. So we're in the right part of the country to be reasonably focused.

Kevin Murphy - *Morgan Stanley*

I guess the problem I have was, is your definition of strength, when you chalk up these types of losses, you know, I recall Eastern used to do the same thing, an a week after they shut down nobody missed them. I really think you're a long way from profitability, and we have to hear more on what you're doing with labor and how this is going to be a permanent fix.

Unidentified

Well we're clearly, as you look at us as a franchise, again we have strong revenue potential in the east, very strong market positions. We have an industry leading product, and our 36,000 employees have been delivering that very consistently every day, so I'd say measured by our customers, we are a company that has a tremendous franchise. No question we don't have a cost structure, given that revenue base, that allows us to make money and we're focused very clearly, and we're working very hard to address that issue.

Kevin Murphy - *Morgan Stanley*

Best of luck, thank you.

Unidentified

Thank you.

Operator

Thank you. Our next question is coming from H e l e n e B e c k e r (ph) . Please state your affiliation.

Helene Becker - *Buckingham Research Group*

Thank you very much operator. I'm with Buckingham Research Group. Hi Dave and crew. Four easy questions I think. First, in total you received Neal, two income tax refunds, one for 169 and one for 149, and one represented the carry-back for five years, is that right?

Neil Cohen - *US Airways - Executive Vice President and CFO*

I appreciate the preface about the easy questions by the way, let me just let you know that that's appreciated on this end. No, we received one income tax refund for 169 million, and that reflects the carry-back for five years, and we have sort of totally used up our ability to carry-back against prior years, so we would characterize that, you know, refund as a one-time item.

Helene Becker - *Buckingham Research Group*

OK. And then, you answered somebody's question about the book tax rate, and I spaced out and missed the answer. Could you just ...

Neil Cohen - *US Airways - Executive Vice President and CFO*

Sure, we expect a book tax rate for the balance of the year to be in the 15 to 20 percent range that you would apply against our book earnings.

Helene Becker - *Buckingham Research Group*

OK. And then the other questions probably are for Dave. One, could you just address if you haven't already, the idea of a spin-off of the wholly owned US Air regional, US Airways regional carriers? And two, shuttle comments, could - Delta earlier in the week talked about how poor their shuttle is, is that because you are taking market share from them?

David Siegel - *US Airways - President and CEO*

Sure, let me answer the second question first, sort of like in quiz show. On the shuttle side, we continue to run load factors, I think consistent with Delta, and there's just too much capacity in that market, and I think the articles that you read in the "New York Times" and other periodicals that talk about the fact that the train has become a substitute, there's no question that that has eaten into our business. The reality interestingly is, that if you go to the airport today, you'll find very short waits. You can actually fly our shuttle and get to your destination more quickly than the train. I don't think the perception has caught up with the reality yet.

But both we and Delta are running unacceptable loads, and it's a question of having excess capacity in the marketplace. Having said that, we have picked up some market share in recent months. We run an absolutely outstanding operation on the shuttle, and I think it's really, that market share pick up is really a reflection of the industry-leading product that we continue to deliver. And again, I think the 2001 performance for the network certainly demonstrates that. But the shuttle is probably the best operating segment of our entire network, so as good as it is in the rest of the network, there's nothing better than our shuttle performance. And that has gotten us customers. I have to apologize - can you repeat your first question?

Helene Becker - *Buckingham Research Group*

Yes, it was about a possible spin-off of the regionals?

David Siegel - *US Airways - President and CEO*

We have no plans at this time, I mean, clearly there's a lot of activity in the marketplace, including my pull-down of having a very successful IPO. We have no plans at this time to do anything with the express operation in terms of spinning it out.

Helene Becker - *Buckingham Research Group*

OK. Would there be problems with debtholders if you tried to do something like that? Would there be debt covenants that you would be in violation of on the main line? Is that what ...

David Siegel - *US Airways - President and CEO*

You know, I haven't investigated that, because we have absolutely no plans to do that.

Helene Becker - *Buckingham Research Group*

OK. OK, fair enough. And then just finally, a follow-up on the shuttle. Do you have an increased number of corporate discounts there, or could you just address maybe what the average fare is?

David Siegel - *US Airways - President and CEO*

I'll let Ben (ph) comment on that.

Unidentified

Great.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Helene (ph) , thanks. I can't give you information about the average fair on the shuttle, but I will tell you that we have seen increased -- we see some good success in securing contracts for corporate business on the shuttle. Yet, as Dave mentioned, we believe that that market is over-capacity, and as a result, unit revenue in the first quarter of this year versus last year for the shuttle is actually down greater than the rest of the system, down 26.6 percent.

Although it's on an improving pace that's a little bit steeper than the rest of the industry is, or the rest of our system, as well. So the shuttle dove a little deeper and is recovering a little steeper. But clearly, mix is what drives the shuttle.

Helene Becker - *Buckingham Research Group*

Well, if it's any consolation, B e n (ph) , your decline is not as bad as the Delta decline.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Happy to hear that.

David Siegel - *US Airways - President and CEO*

Thanks, H e l e n e (ph) . If you read "Newsweek" magazine, you'll also see that former president Clinton's one of our customers, as well.

Helene Becker - *Buckingham Research Group*

Actually, Dave, I did see that. I did see that. Thank you very much for your help.

David Siegel - *US Airways - President and CEO*

Thank you, H e l e n e (ph) .

I think we have time for one more question.

Operator

Thank you. Our next question is coming from J a m i e B a k e r (ph) . Please state your affiliation.

Jamie Baker - *JPMorgan*

Yes, J a m i e B a k e r (ph) at JPMorgan. Neil, good afternoon.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Good afternoon, J a m i e (ph) .

Jamie Baker - *JPMorgan*

What size of loan would you consider appropriate?

Neil Cohen - *US Airways - Executive Vice President and CFO*

You know, I don't think we're prepared to say, right now. We're going to work with all the stakeholders on our restructuring plan, and we'll be prepared to sort of comment on that when we resolve that.

Jamie Baker - *JPMorgan*

OK, all right, fair enough. Quick question on the RJ mini-deal, just so I understand. The new jets can only be flown with union carriers, is that correct? So that doesn't eliminate any of your current partners, or independents, does it?

Neil Cohen - *US Airways - Executive Vice President and CFO*

No, it does not.

Jamie Baker - *JPMorgan*

OK. And then finally a follow-on, David, to what Kevin (ph) touched on. You know, you've discussed RJs, the need for an international partner, obtaining a better cost structure, you know, but none of this touches on the basic geographic challenges that you seem to face. You lack presence west of the Mississippi, Pittsburgh and Philadelphia compete with each other in an area already rich with hubs.

You know, Charlotte's close to Atlanta. Is the plan simply to fix what's broken with US Airways today, and retain the current network framework? Or, should we be looking for something more dramatic? I guess I'm just having trouble figuring out what exactly you aspire to be, besides profitable and all that?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, I think being profitable is a great aspiration.

Jamie Baker - *JPMorgan*

Oh, oh, and I agree with you, and I wish you luck there. I mean, absolutely.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, again, I think I was very attracted to this company because of the strong franchise we have in the part of the country where the money is, and the people are. If you look at our network, as a regional network, it's actually I think a very exciting network and a very defensible network. Philadelphia and Pittsburgh can work well together, much like Newark and Cleveland work together for Continental. And Charlotte is actually a very powerful and effective hub completing our network, accessing the mid-Atlantic.

So on a regional basis, it's very strong, and I think there is additional opportunity for us to optimize the schedules in those three hubs, and fine tune the fleet. As well as I think a significant opportunity to improve performance at both Washington National and LaGuardia. Having said that, I think that gives us a very strong position on the East Coast, and again, if we can successfully complete an alliance with a domestic partner and an international partner, we are part of -- a very successful part, I think, and sustainable on a long term basis -- of a very powerful national and global network.

Jamie Baker - *JPMorgan*

OK, that's helpful. Thank a lot.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Thanks. I think that's -- oh, I'm sorry, we have time for one more question.

Operator

Thank you. Our last question is coming from Sam Buttrick (ph). Please state your affiliation.

Sam Buttrick - *UBS Warburg*

It's UBS Warburg. Hey, Dave, if you're working the cost side of the equation, as the company says it is, why do you think your unit costs, ex-fuel, are rising at the fastest rate in the industry?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, I think, as we've commented, a couple things.

Sam Buttrick - *UBS Warburg*

Yes.

Neil Cohen - *US Airways - Executive Vice President and CFO*

For now, it rose faster because we had a more significant shrinkage of our capacity, than the rest of the industry. Also, as we mentioned, as we've downsized we've also had parity increases and other wage increases hit us. So while we've shrunk the workforce approximately in line with the reduction capacity, we've had rates of pay go up, as well as pension and benefit costs go up, hit it from the other direction. Having said that, again, as part of our overall restructuring plan, we're going to look at the entire cost structure, and address all elements of that, in order to get our costs in line with our revenues.

Sam Buttrick - *UBS Warburg*

Do you think your costs are higher than American, or United?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Absolutely.

Sam Buttrick - *UBS Warburg*

Really?

Neil Cohen - *US Airways - Executive Vice President and CFO*

On a unit cost basis, we have the highest costs in the industry, and we're focused on correcting that problem.

Sam Buttrick - *UBS Warburg*

So you would you say looked at in the most proper light, your costs are higher than American's and United's? That's interesting. OK, thank you.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Thank you. In conclusion, I hope that you'll agree that US Airways has a tremendous franchise and tremendous potential, as we've discussed. Particularly, looking at our position in the East Coast. We also believe that there's enormous upside potential to that, as we talked about with regional jets, domestic and international alliances. And we think an optimization of the current flying.

To this end, we are very focused, as we've said, on formulating and implementing a restructuring plan that's going to get us to a situation where we have fully capitalized on the strength of this company. At the same time, we've addressed some of the structural weaknesses that we've identified. I'm very confident that this is going to be a successful airline. I'm very much looking forward over the next couple of months to working with all stakeholders, as we formulate a plan to that end.

And in particular, I am very excited to be here working with our employee group that I had a chance to acquaint myself with now, in these first six weeks, which I think is our greatest strength as a company. And there's no better of that than the operational performance that you see every day, and the recognition that we've gotten by independent third parties, as well as the DOT measurements, and our performance along those.

So I thank you for your interest in US Airways, and I look forward to working with all of you going forward. operator.

Operator

Thank you. Ladies and gentlemen, this concludes the US Airways first quarter 2002 teleconference.

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EDITED TRANSCRIPT

- Q1 2002 US Airways Earnings Conference Call

EVENT DATE/TIME: APRIL 18, 2002 / 5:00PM GMT

OVERVIEW:

US Airways Group reports $269m loss in 1Q02. Q&A focuses on cash balance, revenues, and unit costs.

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David Siegel *US Airways - President and CEO*

Neil Cohen *US Airways - Executive Vice President and CFO*

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Kevin Murphy (ph) *Morgan Stanley*

Helene Becker (ph) *Buckingham Research Group*

Jamie Baker (ph) *JPMorgan*

Sam Buttrick (ph) *UBS Warburg*

PRESENTATION

Operator

Welcome to the US Airways quarterly conference call.

At this time, let me turn the call over to Kimberly Holland (ph) , the company's Director of Investor Relations.

Kimberly Holland - *US Airways - Director of Investor Relations*

Thank you, operator.

Good afternoon and welcome to the US Airways Group fiscal year 2002 first quarter conference call.

I'd like to remind you that we are starting this call with all parties on a listen-only mode. However, the lines will be open for questions and comments following our formal remarks.

Before we begin our discussion, I would like to remind you of a few important points about the information we will be sharing with you today.

Some of the information discussed this afternoon may be considered forward-looking information. A number of risks and uncertainties exist which could cause the company's actual results to differ materially from the results projected in that forward-looking information. More information about the factors that could cause actual results to differ materially from the forward-looking information is contained in the company's periodic filings with the Securities and Exchange Commission.

You should also know that a Webcast of this call is available at www.usairways.com. An archive of the call will remain on our Web site through July 17, 2002. For those people who will be listening to this call as a replay, please keep in mind that the information discussed is as of April 18, 2002. And US Airways assumes no obligation to update that information.

Now I would like to turn things over to David Siegel, President and Chief Executive Officer of US Airways.

David Siegel - *US Airways - President and CEO*

Thank you, Kimberly (ph).

Good afternoon and thanks for joining us. It's a pleasure to be here.

I'd like to begin by introducing members of our senior management team who will be assisting me today in detailing the company's results for the first quarter.

Neil Cohen, our newly-appointed Executive Vice President and Chief Financial Officer; Al Crullen (ph), our Executive Vice President of Operations; and Ben Boldan (ph), the company's Senior Vice President of Marketing and Planning. In addition, Michelle Bryan (ph), our Executive Vice President of Corporate Affairs and General Council, and Jerry Glass (ph), our Senior Vice President of Employee Relations, are joining us today for the call.

As you get to know the new management team in their new roles in the coming months, I am certain you will come to understand the strength of the group that we have in place. We have an experienced core of US Airways managers, and a with new members from the outside. I believe this assembly is an important first step in laying the groundwork for future success.

As I'm sure you can imagine, the last six weeks have been exciting for me. In that period, I had the privilege of getting to know this airline from top to bottom. And, as I've learned more about US Airways, I have come to appreciate its tremendous long-term potential. A potential based on a strong East Coast franchise, a superior product and a talented and dedicated group of employees who produce an outstanding operation each and every day.

That franchise has been ranked, when looking at traffic (ph), number one or number two in approximately 80 percent of the 144 airports we serve east of the Mississippi. Our product has been recognized by the industry survey as a top-ranked network carrier for 2000 and number two overall in the airline quality ranking.

Further, US Airways operational performance in 2001 was another milestone performance for the company, as we were ranked number one in three out of four measurements tracked by the DOT, and the only carrier to finish in the top three in all four matrix. And, in the first quarter of this year, we have significantly improved our performance versus the first quarter of last year.

Despite this great potential and our operational successes, the company's financial results for the first quarter were extremely disappointing. Earlier today, we reported a net loss of $269 million for the first quarter, representing a diluted loss per share of $3.97, which is clearly unacceptable. To help you better understand these results, I'd like to highlight the key drivers of the company's losses, summarize our assessment of the current situation and provide an overview of a strategy we are formulating to restore US Airways financial health.

The company's losses stem, in part, from the weak economic environment, a significant drop in demand and yield, resulting from the events of September 11th, and intense competition from low-cost carriers and regional jets from the East Coast. Further, US Airways faces challenges that are unique to our airline. We have the highest unit cost structure of any domestic carrier, a significantly undersized number of regional jets, and do not as of yet participate in a domestic or international alliance.

To maximize the value of US Airways great assets and to be successful and a profitable airline, we need to restructure our business. In light of the challenges I've just described, we've been working on a plan to do just that. Although we are not prepared to announce the details of that plan today, you should know that a plan will include a new cost structure in which all key stakeholders will need to participate. A strategy to deploy more regional jets into our system, and a means to access the enormous amount of incremental revenue we would bring (ph) to our larger domestic and international networks.

As part of the process of restructuring US Airways, it is likely that the company will apply to the Air Transportation and Stabilization Board for a government-guaranteed loan. Given the company's current cash position and the weak economic environment, this loan will provide liquidity to execute the restructuring plan and fund the business until the industry recovers.

We at US Airways recognize the significant challenges faced by this company, but nonetheless, believe that these challenges can be successfully addressed. We can defend and grow our East Coast position with a competitive cost structure.

US Airways is a strong franchise and has tremendous potential. I'm excited to be here at US Airways and look forward to working with all of our employees in charting our future direction.

With that, Neil Cohen will now discuss the specifics of our financial results.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Thank you, Dave, and good afternoon.

US Airways Group reported a first quarter net loss of $269 million on revenues of $1.7 billion, compared to a net loss of $171 million on revenues of $2.2 billion for the same period in 2001. On a diluted per share basis, the net loss in the first quarter of 2002 amounted to $3.97 versus $2.25 last -- $2.55 last year.

To better understand these results, I'd like to further describe a few significant items that effected our quarterly numbers.

Results for the first quarter of 2002 included a tax benefit of $149 million. Recent economic stimulus legislation enabled US Airways (ph) to recover additional federal income tax it had previously paid. Although US Airways recorded a full valuation allowance for book purposes in 2001, the company an additional book tax benefit in the first quarter of 2002.

In addition to the tax benefit, the first quarter 2002 results included a $17 million credit related to a change in accounting policy for engine maintenance at one of the companies expressed subsidiaries.

When looking at the first quarter of 2002 - pardon me, when looking at the first quarter of 2001, the results included a $22 million, that is $14 million after tax, impairment charge related to the early retirement of certain 737-200 aircraft. Additionally, the results for the first quarter of 2001 included an after-tax credit of $7 million, resulting from US Airways accounting adoption of FAS-133 accounting for derivative instruments and hedging activities.

Excluding accounting changes in both years, and the unusual item in 2001, the pre-tax loss for the first quarter of 2002 was 435 million, or just to put that in perspective, that 435 million equates to $6.42 per share, and that's compared to a loss, again a pre-tax loss, of 248 million, or again, on a per share basis $3.69 for the first quarter of 2001. This loss of $6.42 for the first quarter of 2002 is, we believe, comparable to the First Call consensus estimate of $6.08 for the first quarter of 2002, when neutralizing for this tax issue that we discussed earlier, which we believe was not included in the First Call consensus estimates of the analysts.

US Airways first quarter revenue of 1.7 billion was down 24 percent from last year. ASMs declined 19 percent, while unit, passenger unit revenues declined 11 percent. It should be noted that we were disappointed that although US Airways had the most significant year over year capacity reduction of all the airlines that have reported so far, at 19 percent, our unit revenue declined 11 percent, which seems to be in line with what's been happening at other carriers, even though they have not experienced as much capacity reduction. Ben Baldanza will cover the revenue performance in later part of the call.

Let me now give you some details on expense for the quarter. For the first quarter of 2002, US Airways Group operating expenses were 2.1 billion, down 15 percent excluding the 2001 impairment charge. Unit costs for the airline increased by one percent, with a 19 percent decline in ASMs. We saw significant reductions in maintenance, due to the elimination of older aircraft, and the closing of the company's engine shop.

Commissions have also declined substantially due to a reduction in commission rates, lower sales, and favorable channel shift to the internet. However, personnel costs were only down five percent. While US Airways' headcount has declined 23 percent to 33,900 employees, increased wage rates and benefit costs partly offset the cost savings of lower headcount. Excluding fuel, unit costs increased by six percent.

In terms of fuel, fuel expense declined by $131 million, or 42 percent, driven by lower fuel prices and fewer gallons consumed, reflective of the reduced schedule. For the first quarter of 2002, we hedged nearly all of our consumption at levels that translated to a reported price of 68 cents per gallon, and that includes taxes.

Total balance sheet debt outstanding, including capital lease obligations at quarter end was 3.7 billion. Turning to liquidity, the company's cash balance at quarter end was 561 million. On an operating basis, we continued to consume cash in the first quarter. Those months have historically had lower sales receipts, and we have not yet, and we had not yet seen the full impact of our expense reductions. For the quarter, operating cash flow was a negative 3.5 million per day.

For the second quarter of 2002, we are expecting operating cash flow to turn positive, and we view the company's cash position as stable. We are entering into a season of the year when cash typically accumulates, and we anticipate having an improved cash position in the coming months. Also our cash position will have a one-time benefit from a $169 million tax refund already received in April. However, as you might expect, there would be pressure on our cash position late in the third and in the fourth quarter of this year, without taking into account the restructuring plan Dave mentioned earlier in the call.

Turning to our fleet, during the quarter we retired the remaining 22 F-100s and 14 MD-80s that we announced last fall. We also sold 97 surplus aircraft and took delivery of four A-321 aircraft. At the end of the quarter, US Airways had an operating fleet of 310 aircraft. We are scheduled to take delivery of five additional A-321s during the remainder of the year, and we have secured financing on all of these aircraft.

In terms of guidance for the second quarter of 2002, we expect the company's capacity to be 20 percent lower on the year over year basis, load factors to be up slightly, and revenue per seat to be down five to seven percent. Unit costs for the second quarter, including fuel, are anticipated to increase two to four percent over last year's second quarter.

For the second quarter we have currently hedged 45 percent of our fuel, which translates into a projected price per gallon for the hedged fuel of 64 cents including tax. Additionally, we have locked in prices for approximately 24 percent of our projected needs in the third quarter at 68 percent, pardon me, 68 cents, and that's 64 cents in the second quarter, 68 cents in the third quarter. Unit costs excluding fuel are expected to increase six to eight percent over the second quarter of 2001.

Now let me turn it over to Ben.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Thank you and good afternoon. US Airways first quarter mainline passenger revenue was $1.31 billion, 28 percent below 2001's first quarter revenue. Traffic was down 16 percent while capacity dropped 19 percent. Our load factor of 68.5 percent was up 2.3 points year over year, and passenger yield was down 14 percent, resulting in an 11 percent decline in passenger revenue per available seat mile. This unit revenue performance is particularly disappointing, given that we reported a decline of 7.6 percent in the first quarter of 2001. Continuing economic uncertainty, the impacts of 9/11 on general demand, but especially business demand, and increased competition from low-cost carriers and regional jet operators on the east coast drove this unit revenue performance.

Throughout the quarter, passenger loads built steadily, continuing the recovery from the events of last September. Specifically, load factor was down 0.2 points in January, up 2.6 points in February, and up 4.6 points in March to an all-time record of 78 percent, helped by an early holiday.

Our yield performance through the quarter maintained a fairly steady 14 percent decline year over year. This resulted in the steady improvement in year over year unit revenue from down 14.2 percent in January to down 8.8 percent in March. Unfortunately we have yet to see much of increase in business demand. Throughout the quarter, bookings taken inside seven days of travel were down approximately 20 percent year over year, in line with our decreasing capacity. But revenue build in this same window was down 36 percent, indicating a 16 percent drop in yield.

Revenue for our wholly owned and regional jet express operations was up 0.4 percent year over year in the first quarter. Our wholly owned and regional jet express capacity was up 25 percent year over year, driven by a 47 percent increase in RJ capacity, while unit revenue fell 19 percent. We ended the fourth quarter of 2001 with 67 regional jets in our fleet, and added the final three allowed under our current agreement with our pilots on February 3rd.

Total group cargo revenue in the first quarter was down 28 percent year over year, due to significant reductions in domestic and Atlantic service, as well as FAA restrictions on mail carriage. Freight related revenues were down 15 percent year over year, and mail was down 54 percent versus first quarter 2001. Even though revenues have dropped significantly year over year, US Airways cargo outpaced the industry in revenue ton-mile performance, both domestically and on Atlantic routes. Domestic freight RTMs were up 16 percent versus the first quarter 2001, while other U.S. majors were down eight percent year over year. On the Atlantic, US Airways cargo RTMs were down nine percent year over year, while other major U.S. carriers were down 19 percent.

On the distribution front in the first quarter, online sales were 20 percent of total sales, up 7.3 points from the first quarter of 2001, and a new high for the company. Sales on our web site, usairways.com, were just under nine percent of total sales, and internet agency sales reached 11 percent, both new highs as well for the company. In March, USAirways.com reached an all-time high of over $17 million in revenue for one week. Total traditional travel agency penetration was 66 percent in the first quarter, down 4.5 points from the first quarter of 2001. Additionally, we have seen a growing trend of corporate travelers looking to Internet sites as an alternative to their negotiated rates.

To encourage this activity, USAirways.com has launched a product for our contracted corporate customers that allows them to purchase at USAirways.com and still receive credit, though no additional discount, within their negotiated contract. This has been in direct response to concerns from our highest value customers. Further, USAirways.com recently introduced meeting and conventions online. This feature enables meeting and convention participants to book online and receive credit for these bookings.

We made significant structural changes to our network in the fourth quarter of 2001, eliminating MetroJet (ph) and most other non-hub flying. Most of the fleet decisions made at that time have now been implemented. We have continued to rebuild our operations at Reagan National Airport, here in Washington, D.C. In early September, 2001, we were serving 44 destinations with both mainline and express aircraft. Between the reopening in early October, and our December schedule, we had added back nine destinations with departures at 35 percent of pre-9/11 levels.

By the end of the first quarter, 2002, we were serving 34 destinations with 76 percent of the previous departures, and by the end of the second quarter, we will be serving two more destinations with 83 percent of the previous departures. We remain very focused on working with our government to allow us to fly our full pre-September 11th schedule, and hopefully this will happen in the near future. We are reinstating most of our trans-Atlantic service. For the first quarter, trans-Atlantic capacity was down 20 percent year-over-year, and capacity will be down about 16 percent in the second quarter of 2002. Our trans-Atlantic unit revenue was up four percent year-over-year, and for the quarter.

And, I should add, we had the largest year-over-year increase in load factor among U.S. flag carriers on trans-Atlantic routes in the first quarter, up 7.2 points to 74.5 percent, a record first quarter Atlantic load factor for the company. In the first quarter, we introduced service from Charlotte to Cozumel, Mexico, and Freeport in Grand Bahama Island. Additionally, we have a number of other destinations in the Caribbean that are currently under review with service potentially starting in the fourth quarter of 2002, and beyond.

As Neil mentioned earlier, we are expecting system capacity to be down about 20 percent year-over-year in the second quarter, and for the full year of 2002 capacity will be down approximately 11 percent. We are seeing a continuation of the improvement in year-over-year load factor trends going forward. Load factor for the second quarter should be at least two points higher than last year; however, there is little evidence of improvement in the business travel picture, and the industry is adding back capacity at an increasing rate, indicating that yields will continue to be under pressure.

Specific to US Airways, low cost carrier presence in the area east of the Mississippi continues to grow, with low cost carriers now accounting for 22 percent of the capacity within this region, in the first quarter of 2002, up 4.5 points from 2001. US Airways' capacity share in this region has declined 2.4 points over the same period to 18 percent. Prior to our elimination of MetroJet (ph) and our other capacity reductions, post-September 11th, roughly 38th percent of our domestic revenue stream was subject to pricing actions from low cost carriers, and that was up seven points, from 31 percent, in just one year. Currently, we estimate that figure to be 34 percent, which will no doubt rise quickly, given the growth of carriers in the East. For example, ATA will be starting Midway-Charlotte service beginning on July 18th.

A successful restructuring plan will allow us to effectively compete in this environment. Let me turn the call over to Al Krellen (ph) , who will now discuss our operational performance.

Al Krellen - *US Airways Corporation*

Good afternoon. I'd like to give you an overview of a number of the key operational issues we are focused on at US Airways. As you know, since last September, there have been a number of changes in our operations that have impacted our customers' flying experience. And in an effort to improve that experience, we have implemented an ongoing process to continually refine our operational procedures and processes. Long waits at ticket counters and security check-in points are clearly unacceptable for our customers. To resolve that problem, we have implemented a very focused airport monitoring system to measure the line waits at ticket counters and security checkpoints, and thus, identify and solve problems quickly.

As a result of our actions, we are adding additional lanes at security checkpoints in 16 airports to facilitate more efficient passenger screening. The expansion at eight airports have already been completed, and we expect work at the remaining eight facilities to be completed shortly. Further, by the end of this week, as we have already implemented in Philadelphia, we will add additional priority passenger security lanes for our first class, envoy class, and chairman's preferred travelers, at our Charlotte, Pittsburgh, Boston, and LaGuardia airports. And, we are reviewing additional expansions at other locations.

US Airways is also reducing airport processing time for customers at our ticket counters by installing more self-service electronic ticketing kiosks throughout our system, and have accelerated their deployment. These kiosks offer e-ticketed customers the ability to check-in electronically, bypassing the traditional ticket lines, and reducing processing time by as much as 40 percent. As a result of these benefits, we are in the process of expanding kiosks at 25 more locations, and will have 251 kiosks at 48 airports operating by early this summer. The combination of these enhancements and the efforts of our employees have enabled us, with few exceptions, to return to pre-September check-in times. It is our belief that these improvements, and others to come, will make our customers' flying experience more enjoyable and solidify our position as the carrier they choose to fly.

A major campaign to strengthen US Airways' operations at our Philadelphia hub has also been launched. Focusing on enhancing flight schedules and customer service, combined with marketing and pricing initiatives. Starting in May, we will expand flights between Philadelphia and five of US Airways key business destinations: Chicago, Dallas-Ft. Worth, Detroit, Houston, and Atlanta. Although there are always ways in which we can improve our operational performance, when compared to our peers, US Airways performed superbly on all Department of Transportation measurements in 2001.

When compared to the other major airlines, US Airways ranked first in the least amount of customer complaints, mishandled bags, and involuntary denied boardings. And, ranked third in on-time arrivals for the full year of 2001. When comparing our performance on a year-over-year basis, we continue to see improvements in our results. Specifically, our on-time arrivals and completion factors improved, while the number of cancellations decreased by 70 percent. Further, US Airways ranked second in the 2001 airline quality rating, which is based on the major DOT measurements: on-time arrivals, mishandled bags, customer complaints, and denied boardings. To finish second, and as the top-ranked network carrier, is a real achievement. And one that all of us at US Airways are very proud of.

These honors are a result of the hard work and dedication of our employees during a very difficult time. They have performed admirably in all areas of our operations, successfully delivering a superior product to the traveling public.

With that, let's turn to the operator for questions -- operator?

QUESTIONS AND ANSWERS

Operator

Thank you. The floor is now open for questions. If you do have a question or a comment, please press one followed by four on your touch-tone telephone at this time. If at any point you find you question has been answered, you may remove yourself from the queue by pressing the pound key. Again, if you have a question or a comment, please press one followed by four on your touch-tone telephone at this time. Please hold while we poll for questions.

Thank you. Our first question is coming from Doug Lentay (ph) . Please state your affiliation.

Doug Lentay - *Morgan Stanley Fixed Income Research*

Yes, Doug Lentay (ph) , Morgan Stanley Fixed Income Research. A question on the cash balance? Can you tell us what percentage, if any, if that cash balance is restricted? And, whether the credit card companies have imposed any limitations?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Doug (ph) , this is Neil. The $561 million number I quote has no restricted cash.

Doug Lentay - *Morgan Stanley Fixed Income Research*

And then a follow-up on that. Does that cash balance include the cash proceeds from the sale of the 97 aircraft? And if so, what would the amount be, net of that sale proceeds?

Neil Cohen - *US Airways - Executive Vice President and CFO*

We sold - we're in the process of disposing of those aircraft. I think we disposed of a portion of them in the first quarter. I think it was about $25 million in first quarter proceeds associated with those aircraft.

Doug Lentay - *Morgan Stanley Fixed Income Research*

And what sort of remaining proceeds do you expect? A similar range of magnitude, 25 to $50 million perhaps?

Unidentified

You know I'll have to get back to you on that. I think it will be - as we go through and close those transactions, they'll be closed in April and May. And I would expect them to be probably in about the 25 to $50 million range in the second quarter.

Doug Lentay - *Morgan Stanley Fixed Income Research*

Great - thanks very much.

Operator

Thank you.

Our next question is coming from Jim Higgins (ph) . Please state your affiliation.

Jim Higgins - *Credit Suisse First Boston*

Yes, Jim Higgins (ph) with Credit Suisse First Boston.

Can you give us any update on your pilots' discussions regarding adding regional jets or at least any sense of timing when we might hear something?

David Siegel - *US Airways - President and CEO*

Sure, Jim (ph) , how are you doing?

Jim Higgins - *Credit Suisse First Boston*

Hi, Jerry (ph) , how are you?

David Siegel - *US Airways - President and CEO*

Good.

As you saw - oh, you thought it was Jerry (ph) , sorry.

Jim Higgins - *Credit Suisse First Boston*

Oh, I'm sorry. That's OK, go ahead.

David Siegel - *US Airways - President and CEO*

Dave Siegel, .

Jim Higgins - *Credit Suisse First Boston*

Oh, hi Dave, how are you?

David Siegel - *US Airways - President and CEO*

Good, thanks.

As you know, we've reached a tentative agreement on a mini deal for 70 (ph) aircraft.

Jim Higgins - *Credit Suisse First Boston*

Right.

David Siegel - *US Airways - President and CEO*

And we're going to hear one way or the other - I'd say the next 24, 48 hours on that issue.

Jim Higgins - *Credit Suisse First Boston*

OK.

And those aircraft - it's sort of hard to tell with what's been in the press so far - will they all be flown by Potomac air (ph) ? Or is there some - or some of them may be, some of them may not? I mean how does that piece work?

David Siegel - *US Airways - President and CEO*

Yeah, we're evaluating now whether all or none or some will be flown in Potomac air (ph) .

Jim Higgins - *Credit Suisse First Boston*

OK.

So it's zero to 100 percent is the range, then?

David Siegel - *US Airways - President and CEO*

Right. It's because of a variety of factors, aircraft availability and ability to get, you know, those deliveries within a reasonable timeframe. So we've got a window of opportunity we think to acquire and deploy aircraft, and we're going to look at, you know, some combination of inside and out. But it could range anywhere from zero to 100 percent.

Jim Higgins - *Credit Suisse First Boston*

Great - thank you very much.

Operator

Thank you.

Our next question is coming from Glenn Engel (ph) . Please state your affiliation.

Glenn Engel - *Goldman Sachs*

Glenn Engel (ph) , Goldman Sachs - good afternoon.

Unidentified

Hi G l e n n (ph) .

Glenn Engel - *Goldman Sachs*

Can you talk about - both domestically and internationally there was - the last call you talked about alliances and all that and what your thinking is there?

Unidentified

Sure, G l e n n (ph) , how are you doing?

Glenn Engel - *Goldman Sachs*

OK.

Unidentified

As you know, we've got a very powerful East Coast franchise. One that has caught the attention of international and domestic carriers alike. We are a very exciting unique piece of a puzzle to complete, a global network. And we continue to have discussions both with domestic partners, international partners. I'd say those discussions are progressing very well for the company.

I don't think we're prepared to comment in any more detail than that, but we are very optimistic that we will be able to achieve something in that arena within a reasonable period of time.

Glenn Engel - *Goldman Sachs*

Secondly, I think Delta made some comments the other day about the impact of both being a Northeastern carrier and more short haul was hurting them more. Do you have any numbers to second that?

Unidentified

Sure, I'll make a quick comment and then let B e n (ph) elaborate.

Clearly, when you look at our reduction capacity of 19 percent to achieve similar unit revenue declines and l o a d (ph) factors, as the rest of the industry, I think that reduction in capacity is reflective of that issue.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Hello, J i m (ph) , this is B e n (ph) - or G l e n n (ph) , I'm sorry.

As I mentioned in my talk earlier, we are seeing continued weakness, especially in closer e n d (ph) bookings of business travel. And we know that in our network that we're seeing continued pressure from drive competition at disproportionate rates versus a lot of our competitors.

So we see that, we think is driving clearly some of the unit revenue performance in the 11 percent decline quarter over quarter that we've seen - or year over year, I mean, for the first quarter. And we're trying to attack that every way we can with a combination of A l (ph) making sure the airports work well, and us making sure that we're working with our corporate customers, our frequent flier database and frequent flier customers, and making sure that customers want to fly rather than drive.

Glenn Engel - *Goldman Sachs*

And, finally, can you go through the - if I look at the labor cost reduction and look at the headcount reduction, it implies that the costs per employee went up 19 percent. Can you go through on how come that number is so large?

Neil Cohen - *US Airways - Executive Vice President and CFO*

You know - this is Neil Cohen. You know benefits were up - let me just sort of say that the main driver for our personal costs being down, obviously, was the, you know, substantial decrease in flying. But that was also offset by pension expense increases, employee increases, as well as contractually defined increases and with regard to some of our sort of current parody plus one (ph) formula.

Glenn Engel - *Goldman Sachs*

And the next two, do you get hit by it again by the parody plus (ph) with increases in May and then following again in October?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Yes we do.

Glenn Engel - *Goldman Sachs*

Thanks.

Operator

Thank you.

Our next question is coming from Gary Chase (ph) . Please state your affiliation.

Gary Chase - *Lehman Brothers*

It's Gary Chase (ph) with Lehman Brothers.

I just was curious, Neil, you had guided - we were kind of trying to catch a lot of numbers at once. I think you had guided to chasm ex fuel (ph) of between six and eight percent for the second quarter. Are - that obviously assumes the parody plus one (ph) adjustments that Glenn (ph) was just asking about?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Yes. I think one thing that would also be helpful for - given the tax issue that I talked about in the first quarter, is we'd like to sort of - we expect to have a book tax rate for the balance of the year between 15 and 20 percent. So that would be helpful for people in looking at it given sort of the annualized effect of the tax changes put in place in the first quarter.

Gary Chase - *Lehman Brothers*

OK.

A quick question for Ben (ph). I'm just curious. You know, you embarked on this network restructuring a while ago. You know, are things living up to your expectations in terms of mix, or, you know, are you getting - can you see the improvements that you thought you were going to get? And, also, if you could specifically comment on the Caribbean and the Atlantic and domestic unit revenue, if you don't mind.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Well, Gary (ph), overall the mix is not where we want it to be, certainly. Again, due to fewer business-paying passengers on the airplane or business fare paying passengers on the airplane. But as a result of changes we made with the removal of Metro Jet (ph) and with the - adding some frequencies in key business markets, and some success we're having in the corporate sales arena, I do see the right direction happening in our mix, but not at the pace we would like to see. And certainly we would like to see that accelerate.

The Caribbean continues to be fairly strong for us, and that is mostly the result of having less lower cost competition in the Caribbean. Although, I'll point out that we know Jet Blue (ph) is scheduling to enter the JFK San Juan market shortly. The Caribbean, quarter over quarter - I mean year-over-year unit revenue is down about 10 percent, but that's on a capacity gross of over 23 percent. So we're quite happy with that result.

In the transatlantic, our capacity was down 21 percent year over year for the first quarter, 21.7 percent. And unit revenue was actually up 2.3 percent. That's a result of stronger load factor and some good yield management strategies that have resulted in a little bit better mix in the first quarter year over year.

So, in summary, Gary (ph), what I would say is that we're happy with the direction, but not happy with the slope of the curve.

Gary Chase - *Lehman Brothers*

OK.

And - sorry to hop around here. One last question. Just, you know, we had some government aid that I think you were expecting. Is that still, you know, 50-$60 million? Is that what we should be thinking or...

Neil Cohen - *US Airways - Executive Vice President and CFO*

This is Neil. Yeah, that's correct.

Gary Chase - *Lehman Brothers*

OK, 50-$60 million. OK, thanks a lot, guys.

Operator

Thank you.

Our next question is coming from Brian Harris (ph). Please state your affiliation.

Brian Harris - *Salomon Smith Barney*

Hi, it's Brian Harris (ph) at Salomon Smith Barney.

A question for Ben (ph) . Let me make sure I got this right. I think you said prior to your bringing down capacity and closing down Metro Jet (ph) and so forth, you were competing on 38 percent of your network versus the low-fare carriers. And now you're at 34 percent.

That doesn't sound like much of a change given you're taken 20 percent of your capacity out. And, you know, obviously Metro Jet (ph) and point-to-point markets and so forth, where I would imagine you would have had, you know, the bulk of your low-cost carrier competition. Can you comment a little bit about that issue?

Unidentified

Yes I will. Your numbers, you heard the numbers right, about 38 percent of our revenue stream is exposed to low-cost carrier pricing activity. Now we estimate that number to be about 34 percent. That's the net of two effects, one obviously larger than the other. The biggest effect is the pull-down of MetroJet, which importantly meant the reduction of much of our service in Baltimore, which as you know is where Southwest has a large operation. Currently today we actually don't compete head-to-head with Southwest on any single route in our system, as a result of the pull-down of MetroJet.

On the offset of that, is the fact that growth in JetBlue, AirTran and other carriers, and Southwest's expansion in connecting yields have offset that some, so the net is, we're a little bit less exposed to low-cost competition, but we see that as sort of a short-term blip from the big pull-down in MetroJet, and that number's going to continue to rise as we see it.

Brian Harris - *Salomon Smith Barney*

OK. Can you comment then a little bit about like the percentage of your traffic right now, which is local versus connect versus say a year ago?

Unidentified

Well, as I think you know Brian (ph) we, in our hubs of Charlotte and Pittsburgh, there are significantly more connecting opportunities than local opportunities. So, we continue to be more of a connecting carrier than a local carrier, although with the pull-down of a lot of our point-to-point service which was exclusively, or mostly, local service, we're actually a little bit more connect than local now, than we were a year ago.

But again, that's because today we are a much more traditionally structured airline, with virtually all of our flights flying into or out of a hub, with the notable exception of the US Airways Shuttle product. So generally, we've gotten a little bit more connect and a little bit less local because we've pulled down the point-to-points. But overall we expect that to improve the unit revenue performance given where the point-to-point performance was.

Brian Harris - *Salomon Smith Barney*

OK, I understand. Just one quick comment here, question just for Dave. Do you have a timetable when the new plan will be, you know, fleshed out and we'll get some, you know, details and so forth?

David Siegel - *US Airways - President and CEO*

Well we are, we are in the process of working that plan pretty aggressively right now. We will have a first draft of that plan late this month or very early May, and we'll be sharing that first with our key stakeholders. We expect that the month of May is really a process by which we spend a lot of time with all key stakeholders drafting and redrafting that plan with their input.

Brian Harris - *Salomon Smith Barney*

OK, thank you.

Operator

Thank you. Our next question is coming from Kevin Murphy (ph) . Please state your affiliation.

Kevin Murphy - *Morgan Stanley*

Kevin Murphy (ph) from Morgan Stanley. Have a question on the type of concessions that you seek from labor. In the past, I think it's almost 100 percent of the time, when a carrier's been in difficulties and they get concessions, the concessions are only temporary, and when you look at the magnitude of losses that you're generating, it looks as though you have to totally revamp your business strategy on a permanent basis. What are the chances of you being able to do that, and moving beyond just temporary concessions to boost your liquidity and really changing your business model permanently?

Unidentified

Kevin (ph) how you doing?

Kevin Murphy - *Morgan Stanley*

Good.

Unidentified

Long time no talk. We are in the process of developing this plan that's going to include all stakeholders, not just labor. And so when we talk about fixing our business problem, we are as you say, focused on doing that on a permanent basis to make sure that this is a company that's successful over the long-term. So we're fully committed to that, and that's what our focus is. There's no question we've a very strong franchise on the east, and we have an opportunity to be successful over the long-term if we can have a cost structure that's consistent with the revenue production while at the same time we're clearly going to focus on things like the regional jets, and alliance partnerships to maximize the revenue opportunity. So we're going to include all stakeholders in that process to get the right cost structure. I wouldn't focus on any particular individual stakeholder. We're obviously working with our employees, we're going to include management in that, we're going to include our suppliers and other stakeholders in that process, so it's a total solution and it's a long-term solution that we're looking for.

Kevin Murphy - *Morgan Stanley*

You say you have a strong franchise on the east coast. What is the basis for this claim?

Unidentified

A number of things. One basis is that every domestic and international airline would love to be our partner. So I think the market's telling us that. But clearly if you look at our market position, as I said earlier, in the 144 airports that we serve east of the Mississippi, in 80 percent of those, if you measure us on a traffic basis we're either number one or number two. That's clearly a strength, and the east of the Mississippi is where 70 percent of the population and 90 of the wealth is. So we're in the right part of the country to be reasonably focused.

Kevin Murphy - *Morgan Stanley*

I guess the problem I have was, is your definition of strength, when you chalk up these types of losses, you know, I recall Eastern used to do the same thing, an a week after they shut down nobody missed them. I really think you're a long way from profitability, and we have to hear more on what you're doing with labor and how this is going to be a permanent fix.

Unidentified

Well we're clearly, as you look at us as a franchise, again we have strong revenue potential in the east, very strong market positions. We have an industry leading product, and our 36,000 employees have been delivering that very consistently every day, so I'd say measured by our customers, we are a company that has a tremendous franchise. No question we don't have a cost structure, given that revenue base, that allows us to make money and we're focused very clearly, and we're working very hard to address that issue.

Kevin Murphy - *Morgan Stanley*

Best of luck, thank you.

Unidentified

Thank you.

Operator

Thank you. Our next question is coming from Helene Becker (ph) . Please state your affiliation.

Helene Becker - *Buckingham Research Group*

Thank you very much operator. I'm with Buckingham Research Group. Hi Dave and crew. Four easy questions I think. First, in total you received Neal, two income tax refunds, one for 169 and one for 149, and one represented the carry-back for five years, is that right?

Neil Cohen - *US Airways - Executive Vice President and CFO*

I appreciate the preface about the easy questions by the way, let me just let you know that that's appreciated on this end. No, we received one income tax refund for 169 million, and that reflects the carry-back for five years, and we have sort of totally used up our ability to carry-back against prior years, so we would characterize that, you know, refund as a one-time item.

Helene Becker - *Buckingham Research Group*

OK. And then, you answered somebody's question about the book tax rate, and I spaced out and missed the answer. Could you just ...

Neil Cohen - *US Airways - Executive Vice President and CFO*

Sure, we expect a book tax rate for the balance of the year to be in the 15 to 20 percent range that you would apply against our book earnings.

Helene Becker - *Buckingham Research Group*

OK. And then the other questions probably are for Dave. One, could you just address if you haven't already, the idea of a spin-off of the wholly owned US Air regional, US Airways regional carriers? And two, shuttle comments, could - Delta earlier in the week talked about how poor their shuttle is, is that because you are taking market share from them?

David Siegel - *US Airways - President and CEO*

Sure, let me answer the second question first, sort of like in quiz show. On the shuttle side, we continue to run load factors, I think consistent with Delta, and there's just too much capacity in that market, and I think the articles that you read in the "New York Times" and other periodicals that talk about the fact that the train has become a substitute, there's no question that that has eaten into our business. The reality interestingly is, that if you go to the airport today, you'll find very short waits. You can actually fly our shuttle and get to your destination more quickly than the train. I don't think the perception has caught up with the reality yet.

But both we and Delta are running unacceptable loads, and it's a question of having excess capacity in the marketplace. Having said that, we have picked up some market share in recent months. We run an absolutely outstanding operation on the shuttle, and I think it's really, that market share pick up is really a reflection of the industry-leading product that we continue to deliver. And again, I think the 2001 performance for the network certainly demonstrates that. But the shuttle is probably the best operating segment of our entire network, so as good as it is in the rest of the network, there's nothing better than our shuttle performance. And that has gotten us customers. I have to apologize - can you repeat your first question?

Helene Becker - *Buckingham Research Group*

Yes, it was about a possible spin-off of the regionals?

David Siegel - *US Airways - President and CEO*

We have no plans at this time, I mean, clearly there's a lot of activity in the marketplace, including my pull-down of having a very successful IPO. We have no plans at this time to do anything with the express operation in terms of spinning it out.

Helene Becker - *Buckingham Research Group*

OK. Would there be problems with debtholders if you tried to do something like that? Would there be debt covenants that you would be in violation of on the main line? Is that what ...

David Siegel - *US Airways - President and CEO*

You know, I haven't investigated that, because we have absolutely no plans to do that.

Helene Becker - *Buckingham Research Group*

OK. OK, fair enough. And then just finally, a follow-up on the shuttle. Do you have an increased number of corporate discounts there, or could you just address maybe what the average fare is?

David Siegel - *US Airways - President and CEO*

I'll let Ben (ph) comment on that.

Unidentified

Great.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Helene (ph), thanks. I can't give you information about the average fair on the shuttle, but I will tell you that we have seen increased -- we see some good success in securing contracts for corporate business on the shuttle. Yet, as Dave mentioned, we believe that that market is over-capacity, and as a result, unit revenue in the first quarter of this year versus last year for the shuttle is actually down greater than the rest of the system, down 26.6 percent.

Although it's on an improving pace that's a little bit steeper than the rest of the industry is, or the rest of our system, as well. So the shuttle dove a little deeper and is recovering a little steeper. But clearly, mix is what drives the shuttle.

Helene Becker - *Buckingham Research Group*

Well, if it's any consolation, Ben (ph), your decline is not as bad as the Delta decline.

B. Ben Baldanza - *US Airways Group, Inc. - Senior Vice President of Marketing and Planning*

Happy to hear that.

David Siegel - *US Airways - President and CEO*

Thanks, Helene (ph). If you read "Newsweek" magazine, you'll also see that former president Clinton's one of our customers, as well.

Helene Becker - *Buckingham Research Group*

Actually, Dave, I did see that. I did see that. Thank you very much for your help.

David Siegel - *US Airways - President and CEO*

Thank you, Helene (ph).

I think we have time for one more question.

Operator

Thank you. Our next question is coming from J a m i e B a k e r (ph) . Please state your affiliation.

Jamie Baker - *JPMorgan*

Yes, J a m i e B a k e r (ph) at JPMorgan. Neil, good afternoon.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Good afternoon, J a m i e (ph) .

Jamie Baker - *JPMorgan*

What size of loan would you consider appropriate?

Neil Cohen - *US Airways - Executive Vice President and CFO*

You know, I don't think we're prepared to say, right now. We're going to work with all the stakeholders on our restructuring plan, and we'll be prepared to sort of comment on that when we resolve that.

Jamie Baker - *JPMorgan*

OK, all right, fair enough. Quick question on the RJ mini-deal, just so I understand. The new jets can only be flown with union carriers, is that correct? So that doesn't eliminate any of your current partners, or independents, does it?

Neil Cohen - *US Airways - Executive Vice President and CFO*

No, it does not.

Jamie Baker - *JPMorgan*

OK. And then finally a follow-on, David, to what K e v i n (ph) touched on. You know, you've discussed RJs, the need for an international partner, obtaining a better cost structure, you know, but none of this touches on the basic geographic challenges that you seem to face. You lack presence west of the Mississippi, Pittsburgh and Philadelphia compete with each other in an area already rich with hubs.

You know, Charlotte's close to Atlanta. Is the plan simply to fix what's broken with US Airways today, and retain the current network framework? Or, should we be looking for something more dramatic? I guess I'm just having trouble figuring out what exactly you aspire to be, besides profitable and all that?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, I think being profitable is a great aspiration.

Jamie Baker - *JPMorgan*

Oh, oh, and I agree with you, and I wish you luck there. I mean, absolutely.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, again, I think I was very attracted to this company because of the strong franchise we have in the part of the country where the money is, and the people are. If you look at our network, as a regional network, it's actually I think a very exciting network and a very defensible network. Philadelphia and Pittsburgh can work well together, much like Newark and Cleveland work together for Continental. And Charlotte is actually a very powerful and effective hub completing our network, accessing the mid-Atlantic.

So on a regional basis, it's very strong, and I think there is additional opportunity for us to optimize the schedules in those three hubs, and fine tune the fleet. As well as I think a significant opportunity to improve performance at both Washington National and LaGuardia. Having said that, I think that gives us a very strong position on the East Coast, and again, if we can successfully complete an alliance with a domestic partner and an international partner, we are part of -- a very successful part, I think, and sustainable on a long term basis -- of a very powerful national and global network.

Jamie Baker - *JPMorgan*

OK, that's helpful. Thank a lot.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Thanks. I think that's -- oh, I'm sorry, we have time for one more question.

Operator

Thank you. Our last question is coming from Sam Buttrick (ph) . Please state your affiliation.

Sam Buttrick - *UBS Warburg*

It's UBS Warburg. Hey, Dave, if you're working the cost side of the equation, as the company says it is, why do you think your unit costs, ex-fuel, are rising at the fastest rate in the industry?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Well, I think, as we've commented, a couple things.

Sam Buttrick - *UBS Warburg*

Yes.

Neil Cohen - *US Airways - Executive Vice President and CFO*

For now, it rose faster because we had a more significant shrinkage of our capacity, than the rest of the industry. Also, as we mentioned, as we've downsized we've also had parity increases and other wage increases hit us. So while we've shrunk the workforce approximately in line with the reduction capacity, we've had rates of pay go up, as well as pension and benefit costs go up, hit it from the other direction. Having said that, again, as part of our overall restructuring plan, we're going to look at the entire cost structure, and address all elements of that, in order to get our costs in line with our revenues.

Sam Buttrick - *UBS Warburg*

Do you think your costs are higher than American, or United?

Neil Cohen - *US Airways - Executive Vice President and CFO*

Absolutely.

Sam Buttrick - *UBS Warburg*

Really?

Neil Cohen - *US Airways - Executive Vice President and CFO*

On a unit cost basis, we have the highest costs in the industry, and we're focused on correcting that problem.

Sam Buttrick - *UBS Warburg*

So you would you say looked at in the most proper light, your costs are higher than American's and United's? That's interesting. OK, thank you.

Neil Cohen - *US Airways - Executive Vice President and CFO*

Thank you. In conclusion, I hope that you'll agree that US Airways has a tremendous franchise and tremendous potential, as we've discussed. Particularly, looking at our position in the East Coast. We also believe that there's enormous upside potential to that, as we talked about with regional jets, domestic and international alliances. And we think an optimization of the current flying.

To this end, we are very focused, as we've said, on formulating and implementing a restructuring plan that's going to get us to a situation where we have fully capitalized on the strength of this company. At the same time, we've addressed some of the structural weaknesses that we've identified. I'm very confident that this is going to be a successful airline. I'm very much looking forward over the next couple of months to working with all stakeholders, as we formulate a plan to that end.

And in particular, I am very excited to be here working with our employee group that I had a chance to acquaint myself with now, in these first six weeks, which I think is our greatest strength as a company. And there's no better of that than the operational performance that you see every day, and the recognition that we've gotten by independent third parties, as well as the DOT measurements, and our performance along those.

So I thank you for your interest in US Airways, and I look forward to working with all of you going forward. operator.

Operator

Thank you. Ladies and gentlemen, this concludes the US Airways first quarter 2002 teleconference.

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04/18/2002 02:00 pm	ACPW	**Active Power (ACPW) − ACPW Q1 2002 Earnings Conference Call**

THE OPERATOR:
At this time, we'd like to turn the call over to today's conference host Mr. Bob Gray, Director of Investor Relations. Sir, you may begin.

MR. BOB GRAY:
Thank you, Cheslie (phonetic). Good morning and welcome to Active Power(TM)'s 1st Quarter 2002 Conference Call. I'm Bob Gray, Director of Investor Relations.

We released our earnings this morning and if you don't have a copy, they can be found on our website.

Joe Pinkerton, the CEO and Chairman of Active Power(TM), will lead today's call. Dave Gino, our Chief Financial Officer and Chief Operating Officer, is also on the call and will discuss the quarter's financial details. Afterwards, we'll be pleased to answer your question during the QAsection.

Before we begin, let me remind everybody that any forward−looking statements we may make are based on our current views and expectations. Although we believe our expectations and views are based on a least small assumptions, we can get no assurance that they will be attained. Factors and risks that could cause actual results to differ materially from expectations include but are not limited to inability to accurately predict revenue and budget or expenses for future periods, fluctuations and revenue and operating results, overall market performance, inability to manufacture products of a quality necessary to be accepted in the top quality market are dependent on our relationship with Caterpillar(R), and inability to successfully integrate new OEM channel partners, competition to ways and research and development, and inability to increase sales volume to fully utilize our increased manufacturing capacity, potential to future acquisitions, the volatility of our stock price regardless of actual financial performance, and finally, other risks set for in Active Power(TM)'s most recent SEC filings. Joe.

MR. JOSEPH PINKERTON:
Thanks, Bob.

As reported earlier today, our Q1 revenue was 4.1 million and our loss per share was 16 cents. Highlights from the quarter include a 21 percent increase in the number of end−user installations since Q4, a 22 percent increase in sales of our CleanSource(R) UPS, and a three−fold increase in sales of our CleanSource(R)2 product to Powerware. We see returns of sequential growth in Q2 with approximately 5 million in revenue and believe total revenue for 2002 will be in the neighborhood of 27 to 30 million, a 20 to 33 percent increase over 2001.

Behind the drive growth over the next 18 months can reach profitability in 2003, by executing on the following four initiatives: first, leverage are rapidly growing in installed base of reference sites, to potentially increased the number of fully engaged OEM salespeople, release a periods of new products that will triple our addressable markets, and finally, reduced our products' material cost by 30 percent, I'll announce you as more detail on each of these efforts. Third, our installed base. Reversible installations are key ingredient for Active Power(TM)'s future growth and we are excited about the progress we have made in this area. Installations grew dramatically during Q1 with over 12 megawatts of equipment being in placed in the service. We have increased our reference sites by a factor of 10 since the beginning of last year including particular success in the process manufacturing hospital, broadcasting, and pharmaceutical factor. A quick program note, for competitive reasons, we will no longer specifically name end−user customers. However, we will continue to talk about specific market segments.

To highlight one particular sector, we are enjoying success in broadcasting with several repeat customer in our 3−megawatt installed in the past few quarters at eight different stations. We also attended the National Consultation of Broadcasters' Convention last week and received favorable feedback from potential customers in the U.S. and abroad. One such success story in major broadcasting company, runs its one of our UPS units from Caterpillar(R) last fall. And based on product performance, that network ultimately purchase not only the rental unit but an additional two systems. These units are now being installed to protect television transmitters in Manhattan, which were launched last September.

Another example of strong performance is with the multi−megawatt−manufacturing customer. This past weekend, severe thunderstorms caused four power interruptions within a 24−hour period. As expected, our equipment cut those customer online and fully operational through the utility disturbances. Both the customer in the local camp dealer called to say how pleased they were with our products performance since its installation in February. We now have customers in a wide variety of sectors including; heat broadcasting sites totaling 3 megawatts of power protection, 7 government agencies totaling 3 megawatts, 6 hospitals and medical facilities totaling 2 megawatts, 8 data centers totaling 14 megawatts, 5 pharmaceuticals sites totaling 3 megawatts, 13 process manufacturing customers totaling 6 megawatts, 4 fiber extrusion sites totaling 3 megawatts, 5 semi−conductor facilities totaling 9 megawatts, and finally, 7 utility customers totaling 3 megawatts.

In the industry, specific references like this, combined with dozens of others, which will propel Active Power(TM) to strong sequential growth this year and beyond.

Second, increase the number of fully engaged OEM salespeople. The Caterpillar(R) dedicated UPS salesperson effort is well underway. There are currently five dedicated salespeople in the Caterpillar(R) network and an additional 13 dealers who agreed to hire a dedicated UPS salesperson. We should exceed 3 to 5 hires per month over the next few months. This dedicated UPS salesperson effort demonstrate CAT(R)'s continued commitment and focus on the power quality business. The CAT(R)'s electric power continues to strive for its stated growth targets. The Active Power(TM) products are gaining money share among CAT(R) corporate and the dealer network. Because of this increased focus on the power quality business, you should see an increase in CAT(R)'s direct promotional and selling activities. A good example of this is the new CAT(R) UPS.com website that went live earlier this month.

A great neutral opportunity to expand the number of fully−engaged CAT(R) dealers will be tagged Annual North American Dealer Meeting, which is being held in Austin next month. Active Power(TM) will host the dealers and several high ranking CAT(R) personnel in the manufacturing facility one afternoon to review both existing and future products. This will be an instant opportunity for us to showcase our world−class manufacturing facility, count the advantages of both existing and future products, and share dealers' success stories.

We are often multiplying the deed on the street within Powerware's web channel, evident by a three−fold increase in CS2 sales to Powerware in Q1 over Q4. Last week, we completed the first level of training for Powerware's North American sales force and Powerware's National Sales Conference held in Chicago. We trained over 40 reps at this meeting and 30 Power reps have signed up for additional training next month in our headquarters. We've also hired a new Active Power(TM) regional salesperson to increase our focus on the New York City areas, the largest UPS market in North America. This additional hire, combined with the commitment of the two dealers in the region to hire dedicated UPS salespeople, should yield returns in the second half of this year, rather release a series of new products.

Product development is progressing well. We expect to introduce four major new products to the remainder of this year and 2003. These products will approximately triple our addressable markets by the end of next year. This year, we will introduce two new products, the first of which is a 150 kVA 5−wheel base UPS. This new line will address a large market that has fared particularly well during the recent downturn. We expect to begin commercial sales of the system in early Q3. This product has an addressable market of approximately $500 million and we planned to distribute it through Caterpillar(R).

In Q4, we will begin early shipments of our 1200 kVA claimed to our CPS. This system will address a high power UPS market above our current 900−kVA product. In addition to lower cost for kVA, the system will have unique flexibility regarding the types of energy and power sources with which are in effect. We've already filed one plan on this innovative system.

In 2003, we planned to introduce a variable speed continent frequency or VSCF system at both 1200 and 600 kVA. The key attribute of this new product line is its ability to add line to engine generators, you can distribute a generation applications as well as its standby genset we work with today. VSCF allows a genset to produce more power for given engine site and achieve increased fuel efficiency. The first product using this VSCF technology will be launched in Q2 of next year.

Finally, reduced our product material cost by 30 percent. We quite (indiscernible) quarter in 2003, a major component of this effort is the amount of cost reduction programs. It is our objective to reduce our dollar per kVA material cost by 30 percent by the end of '03.

The first initiative here all even pass from engineering to manufacturing and we expect a 10 percent material cost reduction to impact our bottom line by the end of this year. Two additional cost production program that we believe we'll launch and we expect to see the impact of this initiative next year. Collectively, these efforts will reduce our material compound approximately 30 percent before the end of 2003.

In summary, we plan to drive growth over the next 18 months and reach profitability in 2003 by executing on a following four initiatives: (1) leverage on (indiscernible) to; (2) substantial increase in a number of fully−engaged OEM salespeoples; (3) release a series of new products that will triple our addressable market; and (4) reduce our part of material cost by 30 percent before the end of next year.

Let me now turn the call over to Dave for a more thorough review of our financial results.

MR. DAVID GINO:
Thanks, Joe.

Revenues for the quarter was $4.1 million within the guidance stand provided on our Q1 Call in January, down 20 percent from Q1 of last year and 9 percent sequentially.

During the quarter, we shipped 30 megawatts of equipment or 54 units with an average selling price of $55,000 per quarter megawatt flywheel.

Q1's ASP was up 20 percent from Q4 due to shipped in mix to our UPS product line. Also part of (indiscernible) effect to news due this quarter was an increased in product option demands on our UPS product sales. The financials UPS in CleanSource(R) DC mix was approximately 73. We continue to expect all kinds of UPS products to be approximately 70 to 80 percent of our sales for 2002.

The regional distribution of our sales through the quarter was: 65 percent domestic; 35 percent international, including sales to Italy, Canada, Turkey, Spain, The Czech Republic, and Brazil.

We received $1 million for development funding from Caterpillar(R) during the quarter as we successfully completed the second development milestone on our new 1.2−megawatt UPS product line. We expect to achieve the third of our milestones in Q2, which will result in another $1 million for development funding.

Cost margins improved slightly from Q4 on lower volumes due to a positive impact of mix and reductions to our manufacturing spending.

As Joe noted, we continue to make steady progress in our product cost reduction efforts with numerous product enhancements recently released by engineering to manufacturing that will work their way through the supply chain and into our product shipments and product margins in Q4. The impact of this change will reduce our product cost by $7,000. Research development engineering cost were down approximately $600,000 from Q4. This reduction was driven by two factors: the level of activity on our 1200kVA UPS product development increase significantly from Q4 from $283,000 to $741,000. This increase in the overall percent a stock up in our overall spending by the shift in the level of our product development activities between projects. The cost associated with our higher power UPS development is match against the funding we received for this development and move at the bar indeed and reported on separate line on our income statement, Cause to Development Funding.

To effectively compare of RDspending trends, we suggest combining both the RDand the cost to development funding lines on the income statement. At combined basis, we experienced the decrease in RDof approximately $300,000 from Q4. This decrease is resulted in reductions in allowable spending on our low power product developments.

SGAfor the quarter remained flat with Q4 and net loss for the quarter was $6.5 million or 16 cents per share on track with our January guidance and one cents better in Q4.

Turning to the quarter's balance sheet and cash flow. During the quarter, we consumed $8.2 million slightly−better−than−expected. Inventory at quarter end was 7.8 million relatively flat with Q4, up to 7.8 million: 600,000 was in finished goods and 3.9 million was work in process. Payables for the quarter grew up 2.3 million from Q4 and so non−recurring (indiscernible) primarily for construction down on our new facility received in Q4 were paid in Q1.

Before we open the call to your questions, I'll provide some insights into our current financial projections. Our intent in providing this conference is not to share all of the specifics on our internal financial plan, but to give everyone a general and consistent view of where we believe things that headed.

We believe Q2 revenues will be up sequentially to approximately quite $5 million. But for the year 2002, we expect revenues to be approximately 27 to 30 million of 20 to 33 percent from 2001.

Our visibility has improved steadily since last fall. Although our sales cycle had stretched out to three to eight months due to a challenging economic climate for capital equipment purchases, our sales activity level continues to improve. A good portion of this disimprovement is directly associated with the solid performance record on a rapidly growing end−user installed base. We believe Q2 earnings per share will be a loss of 15 to 16 cents with a −− for the year 2002 loss of 57 to 62 cents. We continue to expect steady progress and project −− product margins driven by engineering designed equipment and volumes. We believe our product gross margin' breakeven point is approximately $10 million a quarter. We expect the RDand cost to development funding a combined spending to remain collectively flat in Q2 and through the balance of 2002. SGAis expected to increase approximately $200,000 per quarter through the balance of 2002, driven primarily by an increases on the wanted reserve associated with the increase in sales and due to expect in increases in sales and service report.

We believe inventory levels will flatten out for the next several quarter. And capital expenditures to be $2 to $3 million for the year. Our cash assumptions should begin improving in Q2 to approximately $2.5 million a month with their full year 2002 burn rate dropping to approximately $30 million. That leaving us with approximately $82 million or $2 a share in cash at the end of the year. More than adequate to fully fund our current business plans.

Thanks again for your interest on Active Power(TM). And now Joe, Bob, and I will be glad to answer your questions.

THE OPERATOR:
Thank you. If you like to ask a question, (CALLER INSTRUCTIONS). Christine Francis (phonetic), of Merrill Lynch.

THE CALLER:
Thank you very much. A question regarding a unit sale ramp up to reach about $30 million or $27 to $30 million in revenues suggest a significant ramp up in unit sales with the higher ASP notwithstanding. Are you seeing the potential multiple orders or a larger orders from repeat customer than you have in the past?

MR. DAVID GINO:
Yes, we are. I've mentioned one of them in the call a broadcasting company that we are also seeing quite a few in the banking sector and the process−manufacturing sector. I mean, if we −− this order stay involves the units at one client for example and they work well. And so they start to install them another plan citing with real a bunch of names that I have mentioned earlier for competitive reasons why do have to stop doing that.

THE CALLER:
And in terms of your overall guidance for revenue and the plans to launch a new product in the second half of the year. Do your current revenues incorporate any estimate for sale for the new product, from the new product?

MR. JOSEPH PINKERTON:
That they include some sales up at a 150−kilowatt system. Yes, we do have a few systems at the 1.2−megawatt system in late Q4, but it really doesn't have effect on the overall revenue for the year.

THE CALLER:
Okay, and final question in terms of sale cycle, you indicated that it had lengthen from 3 to 8 months. Are you comfortable or are you seeing that broad amount and some increase confidents that customers are −− your comfortable with that 8 months versus increasing to perhaps 12 months?

MR. JOSEPH PINKERTON:
Yes, let me clarify first. It has not increase from 3 to 8. The bond that we're seeing has it increased from 2 to 6 to 3 to 8, I mean there's always a (multiple speakers) pretty large spread. Again, it actually have you know what were seeing is improve. But during Q1 and of course Q4, it was very (indiscernible) deals that improve in Q1 that −− relative to −− but a last year that the sale cycle has increase by a couple of months but we've made a lot of progress in

terms of planning stage last quarter. So, we plan to see the fruits of that efforts this quarter and in third quarter.

THE CALLER:
Right. Thank you, Joe.

MR. JOSEPH PINKERTON:
Thanks.

THE OPERATOR:
Kent Morisson (phonetic), of Roberts Beard.

THE CALLER:
Robert W. Baird. Joe, I just like follow−up on that. I mean if there's a big ramp up for the second half. It just came out for quarter where you're hit your range but sure at the lower round. I mean, do you haven't been giving us orders and backlog before but I mean do you have a good junk of I mean specific visibility with regards to those orders?

MR. JOSEPH PINKERTON:
Well, I think one thing you've got to look at is, as I mentioned there was a 25 percent increase in CleanSource(R) UPS sales to cancel out a significant increase in a PS2 sales to a Powerware. You know, you look at those trends and their as pretty healthy sequential growth and so we see that continuing in addition, adding on for example the 150kVA product in early Q3 when out of big, hot market right now.

And so that is significant. Also all note that it's just −− you know, the simple multiplication game. We are just getting more and more dealers selling our products the CleanSource(R) CPS product. And more and more Powerware selling as the CS2 product. I mean, you increase −− you double the people that selling your product and you double your product line and you can see pretty substantial growth. And we are saying that we're also seeing a significant increase in coding activity and associated customer interest.

So, this are −− we're very tangible terms. we have strong sequential growth in a certain product line. To a certain customers quarter−to−quarter. And we see that activity increasing going forward

THE CALLER:
So this connect between your sales growth and your installation, is that product coming out of the inventory Caterpillar(R)?

MR. JOSEPH PINKERTON:
In some instances, it is −− there's also someone of that is lay between shipping in and having down install, the combination of those two things. But you also saw that inflation we're up a 100 percent in Q1 of this year relative to last year. But it really is an indication of a very real progress and momentum in this channel (multiple speakers). We look forward to next quarter looking back and talking about the sequential growth overall.

THE CALLER:
Sure.

MR. JOSEPH PINKERTON:
Just quick to clarify a couple of points. One, the level of installations were decimally equally to the level of shipments. So, we're not shifting to inventory at this point. Where no −− any customer during Q1 that took product for inventory of any significant, I think the installations were 52 on the shipments of 54.

THE CALLER:
Okay.

MR. JOSEPH PINKERTON:
So, the differential to 101, which exactly what we want to see.

THE CALLER:
Right.

MR. JOSEPH PINKERTON:
We would be much more concern of big portion of the sales in Q1 is going into inventory.

THE CALLER:
So, how much inventory do you think you still have out there? Did you −− do you think it's pretty much cleared out at this point? It's kind of what you're implying, I guess.

MR. JOSEPH PINKERTON:
What we have said in the past and it's still true today, there was a couple of dealers in the CAT(R) network that took products during the early part of 2001.

THE CALLER:
Right. And they're working that inventory down. We do not believe any other dealers in the Caterpillar(R) networks have any significant inventory. Now, when you were all originally talking about the lower voltage unit. And you weren't necessarily sure what is out distributed through CAT(R) or not. And it's sounds like the 150−kVA unit will be distributed through CAT(R)?

MR. JOSEPH PINKERTON:
Yes, we haven't signed that one in broad yet but we plan the distributor of product can move allot faster. And we've already got that channel up and running and dealers are really demanding that will our power product and that's where a lot of the business is today.

THE CALLER:
What's the primary target market there?

MR. JOSEPH PINKERTON:
It's the range of commercial market. It's a way from the big data centers and more −− towards more medical and broadcasting and small−to−medium size businesses.

THE CALLER:
And Dave, can you give us the ASP's for the two different products and what your service revenues were in the quarter?

MR. DAVID GINO:
Yes, sure. The ASP's for various products on the UPS product line, the average ASP is about $60,000 per quarter network flywheel.

THE CALLER:
Okay.

MR. DAVID GINO:
For the CleanSource(R) issue product is about 28 to 30.

THE CALLER:
28 to 30.

MR. DAVID GINO:
And relative to service installation and revenues outside the product, it was just over a $100,000 for the quarter.

THE CALLER:
Great and then just −− did you have any sales to GE this quarter or any update on kind on GE relationship?

MR. JOSEPH PINKERTON:
The GE relationship is doing well. For we −− just the structure of their business, there is a initial shipment of units before they really at the ramp up and their sales and marketing equity was made plan. And that's working it's way through their system. So, we expect to see additional business from GE Digital Energy later this year.

THE CALLER:
Great. Thank you.

MR. JOSEPH PINKERTON:
Thank you.

THE OPERATOR:
David Smith of Salomon Smith Barney.

THE CALLER:
Good morning guys?

MR. JOSEPH PINKERTON:
Good morning.

THE CALLER:
You're not totally clear on the number of units. Like you talked about sales, I think your referring to dollar sales in the release. Can you just give us a number of units I might have miss that?

MR. JOSEPH PINKERTON:
The number of units shipped in the quarter was 54 (multiple speakers) installation was 52.

THE CALLER:
Can you have −− can you break it down by CleanSource(R) and UPS?

MR. JOSEPH PINKERTON:
If it was on revenue basis at 70:30 UPS to CleanSource(R).

THE CALLER:
Okay, stay with the ASP so I can say what you're saying exactly. You're not getting into numbers?

MR. JOSEPH PINKERTON:
No.

THE CALLER:
Alright. In term to growth margin. And I'm not totally clear in the growth to gross margin for quarter, I think if you work out the numbers up to negative 8 percent. But as I count like the CAT(R) $1 million contribution lets say, I'm assuming it's correct, correct me if I'm wrong, it seems that going down year−over−year with what I think and correct in saying that?

MR. JOSEPH PINKERTON:
You're correct. On the product gross margin basis, it was about 42 percent negative. Now again this line went down year−over−year, Q1 0f '01 to Q1 of '02 sequentially volume.

THE CALLER:
Okay.

MR. JOSEPH PINKERTON:
Now, it did improve from Q4 and now at the level of product sales was lower and that's correctly associated with both mix and reductions in our manufacturing spending.

THE CALLER:
Okay.

MR. JOSEPH PINKERTON:
And we do a continuous yield better in his remarks, say a significant improvement in matter of both on that's absolute improvement to material cost from the product as well as volume improvement as we offset some of the overly cost with higher volume.

THE CALLER:
Okay. If I was to track records those you talked about cash flow of September sent for this year, can you give us a cents on what you saw in terms of the cost reduction on a precise basis last year?

MR. DAVID GINO:
Of last year, we are just being get into their commercial supplier of products and therefore we're focused on releasing the products, get them into the market without necessary on reducing the cost of the product. I mean the two products we talked today, the CAT(R) UPS 339 kVA and CS2 that were both −− the percent and the bulk for last year. So that in analysis turning points, and that we're reducing from that point forward.

I mean, that's pretty powerful combination, you get volumes up, gross margins are heavily of course time to that and then you combined it with the material cost reduction and gross margins in groups pretty quickly. I mean, we plan to be a gross margin positive certainly by the end of this year.

THE CALLER:
Okay so, in terms of gross margins, I could probably assume breakeven took slightly up in the fourth quarter?

MR. DAVID GINO:
Well, we certainly call was we would be gross margin and breakeven at $10 million in revenue. So just in 27 to 30, more than likely you're going to get 10 million minus 4th quarter unless you kind of do that now. And therefore, the gross margin positive during that period.

THE CALLER:
Going back to couple of previous questions, in terms of the ramp−up in the second half being pretty aggressive, the Powerware sales, did they all go out to customers or you know, I appreciate your comments in inventory in the last call but the last question but is that kind of a one−time shot or is that something...

MR. DAVID GINO:
About 100 percent of the Powerware units went to end−user customers.

THE CALLER:
They did. Okay. So we can expect that to kind of be part of the gross story.

MR. DAVID GINO:
Yes.

THE CALLER:
Okay, thanks.

MR. DAVID GINO:
Thank you.

THE OPERATOR:
David Kurnsman (phonetic) of HC Wainright.

THE CALLER:
Hi, folks. A couple of things quickly just to clarify, When you say the 10 million per quarter gross margin breakeven, that is excluding any development revenues from CAT(R)?

MR. DAVID GINO:
It should have be better than −− if the $2 million would be total revenue.

THE CALLER:
Total revenue, okay. And the inventory breakout went kind of quickly. Can I just get that breakout one more time, please?

MR. DAVID GINO:
Sure, what was that again?

THE CALLER:
The inventory breakout, all I got was the 3.9 in webs. What were the other components?

MR. DAVID GINO:
Installation it was 600,000 finished goods and 3.9 million in webs.

THE CALLER:
Okay, very good. And in terms of the profitability in 2003, are you saying that you're going to be profitable for the full year 2003, or sometime in 2003?

MR. JOSEPH PINKERTON:
Of course, couple of quarter will be in 2003, we will not be profitable for the -- we don't expect to be profitable for the full year 2003.

THE CALLER:
Okay, great, thanks.

MR. JOSEPH PINKERTON:
Thank you.

THE OPERATOR:
Marco Thinker (phonetic) of Credit Suisse First Boston.

THE CALLER:
Yes, good morning. A couple of questions. First of all, your receivables popped in the quarter; can you just give us some insight to what the increase?

MR. DAVID GINO:
Sure, it really was the trend of our sales during the quarter as we've mentioned these activities picked up during the course of the quarter and from the fall and so our sales were slanted towards the back end of the quarter.

THE CALLER:
And your experience with your actual customers, I mean they haven't point in their payables?

MR. DAVID GINO:
No, it's not inherent to any issues with our customers.

THE CALLER:
Okay. Here's my -- how many dealers CAT2 is your currently selling product through?

MR. JOSEPH PINKERTON:
It's 25 active dealers and then others there's market side is -- that 25 active dealers and then we've trained 77 dealers now.

THE CALLER:
Okay.

MR. JOSEPH PINKERTON:
I mean the kind of load numbers the ordered 60, but in terms of going−forward and an individual quarter, about 25.

THE CALLER:
Okay.

MR. JOSEPH PINKERTON:
Last call, we have out of the 2 and 10 dealers that we have. So, we −− again I mentioned the dealer meeting next month where we're going to have about 70 dealers principles comes to our facilities it should be a great opportunity to expand that number.

THE CALLER:
Okay. Last, have you talked about the cost in issue and that's hope to under take the raw materials. My question is for the strategic standpoint, do you intend to change your pricing to some degree or do you hope to substantially have a 100 percent of those costs flow through the bottom line.

MR. JOSEPH PINKERTON:
And we're not seeing a lot of price pressure, I mean a positive, completely unique, and we have set prices from our OEM. So, we believe that the vast majority of those savings will enhance our gross margin.

THE CALLER:
Okay. And have you had any experience wherein there has been a price shift to the ultimate end customer? Has that led to a proportionate increase in unit sales or is this a failure price for the last process at this point in time?

MR. JOSEPH PINKERTON:
We have a channel of variability in our end−user sales associated with the price adjustment. We're seeing some modest price adjustments to try to capture a deal but nothing is significance.

THE CALLER:
Okay. Thanks so much guys.

MR. JOSEPH PINKERTON:
Thank you.

THE OPERATOR:
Ali Aga (phonetic) of Bank of America Securities.

THE CALLER:
Thank you. A couple of quick questions. First, they're just confirming your revenue numbers for the full year, that assumes about 4 million of CAT(R) development funding?

MR. JOSEPH PINKERTON:
That's correct.

THE CALLER:
Okay. And the price for the unit that we saw in the first quarter for the different product lines, is that what you would expect to continue throughout the year?

MR. JOSEPH PINKERTON:
I think that's probably a good estimates because the mix was about what we expect going forward as well.

THE CALLER:
Okay. And what should we expect for the 150−kVA product when that is launch from the pricing point of view?

MR. JOSEPH PINKERTON:
We haven't released that price point, but I would say low 50 is probably a good number to work up with.

THE CALLER:
Okay. And also can you remind us your budget for the full year for '02, how has that changed? Was it your expectations when you started the (technical difficulty)?

MR. JOSEPH PINKERTON:
I think it's pretty well in line. If anything we've seen some improvements on the cost side from a lot of the excellent work being done on product cost and an overall spending on the offering side, those are the two areas that would highlight as being an actually positive from what we saw and what our plans would have indicated over the last couple of quarters.

THE CALLER:
What about revenues and volumes? If I'm not mistaken, haven't those parameters come down?

MR. JOSEPH PINKERTON:
If you look for the last quarter, I would say no. If you go back two quarters into the September quarter, yes they have. And I think that's a direct reflection of the challenge in economic plan and for capital spending that really hit the wall last fall.

THE CALLER:
But incrementally, over the 3−month period, you mentioned that inquiries are picked up, sale cycles have lengthen when you combined the two overall, you would say that business from the budgetary point of view is similar to what you expected three months ago?

MR. JOSEPH PINKERTON:
Yes.

THE CALLER:
Okay. Last question, in terms of inquiries that you're seeing out there in the market right now, what area, and I think you never address in full, but which end markets or even regions are

you seeing the most interest right now for your products?

MR. JOSEPH PINKERTON:
Yes, I think what's the real up is the negative of the airs with the strength. But a lot of interest in process manufacturing and that's in −− we see that all over the world, also hospital medical facilities. Just recently, we've had a pretty impressive spike in interest in sales and to the broadcast sector. Everything but the Internet data centers.

THE CALLER:
Yes, right. Thank you.

MR. JOSEPH PINKERTON:
Thank you.

THE OPERATOR:
Steven Colbert (phonetic) of Johnston Merchant Partners.

THE CALLER:
Good morning. Couple of questions if I could. First of all, can you just elaborate a little bit more from the relationship here with (indiscernible)? Are you giving the type of support that you initially expected from this (indiscernible) in terms of the offering dealer incentives or financing packages to customers or any field from that nature?

MR. JOSEPH PINKERTON:
The list is pretty long in terms of what they step up to do. They recently launched a guarantee program where they guarantee this to even at will, will performance relating there's a financial penalty through Caterpillar(R). They have state and mentioned open the CAT(R) UPS.com website. I think, the fact that several high ranking CAT(R) corporate people and a few hundred dealer personnel are coming down to open for their annual meeting is reflective of their strong commitment to the program.

THE CALLER:
To effect all that at this point and I think is of absolute report this only about 25 active dealers, somewhat below. Would you −− what have thought maybe a year ago?

MR. JOSEPH PINKERTON:
Well, If you look back at the half Caterpillar(R) Electric Farm Generation Programs like rental units, or even not even way back to their genset business. They start up low with a couple of dozen dealers. Those dealers show success and then it spread pretty rapidly on that point. I think now, the rental business, is 6 or 7 or $800 million business? It's safe to watch and come up, set up, for a second like Catterpower. We'd like it to happen overnight but it doesn't happen overnight. But it does happen.

THE CALLER:
Okay. The second question is, it sounds like from what I'm hearing you're service −− you're expecting to be gross margin positive in the fourth quarter? Is the fact that the 150kVA unit shipping at there point a factor in getting you there?

MR. DAVID GINO:
It is a factor in us getting into the $10 million of revenue, which would be required to get to the overall current gross margin positive point. I mean its not a huge factor for 2002 since its only being released in Q3 and going to take some time to ramp up. But it is a factor in/or 2002 revenue, yes.

THE CALLER:
(indiscernible) to address this, is it effect the margin that unit higher than what it should be at this point?

MR. JOSEPH PINKERTON:
It would be positive gross margin. It won't be as higher gross margin as our other product lines.

THE CALLER:
It would not be, okay.

MR. DAVID GINO:
Well, not initially, because it's early...

THE CALLER:
When do you think you gets to the point where it's equal to a better than in the product lines?

MR. JOSEPH PINKERTON:
I think early 2003.

THE CALLER:
2003. Okay, and last question, if I could. You talked about getting to breakeven. I think you said for a, I mean, quarterly basis in '03 but not for the full year '03?

MR. JOSEPH PINKERTON:
You're right.

THE CALLER:
That's what I heard. And can you help us at all on the cash flow basis when you get to a breakeven on that point?

MR. DAVID GINO:
Late '03 as well.

THE CALLER:
Late '03. Okay, thank you.

COMPANY REPRESENTATIVE:
Thank you.

THE OPERATOR:
Stephen Warslo (phonetic) of Thomas Weissle.

THE CALLER:
Hi guys. How are you?

MR. JOSEPH PINKERTON:
Good.

THE CALLER:
I was hoping we could get in a little more detail on the piece of orders over the quarter. It looks like, you guys mentioned, that there are receivable that you were putting back and waited, could you elaborate on that?

MR. DAVID GINO:
What I can give out is specific breakdown of the quarterly revenue. But clearly, we saw a back and waiting of revenue. I mean January, as we mentioned at the last call in January this ability wasn't particular great when we started the quarter. There was a result of everything that went on during the fall with capital spending that began to pick−up in December and as we work through the sales cycle, which takes some time. About a three to eight months to get through the sales cycle and get the whole order and ship the product. You know, the momentum began to build at the second half of the first quarter.

THE CALLER:
Okay, thanks. And, did you guys seeing any reaction by competitors to your products in the marketplace?

MR. JOSEPH PINKERTON:
We see the same old composite flywheel companies coming and yelling. But I haven't seen −− the only thing I've really seen is Beacon, the public company, came out and said that well, in other well−powered pelican flywheel is not going well and that they thought that they might shift up to a quarter megawatt bubble, which of course is our basic building block today. But nothing less beyond that.

To tell you the truth, I'm very surprised. We've been out there a couple of years now, with the Plug Compatible Replacement for batteries and we still don't see any competitors out there that can just get rid of batteries and plug in a battery create system. And I think the recent downturn, both in the economy and in the private and public markets has really hurt several would−be competitors in terms of funding.

THE CALLER:
Is a battery guy doing any aggressive pricing to try the −−− have to take you on or they just ignoring you?

MR. JOSEPH PINKERTON:
We don't see any change in the flexibility around the room. I mean they, the prices go up a couple of percents relative to the price of lead−oxide. But there is −− they don't have lots of flexibility. I mean, what's great about our product is, as I mentioned, its brand new to −− we're competitive now, and yet we can down natural cost of 30percent and in 18 months, this battery that people can't do that. So, we're excited about that.

THE CALLER:
All right, thanks guys.

COMPANY REPRESENTATIVE:
Thanks.

THE OPERATOR:
Steven Brink (phonetic) of Mosamo Capital.

THE CALLER:
Good morning. Could you talk a little bit about the five dedicated CAT(R) salespeople and their backgrounds? Were they previously genset salespeople, or maybe you could just talk about that a bit?

MR. DAVID GINO:
If you're (indiscernible) we're saying up. So, I should say that, a big part of the Caterpillar(R) sales that are coming in today, are coming in from CAT(R) genset and the service personnel. We find that there can't be even more success if there's someone dedicated to the UPS program buying large the people that they are hiring are not genset salespeople. They are a people with electrical equipment background, such as switchgear or automatic transfer switches, or UPF people that some of the equipment preface electrical equipment.

THE CALLER:
Okay, so −− in general, you would expect a relatively short period of time before they are trained up and running and ready to go.

MR. JOSEPH PINKERTON:
Yes, we've seeing that. There are a handful of dealers and the people come up to speed pretty quickly. We find it just, you know these dealers are so big like, what we deal with our new order $500 million Kennedy (multiple speakers) at somebody that wakes up in the morning thinking about UPS and making out. Just letting their cash burns knows that they're in the UPS business that can make a tremendous amount of headway, pretty quickly.

THE CALLER:
Okay. And finally, you indicated that there were thirteen dealers who had agreed to hire a dedicated salesperson, I didn't catch whether you put a time frame on that. Was that by mid−year or end of the year?

MR. JOSEPH PINKERTON:
So, we mentioned that we felt that now that they made the commitment and based on a tea bag that we received that we see three to five dedicated salespeople come up for the next few months.

THE CALLER:
Okay. Thank you very much.

COMPANY REPRESENTATIVE:
Thank you.

THE OPERATOR:
Gary Holsworth (phonetic) of (indiscernible).

THE CALLER:
Hi, folks. I wanted to just get a little and apologize if it's already been asked but I want to get behind the cost reduction and where is it, in a lower part count plus a combination of that, plus better engineering design into the systems. Where is this cost reduction coming from?

MR. JOSEPH PINKERTON:
It's interesting even though it's not intended, a detail meeting on that yesterday. It's a, when you look back, we developed the product, the Series 300 in approximately 12 months in PS2 and in eight months and our time to market was our rallying time. I can not tell you all over again, we'd still do it that way, but when we're doing things that quickly, we just grab the first component we find that works and we order it, and we plug it in and go, and now it's pretty encouraging. We've got the whole the engineering team together and we just waiting down, line item by line item. There were literally, a 180 cost reduction ideas that came in the play, we goggled that down to about a third dose, and they come totally simple. I mean very alarmed, I just going out and there's a standard let say power supply. And we go out and we simply find one that is at least in a good quality for two−third supply.

Other costs reduction items are of small design and process changes, and we're seeing them in the flywheel, we're seeing them in the power electronics, we're seeing them in the wire assembly. So, we're seeing them across−the−board. We're also seeing, not only costs ration coming from engineering in terms of specifying level, cost cards, and designing lower cost cards but also in manufacturing or simply going back to suppliers and getting better deals. Our processing group is doing a lot of good work, and it's a different rule of court than it was 12 months ago or 18 months ago in terms of suppliers. They're quite a bit hungrier than they used to be.

THE CALLER:
But you have some better design for manufacturability?

MR. JOSEPH PINKERTON:
Well, absolutely. And we've make some next month hires a couple of course ago, or saying the benefits of that. That's a good point in addition to just the material cost reductions. There are process cost reduction that come from even manufacturing.

THE CALLER:
Then after this next 30 percent, kind of move or that too much to mentioned. Would you just expect the further cost reductions based on volume or do you think there's even more, even that are required the next generation of device or in other more in line for future years?

MR. JOSEPH PINKERTON:
There are a couple of things, I mean clearly you can say for any given power level that you picked and if you designed something but however, you're automatically get a coming order about 25 percent cost reduction versus something, that, for example, the building block of −− it's not we, when we sat down with this lift and we narrowed it down, that irons that didn't make it on the list for this purpose, major push are still there for the next lump site. I see a lot of opportunity even beyond the 30 percent.

THE CALLER:
Great, thank you.

COMPANY REPRESENTATIVE:
You're welcome.

THE OPERATOR:
Eric Prouty (phonetic) of Adams Partner.

THE CALLER:
Great, thank you. Quick question on the CAT(R) dealership network. They are currently offering your UPS products for Wintell. And, if so, how many are in the Wintell fleet right now would be your best guess?

MR. JOSEPH PINKERTON:
They are -- but really just getting started with that. We made a handful of units and is much modern, and liked them, and in assemblance that this -- they bought, and took them off to rental market, and so we're building more. I expect that to be growing further business and in addition to the rental market we're finding that said customers would like complete packaged units, the gensets, flywheel, UPS, and automatic transfer switch. You know that I might need miles, I can just put outside and so we expect to see an increase in activity for packaged systems as well as through mechanically.

THE CALLER:
And how many of pure units are in the rental fleet to CAT(R) dealerships right now would be your best guess?

MR. JOSEPH PINKERTON:
My best guess would be, as many as we got, which is I think three or four.

THE CALLER:
Okay, great. Thank You.

THE OPERATOR:
Thank you. At this time, I like to turn the call over to Mr. Bob Gray.

MR. BOB GRAY:
Thank you. Any remaining questions?

MR. JOSEPH PINKERTON:
I just want to thank everybody for joining us and I appreciate your continued support.

THE OPERATOR:
Thank you. This concludes today's teleconference. All participants, please disconnect at this time. (CONFERENCE CALL CONCLUDED).

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Flexsteel Industries, Inc (FLXS)
Q3 2002
Event Transcript

Wednesday, April 17, 2002 9:30 am

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Flexsteel Industries, Inc (FLXS)
Q3 2002
Wednesday, April 17, 2002 9:30 am

THE OPERATOR:
Welcome to Flexsteel Industries, Inc. Third Quarter 2002 Operating Results Conference Call.

At this time, it is my pleasure to introduce your host for the call, Flexsteel Industries' Chief Financial Officer, Mr. Ron Klosterman.

MR. RONALD KLOSTERMAN:
Good morning and welcome to our conference call to review our March 31, 2002 quarterly results. We appreciate your participation this morning. Joining me this morning via telephone from our showroom in Highpoint, North Carolina at the International Home Furnishing Center is Bruce Lauritsen, our President and Chief Executive Officer.

During our call today, we may make forward-looking statements that are subject to risk and uncertainty. A discussion of factors that could cause actual results to differ materially from management's expectations is contained in the company's SEC filings included for the most recent annual report to shareholders and 10K and the press release dated April 16, 2002 announcing the results of operations for the quarter in nine-month period ended March 31, 2002. Any forward-looking statements or opinion as of now and we take no obligation to update or revise any forward-looking statements to reflect events or circumstances after today's call.

At this time, Bruce has some opening comments before we open up the session for questions from analysts. Bruce.

MR. BRUCE LAURITSEN:
Good morning everyone. What I'd like to do is go over -- just a brief restatement of our press release last night. A couple of items there and I'll give you a little current scenario of what's going on and where we're at in our three businesses.

Net sales for the quarter ended March 31, 2002 were 73.7 million compared to the prior year quarter of 72 million, an increase of 2 percent. Net income for the current March quarter is $2 million or 33 cents per share, compared to the year earlier quarter of 8 cents, or 800,000 -- I'm sorry, or 13 cents per share. Net sales for the nine-months ended March 31, 2002 were 202.8 million compared to 215.9 million in the prior year nine months, a decrease of 6 percent. Net income for the nine months ended March 31, 2002, up 2.9 million or 48 cents per share decreased in the March 31, 2001 net income of 4.4 million or 71 cents per share.

Now I'd like to tell you a little bit about what happened in the quarter that -- we're just reporting on. Orders really rebounded very nicely during the March quarters starting right after the January 1st holiday and various inventories were very good starting in January and continued on through most of the quarter. The recreation of vehicle seating business volume build-up during the quarter month after month and comparing to March 2000 quarter to the December 2001 quarter, residential shipments increased 10 percent, RV shipments increased 28 percent. And just as important, our backlog in the hospitality and the contract seating business increased, ended to the double-digit area. Things that we've been working on the prior nine-months with beds, and boats, etc., came to fruition during the March quarter. The cost of raw materials had little changed during the quarter, however, we may see some increases in the steel prices during the latter part of calendar 2002 due to the impact of just recently inactive import tear-ups (phonetic).

Some other points of interest -- here in the recreation of vehicle business are -- during the Valentine (phonetic) over the last 18-months, net industry. We stayed true to our strategic plan and worked very hard in increasing our market penetration. And in fact, open up 14 new customer chairs in an area that we have a 60 percent plus market shares, so we're really, really happy about them. In the residential seating area, we have 350 comfort seating galleries opened and 45 additional signed contracts that we hope to get opened in the next four to six months. Our new Christopher Lowell collection, which debut in October of 2001, we have 40 completed and open and over 135 signed commitments to bring to fruition and get open this year. Our outlook for commercial seating business is as strong as I've seen it in the last 12 to 14 years. We have just been blessed with the number of clothes and beds on projects all over United States for re-dos (phonetic) in the hospitality business as Lowell's new properties. So, we're really thrilled with what's been going on for about the last four-and-a-half to five months and especially the business that we've received in the last 90-days and we're going into the final quarter with a real strong business backlog as well as prospects for continuation of running business.

At this particular time, I'll open up the forum to questions that any of the analysts may have.

THE OPERATOR:

At this time, we will be taking questions from analysts. (CALLER INSTRUCTIONS) Penn Sincleton (phonetic) of Merrill Lynch.

THE CALLER:

Good morning. Bruce, could you talk just a little bit more about your utilization rate? How orders are trending in so far in April and what's your plan are for new introductions at the upcoming April market?

MR. BRUCE LAURITSEN:

Well, our orders continue. They soften a little bit in the residential area the last two weeks of March and I think it's a combination of many factors in early Easter as well as -- just the prior two months, there was a lot of buying going on and it's picked up as we came to the high point. We have enlarged our Christopher Lowell collection for five new occasional groups and to the collection, which we didn't have in October; tables and some wall, wall units, etc., as well as some upholstery pieces. We've got new -- really across the board, we've got three fabulous leather sofa-loveseat chair combinations as well as some beautiful of Lowell style upholstery. We feel real good about this market. Our sales force is really very, very comfortable with our new introductions and they feel good about the customers coming here as well as what they take to peer it back going on the field. Going further, just a little bit ended the recreation of vehicle business. We feel real good of that business has re-solidified itself and its moving back into the range that we expressed a couple of years ago and the prospects for that, we feel for the next 10 to 12, 15 years are very good.

THE CALLER:

Did you mean 10 to 15 months Bruce? You said...

MR. BRUCE LAURITSEN:

No. Just looking out, as a demographics as to...

THE CALLER:
Really?

MR. BRUCE LAURITSEN:
Yes. Where we feel that the baby boomers are just entering into that first stage of possibly doubles and then motorized, etc. So, that industry is a -- we're really feel good about the future of that business. But right at the present time, we're just pleased that the consumers are back in the marketplace purchasing and taking us back to the levels that we experienced prior to the downturn.

THE CALLER:
Okay. I'll just have good couple of more questions 'cause I know there are others. I wanted to get an idea of what type of volume do you think is reasonable for the Christopher Lowell line over the next -- say, couple of years? And do you expect to add any new accounts, not Christopher Lowell but just Flexsteel in general -- at competing (phonetic) in general at this market?

MR. BRUCE LAURITSEN:
We do. (1) The volume PMI (phonetic) would be -- I'd be stabbing (phonetic) at a number that I wouldn't be comfortable with. Maybe by the time I see you tomorrow or the next day, I can give you a little bit better number. But we feel that, that has a potential of this market, just at this market of possibly signing up another 25 to 35, 40 additional retailers. We have experienced an interest on a Christopher Lowell collection from certainly some of our long-time retailers. But more importantly, or just as important is the interest that we picked at from people who we haven't done business with, and that's the exciting part. We thought that might happen but it's really reaching a different consumer, maybe a younger consumer or a consumer that's doing things on their own that they come in the store and the stores that are open right now or for the most part, really, really doing a nice job.

THE CALLER:
Okay. Last question. Just give us an update on your retail business, where it stands right now, and what it might have accounted for in the quarter you just released?

MR. BRUCE LAURITSEN:
Penn, I can tell you that right now we've got five stores just as we start the year with five, we have a lease expired in Chicago. We're down to one store in Chicago, that store was successfully converted to one -- two stores to one. And in Indianapolis, we have three and again the lease had come too, and we took it from three stores to two and that 's where we set right now. We have seen a nice uptick in the retail business as most people have a country and it's come into the stores. We're continuing to try to fine tune the footprint and we're not going to draw that particular segment of the business any further than over the years.

THE CALLER:
Was it profitable?

MR. BRUCE LAURITSEN:
No.

THE CALLER:
All right. Thanks very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) And gentlemen, I'm showing no further questions at this time.

MR. BRUCE LAURITSEN:
Thank you everybody. We appreciate your calling-in and thanks for all your support. (CONFERENCE CALL CONCLUDED)

Flexsteel Industries, Inc (FLXS)
Q3 2002
Event Transcript

Wednesday, April 17, 2002 9:30 am

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THE OPERATOR:
Welcome to Flexsteel Industries, Inc. Third Quarter 2002 Operating Results Conference Call.

At this time, it is my pleasure to introduce your host for the call, Flexsteel Industries' Chief Financial Officer, Mr. Ron Klosterman.

MR. RONALD KLOSTERMAN:
Good morning and welcome to our conference call to review our March 31, 2002 quarterly results. We appreciate your participation this morning. Joining me this morning via telephone from our showroom in Highpoint, North Carolina at the International Home Furnishing Center is Bruce Lauritsen, our President and Chief Executive Officer.

During our call today, we may make forward-looking statements that are subject to risk and uncertainty. A discussion of factors that could cause actual results to differ materially from management's expectations is contained in the company's SEC filings included for the most recent annual report to shareholders and 10K and the press release dated April 16, 2002 announcing the results of operations for the quarter in nine-month period ended March 31, 2002. Any forward-looking statements or opinion as of now and we take no obligation to update or revise any forward-looking statements to reflect events or circumstances after today's call.

At this time, Bruce has some opening comments before we open up the session for questions from analysts. Bruce.

MR. BRUCE LAURITSEN:
Good morning everyone. What I'd like to do is go over -- just a brief restatement of our press release last night. A couple of items there and I'll give you a little current scenario of what's going on and where we're at in our three businesses.

Net sales for the quarter ended March 31, 2002 were 73.7 million compared to the prior year quarter of 72 million, an increase of 2 percent. Net income for the current March quarter is $2 million or 33 cents per share, compared to the year earlier quarter of 8 cents, or 800,000 -- I'm sorry, or 13 cents per share. Net sales for the nine-months ended March 31, 2002 were 202.8 million compared to 215.9 million in the prior year nine months, a decrease of 6 percent. Net income for the nine months ended March 31, 2002, up 2.9 million or 48 cents per share decreased in the March 31, 2001 net income of 4.4 million or 71 cents per share.

Now I'd like to tell you a little bit about what happened in the quarter that -- we're just reporting on. Orders really rebounded very nicely during the March quarters starting right after the January 1st holiday and various inventories were very good starting in January and continued on through most of the quarter. The recreation of vehicle seating business volume build-up during the quarter month after month and comparing to March 2000 quarter to the December 2001 quarter, residential shipments increased 10 percent, RV shipments increased 28 percent. And just as important, our backlog in the hospitality and the contract seating business increased, ended to the double-digit area. Things that we've been working on the prior nine-months with beds, and boats, etc., came to fruition during the March quarter. The cost of raw materials had little changed during the quarter, however, we may see some increases in the steel prices during the latter part of calendar 2002 due to the impact of just recently inactive import tear-ups (phonetic).

Some other points of interest -- here in the recreation of vehicle business are -- during the Valentine (phonetic) over the last 18-months, net industry. We stayed true to our strategic plan and worked very hard in increasing our market penetration. And in fact, open up 14 new customer chairs in an area that we have a 60 percent plus market shares, so we're really, really happy about them. In the residential seating area, we have 350 comfort seating galleries opened and 45 additional signed contracts that we hope to get opened in the next four to six months. Our new Christopher Lowell collection, which debut in October of 2001, we have 40 completed and open and over 135 signed commitments to bring to fruition and get open this year. Our outlook for commercial seating business is as strong as I've seen it in the last 12 to 14 years. We have just been blessed with the number of clothes and beds on projects all over United States for re-dos (phonetic) in the hospitality business as Lowell's new properties. So, we're really thrilled with what's been going on for about the last four-and-a-half to five months and especially the business that we've received in the last 90-days and we're going into the final quarter with a real strong business backlog as well as prospects for continuation of running business.

At this particular time, I'll open up the forum to questions that any of the analysts may have.

THE OPERATOR:
At this time, we will be taking questions from analysts. (CALLER INSTRUCTIONS) Penn Sincleton (phonetic) of Merrill Lynch.

THE CALLER:
Good morning. Bruce, could you talk just a little bit more about your utilization rate? How orders are trending in so far in April and what's your plan are for new introductions at the upcoming April market?

MR. BRUCE LAURITSEN:
Well, our orders continue. They soften a little bit in the residential area the last two weeks of March and I think it's a combination of many factors in early Easter as well as -- just the prior two months, there was a lot of buying going on and it's picked up as we came to the high point. We have enlarged our Christopher Lowell collection for five new occasional groups and to the collection, which we didn't have in October; tables and some wall, wall units, etc., as well as some upholstery pieces. We've got new -- really across the board, we've got three fabulous leather sofa-loveseat chair combinations as well as some beautiful of Lowell style upholstery. We feel real good about this market. Our sales force is really very, very comfortable with our new introductions and they feel good about the customers coming here as well as what they take to peer it back going on the field. Going further, just a little bit ended the recreation of vehicle business. We feel real good of that business has re-solidified itself and its moving back into the range that we expressed a couple of years ago and the prospects for that, we feel for the next 10 to 12, 15 years are very good.

THE CALLER:
Did you mean 10 to 15 months Bruce? You said...

MR. BRUCE LAURITSEN:
No. Just looking out, as a demographics as to...

THE CALLER:
Really?

MR. BRUCE LAURITSEN:
Yes. Where we feel that the baby boomers are just entering into that first stage of possibly doubles and then motorized, etc. So, that industry is a -- we're really feel good about the future of that business. But right at the present time, we're just pleased that the consumers are back in the marketplace purchasing and taking us back to the levels that we experienced prior to the downturn.

THE CALLER:
Okay. I'll just have good couple of more questions 'cause I know there are others. I wanted to get an idea of what type of volume do you think is reasonable for the Christopher Lowell line over the next -- say, couple of years? And do you expect to add any new accounts, not Christopher Lowell but just Flexsteel in general -- at competing (phonetic) in general at this market?

MR. BRUCE LAURITSEN:
We do. (1) The volume PMI (phonetic) would be -- I'd be stabbing (phonetic) at a number that I wouldn't be comfortable with. Maybe by the time I see you tomorrow or the next day, I can give you a little bit better number. But we feel that, that has a potential of this market, just at this market of possibly signing up another 25 to 35, 40 additional retailers. We have experienced an interest on a Christopher Lowell collection from certainly some of our long-time retailers. But more importantly, or just as important is the interest that we picked at from people who we haven't done business with, and that's the exciting part. We thought that might happen but it's really reaching a different consumer, maybe a younger consumer or a consumer that's doing things on their own that they come in the store and the stores that are open right now or for the most part, really, really doing a nice job.

THE CALLER:
Okay. Last question. Just give us an update on your retail business, where it stands right now, and what it might have accounted for in the quarter you just released?

MR. BRUCE LAURITSEN:
Penn, I can tell you that right now we've got five stores just as we start the year with five, we have a lease expired in Chicago. We're down to one store in Chicago, that store was successfully converted to one -- two stores to one. And in Indianapolis, we have three and again the lease had come too, and we took it from three stores to two and that 's where we set right now. We have seen a nice uptick in the retail business as most people have a country and it's come into the stores. We're continuing to try to fine tune the footprint and we're not going to draw that particular segment of the business any further than over the years.

THE CALLER:
Was it profitable?

MR. BRUCE LAURITSEN:
No.

THE CALLER:
All right. Thanks very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) And gentlemen, I'm showing no further questions at this time.

MR. BRUCE LAURITSEN:
Thank you everybody. We appreciate your calling-in and thanks for all your support. (CONFERENCE CALL CONCLUDED)

Flexsteel Industries, Inc (FLXS) - Q3 2002
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04/17/2002 01:00 pm	**RUSH**	**Rush Enterprises (RUSH) − Q1 2002**

THE OPERATOR:
(CALLER INSTRUCTIONS) I would now like to introduce your host for today's conference, Mr. Marvin Rush, Chairman and CEO. Please go ahead, sir.

MR. MARVIN RUSH:
Good morning and welcome to our first quarter earnings release conference call. I would like to introduce the attendees today. First, myself, Rusty Rush, the President and COO, Robin Rush, Executive Vice President, Marty Naegelin, Senior VP and CFO, John Hiltebiller, our Controller, and Steve Keller, our Director of Financial Reporting. Now I'd like Marty to say a few words regarding forward−looking statements.

MR. MARTIN NAEGELIN:
Certain statements we will make today are forward−looking statements, as such term is defined in the Private Securities and Litigation Reform Act of 1995. Because these statements include risks and uncertainties, our actual results may differ materially from those expressed or implied by such forward−looking statements. Factors that could cause our actual results to differ materially from those expressed or implied by such forward−looking statements include, but are not limited to, those discussed in our annual report on Form 10−K for the year ended December 31, 2001 and in our other filings with the Securities and Exchange Commission.

MR. MARVIN RUSH:
Now we would like to give an update on several key issues. Let's talk about the first quarter results. Revenue decreased 11.1 percent from $204.5 million to $181.7 million. Our gross

profit margin increased from 18.1 to 20 percent due to change in the product mix. Increases in parts, service and retail sales, our higher margin revenue categories, grew as a percentage of total revenues, while new and used trucks and construction equipment sales, lower margin revenue categories, decreased as a percentage of total revenue. SGAexpenses increased $800,000 from $30.1 million to $30.9 million. Approximately $1.8 million of the 2002 SGAexpense are directly related to new stores and facility expansions made subsequent to the first quarter of 2001. SGAexpenses net of new store openings and facility expansions decreased $1 million or 3.3 percent from the first quarter of 2001. Net income increased approximately $279,000 or 180 percent. Let's go to the truck operations. The (indiscernible) sold 19,339 new trucks during the first two months of 2002, a 24.5 percent decrease from the first two months of 2001 and expects to sell approximately 120,000 during the remainder of 2002. New truck sales for the quarter for us ended March 31st, 2002 totalled 975 units, a decreased of 412 units from 29.7 percent from the first quarter of 2001. Our average sales price increased 7.3 percent, resulting in an overall new truck revenue decline of 27.3 million or 24.6 percent. Used trucks sales for the first quarter of 2002 totalled 482 units, a decrease of 31 units or six percent from the first quarter of 2001. Our average sales price decreased 2.9 percent, resulting in an overall used truck sales decline of $498,000 or 3.4 percent. Parts and service, my (indiscernible) revenues, increased 13.5 percent from $43.8 million during the first quarter of 2001 to $49.7 million for the first quarter of 2002. Gross profit from our parts, service and body shop increased 9.4 percent from $16.9 million $18.4 million. Let's talk about the construction machinery business. The industry sold 14,902 new construction equipment units during the first quarter of 2002, compared to 15,675 units for the same period of 2001, and expects to sell approximately 70,000 during the remainder of the year. New and used construction equipment units sales revenues, for us, decreased $2.9 million or 20.9 percent from the first quarter of 2001 to the first quarter of 2002. Parts and service revenues increased 3.6 percent from $5.5 million to $5.7 million, while as part of our planned rental fleet reduction, rental revenues were down 28.6 for the first quarter of 2001. Due primarily to the 52 percent pure direct sales by John Deere into our territories, and a reduction in our rental fleet, John Deere's year−to−date market share in the company's area of responsibility decreased from 15.5 to 12.7 percent from 2001 to 2002. In the construction equipment industry, marketshare is calculated using dealer sales and rentals, as well as direct sales from the manufacturer. Our growth strategy is still growth through internal and external expansions. Let's talk about internal expansions. We're currently in the process of purchasing real estate in Albuquerque, New Mexico to construct a new dealership to replace our existing facility. We expect this facility to be completed during the first quarter of 2003. We're in the process of replacing five state−of−the−art paint booths at our San Antonio, Phoenix, Denver, Fontana, California and Peco Revera, California dealerships. The total aggregate cost is expected to be approximately $1.1 million with the expected completion dates extending through December, 2002. Any additional capital expenditure items are limited to replacement of existing equipment and essential operational assets. In regards to additional acquisitions, we have nothing definitive to report at this time. Now I'd like to open it up for questions and answers.

THE OPERATOR:
(CALLER INSTRUCTIONS) Scott Stember, please state your company name, followed by a question.

THE CALLER:
Sedoni (phonetic) Co. Good morning gentlemen. I have a question about, in the press release,

we've all heard about about the order board is probably going to be increasing over the next couple of quarters due to these new emission standards due October 1. Could you talk about a little flavor for the order board for the next couple of quarters so we can maybe model a little more definitively? And just maybe give us a little bit update on the overall situation there?

MR. MARVIN RUSH:
I'll let Rusty bring that up for you.

MR. W.M. RUSH:
Well, obviously the order board has been increasing, especially for the pack car (phonetic) line. We have picked up additional orders over what we usually, I would say, comparatively, say to last year's second quarter and third quarter. I can't tell you at this time. I can't really tell you the numbers and give you any guidance on that because we're the process right now of going through that. We are in the midst of it right at this moment. So as far as giving you guidance on what unit numbers, etc., I would probably be little bit premature in doing that. But the overall flavor of the industry, I think a lot of customers are coming out of this two−year down cycle we've had from a trucking perspective, and also from a valuation perspective on trades on used. And with used values seeming to have flattened out now and stop taking the hits they have been taking over the last couple of years, I anticipate those numbers and the activity to continue remain pretty heavy.

THE CALLER:
Okay, and that figure that you gave earlier Marvin, when you discussed the additional 120,000 trucks that we sold for the year, are you including these additional trucks which are going to be sold within the next couple of quarters?

MR. MARVIN RUSH:
Well, that is kind of the industry's guess. We don't have a feel for what it's going to be, other than we think it'll be that good.

COMPANY REPRESENTATIVE:
We're in the midst of it, Scott. It's really hard to say. In the second quarter I can tell you our numbers should be up in unit deliveries. How much? I really don't know that I want to give you any guidance right at the moment on that, because we're watching stock activity pick up. As owner−operators were getting into equity positions in their trades, which most of them have not been in the last couple of years, we should see a lot more heightened activity on that owner−operator level and, as you know, that's a spontaneous type of buy so it's hard to really predict.

THE CALLER:
Marty, can you just give me what the CAPEX number was for the quarter?

MR. MARTIN NAEGELIN:
We were at 3 million 5 for the quarter. Of the 3 million 5, 1 million 8 of that was leasing vehicle additions, leaving a net of a million 7. Take the million 7, back off about 750,000 for computers, and that gives you 950,000. Now the computers (indiscernible), those are a onetime replacement because the manufacturers came out with new prospecting software that you use to inspect a truck, and this required us to buy about 450 new computers. So that was more of a one−time capital expenditure than it is a recurring. (indiscernible)

THE CALLER:
That's all I have. Thanks guys.

THE OPERATOR:
Linda Donnelly.

THE CALLER:
Franklin Management Group at Prudential. I just wanted to confirm with you, you had given us some guidance before on what you thought CAPEX and depreciation would be for this fiscal year. Are you still planning on about 18 6 for capital expenditures and just under 12 for depreciation?

COMPANY REPRESENTATIVE:
I think that is probably still in the ball park.

THE CALLER:
Great. Thank you very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) At this time, I am showing no further questions. Please continue with any closing comments.

COMPANY REPRESENTATIVE:
Thank you all for listening and I look forward to talking the next quarter. If you've got any questions between now and then, please feel free to call Marty of any of us. We'll be glad to talk to you.

THE OPERATOR:
Ladies and gentlemen, that does conclude today's conference call. You may all disconnect and thank you for participating. (CONFERENCE CALL CONCLUDED) \plain \fs24 \ATXts750\sl495 \ATXnt755

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04/17/2002 10:00 am	ALL	Allstate Corporation (ALL) − ALL Q1 2002 Earnings Conference Call

THE OPERATOR:
Ladies and gentlemen, thank you for standing by. Welcome to the Allstate Insurance Company's first quarter conference call. During the presentation all participants will be in a listen−only mode. Afterwards, we will conduct a question and answer session. At that time if you have a question, please press the one, followed by the four on your telephone. As a reminder, this conference is being recorded Wednesday, April 17, 2002. I would now like to turn the conference over to Mr. Bob Block, Vice President of Investor Relations. Please go ahead, sir.

MR. BOB BLOCK:
Good morning, everyone, and welcome to our first quarter earnings conference call. Ed Liddy and John Carl join me again today as we discuss our results for the first quarter of 2002. The question and answer period will follow. As a courtesy to all who have questions, please keep to one question and a follow−up. This allows us the opportunity to hear from as many of you as possible and this call will be completed within one hour. We issued our press release earlier this morning. If you need a copy of the release it is available on our Web site. Also this morning, we posted most of our investor supplement on our IR Web site for your use. It's important for you to note that the following discussion may contain forward−looking statements regarding Allstate and its operations. Allstate's actual results may differ materially from those projected in the forward−looking statements. For information on important factors that could cause such differences, please see the forward−looking statements and risk factors effecting Allstate's (indiscernible) in Allstate's latest report to the SEC on Form 10−K for the year 2001 and in today's press release. This call is being recorded and the recording is the property of Allstate. It is not for reproduction or rebroadcast by any other party without the

express consent of Allstate. A reply −− a replay will be available following the conclusion of this call. Your participation in the call will constitute consent to the recording, publication, Web cast, broadcast, and use of your name, voice, and comments by Allstate. If you do not agree with these terms, please disconnect now. Now let’s begin with some comments from Ed Liddy. Ed?

MR. ED LIDDY:
Good morning and thank you all for joining us. Let me quickly review our strategic intent so that we all have the same perspective on the quarter. Our goals, quite simply, are to get better in the property casualty business, to get broader in the financial services area, and to generate more consistent earnings growth and returns in excess of our cost to capital. We’ve taken a number of actions over the last couple of years that have positioned us well to achieve these goals and our recent actions to correct a short−term imbalance in some of our operations are beginning to bear fruit and will continue to do so over the next several quarters. Now, with respect to the quarter, overall I view this quarter as a very solid one. As our press release indicated, we had earnings per share of 70 cents or 68 cents after restructuring items and that is after we built reserves for prior periods primarily related to mold to the tune of about 20 cents or 21 cents. We do not want to be caught short in this area. Our earned premium growth continued to escalate, up 4.6 percent from the fourth quarter. That’s up about a full 1.5 points. We are taking rates, they are holding, and they are being reflected in our income statement. Allstate Financial had a very good quarter. We had excellent expense control and our Ivantage (phonetic) continued to show some improvements. It’s always tough in our quarterly calls to take out the effect of weather. In the last year, in the first half of the year and particularly in the second quarter, weather definitely hurt us. This year we clearly benefited from good weather, but when we sort through all of the details we come to the conclusion that our tactics are having a very positive impact on our P A couple things I’d like to highlight. We continue to take significant rate actions in most markets and the earned premium and auto and homeowners is beginning to reflect those actions. Where we can’t get sufficient rate relief, our risk management practices and administrative actions are implemented to protect and to improve our profitability, but reductions in new business and retention ratios have begun to occur in those markets and those lines where profitable growth is more of a challenge. Our auto frequencies look better than they did in the fourth quarter and this is clearly beyond simply the benefit of good weather. Our liability severities are increasing at a rate much less than inflation. Our property casualty underwriting expense ratio improved by a full point over the first quarter of 2001 and, in fact, our expenses were up less than about $15 million in that area. Allstate Financial posted another good quarter, despite the difficult market challenges, and our cash flow in property casualty has turned positive and new purchase yields are higher today than they were at this time last year. Now, there are a couple of items that I put in the category of they just are and I’d comment on one negative item. First under the category of items that just are, our Ivantage business, which is our independent agency business, posted a better underwriting performance than in the last few quarters and we’re pleased about that, but the business still has a way to go to get to acceptable returns. Second, our auto physical damage severity increases this quarter were at a higher rate than last year, but overall, it’s a manageable level from a pricing perspective. My third just are, our partnership income this quarter compared to the same quarter last year was a lot less. We’ve always said that this type investment produces lumpy results, but that long−term the returns are well worth the lumpiness. On the negative side, our homeowner loss cost trends continue to escalate. Our frequency is much improved over last year, but weather related severity trends show no sign of slowing down, particularly in Texas where losses related to mold

continue to develop. So, we took the opportunity this quarter, we looked at the trends, and we put up $125 million in reserves. As I mentioned, we do not want to be caught short in this area. We also continue to take significant rate actions. We continue to make policy changes and utilize other risk management practices to address the situation. I'm confident that we'll return this line to acceptable levels of return by mid 2000 that is now six quarters away. In summary, we are taking a number of hard actions in many of our markets to generate future earnings opportunities. We are totally focused on execution of our strategies and in driving shareholder value and I think the first quarter shows good signs of progress. I'd like to ask Bob to put a little bit more flavor on our quarter.

MR. BOB BLOCK:
Today, as you know, we reported operating earnings per share of 68 cents for the first quarter. This result was eight cents less than earnings per share in the first quarter of last year. The difference coming primarily in two areas, lower catastrophe losses this year worth about three cents per share and less property casualty after tax investment income worth about six cents per share, reduced partnership income accounted for four cents of the reduction. Sequentially, our earnings per share increased 25 cents. The fourth quarter contained several special charges, such as those arising from the Georgia Diminished Value (phonetic) litigation and the increase in guaranteed fund assessments, restructuring initiatives, and some beneficial adjustments in Allstate Financial. Net of these accounts −− net of these accounts for about 17 cents of the improvement and the balance comes from a better underwriting result. This underwriting improvement reflects not only the effects of the mild winter, but also the beginning of improvements stemming from our delivered actions to generate profitable growth. From a capital management perspective, we repurchased approximately 2.4 million shares of our stock at a total cost of about $85 million, the average cost being $35.64. This puts us on pace to finish this authorization of 500 million by year−end 2002. We are about 28 percent complete as of the end of the first quarter. Also during the quarter we issued $350 million in debt, bringing our debt to capital ratio to 19.6 percent at quarter's end and below our 20 percent goal. Now, let's take a deeper look at the trends in the business. Total net written premium for personal lines increased 5.1 percent in the quarter. This increase came from both policy growth in our core lines and average premium increases as the effect of rate actions continue to play out in the numbers. This increase was less than that experienced in the fourth quarter of the effective market as specific actions take hold, actions that are designed to improve profitability, while setting the stage for longer−term targeted growth. We are serious about getting to a more consistent level of profitable growth and are moving more quickly to detect and correct market imbalances. Total personal lines earned premium grew at 4.6 percent over prior year and that is a sequential increase of 1.9 percent from the fourth quarter of 2001, reflective of the increasing impact of our rate actions being earned. This impact should continue to accelerate over the next several quarters as more of the rate increases are earned. Overall, the combined ratio in the quarter was 99.2 percent, an increase from the first quarter of last year of 1.2 points, seven−tenths of which resulted from an increase in catastrophe losses and restructuring charges. Looking at the expense component, our first quarter expense ratio declined by seven−tenths of a point, a full point excluding restructuring charges. In the quarter, our underwriting expense level in dollars, excluding restructuring, only increased $12 million on a base of almost $1.3 billion. Compared to the fourth quarter of 2001, the combined ratio was reduced by over five points. Again, adjusting out all of the noise you get to an improvement of over a full point in the combined ratio this quarter over the fourth quarter of 2001. Now taking the conversation down to the next level, net written premium for the Allstate brand grew by 5.5 percent. All of the increase came from

average premium. Standard auto grew 6.8 percent. The rate actions we have taken and continue to take in order to improve the margins in this line are having the desired effect with the loss ratio showing signs of improvement. These pricing actions, as well as additional underwriting and administrative actions taken in specific markets, are having a negative effect overall in the quarter on our new business production, down 24.5 percent, our retention ratio down 1.3 points, in line with expectations based on our elasticity models and occurring in the states where profit is an issue, and our PIF, which increased at a slower pace sequentially, up 1.9 percent. We continue to take the necessary rate actions to bring this line into our desired profitability range. During the quarter we implemented rate actions in 16 states with annualized effects of 7.8 percent. In the quarter, our average premium −− averaged written premium increased 7.2 percent. Three−quarters of that came from rates taken over the last several quarters. Average earned premium for standard auto increased 4.9 percent, a rate higher than our loss cost trends at this time. This will continue to increase as the rate actions are earned over time. Non−standard auto net written premium continues to decline, falling 10.4 percent in the quarter. Unit growth fell by 19.3 percent, partially offset by increased average written premium of 11.4 percent. New business production remains down, off 24.6 percent from the first quarter of 2001. Retention, however, increased slightly staying at a level of 72 percent. We implemented rate actions in 19 states this quarter with an average annual impact of 10.1 percent. We continue to manage this line down as we improve its profitability. This quarter the loss ratio improved almost seven points from the first quarter of 2001 and about six points sequentially. While we can’t declare a victory yet, we are winning the war. Our homeowner’s net written premium jumped 15.9 percent over prior year, obviously benefiting from rate actions taken over the last several quarters. This quarter we have implemented rate changes in 27 states, plus the District of Columbia, averaging 19.8 percent on an annual basis. Average written premium in the quarter increased 18 percent, while the average earned premium grew only 6.9 percent, demonstrating the delayed effect of rates in the P The average earned premium will, obviously, continue to increase over time given the size of the rates we have all ready taken. Even with the aggressive rate actions put in place to drive this line back to acceptable return levels, new business production is only off eight percent in the quarter and our retention ratio at 88.4 percent is only down slight. Both of these factors performing better than expected. Policies in force have declined sequentially, but are up 1.5 percent over prior year. For Ivantage, which includes our Encompass and Deerbrook brands, overall written −− net written premium is down slightly as we work to improve the profitability of the business. For Encompass, we have stepped up our rate activity with auto rate changes implemented in eight states with an average annual increase of 4.4 percent and homeowner rate changes in seven states averaging annual increases of 38 percent. Now moving on to losses, any analysis of loss trends is complicated by the decidedly different weather patterns experienced this quarter compared to the first quarter of 2001. We estimate that compared to the first quarter of 2001 we had a favorable impact on our combined ratio of approximately 2.6 points, which equates to a 14 cent impact on operating earnings per share. So with that as a backdrop, let me provide you with our typical loss statistics. Standard auto frequency results were as follows: bodily injury increased 1.6 percent and property damage declined 3.5 percent. For non−standard auto, bodily injury frequency declined 4.6 percent, while property damage frequency fell seven percent. For total auto paid severity results, bodily injury increased only .6 percent, while property damage grew at 4.5 percent. Regardless of the distortion created by the weather, auto loss costs are still behaving relatively well. There are some pressure points in prior year reserves, so we adjusted the reserve levels by $87 million, primarily in the physical damage coverages (phonetic). In homeowners, the trends were also impacted by the differing weather conditions. Frequency, excluding catastrophes, fell 21.9 percent, while paid severity in −− excluding catastrophes increased 29.2 percent. The combination of the two gives you a loss cost trend in the high single digits. Losses related to mold, primarily in Texas, continue to develop upward placing pressure on our reserve position and we increased homeowner reserves by $125 million in the quarter to account for this. For property casualty net investment income the first quarter saw a continuation of the trends towards lower income. Pre tax net investment income declined 14.4 percent as the contribution of partnership income this year was significantly lower than last; only $5 million versus $46 million when we had one particular investment pay off. Excluding the partnership income the decline was only six percent. With an effective tax rate of 17 percent this quarter, the per share contribution from investment income dropped six cents from the first quarter of 2001. On a positive note, however, the earnings per share contribution of the investment income, excluding partnerships, increased this quarter compared to the fourth quarter of 2001. Cash flow trends are beginning to improve, which over time will help investment income. Shifting to Allstate Financial results, operating income was $143 million in the quarter, an increase of $16 million from the first quarter of 2001. Of that increase, $8 million was due to the elimination of goodwill amortization this year. The rest resulted primarily from favorable mortality trends in the quarter. Compared to the fourth quarter, operating income showed a $4 million decline, but as we disclosed in our fourth quarter call, last quarter's operating income was favorably influenced by several one−time adjustments. When you put the quarters on equal footing the operating income remained relatively flat. While total statutory premium was below prior year, it was up 17 percent sequentially over fourth quarter of 2001 driven by sales of structured financial products. Variable annuities were flat with the fourth quarter, but significantly below last year. The equity markets have not stabilized enough for sales of this product to return to previous levels. We continue to have some success in broadening our product output from the bank channel with increased performances seen in VAs, market value adjusted annuities, and life business. We've maintained our focus on widening spreads where the market will allow and this has not had an adverse impact on persistency. Steady progress was made in terms of moving the Allstate agency system toward a broader distributor of financial products. We now have 6,250 agencies that have received their Series Six (phonetic) and 63 licenses. These agencies produced issued premium and deposits at a rate more than twice last year's level, an increase primarily due to larger annuity and bank deposits, as well as non−proprietary mutual fund sales. We continue to strive to become a much broader personal financial services company serving more of our customer's protection and retirement needs in the future. Overall, the first quarter proved to be a solid one for us. The tactics we have employed over the last several quarters are beginning to bear fruit. We received the benefit of mild winter, but still have upward pressures on loss costs, primarily in weather related severities, including mold losses. Cash flows with property casualty have improved and we continue to make progress on our share repurchase program. Allstate Financial is off to a good start and our over arching strategy of getting in property casualty and broader in financial services is on track. Finally with the first quarter now behind u, we remain comfortable with the guidance we provided last quarter, that being, 2002 earnings per share, excluding restructuring, of a range of $2.50 to $2.70. Again, this guidance is based on assumption of normal weather for the year, as well as an expectation that no major negative trend shift occurs in the business. Now, let's open it up for your questions. Operator?

OPERATOR:
(CALLER INSTRUCTIONS) Nancy Benacci with McDonald Investments.

THE CALLER:
Could you talk a little bit about your direct business, which you didn't mention on the call, in terms of how much is coming in either phone or Internet today? And also, along with that if you could give us a sense of commission levels for business that's coming in either on the direct side, either phone or Internet? And secondly along with that, you had mentioned before that you're revisiting the total commission structure with the agent force and give us an update as to that.

MR. ED LIDDY:
Let me −− let me see if I can respond. Our direct business continues to do well. It's both a blend of sales and service. There are some pretty impressive statistics. We had something like 4.5 million unique visitors to our Web site in the first quarter of this year. There's approximately 750,000 times in the first quarter that people went to the agent locator and then followed up and talked to agents or talked to the folks in the call centers. We continue to see some transfer at work out of agent's offices and into the call center. The activity through the call centers continues to behave pretty much the way we wanted it to. No change in terms of commissions on our products. You know the stuff that comes in on the Internet are through call centers, as you know, is a lower commissioned product and is that which is generated through the agent's offices. No change in that area whatsoever. And I would put a slightly different spin on the last part of your question. What we are really trying to do is to make sure that our agent's efforts are aligned very much with our efforts. So, what we don't want to do is incent agents −− let me just say, for example in a state like Texas, to go out and sell homeowner's policies when we are losing money on them. So, it is less of an initiative to revise downward our commission structure and it's more of an initiative to get people aligned properly so that our agents are rewarded for a high quality book of business. They're rewarded for growing their books of business where we want them to do that and they're rewarded for cross selling penetration of their books of business. Those are the kinds of things that when they do well with them we will do well. So, it is more of an alignment issue that we're working at −− on as opposed to a cost reduction issue.

THE CALLER:
Is that alignment taken place all ready at this point or is that still in the development stage?

MR. ED LIDDY:
Oh, no. It's very much in the development stages. You know we really just kind of started that inquiry beginning of −− at the end of last year, beginning of this year. You know we're working with our agents. We're doing it in a very public way. We don't want to surprise or cause any disconnect in terms of what we're doing, so more to come on that in future quarters.

OPERATOR:
Charles Gates with Credit Suisse First Boston.

THE CALLER:
Two questions. The first question, could you elaborate on the reference to favorable life insurance mortality experienced during the period? To what extent did that benefit earnings versus the prior year period?

MR. ED LIDDY:
Charlie, you want to ask the second and we'll come back get them both at once?

THE CALLER:
Sure. My second question, could one of you elaborate on the auto physical damage severity that you made reference to?

MR. ED LIDDY:
Sure, Bob, go ahead.

MR. BOB BLOCK:
You want to, Larry?

COMPANY REPRESENTATIVE:
Yeah. This Larry (indiscernible), Charlie. Yeah, for life insurance you have three things that drive life results, mortality margin, expense margin, and investment margin and mortality margin was the primary driver of that. And that's our cost of insurance charges on our products less the mortality that we have and experienced. So, that's pretty much the driver.

MR. ED LIDDY:
Bob, as you know or Charlie, as you know, that number moves around on us on a quarter to quarter basis in balance in the course of the year we tend to get improvements. We got some decent improvements in the first quarter. Now auto physical damage, Bob, you want to comment on that?

MR. BOB BLOCK:
Yeah, what we saw, Charlie, coming through the first quarter was a little bit of an upward movement from the 2001 report year on auto physical damage. We're looking at that to see just what the effects of the trends are. We did boost the reserves associated with that report year simply because they pay out so quickly. You can peg what the proper reserve levels should be, so that's what we did there.

OPERATOR:
Michael Lewis with UBS Warburg.

THE CALLER:
Ed, it seems that you had some pretty good body language where you seem to be pretty pleased with the first quarter numbers all considered. What I have a hard time understanding is if you're making a comfortable estimate range this year of $2.50 to $2.70 and looking at the first quarter and this is ex restructuring charges, just annualizing that number is above the upper end of your range. You've taken −− and if you basically look at the fact that you've taken reserve additions that exceed the weather related impact I'm hard pressed to see why you're so conservative your −− with your estimates based on all the positives you've just delivered to us? So, maybe you can explain that a little bit better. And my other question has to do with broadening your financial service business. How and when and how dynamic is that going to be and can you give us any time frame?

MR. ED LIDDY:
Mike, with respect to your first question one quarter does not a trend make. We like our

performance in the first quarter. The second quarter is very iffy from a weather standpoint. Those of you that follow this industry for a while know that it's just too soon to declare victory. I'm comfortable with that range at $2.50 to $2.70. When and if it's appropriate to raise it we will do it; based on one quarter's results not appropriate to raise it. With respect to broadening the financial services footprint, you know, we've been at this for a while. This is what getting our agents licensed to sell Six and 63 products is all about. As Bob Block mentioned, we have about, oh, 6,200 to 6,300 of our agents now fully licensed. There's a good endorsement and acceptance of that product. That is what the initial thrust of the Allstate Putnam alliance is all about. That's what the purchase of American Heritage Life is all about. That's what establishing the Allstate Bank is all about. What we want to be able to do is to serve middle America where many of what would be viewed as competing firms simply don't have the infrastructure or capability or capacity to serve that market, we can do it because we all ready have these roughly 12,000 Allstate agents out there, plus a thousand Allstate financial specialists. The goal, again, is in addition to selling copious quantities of our protection products, which we are very good at and we want to get better at, we want to get broader by serving the needs, the retirement needs, the financial planning needs, the life insurance needs, mutual funds, variable and fixed annuities, et cetera, et cetera, of middle America and that's what that broadening concept is all about. You know, I read into your question a hint of, gee, are you on an acquisition hunt or a trail? We are not. We look at acquisition all the time. If we found something that would further our strategic goal and get us where we wanted to be in a better or a more quality way or faster we might look at it, but we don't feel the need to go out and purchase anything. The fact that we have more than half of our Allstate agencies who, in the last two years have gone out and become licensed to sell Series Six and 63 registered products, I think is a strong endorsement of our organic transformation to a broader financial services company. Again, the goal is sell more property casualty stuff and get better at that and at the same time become a broader based financial services company.

THE CALLER:
Okay, just quickly, Ed, the fact is we're not talking about weather. Just on your estimates you said assuming normal weather you would do $2.50 to $2.70, so really what my question is, what has you so concerned that believes you can get hit going forward, especially after the reserve hit you just took?

MR. ED LIDDY:
Yeah, Mike, I'm just not prepared to raise that guidance right now. You know, $2.50 to $2.70 is where we were in February. We like the performance in the first quarter. We're going to stick with that guidance.

THE CALLER:
Okay, Ed, and I tried.

OPERATOR:
Ron Frank with Salomon Smith Barney.

THE CALLER:
Just before asking my question I just wanted to quickly wish John Carl well. My questions are two. One, just −− and I'll ask my follow−up afterwards. On premium growth, your 6.8 percent reported it for the auto brand −− actually the auto and the non−standard −− the

standard and non−standard, both declined significantly sequentially from fourth quarter. You've attributed that to new business, primarily, if I was hearing correctly. And what I'm trying to figure out is we're all hearing about a firming auto market, about State Farm, perhaps, pulling in its horns a little in reaction to their big losses. I guess I'm a little bit surprised that your competitors apparently didn't see fit to take as aggressive action as you in the states where you needed to take them and that as a result your new business levels fell so much. And I was wondering if you could give me some observations on what we're −− how we should interpret this? Is the market not as quite as hard for auto as we thought or are you being overly aggressive or what have you and where the lines may cross? How much should we expect growth to decline in terms of these territorial actions?

MR. ED LIDDY:
Let me start and then my companions will chip in as they feel appropriate. State Farm's results in 2001 were pretty amazing in terms of the size of the losses. I read that to be that they will clearly begin to take actions if they haven't all ready. As you know, in a regulated industry you don't come in on a Monday and simply raise the rates. It takes a little bit of time to begin to see these. We continue to believe, as you just postulated, that the market is hardening, that rates are being taken more aggressively, and that that will, in fact, play into our strength. We think we are ahead of many of our competitors. We want to improve our margins. We have a couple of states, California and Florida, California in particular, where the auto business is difficult. We are on top of that and we want to improve our results. But I don't see anything in our results and as I think about the marketplace and talk to people and see what's happening, I don't see anything that suggests that there's not a hardening of the market. I don't know, John or Bob, if you want to add anything to that?

MR. BOB BLOCK:
It's not all new business either. Our retention ratios did drop specifically in those states where we're taking a lot of action, so it's not just new business.

THE CALLER:
Obviously.

MR. BOB BLOCK:
And actually the −− and the component of written premium that will be attributable to rates will actually go up as we move through the quarters because of the rate levels that we're taking. And then −− and if you want to take it one step further, I agree that −− with Ed that the markets are clearly hardening. The actions that we're taking are designed to get us and keep us in our targeted profitability ranges, which are significantly lower than where State Farm is operating right now.

THE CALLER:
But based on what you're saying about new business and retention and what we're seeing in the −− in those auto lines it's safe to say or fair to say that for now, at least, your competitors are not following you up on rate all the way?

MR. ED LIDDY:
No.

MR. JOHN CARL:
I don't think you can say that. You're making the presumption that each competitor has the exact same market share relativity in each state and has a similar kind of book of business in each state and most of our action is concentrated on four states and we are, as Bob said, taking actions in those four states to make sure those states, which are relatively large states, get into that targeted profitability range. And actions that we take are different than actions are competitors will take because they're in a different market position than we are.

THE CALLER:
Okay, let me move on to my next question, which sort of gets to Mike Lewis' issue, which is is there any reason that we shouldn't just take out the four points of reserve strengthening and say, okay, ex catastrophes you had a five point sequential improvement in your loss ratio from fourth quarter to first. What was −− as opposed to the year over year, was weather significantly better in first quarter than in fourth quarter or was that five points underlying all −− really just the underlying business?

MR. ED LIDDY:
Well, I think if you're going to make that leap then you have to, while you're taking out the reserve changes, you also have to put back in the different weather and seasonally the first quarter, believe it or not, tends to just historically be a little bit better than the fourth quarter. And this year it was even better than what the normal seasonality would be.

THE CALLER:
Okay.

MR. ED LIDDY:
To just eliminate the reserve charges and say, okay, you improved five points and then project that type of improvement forward would probably be a very optimistic way of looking at the numbers.

THE CALLER:
Okay, that's very helpful, thanks.

OPERATOR:
Alice Schroeder with Morgan Stanley.

THE CALLER:
I have a follow−up to Ron's question about the actions that you're taking and the rates. Our understanding is that State Farm has all ready began taking significant underwriting actions even though it has not yet filed a lot of rate changes, which suggests that you could see unprofitable customers moving into the market and get a strategy of not growing would avoid picking up those customers allowing you to expand your margins right now and avoiding taking on other people's losses. Could you describe whether you agree with that and how that fits into your strategy? And then second, could you give us the comparison of the Allstate's standard book loss ratio from last quarter and last year? I think this is the first time that you've given that separately.

MR. ED LIDDY:
Alice, with respect to State Farm's action I can only speculate. I see much of the same things

that you see. When you lose −− when you have underwriting losses of $9.3 billion in a year you need to take action on all fronts. So, I suspect what they will do is they will clearly take rate increases, but at the same time as they're doing that they will slow down their growth. In fact, my guess is they'd slow it down to zero, apply quotas to many of the parts of the country and to their agencies, and shrink in some areas. Now, they'll try to do that in the right way so as they're able to maintain the right level of customers. I think what comes out of all of this is that Allstate, and perhaps one other company, really are way in front of the industry in terms of the techniques we have for risk selection, underwriting, and pricing. So, we've talked to many of you from time to time about strategic risk management and the fact that we now have much more sophisticated tools that enable us to get the right price for the right product across a broader spectrum of discreet policyholders. That's a huge advantage and if you wake up and you say, "Well, I'm going to take some underwriting actions like not grow my book of business or shrink or take rate increases," if you don't have some fairly sophisticated underwriting techniques I think it's going to be fairly difficult to get the kinds of improvements that they want. I think what the marketplace is going through right now, as I mentioned before, plays to our strengths. I think it plays to the fact that we were early on the rate increases. I think it plays to the fact that we have (indiscernible) up and developing more sophisticated risk underwriting and pricing capabilities and I think it's going to serve us well. Now, Alice, the second part of your question. Bob, I don't know that −− I don't have anything in front of me that enables −− we have the numbers, I just don't have them.

THE CALLER:
Okay, thanks.

OPERATOR:
Bijan Moazami with Friedman, Billings, Ramsey.

THE CALLER:
Actually two questions. The first question is could you break up the 6.8 percent premium volume increase that you had in Allstate branded standard auto line and tell us how much of that is unit growth work versus price? Second, I didn't hear Alice's last question. I don't know if my question is the same or not, but I want to see how much of the $227 million pre tax addition to the loss reserves was a 2001 accident year?

MR. ED LIDDY:
Okay, Bob you want to?

MR. BOB BLOCK:
Yeah, let's see, the split between units and average premium, bear with me one second. Yeah, our standard auto units went up one−nine, so the balance would be average premium of the 6.8. So, it's about two−thirds average premium, one−third unit growth.

OPERATOR:
Brian Meredith with Banc of America Securities.

MR. ED LIDDY:
Hold on. Let's go back to the second part of that question.

MR. BOB BLOCK:
Yeah, the second part of the question was how much was specifically targeted to –– for your 2001…

MR. ED LIDDY:
And prior.

MR. BOB BLOCK:
… and prior is –– was…

MR. ED LIDDY:
The majority of it.

MR. BOB BLOCK:
By far the majority of it.

MR. ED LIDDY:
Two weighted –– it's the whole thing. It's 2001 and prior.

MR. BOB BLOCK:
And by far the majority of it is the mold claims in Texas. Does that help?

MR. ED LIDDY:
Okay, operator, I guess we'll go to the next question.

OPERATOR:
Brian Meredith with Banc of America Securities.

THE CALLER:
Yeah, two questions. First one, hopefully a quick one. Of the reserve charges that you took or the reserve strengthening that you took how much of that was Ivantage?

MR. ED LIDDY:
Very little.

THE CALLER:
Very little it was?

MR. BOB BLOCK:
Well, mostly all in the Allstate brand. I'm not…

MR. ED LIDDY:
Six million. Eight million, I think, was Ivantage.

MR. BOB BLOCK:
$6 million to $8 million would be Ivantage.

THE CALLER:
All right, terrific. My second question, if I look forward a little bit here and I look at –– first

of all, look at your loss ratio that you had in your standard auto lines and adjust that for the reserve strengthening and the cat losses and then I take a look at what your price increases have been or at least your average written premium relative to your average earned premium, it looks like risk −− you had pretty significant improvement here in your loss ratio here going forward to the second half of the year and into 2003, maybe down into the 70 percent, maybe high 60s range. If that is the case, I guess my question has to do more with what the outlook here is for price increases and whether you’re going to be able to take price increases the second half of the year in excess of loss costs and whether regulators are going to let you do that given that you’re going to be making a fair amount of money in your standard auto business. And do you see the rest of the industry having similar circumstances, excluding State Farm?

MR. ED LIDDY:
Okay, let me see if I can break it down into the eight questions that you had there. Let me just see if I can get at it. We took a heavy dose of rate increases last year in the back half of the year, which are beginning to flow through the PLnow. Again, an auto policy is a six month policy; the homeowner’s policy is a 12 month policy. So, they are beginning to flow through now. Second, we have taken rate increases so far this year, I’m thinking in standard auto, Bob just had a couple numbers. I think it was 20 −− in 21 states we’ve taken rate increases so far this year. Those will clearly effect the third and fourth quarter and then the year 2003. We think that puts us −− it begins to put us in pretty good shape, but we will continue to take rate increases in those lines and in those states where we still do not have adequate margins. Remember from a regulatory standpoint in many cases, the regulations are written on an ROE basis. Part of the ROE calculation is what are you making on your investment book? As investment returns are below what they were in prior periods you have to make that up with a higher combined −− with a lower combined ratio. So, regulators −− we are educating them. They more or less understand the dynamic. You know, there’ll be places where regulators will drag their feet or we won’t get what we want and in those locations we move to more aggressive administrative actions. So, I don’t see anything on the horizon from a regulatory standpoint that makes it more it difficult than it normally is to try to get some rate increases. And I also think that if you looked at the performance of the personal lines carriers in the year 2001, you’ll see that most of them are clearly in need of having to do the exact same thing that we are. You know, perhaps we and Progressive are out in front from both a pricing standpoint and a strategic risk management standpoint and most of the other players, I think, are behind us. So, I think this is a dynamic that’s not much changed from the last time we chatted or the last couple of conference calls that we’ve had.

OPERATOR:
Jeff Thompson with KBW, Incorporated.

THE CALLER:
I had two questions. First a numbers question, just if you had the paid losses in the quarter? And then a follow−up question is I was wondering what’s driving up homeowner’s severity? Is it or are other states starting to contribute, like California, and do you expect the problem to grow before it bottoms?

MR. BOB BLOCK:
The paid losses −− I’ll answer the paid losses. It was 4,281,000,000 in the quarter.

MR. JOHN CARL:
The issue on severity is you have to look at last year we had a very high frequency in the first quarter because of the winter storms and those tend to have low severities. So, a part of what you've got there is just an issue of high frequency, low severity last year compared with more normal mix of activities this year.

THE CALLER:
Are you talking about homeowner's?

MR. JOHN CARL:
Yeah.

MR. ED LIDDY:
And those are the ice standing claims that tend to have a lower average severity.

THE CALLER:
Okay, I was talking more about mold and is that problem spreading to other states and when do you expect to see the severity of that problem begin to bottom?

MR. ED LIDDY:
Remember, the mold issue -- I wouldn't want to suggest that it's unique to Texas, but it is more intense in Texas. The Texas Department of Regulation specifies the words used in the policy. They do not have words of sudden and accidental. When you don't have those words in an insurance policy, which we are all forced to use, their insurance policy's can amount to a deferred maintenance policy. That has changed and all new policies that we are now writing do have sudden and accidental and do have limits on mold coverage. So, the issue is, again, not unique to Texas. There are a few other states where the policy forms that we're required to use are a little looser than we'd like them to be. We do not see a wholesale transportation of this issue to other states.

THE CALLER:
Okay, so the answer is -- short answer is you do expect to see it bottom soon?

MR. JOHN CARL:
Yeah, but realize we started writing on those new policies in March, so it will take you a full year for -- to get off of all those old policies.

THE CALLER:
Okay, great. Thank you.

MR. ED LIDDY:
You know, we don't mean to be evasive. You have to make a decision on human nature. Will people, because they know policies are changing, will they rush to try to get something that may not be warranted? There's a whole lot of dynamics that go into that question, but that's also why we built the reserves. We want to make sure that we are adequately protected.

OPERATOR:
Tom Cholnoky with Goldman Sachs.

THE CALLER:
Yeah, good morning, Ed, most of my questions have been answered, but I just want to go back to the issue of the 119 million that impacted your quarter, which I guess in part, was reserve strengthening. I thought in prior calls and I just want to understand this, is this mold claims that have just emerged or is this a −− really a forward looking reserve what you think will emerge in terms of more claim −− more mold claims? So in other words, is this kind of −− I mean should we think about that at the second quarter you might actually see some more adverse development on mold or how should we view this reserve strengthening?

MR. JOHN CARL:
You ought to reserve −− view that primarily as a prior year adjustment. It's looking at the actual development we saw in the first quarter, projecting out how we think that will develop, and reserving for that. Also, though, that impacts the fix that we make this year for our reserving. So, there's kind of an ongoing process of updating your picks for this year, but it's more of a backward looking issue.

THE CALLER:
So, should we think that in the second quarter that the amount that you have to add to reserves for mold should actually decline then?

MR. JOHN CARL:
You know, we're not planning on taking any reserve strengthening in the second quarter, but we don't know the results yet for that. If we knew that we would have taken them now.

OPERATOR:
Alain Karaoglan with Deutsche Banc.

THE CALLER:
A couple of clarification questions. The 2.6 points on the combined ratio due to weather is −− are you thinking of non−cat weather or both cat and non−cat weather related losses? And the question relates a little bit to the prior questions on the accident year and you have alluded to it in the prior comments. If we were to take out the asset −− the reserve additions, in setting your loss picks or your reserves for the business that you wrote in the first quarter did you take into account the adverse trends that you've seen in both the homeowners and the auto line of business?

MR. BOB BLOCK:
The estimate that we made on this winter versus last winter essentially does not include any distinction in catastrophes, which was about $25 million to $30 million. It's really trying to gauge what the impact of weather patterns on auto frequencies and homeowner losses would be from season to season. In terms of your question about did we factor into current year reserves, what we're seeing in the −− in prior year reserves, yeah, that's the way, as John explained, that we do −− when we looked at the current year we take a look at what's happened in the prior years and factor in that type of experience in making our picks for the current year.

THE CALLER:
So, if things develop as you have −− as they've developed so far we shouldn't see additions to reserves in the second quarter?

MR. BOB BLOCK:
We have made our picks and have stated our reserves, given all the information that we have today.

THE CALLER:
And the expense ratio on Ivantage went up a little bit this quarter versus last year to 31.3 percent versus 30.6 percent. Anything behind that?

MR. BOB BLOCK:
I think that may as much the fact that the premium top line is shrinking…

MR. JOHN CARL:
Right.

MR. BOB BLOCK:
… and not covering as much as the fixed costs.

MR. ED LIDDY:
That premium volume was down, oh, just a couple million dollars, I think. In fact, the shrinkage in the premium slowed over what it has been in prior quarters, but I think it's playing tricks with the percentage. That's why when Bob was talking about the expenses in the Allstate brand, the ratio −− the expense ratio going down is clearly helped by an improvement in the top line. But if you look behind that and you look at the level of very moderate increases in dollars we're pleased with our cost control this quarter.

MR. BOB BLOCK:
Take one more question.

OPERATOR:
Ira Zuckerman with Nutmeg Securities.

THE CALLER:
Just a couple of follow−up questions. First of all, in terms of Ivantage you've given us underwriting results. Is there any way you can give us an idea of how over −− profitable it is on an overall basis and how −− when you expect the premium volume to bottom?

MR. ED LIDDY:
Profitable on an overall basis? You mean including…

THE CALLER:
Including investment income.

MR. ED LIDDY:
You know, you could probably get there without us providing it to you, probably could get there if you'd just make a simple assumption on what the premium and the surplus ratio is.

MR. JOHN CARL:
Two to one.

MR. ED LIDDY:
You know, take a .8 or two to one and it will earn. That portfolio would earn about the same amount as our overall portfolio. I think in terms of when the premium shrinkage bottoms out, we're getting very close to that right now. If you look at premium shrinkage in each of the quarters last year, it was in the third and fourth −− in the second and third quarter it went up, slowed in the fourth quarter, and the premium shrinkage in the first quarter this year, largely as a result of rate increases, really has begun to bottom out.

THE CALLER:
Okay and the other −− just the other follow−up question is on non−standard auto. You've, obviously, been shrinking the book for the last almost two years now and it's neither −− shown some impact on the loss ratio. When do you expect to bottom, as well?

MR. ED LIDDY:
I think we're getting very close to that. That'll continue to happen probably through the third quarter and then I think the results will be much more stable. I would like to tend this conference, but before everyone hangs up, I want to pick up on something that Ron Frank said earlier. I would like to publicly acknowledge John Carl. In the three plus years that John has been with us he has made an extraordinary contribution to our company. He served us well. I believe that he served our shareholder's very, very well and I think those of you that have had the pleasure and the privilege of dealing with John know just how broad based a business person he is. As you all know, we put out an announcement a month ago that John has decided to retire from the company. That will happen about the end of the second quarter. I will miss him dearly. He's both a competent professional and a good friend and thank you all. (CONFERENCE CALL CONCLUDED)

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04/17/2002 01:00 pm **IONA IONA Technologies PLC (IONA) − Q2 2002**

THE OPERATOR:
Good morning ladies and gentlemen. Thank you for joining us to discuss IONA's first−quarter 2002 results. In the room with me today are Barry Morris, Chief Executive Officer; Dan Demmer, Chief Financial Officer; and Bob Potter, Executive Vice President of business operations. The format of today's call will include a business update by Barry, followed by financial statements by Dan, and then we will open the call for questions. The press release announcing IONA's first−quarter 2002 results was issued at 8:30 AM Eastern time today, Wednesday, April 17th. It was sent to interested parties and can also be accessed on our Website at www.IONA.com. Before we began, I will go over the Safe Harbor statement. During this conference call, our remarks will include forward−looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans and objectives of management, management's expectations about future revenue, expenses, financial performance, profitability, marketing position, growth demand, and opportunity. The forward−looking statements made during this conference call are neither promises nor guarantees and are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated or indicated, including risks and uncertainties relating to the integration of proposed acquisitions, IONA's End 2 Anywhere strategy, IONA's enterprise sales model, volume, timing, and seasonal patterns of product sales, impact of competitive products and pricing, development and market acceptance of new and improved products, undetected errors in software, and general economic conditions. For more detailed discussion of the risks and uncertainties, please refer to our most recent annual report, other periodic reports, and registration statements filed with the Securities and Exchange Commission. Do not place undue reliance on any such forward−looking statements made in this conference call, which are current only as of today, April 17. You should not

expect that these forward−looking statements will be updated or supplemented as a result of changing circumstances or otherwise; and IONA disavows and disclaims any obligation to do so. Now I would like to introduce Barry Morris, Chief Executive Officer of IONA.

MR. BARRY MORRIS:
Good day, ladies and gentlemen and welcome to IONA's first−quarter conference call. Let me start by reviewing our financial results. For the March quarter, we had revenues of $39.5 million; and a pro forma loss of $2.4 million or 8 cents per share. In addition, we significantly strengthened our balance sheet in the first quarter with a successful follow−on offering. But let me be very clear. Whilst our pipeline is building, the coming quarters will be extremely challenging for the software sector. We are seeing tight budget control for IT spending across all geographies. Our CFO Dan Demmer will review the details of our financial results and provide additional color on the quarter at the conclusion of my comments. Here's my analysis of how we performed in the first quarter. I am very pleased with our execution. I strongly believe the reason we were able to hit our numbers in such a difficult market are the strength of our installed base and the strategic nature of our customer relationship, as well as the recognized strengths of our product portfolio. For those of you who track relative market share in the integration space, I am pleased to announce that over the last twelve months IONA has gained market share relative to the independent EAI vendors. Lost of companies can flash a few customer logos in a presentation; but very few of them can point to as many substantial markets where they have positions as strong as IONA. We offer platform based solutions suitable for a broad range of horizontal applications; but we are also the leading integration platform vendor for several substantial vertical markets. Take the telecommunications industry. More than 80 percent of the telecommunications companies in the Fortune 500 are customers of IONA. In the first quarter we signed contracts with NTT, Ericsson, Sprint, Telcordia, Korea Telecommunications, Telstra, Nokia, Alcatel, Telefonica and Omnitel. Every time you make a phone call, wired or wireless, anywhere in the world, chances are you are communicating over a network tied together by our integration platform. As a strategic integration platform, IONA Technologies is often the foundation of our customers most critical applications. Take Verizon, the number one telecommunications vendor in the Fortune 500. IONA Technologies is built into 70 percent of all their applications. Or ATthe number two telecommunications company in the Fortune 500. IONA Technologies is at the heart of 30 ATTapplications deployed at 74 locations around the world. Our success in banking and financial services is just as impressive, and just as important to our continued success. Every one of the top five banking firms in the global 500 are IONA customers. In the first quarter we signed contracts with ING Barings, Lehman Brothers, CIBC, and Winterthur. Winterthur, one of the largest insurance companies in the world, has already standardized on our application server platform and mainframe integration solution. In the third quarter they expanded their relationship with IONA by standardizing on our Web services integration platform. This win is similar to the contracts for Orbix E2A that we signed in Q4 with Boeing, one of our largest customers in the manufacturing vertical, and just as significant for our Web services offering. Both of these deals also demonstrate why the depths of our installed base has enabled IONA to perform while others struggle. In addition, these strategic customer relationships give us a unique advantage when new markets emerge, like Web services integration. And they position us strongly to take advantage of any economic recovery. I am very pleased with the progress we made signing partners. In Q1 we find alliances with several more top tier systems integrators, including KPMG, whose 18 months experience delivering Web services integration services is a strong vote of confidence in our Orbix E2A solutions. And we expanded our relationship with Compaq Global Services

who are standardized on our Web services integration platform and who will build a global enterprise integration practice dedicated to the delivery and implementation of IONA's Orbix E2A. We also expanded our relationship with Computer Science Corp. who will be using Orbix E2A to deliver Web services integration solutions to their customers in the banking and insurance industry. We are now working with more than 20 system integrators around the world. We signed more than 50 ISB deals in Q1, including new contract with Manugistics, Business Objects, and Dabow Systems. Platform vendors win when they achieve ubiquity. And the fact that IONA now has more than 270 ISP partners is a strong indicator of our leadership in the market for integration platforms. IONA has always had great technology, but not enough people know about it. And this is an area where I am determined to make progress. What we have done well since November of last year is create the category of Web services integration, and establish IONA as its leader. The definition of leadership is that you have followers, and we are clearly setting the agenda for a number of companies, large and small, who are scrambling to catch up. Just check their press releases. Some have gone so far as to borrow our product name. We had expected competitors to follow our lead, which is why I am quite pleased with the job we are now doing marketing the strength of our technology. Our competitors will have a tougher time imitating that. Over the past several months our Orbix E2A products have won numerous awards, including the eWEEK excellence award for Web services product, a significant win over 60 companies including Microsoft. We were also awarded Best of Show at the XML Web Services conference in London; and achieved top ratings in tests by Infoworld and Web Services Journal. At the macro level I am pleased with the way our industry continues to rally around Web services. Nothing succeeds like success, and nothing builds momentum like momentum. I think the most significant industry in the first quarter was the founding of the Web services interoperability forum, which we joined, to accelerate the adoption and deployment of Web services. Consistent with our long history of leadership in the standards community, IONA and Microsoft hosted a Web services interoperability forum at our offices in Boston. The results of the forum's interoperability testing can be found on our Website. Let me close with a few comments on our strategy. A few simple Web services standards have forever changed the way customers will solve their integration problems. And I am completely convinced our platform based approach to Web services integration is the right one. Vendors who offer proprietary integration broker applications will inevitably hit the wall, as a few already have. And people who believe that Web services are a function of application servers will come to learn that application servers are, in fact, a function of Web services. In summary, we are executing well. We are building a pipeline that includes many companies new to IONA. We still expect the rest of this year to be tough, but we are in a strong position to take advantage of any economic recovery. Expect more partner announcements, greater awareness, and increasing customer commitment to our Web services integration platform. With that I will not turn it over to Dan.

MR. DANIEL DEMMER:
Thanks, Barry. I am pleased with our performance in what continues to be a difficult economic environment for the software sector. Our ability to execute in this tough environment is contrasted by the results of many other companies in the infrastructure space. Some key first quarter highlights are: we strengthened our balance sheet through the successful completion of a follow−on offering, closing the quarter with $111 million in cash. The depth of our customer relationships was evidenced by the nine transactions over $1 million signed during the quarter; the largest number in the company's history. Lastly, we delivered the results we said we would in a very difficult environment. I will now go through

our pro forma first quarter numbers followed by some brief comments on expected Q2 business conditions and performance. (inaudible) Revenue for the first quarter was 39.5 million, consisting of 25.6 million of product revenue, and 13.9 million of service revenue. Product mix as a percent of revenues was 65 percent. During the quarter, we closed nine transactions over $1 million; and an additional 13 transactions over 250,000 of less than a million. The average order value was 55,000 for the quarter. In the geographical perspective, Americas revenue was 23.5 million, representing 60 percent of total revenue. AMEA revenue was 12 million, representing 30 percent of total revenue. And Asia−Pacific revenue was 4 million, representing 10 percent of total revenue. Total gross margin was 80 percent. Total operating expenses for the first quarter were 34.4 million; consisting of sales and marketing expense of 20.7 million; research and development expense of 10.2 million; and general and administrative expense of 3.5 million. We had an operating loss of 2.8 million in the quarter. Pro forma net loss for the first quarter was 2.4 million, and pro forma loss per share was 8 cents. Additional first quarter details. (indiscernible) headcount was 884. Sales headcount was 313 at quarter end. DSO was 85 days. Deferred revenue was 29 million. And as I mentioned earlier our total cash balance ended at 111 million. Our tax rate for the quarter was 16.5 percent. Our business performance was solid in the first quarter. We are pleased with both the heightened awareness of IONA as a leading integration platform vendor and the traction we are seeing for our Orbix E2A products. Customers, however, continue to be sensitive to the uncertainty they face in their own businesses in committing to IT spending. This is consistent with our belief that the environment (technical difficulty) in the past twelve months. The balance sheet is strong, expenses are under control, and our corporate strategy and investments leave IONA well positioned to expand our market leadership as the economy recovers. With that I'll go back to you, Lisa.

COMPANY REPRESENTATIVE:
Operator, we will now move to the question and answer portion of our call. Would you please poll the participants?

THE CALLER:
Hello? Sorry. This is Rick Pasness (phonetic) from Prudential Securities. I was just −− We got cut off from the conference call. I am not sure if everyone else did also. But I guess my question is: can you talk about the large deal pipeline that you have seen?

MR. DANIEL DEMMER:
We are not sure if you got cut off from the whole thing. Did you hear the statistics on the quarter one large transaction?

THE CALLER:
No, I think the last thing that I heard was the sales force numbers.

MR. DANIEL DEMMER:
We did nine transactions in Q1 that were over $1 million.

THE CALLER:
Okay.

MR. DANIEL DEMMER:
Which is the highest number in the company's history. Did another 13 that were greater than

250 but less than a million. So we had a good strong component in the first quarter. That type of, set of transactions and type of −− exists in our pipeline going forward. In fact Bob you may want to comment just in total on the pipeline.

MR. BOB POTTER:
Yes, the pipeline at this time in the quarter is actually better than it was at the same time last quarter, in Q1. And typically we are looking at anywhere up to 50 percent of our revenue coming from transactions over $250,000.

THE CALLER:
Okay.

MR. DANIEL DEMMER:
Any other questions?

THE CALLER:
Yes, I do actually. I guess also can you just talk about the systems integrator deal that you've signed or expanded this quarter? And I guess the number of consultants that you have currently trained on your products? And what the plans are for that going forward?

MR. DANIEL DEMMER:
There was quite a bit of activity in this area. But let me highlight what I think are three of the big ones in the quarter. The first one, of course, was Compaq Global Services standardizing on our integration platform for heterogeneous integration solutions. That was something we have been working on for quite a while, and we consummated that in the quarter. We are sealing up their organization, training consultants right now as part of the deal. Secondly is KPMG actually has embedded us in one of the telecommunications frameworks. It is for system level integration, OSS systems, and provisioning and all kinds of telco applications. We are actually part of the framework. The other one was CFC, which was a financial services announcement that we made. And there we are also looking at being the integration fabric for their finance applications in the retail sector. Those are three of the highlights. The number of consultants that are being skilled up is growing. But it is less important for us than it may be for the proprietary EAI crowd, in terms of those numbers. Because as you know our products are based on standards. And the partnering of industry, the DSI industry in particular is coming to us. And there is less need to actually be trained. Because it's all based on standards in our case. Does that answer your question?

THE CALLER:
Yes. That makes sense.

COMPANY REPRESENTATIVE:
Next question please.(multiple speakers)

THE CALLER:
I just have one more. It looks like, just based on our model, that the EPS guidance for the second quarter is a little lower than what we had modeled. And I was wondering if that is just due to your conservativism, based upon the economic environment; or what that is.

MR. DANIEL DEMMER:
It's really a function of the overall environment out there; in the sense of its impact on IT spending. Customers today are real sensitive and really tightly controlling their budgets. Our company has performed extremely well in Q1; we are very pleased with it. You can even note the license revenue performance again was quite strong. And it is really the one variable out there that is one that is very difficult to change, is the overall economic impact on customers view of IT spending today. So it's really a function of the macro environment, and that is it.

THE CALLER:
Okay. I guess that is it, thanks.

COMPANY REPRESENTATIVE:
Next question please.

THE OPERATOR:
Barad Barid (phonetic).

THE CALLER:
(inaudible) Can you hear me? Can you talk a little bit about the buying behavior that you saw as you approached the end of the quarter? And in particular, given that you had strength in the larger deals but it appears not so much strength in the midsized deals: was there any particular dead end in this quarter that you encountered for the first time?

MR. BOB POTTER:
Sure, I'll take that question. As Dan indicated in the macroeconomic sense, there definitely is caution out there in terms of IT spending. We are seeing more scrutiny on transactions. We are seeing more signatures that are required. We are also seeing a heightened interest in ROI calculations before companies spend money. In some ways, it is lengthening our sales cycle. But the thing that we are seeing is that when we are installed and we have proven results and our customers understand what we bring in terms of value to their IT infrastructure, we are getting through all of those wickets. It is just very, very challenging right now in this economic environment.

THE CALLER:
Right. Would you say the March demand was tougher than the December quarter demand? Or is it about the same?

MR. BOB POTTER:
It's about the same. It is tougher in some ways. I think, again, the tougher aspect of it is just a lot more scrutiny on the spending. But the demand is there, the pipeline is actually building. It is just getting the purchase order.

THE CALLER:
Okay. And in your guidance for June and beyond, what assumptions are you making about -- what degree of macro pick up will occur? When will it occur? And what might happen to your pipeline and close rate in that context?

MR. DANIEL DEMMER:
In terms of the second half of the year, previously we had, about 90 days ago, we were -- our

assumptions were based on a modest improvement in the overall economic environment out there. So at this point we haven't seen signs that that has occurred. So I am not going to try right now to try to predict when those macro changes will occur. I don't think it is wise for us to try to be in that position, predicting of that right now. So right now, that is where we were. We were assuming that. We haven't seen the signs of those macro changes will improve. They still may. But at this point we haven't seen the signs that they will improve.

THE CALLER:
Okay, and in that environment, would you leave your headcount flattish? Or just where it is now?

MR. DANIEL DEMMER:
What we would do is, as always, we will continue to control our expenses quite tightly. It for some reason we don't (inaudible) assumptions materialize, then what we will do is continue to control our costs. Right now as you know they are basically flat through the first half of the year anyway. And we would −− our goals of course would be to maintain probability for the year. That is always part of our business model.

THE CALLER:
Okay, thanks; and good execution in a tough environment.

THE OPERATOR:
Neil Herman.

THE CALLER:
Just wanted to ask a little bit about last week of the quarter. We've gotten feedback from obviously quite a large number of software companies that big deals and not only did deal sizes shrink, but deals expected to close at the end of the quarter just didn't close. I am wondering if you experienced that same phenomenon. And I guess I'll keep it at that.

MR. DANIEL DEMMER:
We had a really good Q1, all right? We did execute exactly as we were planning to. Even though March −− in the last certainly the last few weeks of March, it was certainly difficult. What didn't materialize was a significant amount of sort of upside transactions. The pipeline is there for that. But we were able to close when we needed to close; right to the last week. It was not significant impact on us in the last week of the quarter, as we have heard from some of the other companies that you mentioned. But again, I think that the baseline is that we don't see that sort of base characteristic changing in the first half this year. It's still going to be a tough June quarter, we believe.

THE CALLER:
Typically the June quarter is sequentially up in license revenue for the software industry. I was wondering if you had any preliminary thoughts on seasonality.

MR. DANIEL DEMMER:
I think so. Even if you look at our guidance we are looking at license revenue increasing roughly 10 percent sequentially. We think that is a pretty good position to be in right now.

THE CALLER:
And lastly can you just give us your assessment of the competitive environment, who are you guys seeing more of competitively, who are you guys seeing less of competitively?

MR. BOB POTTER:
It's Bob. We are seeing the same types of companies we often see. IBM, of course, is the company in our group that has the most similar productline that we have and going after the very strategic integration kinds of opportunities. We see DEA and Web basing kinds of opportunities. We occasionally see the proprietary EAI crowd. Sometimes we win, sometimes we lose. In B2B opportunities most often we see Web methods. But in terms of companies that understand the need for standards based integration, scalable, mission critical kinds of solutions, we do very, very well. There is not a lot that has changed in terms of competition on that front. Does that answer your question?

THE CALLER:
Are you seeing, other than the reticence to sign on the dotted line, are you seeing customers changing their parameters with respect to how they are making these decisions? And I'm talking about from a pure product perspective.

MR. DANIEL DEMMER:
What we are seeing is a move towards standards, particularly Web services integration standards. This whole notion has taken the industry by storm. And we get out in front of this one. We've had products in the market since the fourth quarter. Our pipeline is most building in that particular area. And that is the key thing that we are seeing. We are seeing the need to buy expensive multi−million dollar proprietary EAI solutions going away. That is the thing I'm seeing most.

THE CALLER:
Okay, thank you.

THE OPERATOR:
Ken Kiarash.

THE CALLER:
Good morning. I had a couple of questions. But before my questions, can you talk a little about the guidance for fiscal year '02? I don't know if you guys gave a guidance on that or not. But, Dan, right before you started giving a guidance for second quarter, a number of us were cut off from the call. So I just wanted to know if we missed the guidance for fiscal year '02.

MR. DANIEL DEMMER:
Did you get the guidance for Q2?

THE CALLER:
Yes, I did.

MR. DANIEL DEMMER:
Okay. Basically, not going to give further guidance for the rest of the year at this point. Really the single overriding issue and variable in the second half performance is the economic

environment and its impact on IT investments. And today that variable is just too difficult to predict right now. So our customers really aren't committing the budgets to their budgets well beyond the next quarter in front of us. And therefore we have confidence in our guidance within the next quarter. But beyond that we are not going to give further guidance at this point in time.

THE CALLER:
Okay, and in terms of revenue contribution by vertical, can you break out some of those verticals for us? You mentioned (inaudible) service health care. What were the strengths and weaknesses in the quarter?

MR. DANIEL DEMMER:
Sure. It was again a pretty typical quarter for us. We had, to take manufacturing, finance, and Telecom, and again some ISPs. All of those were just about 20 percent, I think within a couple points of 20 percent of our business. That is the one area where we actually had the biggest improvement in our verticals, was in government defense. That was actually quite a good quarter for us. Government defense. They were up in the sort of midteens or so.

THE CALLER:
And do you expect that strength to continue especially in the second half, as some have suggested? Especially for the integration software guys, where the contribution from government could actually increase?

MR. DANIEL DEMMER:
I think that is possible. Certainly in the pipeline, when you look at the pipeline, that is definitely one of the largest growing vertical sections of our pipeline today.

THE CALLER:
And one housekeeping question, in terms of overall average selling price for the deals.

MR. DANIEL DEMMER:
For the quarter it was about 55,000.

THE CALLER:
Okay. Thank you.

THE OPERATOR:
Eric Brethenoux.

THE CALLER:
Two questions; actually. One is on the competitive environment. On the one hand, you compete against IBM given their presence; but on the other hand you guys have partnerships with them. So I just wondered how the dynamics works between these two. And the second one on the competitive (inaudible) about Microsoft. I wondered, you guys have (inaudible) of the Web services (indiscernible) but when you go in the market can you see some people saying well, maybe we have to see about net? (indiscernible) more than you had so far before we really commit to Web services? Or on the contrary are you seeing companies moving ahead of that trend? And my second question has to do with deferred revenues and I'll come back to that.

MR. DANIEL DEMMER:
Let me take the IBM one first and I will pass it over to Barry on Microsoft. The IBM relationship is complex. We actually sell product to them. They use Orbix as infrastructure in some of their applications. So in that sense they are a customer. Occasionally IBM global services actually uses our products in engagements. So that is a partnering relationship. But by and large we sell middleware solutions, and they sell middleware solutions, and we compete with one another in end−user accounts. There are several very important IONA accounts that use both WebSeer and use Orbix E2A. And we have had the foresight to do what is right for the customers and actually set up our own interoperability lab and test our products with one another before we ship them to those customers. This has been customer driven. We have very high−level commitment in both companies to make sure we are doing the right thing by the customer. And in that sense we are partners. We are partnered on standards, making sure our interfaces work together, making sure our products work with customers. So that is the nature of the announcement we made, and that is in fact our relationship with IBM. Let me pass over the Microsoft one to Barry.

MR. BARRY MORRIS:
(inaudible) made the comment about the Web services interoperability forum, and we actually ran a Web services interoperability event here in Boston for about 30 companies, including of course Microsoft and IBM and all the other guys. And the results of that are up on our Website. The interoperability piece speaks to the heart of your question, which is that you talk about the take up of Web services; and in particular its relationship to Microsoft. The reality about Web services is there is a lot of hype. I talk about it as being sort of overhyped and underestimated. There's a lot of hype about it in relation to anonymous Web services and consumer Web services, and kind of a next generation B2C or something like that. That we have consistently said that where the rubber hits the road in the near−term is in the integration problem. Which is a top three item for CIOs out there today. They have this huge integration problem that has big cost leverage for them. And Web services with a different economic model can get at that much better than proprietary systems that we have seen before. That view is something which we presented last year, and we have seen a lot of people in the industry including the big guys starting to use that same language, and starting to address their attention more and more to this integration problem. Because that is where Web services are going to give the payback in the near−term. As Bob said, when you look at the episode of lead indicators for the Web services deployment in this area, which are to do with our pipeline, to do with the 1000s of downloads that we have of our development toolkit, and to do with general media interest in it, and so forth; what we are seeing if anything is more rapid take up of Web services integration than we had expected in the summer of last year.

THE CALLER:
So in fact any marketing done by Microsoft is helping a little bit; is that what I am hearing?

MR. BARRY MORRIS:
Absolutely. One of the great things about being ahead of the curve, which is where we are on this, is that every marketing dollar any other company puts into it helps to lift up.

THE CALLER:
Thanks. On (technical difficulty) revenues than was cited, is that a seasonal factor? Or is there anything that we should be looking at.

MR. DANIEL DEMMER:
That is strictly seasonal; you'll get increased bookings in the fourth quarter and then less in the first quarter.

THE CALLER:
Thank you very much.

THE OPERATOR:
We have time for one more question. Our last question comes from Rick (indiscernible) of Prudential securities.

THE CALLER:
John McPeake. I have a question about the pipeline in terms of what is out there. And also a little follow−up on that question about the government and defense vertical. First off, (inaudible) about a year ago I think Barry you were talking about a deal potential in with the Department of Defense. And I was wondering if that was progressing. And that also if there are any watershed deals outside of the CORBA space that were or are close to closing some time, maybe in the June timeframe, June quarter timeframe.

MR. BOB POTTER:
It is Bob. So the makeup of the pipeline is changing. The Web services integration is a larger percentage of the pipeline than in prior quarters. But that is something that we planned for and something that we expect.

THE CALLER:
What percentage do you think it is, Bob?

MR. BOB POTTER:
I don't have the exact percentage, but it is substantial. And I may look at that and then talk to Dan, and maybe he can talk to you about that offline.

THE CALLER:
Okay.

MR. BOB POTTER:
In terms of government, like Dan said, we are seeing a lot of traction. But I imagine a lot of vendors are. The important thing for us is that we've had a strong CORBA success in the Department of Defense. It is their standard. Of course you know we are the primary vendor for CORBA solutions. But we are opening up our U.S. subsidiary and getting security clearances, a facility clearance. We are announcing that actually in a couple weeks as a big event down in Washington. We are getting more awareness in this sector. There is a very large classified DOD project that we can't talk about, but we have been shortlisted; we are the favorite. And we are not necessarily expecting that to close in Q2, but it is as a 2002 transaction.

THE CALLER:
Any other companies in the D.C. Beltway area that you're working on?

MR. BOB POTTER:
The answer to that, John, is yes.

THE CALLER:
All right. Thanks a lot.

COMPANY REPRESENTATIVE:
This concludes our first−quarter 2002 conference call. We thank you for joining us and have a great day. (CONFERENCE CALL CONCLUDED)

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04/17/2002 11:00 am	NWPX	Northwest Pipe Company (NWPX) − NWPX Q1 2002 Earnings Conference Call

THE OPERATOR:
Good morning and welcome to the first quarter 2002 earnings release conference call. All parties will be on a listen−only mode until the question−and−answer portion of today's call. This conference is being recorded at the request of Northwest Pipe Company. If you have any objections you may disconnect at this time. I would now like to introduce the moderator for today, Mr. Brian Dunham. Sir, you may begin when ready.

MR. BRIAN DUNHAM:
Thank you, Michel. Welcome to the Northwest Pipe's conference call and the announcement of earnings for the first quarter of 2002. My name is Brian Dunham, I am the President and CEO of Northwest Pipe Company. Before I begin I'd like to remind everyone that the statements we make in this call about our expectations for the future are forward−looking statements, and actual results could differ materially. Please refer to our press release issued earlier today for cautionary information about forward−looking statements and a description of factors that could cause actual results to differ materially. For the first quarter of 2002 we recorded revenues of $64.3 million and net income of $1.8 million, which equates to 27 cents per−share on a fully diluted basis. We'll look in more detail at these results by their −− our two major groups. Starting with the Water Transmission Group, our sales were up 16.2 percent to $43.3 million in the first quarter of 2002 compared to $37.3 million in the first quarter of 2001. Sales in 2002 improved from the first quarter of last year as we worked on our existing backlog that was reasonably well spread among our divisions. Sales were down some from the fourth quarter of 2001, however, due to significant project delays that began in 2001 and have continued into the first quarter. The lack of bidding activity has resulted in lower backlogs and lower production in our facilities. Gross profit decreased 4.3 percent to

$8.8 million or 20.2 percent of sales for the first quarter of 2002 compared to $9.2 million or 24.6 percent of sales in the first quarter of 2001. Gross profit decreased as a result of lower margins on the projects being produced during the current quarter, and additional rental expense resulting from the operating leases completed in the second−quarter of 2001. As noted a moment ago, bidding activity has been below expectations since the third quarter of 2001. As is typical, price competition increases during periods of (indiscernible) bidding activity ultimately resulting in lower average margins on booked orders. The lower bidding activity also resulted in some underutilization of capacity during the quarter. We were able to fill some of the holes in the production schedule with piling work, but this generally has lower margins than engineered system projects, and consequently also contributes to a lower average margin for the Company. We are now seeing bidding activity improve, and we are still projecting a strong market year for water transmission. However, the delays that we have already experienced will continue to effect us adversely in the second quarter due to the leadtimes in our industry. At this time we expect both our bookings and capacity utilization rates to improve in the second half of the year. If bidding does increase as expected we should see sales volume and gross margin percentages improve as well. In the Tubular Products Group our sales were down 20.3 percent to $21 million from $26.3 million recorded a year ago. The decrease resulted from the soft market conditions we have seen over the past several quarters. However, the difficult market conditions that began to effect this segment in the second half of 2000 seem to bottom out in the fourth quarter of 2001. We are seeing improvements in the marketplace for our products. Increased demand is not uniform across our productlines, as you would expect, but we did see at least small increases across the board in the first quarter compared to the fourth quarter of 2001. Overall, sales in the first quarter of 2002 were approximately 10 percent higher than in the preceding quarter. We expect continued improvement in the second quarter of this year. Gross profit during the quarter was $1.4 million. This is well off the $2.7 million recorded last year, but we are again showing improvement from the fourth quarter of 2001. The gross profit in the fourth quarter of 2001 was $467,000. In the first quarter of this year we added almost $2 million in revenues and almost $1 million in gross profit. In the second quarter we expect to see further growth in gross margin as volume continues to increase and price increases, which have already been put into place, start to have an impact on our results. Steel costs are the major component of our overall costs in the Tubular Products Group, and steal −− the cost of steel is a major issue for this group and a major source of uncertainty. The 2001 trade case remedies, which were put in place earlier this year, have begun to impact our operations. President Bush established a 30 percent tariff on steel coil with certain exemptions and established a 15 percent tariff on pipe and tube, again with certain exemptions. Our biggest concern with this action was a possibility that a teriff would be placed on steel coil but none on pipe. This would have put us in a difficult position with certain of our productlines that are subject to import pressure. Instead, we got a resolution that recognizes steel coil and steel pipe need to have similar treatment. And on the surface this is a much better result for us. The steel industry in the United States has moved very rapidly to increase pricing both in anticipation of teriffs and continuing after the announcement. In some cases we have seen 50 percent increases in steel coil costs in the past few months. As of today, further price increases are still expected in the third quarter of this year. To date we have managed to increase our selling prices enough to avoid any significant deterioration in the spread between selling prices and the cost of steel. However, it is unclear if our customers will continue to accept price increases as rapidly and continuously as they are proposed by the steel industry. We are starting to see some imported steel come back into the market, and there is certainly speculation that the combination of a greater import presence, plus the expected re−entry of LTV into the market, may have a leveling impact on future increases. At this time, however, it is very difficult to offer a conclusive opinion about steel costs. Clearly our ability to manage the spread of selling prices over steel costs will be a significant factor in our margins in the next few quarters. Ultimately we expect the uncertain steel market to return to more normal patterns. When this happens, we believe the full impact of the operational improvements we have made in the Tubular Products Group will keep us very competitive across our productlines and will help return margins to historical levels. Selling, general and administrative costs for in the company as a whole increased slightly to $5.7 million for the first quarter of 2001 compared to $5.6 million in the first quarter −− excuse me, $5.7 million in the first quarter of 2002 compared to $5.6 million in the first quarter of 2001. SGAcosts were down $660,000, however, from the fourth quarter of 2001 as we work to control these expenses. We expect SGAcost to remain at less than $6 million per quarter for the rest of the year. Interest expense was $1.4 million for the quarter, down from $2.5 million for the same period last year. This is a result of the completion of the operating leases in the second quarter of 2001, lower interest rates and lower borrowings. Interest was down slightly from the fourth quarter of 2001 as well. Based on expected borrowings and assuming flat interest rates, we expect interest expense to continue in this range for the rest of the year. After adjusting for taxes, net income was $1.8 million for the first quarter compared to $2.3 million for the first quarter of 2001, and this equated to 27 cents per share based on 6,711,000 shares outstanding, compared to 6,616,000 shares outstanding last year and an earnings of 34 cents per share. Looking at the balance sheet, working capital is approximately $110 million at March 31st, 2002 with a current ratio of 3.3. A year ago those numbers were $77 million for working capital and a current ratio of about 1.8. Debt as a percent of total capitalization is down to 37.7 percent compared to 55.2 percent at March 31st, 2001. Our total assets are approximately $265 million and equity has increased from $110.1 million a year ago to $120.2 million as of March 31st, 2002. As we look ahead, we see opportunities for improvements in both our groups. Demand in the Tubular Products Group is increasing. Demand for these products trend along with the general economy and certain subsets of the general economy. While all indicators are not positive, we are optimistic that a recovery is underway and that it's starting to have impact for our products. We expect this to continue in the second and third quarters. As mentioned earlier, the cost of steel coil is a serious issue for this group. So far price increases to offset the increasing cost of steel have met with market acceptance. We have increased selling prices for all of our product lines, in some cases two or three times in the past few months. We are working to minimize the impact of the rising cost of steel, and also to pass on these costs wherever possible with an objective of maintaining our spread. The Water Transmission Group has suffered from a slowdown in bidding activity over the past several months. This is clear from our backlog which is at its lowest point in the past two years. This will have an impact on our results in the second quarter. We expect to see slightly lower revenues and margins in this quarter. Obviously we are continuing to work to fill available capacity during the quarter, but with today's extended leadtimes this appears increasingly unlikely. We do expect bidding activity to improve and our backlog to build during the second quarter. This should lead to better results in the second half of the year. In the long−term we continue to expect strong markets in water infrastructure as new systems are built to address population growth, as well as to replace aging and possibly failing pipelines. We are taking steps internally to address the markets we see in the near future. We are focusing on improving our operations and also updating equipment in four key facilities in order to enhance our competitiveness. In conclusion, we were pleased to see an upturn in Tubular Products during this quarter. We have worked hard to improve our operations in this group, and we are looking forward to demonstrating this improvement if the market continues to recover. At the same time, the Water Transmission results are somewhat disappointing. This business is often subject to uneven bidding activity and unfortunately this is impacting us right now. We are convinced this is a short−term issue, however, and are looking forward to increasing activity which will lead to better results. At this time I will be happy to answer any questions. Michel.

THE OPERATOR:
(CALLER INSTRUCTIONS) Our first question comes from David Flandry (phonetic). Your line is open.

THE CALLER:
Good morning, Brian. Can you −− on the tubular product side revenues were up about a million dollars over the fourth quarter, but can you give us some idea about volumes? If you've put through all these price increases, some of that increase in revenue is clearly the result of volume as opposed to −− a result price as opposed to volume.

MR. BRIAN DUNHAM:
David, most of the −− almost all of the increase in the first quarter is volume related. Most of the price increases went into place −− announce in the first quarter took effect towards the very end of the quarter. And we have further ones taking effect in the beginning of the second quarter. So virtually all of that increase is volume.

THE CALLER:
Okay. And when you talk about spreads, are you talking about widening margins? For example, if I have a piece of product that I sold for $100 and I take it to $120, and I sustain my gross margin percentage, I should get more absolute gross margin dollars. Is that the kind of effect you would expect in tubular products as we go forward?

MR. BRIAN DUNHAM:
When we talk about the spread we're really talking about two components to it, the selling price obviously and the cost of steel. We take out of that our processing cost which we believe we can hold pretty consistently. And what we are hoping to do is maintain the spread over the cost of steel. So if steel goes up $20 your selling price goes up $20. If your conversion costs or your processing costs stay the same, you're going to end up with the same dollars but a different percentage in margin. If you're able to increase your spread higher than the cost of steel, you'll end up with growing dollars in margin but you may not end up with a growing percentage because obviously you based the percentage on that increased steel price.

THE CALLER:
Right, okay. So you're saying you want to hold your spreads or you're hoping to hold your spreads constant, which really is not going to give you more gross margin dollars?

MR. BRIAN DUNHAM:
Certainly we would like to see margins improve, but the first objective is to not lose anything as you see the steel market go through this gyration that it's going through right now.

THE CALLER:
And in the tubular markets as we move into Q2 and Q3, I mean they are typically seasonally stronger periods, are they not?

MR. BRIAN DUNHAM:
Yes, we typically are a little stronger in Q2 and Q3. Q1 is probably the third−best quarter and Q4 is the generally the fourth.

THE CALLER:
Okay. And I'm sorry, Brian, I missed the early −− I had a wrong conference number, and I missed your early comments. But can you just talk a little bit more or can you give us a little more flavor on why you're confident that bidding in the second quarter should be stronger? Are there more opportunities that you're tracking, what gives you confidence that Q2 bidding activity will increase?

MR. BRIAN DUNHAM:
Well, as you know, we track the agencies activities very, very closely. And in the delays that we saw in this quarter, if you go back, we talked about those in our last quarterly release as well. We expected to see this. We did. But we also expect to see those jobs start to break loose in the second quarter. We've already seen that activity start to pick up here in the first 15 days or so in this quarter, and at this point we don't see anything to suggest that we're not going to see that stronger bidding activity in the second quarter and continuing on through the rest of the year.

THE CALLER:
And Lastly, can you kind of give us some idea what the competitive environment is? Is your primary competitor still staying reasonably rational on their bidding activity?

MR. BRIAN DUNHAM:
As always, when bidding activity is lighter the competitive environment gets a little bit tougher. Everybody has the same issues that we do with a relatively high fixed cost in these manufacturing facilities and especially with longer leadtimes not as many opportunities to fill those spots. So it tends to get more competitive when bidding is light, and I think we have seen that. And so the margin that's in our backlog is not as good as what we'd like it to be. But we also think the margin will improve as bidding improves, and we have every reason to expect that will happen.

THE CALLER:
Great, thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) At this time I have no questions. Thank you.

MR. BRIAN DUNHAM:
I guess if there are no further questions we'll conclude the call. Thank you very much for your participation, and we will announce the second quarter earnings release in a couple of months. Thank you very much, bye.

THE OPERATOR:
Thank you and have a nice day. All parties may disconnect. (CONFERENCE CALL CONCLUDED) \plain \fs24 \ATXts750\sl495 \ATXnt874

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04/17/2002 04:00 pm	SRX	SR Telecom (SRX) − Q1 2002

THE OPERATOR:
Good afternoon ladies and gentlemen. Welcome to this first quarter conference call hosted by SR Telecom Inc. Before turning the meeting over to management, please be advised that this conference call will contain statements that are forward−looking and subject to a number of risks and uncertainties that could cause actual results to differ materially from those anticipated. I will now turn the meeting over to Mr. Pierre St−Arnaud, President and Chief Executive Officer of SR Telecom. Please go ahead, Mr. St−Arnaud.

MR. PIERRE ST−ARNAUD:
Thank you and good afternoon, ladies and gentlemen. Welcome to our conference call for the first quarter ended March 31st 2002. With me here is David Adams, Vice President of Finance and CFO; Dave will review the specific numbers in detail shortly and we will be pleased to answer questions after that. First I am very pleased to report a very profitable first quarter in our core fixed wireless access business. Our operating earnings in the segment were $2 million on revenue of 40.6 million. What is very important and what we are very proud of is that we have now posted four consecutive quarters of improvement in operating results in our fixed wireless segment. Q1 also represents the third consecutive quarter of profitability in this business. We are very encouraged by this performance, especially when compared to the severe difficulties many other companies in this business are still experiencing. The consolidated net loss for the first quarter was 2.6 million on total revenue of 45.5 million, which represents a loss of 5 per share including CTR. This compares to a net loss of 1.5 million on revenue of 35.4 4 million or 3 cents a share in the previous year. This increase in consolidated net loss is directly related to our decision to treat CTR as a continuing operation as of December 31, 2001. If CTR had been treated in the same way last year, the loss during

Q1 2001 would have been 9 cents per share. David will provide more details on this in a few moments. As I've outlined to you over the past twelve months our fundamental objectives have been very clear: to improve the Companies profitability and competitiveness in a weak economy and to position ourselves to take advantage of the eventual market recovery. The turnaround in our fixed wireless business, which began in the second half of last year, and has continued during our most recent period, is a direct result of the (inaudible) measures we put into place last year and which continues to be implemented. These measures have been designed to improve our operational efficiency and broaden our customer base. In addition the 36 percent boost in our first quarter fixed wireless revenues, over the same period last year, comes largely as a result of the strategic acquisition of Lucent's SWINGs product line which we finalized in September of last year. The cost reduction and business process improvement program we introduced have also a material impact on results. Coupled with the increased volume, these programs contributed to an increase in the gross margin of our wireless business in Q1, which rose to 20.2 million or 49.8 percent of revenues, up from 12.6 million or 42.4 percent in the corresponding quarter last year. Another very important indicator of our performance is the level of capital we employ in relation to our revenues. Even though the telecommunications markets have been in a grand slump, we decreased our level of capital employed while increasing our revenues. As I said our restructuring programs are ongoing. It is one of our top priorities to continuously improve our working capital position. In quarter one the Company's net cash increased to 20.8 million, up from its year−end level of 20.4 million. We've made our manufacturing processes more efficient and more market−driven and have improvements in achieving contract (indiscernible). There been two significant developments since the beginning of fiscal 2002. First we drove our deal to acquire the assets related to the Velocity 2000 product line from NERA Telecommunications. This is a highly strategic transaction. Velocity 2000 is a TDMA based fixed wireless access solution for carrier grade voice and IST data networks. It will be marketed to telecommunications provider formally serving the rural areas of the United States. This positions us for growth in a market where until now we have not been very active. The second highlight is the $30 million contract we won in Thailand. Under the terms of the contract we will supply our (inaudible) point−to−multipoint solution to the Telephone Organization of Thailand, that country's national exchange carrier. I want to point out that this contracts represents the fourth major expansion in the project that was initiated in 1994. SR Telecom has delivered over 250 systems to the Telephone Organization of Thailand, serving close to 170,000 subscribers in villages throughout that country. Our ability to win this kind of repeat business demonstrates the strong long−term relationship that we have been able to build with our customers. It clearly emphasizes the confidence TOT has in our telecommunications systems and solutions. I'm very pleased that we have been able to realize these successes in a climate that is still very difficult for the telecom industry. Turning to CTR, I wish to affirm that we are still very committed to disposing of our assets in Chile. This is a process that has been made more challenging as you know because of the financial uncertainty in the South American market as well as the continuing weaknesses of the telecom industry over there. The Argentina economic crisis has made this situation even more difficult. For these reasons a sale is unlikely in the short−term; however I believe CTR is an attractive acquisition target for the right company. In fact CTR will add to valuation of almost any Chilean telecom company on the basis of its EBITDA per line or average revenue per user. Going forward, we expect to continue to benefit from the operational efficiencies and strategic initiatives we have accomplished within SR Telecom. These measures have a strong −− these measures have made us a much stronger, more focused and more market−driven company than we were a year ago. We have returned our core business to profitability and greatly increased our competitive stature. In my view, the industry has been facing a difficult environment and will not recover immediately. Therefore I do not expect revenue to grow for the next two or three quarters compared to Q1. That said, I also feel that our industry presents well managed and well positioned companies like ours with abundant opportunities. We are now in an excellent position to take advantage of a market turnaround as and when it occurs. I would now like to ask David Adams to provide us with more details on our first quarter results. David.

MR. DAVID ADAMS:
Thank you Pierre, and good afternoon ladies and gentlemen. I would like to elaborate on some of the financial data that the Pierre has provided and discussed plus a few other notable developments. Turning to the results of our core wireless business, revenues were 40.6 million for the first quarter, a 36 percent increase over the 29.8 million for the corresponding period in fiscal 2001. As mentioned, primarily due to the (inaudible) product line we acquired from Lucent. For the third consecutive quarter this sector was profitable. Net earnings were 176,000 as compared to a net loss of 1.5 million for the first quarter last year. Gross margins both in absolute and percentage terms were also up substantially. The most important indicator of the company's turnaround is our operating earnings from continuing operations. For the first quarter, these earnings reached $2 million, a considerable improvement over the $2.9 million loss we reported in the first quarter of last year and double what we had achieved in the last quarter of 2001. This is the fourth consecutive quarter in which operating earnings have improved. We have continued to reduce the combined receivables and inventory position of the company, quarter over quarter by 2.1 million and year−over−year by $27 million. This was accomplished despite the impact of increasing sales volumes over the last several quarters and a onetime purchase of inventory associated with the Lucent (inaudible) acquisition. The restructuring programs we put into place in 2001 have permanently reduced our cost base on a comparable basis. If we exclude the impact of the Lucent acquisition, our operating expenses have decreased by 13 percent from their Q1 2001 level. Also, gross research and development expenses on a comparable basis have decreased by more than $1.5 million over their Q1 2001 run rate, an estimated savings of approximately $6 million per annum. Backlog at the end of the first quarter was 146 million versus 199 million at the end of the first quarter in 2001, And $150 million at the end of last fiscal year. I remind you that we have changed our policy with respect to reporting backlog. The March 31st 2002 backlog includes only the first year of multiple year frame contracts in Saudi Arabia and Australia rather than anticipated deliveries over the life of the project. It is expected that approximately $99 million of this backlog will be deliverable in the balance of current fiscal year. The backlog also reflects the $70 million reduction taken in the third quarter of 2001 to reflect the slowdown in deliveries to Agitel (phonetic) . Our own capital expenditures are being kept to the minimum level required to execute the company's business plan. Wireless products additions for the quarter were half a million dollars, identical to Q1 2001 figures. CTR property plant and equipment additions were 200,000 compared to 2.9 million in the same period last year. As Pierre has already mentioned our consolidated results for Q1 2002 show a loss of 2.6 million or 5 cents per share; compared to the loss of 1.5 million or 3 cents per share in Q1 last year. This requires some explanation, which has to do entirely with the way we are now reporting the results of our telecommunications service provider operations in the income statement. As you know, on December 31st, 2001, we decided to stop treating CTR as a discontinued operation. This requires a series of complex accounting transactions, the results of which were incorporated into our fourth quarter release. This decision now has an effect on our quarter over quarter figures for 2002 that could be somewhat misleading when you want to measure how we are doing compared to the corresponding period last year. Last

year, the operating losses of CTR were applied against the provision for loss on disposition, which was shown on the balance sheet, and did not appear on the income statement. But now with the reversal of this treatment, we must take into account the results of CTR each quarter as a continuing operation. Obviously we're not allowed to restate reported net income for prior years. On an apples to apple's basis, though, if we were to add the CTR losses back in, our consolidated net losses in the first quarter 2001 would have been 9 cents per share, compared to losses of 5 cents per share for the same period in 2002. In other words, the first quarter 2002 results would represent a 4 cent per share improvement in the bottom line. Regarding CTR's results, the company lost 2.8 million in the first quarter of 2002 on revenues of 4.9 million, compared to a loss of 2.9 million on revenues of 5.6 million in the corresponding quarter last year. However the first quarter results were significantly better than those of the immediately preceding quarter where CTR posted a net loss of 4.1 million on a comparable basis. The drop in revenues is primarily due to the effect of the devaluation of the Chilean peso. CTR also continues to be impacted by a weak local economy in the aftermath of the Argentinian economic crisis. CTR generated positive EBITDA in excess of one million Canadian during the current quarter. Line growth is being accomplished through various initiatives within the existing backlog. The principal focus is on integrating the recently acquired satellite based network with the existing wireless network infrastructure. Limited financial resources are being allocated to minimize customer churn and improve the quality of service throughout both networks. So even in the midst of a very difficult environment, CTR continues to drive towards improved results. However I will reiterate that disposing of these assets is one of our top priorities. I'm confident that the renewed focus on our profitable wireless business and the measures that we took in 2001 and continue to put into practice will steadily improve our operating results and strengthen our balance sheet. I will now turn things back to Pierre.

MR. PIERRE ST−ARNAUD:
Thank you David. We would now be pleased to answer any of your questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) Barry Richards with CIBC World Markets; please proceed with your question.

THE CALLER:
Good afternoon. Pierre your results seem to be a fair bit better than many of your competitors. And I am wondering if you have seen just in the last six−months specifically a change in the competitive level of the bidding on new projects?

MR. PIERRE ST−ARNAUD:
Thank you. Actually we have a dominant position in the rural sector. And we have I think products which provides an especially good solution for that market. We have seen some competitors making efforts and trying to enter the market, and starting to bid on some of these projects. But as of yet we've not seen any erosion of our market position; nor have we seen erosion in our prices. As a matter−of−fact here, looking ahead, I think that's a business which is not following the trend of the overall telecom infrastructure. You know as deregulation spread throughout the telecom world over the past few years here, the ILECs concentrated on defending their market position against attack mostly in urban areas. Although it is widely recognized now that the deregulation has not provided a solution for remote areas. And so as once again the ILECs will move again in investing in the rural infrastructure. And we have

seen evidence of that in many markets actually. with countries starting to subsidize rural again, in many countries funds being created from earnings of operators to force them to reinvest in remote areas. So as a matter−of−fact I think part of our success here is the fact that we are in a segment of the market which has been less affected; I mean, it is clearly not the segment of the market which is overbuilt.

THE CALLER:
Can you help us track your progress in terms of some revenue characterizations? I am thinking about the number of revenue generating customers I guess specifically on the equipment side.

MR. PIERRE ST−ARNAUD:
In terms of how many customers we have to create these revenues?

THE CALLER:
In the quarter. I know you have got hundreds of customers historically. But in the quarter can you just give us a sense for how many customers are generating revenues? And maybe just about whether there's a revenue concentration issue? Clearly some of the big projects are generating the bulk of the revenues; but if you could just give us a a sense of that.

MR. PIERRE ST−ARNAUD:
Not, actually, not in the first quarter of this year. As a matter of fact, the first quarter of this year I would say is especially made of a number of contracts; and there is no dominant contracts in that part. As you know last year I think three of our customers last year represented roughly 30 percent of our overall revenues. And I would say that certainly in Q1 this is −− it has not been any different or even I would say less concentrated than it was actually last year.

THE CALLER:
So, David, would we be talking about 20 customers that are generating revenues, or a lower amount?

MR. DAVID ADAMS:
More than 20; single largest concentration would've been deliveries into Australia.

THE CALLER:
Can you help me understand the percentage of revenues that come from the SR500?

MR. PIERRE ST−ARNAUD:
I would say it is the majority of the revenue are coming from the SR500 than from the SWING product in France, which are similar applications and markets. Typically in different geography. Because historically SWING had −− its success were (indiscernible). So they are very complementary in terms of geography. But most of the revenues are coming from that. And then you have something like 10 percent or so which is coming from service activities and after−sale services.

THE CALLER:
Okay. You have kept a book−to−bill above 1 or around 1 for some time. Given the telecom slowdown, we are looking out four quarters. Which geographical regions do you think are

most likely to help you maintain that book−to−bill ratio?

MR. PIERRE ST−ARNAUD:
Well I would say for us Asia and the Arab worlds are still very active markets; there is a lot of opportunities in the northern part of Africa. I would submit to you that in South America the market has been slower than we expected. But it has been stronger in North America and part of Central America.

COMPANY REPRESENTATIVE:
Thanks so much and good luck.

THE OPERATOR:
Rod Ireland with Northern Securities.

THE CALLER:
Good afternoon, gentlemen, look forward to seeing you at the annual meeting. Couple of questions. One on Axtel, I know you changed the method of recording the order book. But are they in fact drawing any stuff down. And what is the status of that original vendor financing that you did?

MR. DAVID ADAMS:
We are delivering. There's modest deliveries to Axtel that are occurring. If you recall I guess, in the third quarter of 2000, there, our deliveries to them slowed down considerably as they reduced their build. That was when as saw, when the capital markets crisis really began to impact the telecom industry. They are actually quite well managed and took corrective response very rapidly. So we've begun again delivering equipment to them. They're concentrating on maximizing their customers within the existing backbone. So what we are selling them is (indiscernible) premise equipment. And we're talking to them. They have gone EBITDA positive and have a pretty aggressive business plan for this next year, which is should enable us to be able to restart deliveries to them, hopefully in the future. But during the next little while, it's a pretty slow rate of absorption. The vendor financing, they are current. And as you know it was very conservative. We provided vendor financing which was effectively 360 day notes for 50 percent of the equipment value; and at least half of that has been repaid; and they are current on their program to repay the balance.

THE CALLER:
Excellent. As far as CTR is concerned, how close are you to reaching a subscriber number for completing the build out for the nonrecourse debt?

MR. PIERRE ST−ARNAUD:
We have currently about 21, 2200 lines generating revenue.

THE CALLER:
(multiple speakers)

MR. DAVID ADAMS:
So we are relatively close. As you know we are within the number that was defined was 22,500 revenue generating lines.

THE CALLER:
Right. And your 21, 2. Excellent. Okay. See you tomorrow.

THE OPERATOR:
Chris Bonnet (indiscernible) with Desjardais (phonetic) Securities.

THE CALLER:
Can you talk about the gross margins going forward? And also tied in with that an update on the Velocity product portfolio and when that's going to kick in?

MR. PIERRE ST−ARNAUD:
Yes. Velocity, we have closed the transaction. As you know, a few weeks back or a week back or so. There is still RDto perform to complete the product. We foresee that the first commercial delivery will be probably at the end of Q1, 2003, or so; around. We are going to start aggressively commercialize the product sometime like September, October. With likely four to six month delivery.

THE CALLER:
So September October are trials on customers?

MR. PIERRE ST−ARNAUD:
We're going to start to commercialize the product in September October. So there was trials already done with some of the customers.

THE CALLER:
Do you have any forecast in terms of what that will contribute to the Company in '03?

MR. PIERRE ST−ARNAUD:
There will be no contributions from there in 2002. In 2003 we have not published (multiple speakers) how much we expect to get out of the market here. We don't want to attract too much attention to some other people.

THE CALLER:
(inaudible) Long−term goal, like you expect it to be a third of your revenues, half of your revenue, quarter of your revenue?

MR. PIERRE ST−ARNAUD:
It is the materials; it is a very material event for SR Telecom if we are successful to go forward.

THE CALLER:
Okay. So going forward in the next couple of quarters, you said no growth. Does that mean do you expect a decline at one point in one of the next couple of quarters versus the current quarter?

MR. PIERRE ST−ARNAUD:
Not at all. We do not expect any growth over the Q1 revenue we have today. We don't have any reason to believe that it would significantly go down.

MR. DAVID ADAMS:
Either.

THE CALLER:
Okay. But if it does it will be like a percentage or two, not significant.

MR. DAVID ADAMS:
That's what we see today, it's to say. We don't see significant growth, but we don't see significant decline either. With respect to margins, I think the margins that you see there now, we put, I think reflecting the fact that we put a bunch of cost reduction activities that we put into place; and those are going to continue. So it's our expectation that we will be able to continue to improve.

MR. PIERRE ST−ARNAUD:
We're making −− we have made a few statements here saying that one of the things we did here was not programs to change the (indiscernible); it was more to introduce the culture to continuously improve on where we are. And we will certainly fight to keep improving the margin going forward.

THE CALLER:
Okay. Lastly on inventory how do you plan on keeping that and any write−offs?

MR. DAVID ADAMS:
No, not at all. I think the increase you see in the inventory is completely due to a onetime buy that was done with the Lucent acquisition. We structured the transaction so that we would be able to procure inventory on extremely favorable terms.

THE CALLER:
And this was all finished products?

MR. DAVID ADAMS:
No it's not; as a matter of fact, there's in some cases it is components; in many cases it's components. Because we're going to be supporting the installed base of both the RRT (phonetic) product line and the SWING product line for some time to come. So it's a combination of.

THE CALLER:
So this inventory from the Lucent acquisition, does that support the 99 million in backlog?

MR. PIERRE ST−ARNAUD:
Yes for the part which is coming from France. I would like to comment further here that you know we have been fighting a lot on inventory and receivables, to free up capital from the balance sheet. And we are continuing to do that. As a matter of fact here we have been able to assimilate requirements in capital in France out of Lucent within the existing level we are at. Which means that in fact we have reduced further capital employed in our core business in Montreal and had (indiscernible) on the other end.

THE CALLER:
Lastly CAPEX for the year, what do you expect?

MR. DAVID ADAMS:
The levels are pretty light right now. Any capital expenditure that we will be −− first of all on the second quarter you are going to have the impact of the Nera acquisition, which is going to be extremely modest. Then we have any continuing expenditure will be completely (indiscernible) on R It's all on RDline; that is where it will happen. (inaudible) Capital expenditure to support R

THE CALLER:
More or less split between here and the Lucent stuff?

MR. DAVID ADAMS:
Yes, but it is small stuff.

MR. PIERRE ST−ARNAUD:
Most of the RDcomes as you know, in our accounting practices, as expense. That is not expense. It is the equipment as such. So it is a very small amount.

THE CALLER:
Right. Thank you very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) Gentlemen there are no further questions at this time. I will now turn the call back to you. Please continue with your presentation or closing remarks.

MR. PIERRE ST−ARNAUD:
Thank you. Our first−quarter 2001 results shows a continuing improvement in virtually as aspects of our fixed wireless access core business. We have delivered on our objective to improve the company's profitability and to position us (inaudible) to take advantage of the eventual market turnaround. For the third consecutive quarter our core business has been profitable, and for the fourth consecutive quarter we've shown continuing improvement in operating results. I firmly believe that we are now on the right track and very well positioned for the future. And I most welcome you tomorrow to participate in our general annual meeting. Thank you very much.

THE OPERATOR:
Ladies and gentlemen that does conclude the conference call for today. We thank you very much for your participation and ask that you please disconnect your lines. (CONFERENCE CALL CONCLUDED)

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04/17/2002 02:00 pm **QMRK QualMark Corporation (QMRK) − Q1 2002**

COMPANY REPRESENTATIVE:
Excuse me, I very much (indiscernible) for your patience in holding. Please be aware that during today's presentation each of your lines will be in a listen−only mode. At the conclusion of the presentation we will opening the floor for questions. We will give instructions at that time for the procedure to follow if you would like to ask a question. At this time I would like to refer the Safe Harbor statement under the Private Securities Litigation Reform Act of 1995. During this conference call management may discuss financial projections, information, or expectations about the company's products and markets or otherwise make statements about the future, which statements are forward−looking and subject to a number of risks and uncertainties, which could cause actual results to differ materially from the statements made. These risks and uncertainties are detailed in the company's filings with the Securities and Exchange Commission. At this time I will turn the teleconference over to Mr. Charles Johnston. Sir.

MR. CHARLES JOHNSTON:
Good morning and welcome to QualMark's first quarter 2002 conference call. My name is Charles Johnston and I am the President and CEO of QualMark Corporation. Anthony Scalese, the company's Vice President of Finance and Administration and Joseph Ruth, our Vice President of Sales and Marketing is also with me today. We appreciate your interest in this conference call and are encouraged by your participation. This morning, we will review our first quarter results and then open the conference call for questions. I assume that most of you have seen our earnings news that was released this morning. If you do not have a copy of this earnings release you can access one on our web site at http://www.qualmark.com. As a quick overview of the first quarter 2002, the company posted total revenues of a $1,90,300

with quarter−over−quarter sequential income up by $604,000. This was well ahead of our internal forecast. This represented a net loss of a $121,000, which included a charge of $36,000 for professional fees associated with our NASDAQ listing appeal. Without the additional professional expenses our net loss would have been narrowed to $85,000 for the quarter or less then $30,000 a month and we once again were within one chamber of profitability. Although we incurred a loss for the quarter, I believe that the first quarter has many encouraging developments to report. As most of you know QualMark has completed the transaction with Roser Venture L.L.C. Over eight months ago management initiated an orderly process to continue to restructure and recapitalize the company. On March 27th, the company closed a $1 million capital infusion. This infusion for which we will require shareholder approval will enable QualMark to remain trading on NASDAQ small cap market, as well as strengthen our financial position and liquidity. The company's continuing relationship with Roser Ventures will allow the company to make acquisitions strategic to QualMark's future business. The first quarter of 2002 showed the first signs of improvement since February of 2001. We have seen a growing order flow beginning at the first of the year, which translated to an increase of total revenues of 46 percent or again $604,000 this quarter over last quarter. We enjoyed revenue in the first quarter of 1.9 million and surpassed the revenue of 1.5 million posted in the third quarter of 2001 and $1.29 million posted in the fourth quarter of 2001. I would like to add another positive note that we increased our margins upwards by 3 percent over our margins in 2001. We realized that sales are the journey, but the net profits are the destination. We are encouraged by an increasing trend in sales and margin expansion that we saw during the last quarter. Our relationship with our offshore customers such as Sony, Sumitomo, Samsung, and LG Electronics have added to the breadth of our global customer base and has made up a large amount of revenue this quarter. We are also seeing an increase in offshore telecom activity especially in China where it seems that they are viewing technology as a method of catching up with the rest of the world. We believe that it is too early to call recovery in the US economy, but as we begin to see growth in this arena we will believe that domestic business will pick up as well. Our exclusive partnership with Weiss Technik is growing and we believe it created value to our shareholders. We have issued quotes on Weiss chambers to American and Japanese automakers well in excess of $2 million, as well as others. And we are optimistic that these orders will come to fruition. Other good news is that since we have the entered in the Weiss partnership QualMark has sold more chambers in the US than were sold in the United States in the previous two years with Weiss's former relationship. I believe that this trend will continue to grow and improve. The efforts of Joseph Ruth, QualMark's Vice President Sales and Marketing continue to be effective. Since we have growing sales in the Asian and European markets and Joseph has done such a good job with our distribution in Asia and Europe we are expanding our marketing distribution through rep organizations in India, Mexico, and Brazil. In closing, the first quarter continued to be challenging, but I believe that we are beginning to see a turnaround in our business volume due to our new sales and marketing efforts in an increasingly improving marketplace. As we continued to look to expand our markets, enhance our Weiss relationships, and monitor our expenses we believe that the company can grow its revenues and profitability in the coming quarters of 2002. I will now turn the call back to the operator to give instructions for the question and answer period.

THE OPERATOR:
Thank Mr. Johnston. (CALLER INSTRUCTIONS). Okay, the first question today comes from Steve Wings (phonetic)of (indiscernible) Epic Financial Group.

THE CALLER:
Yeah. Charles, could you talk about you talked a little bit in the press release about the linearity of the quarter, could you give us any more specifics about that? You know how pronounced, you said that your business seems to be improving month to month, could you give us any more color on that?

MR. CHARLES JOHNSTON:
Steve, a little bit, you know, this company has been a traditional company in the capital equipment. We are aware that we think that our customers were trained poorly and that they would wait till the end of the quarter and come in and try to negotiate lower prices and fast delivery. We have been working on that situation since I came here to try to even out the quarter so that the quarters aren't so chunky and everything comes at the end of the quarter where it pushes your receivables those 90 days or 80 days. We actually had half of the business at the end of January. So, that was really pleasing for us. Yes, some of that was probably due to a little bit of hangover from last year, but there were new things that were developed and closed in January too. Actually, we were quite disappointed in the third quarter of the month because we were doing so well through the first two. So that is still unusual for us that we would be front end loaded like that.

THE CALLER:
You mean the third month of the quarter.

MR. CHARLES JOHNSTON:
Yeah, that's right.

THE CALLER:
Okay. Could you give us any type of, you know, feeling on the macro it has been an awful lot talked about in the whole technology sector, about, you know the capital spending cycle? And could you give us any kind of a −− do you have any kind of a feel on the macro events that, you know, for later this year. Do you feel that there is a strong pick−up coming or moderate pick−up coming perhaps in the second half of this year? And could you give us any color on how you feel about that?

MR. CHARLES JOHNSTON:
Oh, Steve, we have always forecasted that this year would be the second half weighted. We are pleased that we are a little ahead of our internal forecast and so forth for the first quarter. But we have always thought that the economy wasn't totally turned around and that there would be a way more business entered in the second half than there would be in the first half for QualMark. But we still hold to that, we still think that the capital markets lag enough where things won't really get rolling until the third and fourth quarter.

THE CALLER:
Would that be typical of −− is the capital spending cycle typically tied to the macro events and the economy (indiscernible) that is there is at a first pickup in consumer demand in the early part of the cycle and then later on in the cycle the capital spending event. Is that typical, you know is that your past?

MR. CHARLES JOHNSTON:
Cyclic through January and December where people had money to spend at the beginning of

the year and then must spend some before the end of the fiscal year.

THE CALLER:
Okay, so that continued if we continue to get good positive events happening and as far as leading indicators and so forth in the economy that should be positive down the road for your business as we get further into the economic cycle then.

MR. CHARLES JOHNSTON:
Absolutely.

THE CALLER:
Okay. Thank you ery much.

MR. CHARLES JOHNSTON:
Very much for your questions.

THE OPERATOR:
Thank you. Our next question comes from Joe Sylvian of Dorothy Company.

THE CALLER:
Hello, Joseph.

MR. JOSEPH RUTH:
Good morning.

THE CALLER:
Couple of questions from me, can you give a breakdown of international versus domestic revenue?

MR. JOSEPH RUTH:
I do not know I have not but (indiscernible) Anthony. It will take a quick look at it here. I think it was a real high percent probably 70 percent to 30 percent Joseph international to domestic.

COMPANY REPRESENTATIVE:
And Anthony is just shaking his head verifying that.

THE CALLER:
Were there any 10 percent customers in the quarter?

COMPANY REPRESENTATIVE:
No.

THE CALLER:
Okay. Can you talk about the amount of business that came from the Weiss relationship and how does that get booked. Is it booked as Weiss the customer to you or do you bill direct to the customer?

COMPANY REPRESENTATIVE:
(indiscernible) Anthony.

MR. ANTHONY SCALESE:
We actually were able to bill two Weiss shipments this quarter, which amounted to approximately $35,000. The way this transaction works is that we being QualMark -- QualMark are assuming responsibility after we make the order from Weiss. So we are actually then selling it to the customer, so we are getting the revenue booked based on that. And we cannot show that though until the box is complete and has been shipped from the Weiss office in Germany. So, as we have billed two we have several more on backorder that, you know, kind of coinciding with their lead times on shipments.

THE CALLER:
Can you give any more specifics as to what the backlog looks like with Weiss or how it actually evolves. Do you have specific projects that are in shipping mode now or how does the backlog billed there and what does it look like?

COMPANY REPRESENTATIVE:
Joe we do have, (indiscernible) because our competitors love to get on this phone call I do not want to be specific, but we do have a number being ready to be shipped that we have orders in place and that are waiting on shipment in the second quarter. And as I mentioned in my conference call here there is tremendous amount of quoted.

THE CALLER:
Just off of that note, then can you talk about kind of a forward look, do you expect to see sequential improvements in Q2?

COMPANY REPRESENTATIVE:
Yes, we are looking for it, but we also are realistic about the US economy. It has been very slow in the US. We know a number of our competitors continue to lay off people and so it's not all clear yet in the US, that the capital that recession is over and that it has trickled down as the first caller asked to the capital goodwill.

THE CALLER:
And just looking at the increased projects if you might get 35,000 in Q1 with Weiss that should be a fair amount that is significantly up in Q2.

COMPANY REPRESENTATIVE:
We like that to happen and yeah there is a big project that should get billed in the second quarter.

THE CALLER:
Okay, can you just give a general gauge as to what would be the operating break even revenue mark for you?

COMPANY REPRESENTATIVE:
Still $2 million.

THE CALLER:
Okay. So you are pretty close.

COMPANY REPRESENTATIVE:
All things remaining equal, it is $2 million. All right.

THE CALLER:
And finally, I will try this question again, any reason for not giving any balance sheet information and can you give any highlights there maybe what your cash position is or DSOs?

COMPANY REPRESENTATIVE:
Absolutely we can't at this time. We at the last conference call we weren't complete with the audits and I do not want to disclose any information before that was completed. And which one waited for that (indiscernible) in that case. We are complete through that process this time. Cash position is up at $1,140,000

THE CALLER:
What do your DSOs look like?

COMPANY REPRESENTATIVE:
We are running about 80 days, 70 to 80.

THE CALLER:
And would you like to stay at that?

COMPANY REPRESENTATIVE:
I know, realistically it would not be less than 60 to 65 days, that's for the industry has capital goods in general.

THE CALLER:
Moving back on the cash line, I assume the private placement and the transaction with Roser since the (indiscernible) does not include −− the cash does not include that.

COMPANY REPRESENTATIVE:
No, the cash line includes the equity transaction with the Rosers.

THE CALLER:
It does include that?

COMPANY REPRESENTATIVE:
Yeah, that's right. And that money has been forwarded to us. That's right. The deal was closed on March 27th. And so it was transacted before the end of the first quarter.

THE CALLER:
Okay, great. That's all I have, thanks.

COMPANY REPRESENTATIVE:
Thank you.

THE OPERATOR:
Thank you. The next question comes from Michael Cornier (phonetic)of Millers Bank.(phonetic)

THE CALLER:
Charles.

COMPANY REPRESENTATIVE:
Hi Mike, how are you.

THE CALLER:
Well, pretty good. So do you see any or can you talk about any potential acquisitions in the near future because you mentioned that you are maybe looking for an acquisition?

COMPANY REPRESENTATIVE:
Mike I cannot elaborate other than to let you know that both from my desires and the Chairman and right on through the board of directors that it is my top priority to find us an acquisition. We have been interviewing candidates to help us find an acquisition and so -- and we have identified at least one and we are pursuing that.

THE CALLER:
Okay, can you talk about like as to what size the revenue base they might have or any kind of a range or can't you say.

COMPANY REPRESENTATIVE:
Yeah, I mean, you know, it's what we can afford and what kind of money we can raise to secure the things, I would love to find something around 25 million if that's possible.

THE CALLER:
Okay.

COMPANY REPRESENTATIVE:
I don't know if we can find something. If not, I will settle for something for 15 million. But we know that we need to make an acquisition and we want to do it this year.

THE CALLER:
Okay, thank you.

COMPANY REPRESENTATIVE:
Yes.

THE OPERATOR:
Thank you. (CALLER'S INSTRUCTIONS). And our next question today comes from Steve Thompson (phonetic).

THE CALLER:
Hello Charles.

COMPANY REPRESENTATIVE:
Hi, Thompson. How are you.

THE CALLER:
Fine. Quick question. You mentioned that you have quotes out pertaining to Weiss of approximately 2 million to date?

COMPANY REPRESENTATIVE:
Over two.

THE CALLER:
Can you give us an idea what percentage of those are in, let' say, the automotive of industry?

COMPANY REPRESENTATIVE:
Biggest percentage of them. About 70, maybe 60 to 70 percent even are automotive related.

THE CALLER:
Is it the similar type sales cycle with the Weiss products versus the QualMark type products?

COMPANY REPRESENTATIVE:
Well, we usually can deliver pretty quickly here with ours but the problem with these, let's say that they are in $3 to $500,000 range each. These are large projects and let's say, you know, that moved slowly through the process of agreeing what it is, exactly what it is narrowing down all the drawings, getting approvals and then the manufacturing of something as large as these are and in some instances, these are drive in chambers. That's, you know, that's about 34 weeks lead time. And so if we close things in the second quarter, we will be fortunate to deliver before the end of the year.

THE CALLER:
And did you mention earlier, have you sold any Weiss chambers or received any orders so far this quarter for your brand?

COMPANY REPRESENTATIVE:
No, not this quarter. We have not received any orders.

THE CALLER:
You mentioned earlier about expanding your sales reps to India, Mexico, and Brazil. What -- why are you doing this? What stimulated that decision for that in those areas?

COMPANY REPRESENTATIVE:
We know there is business particularly in South America and we have been getting a number of inquiries from India as well, and we haven't had representation there, so.

THE CALLER:
Any particular sectors in electronics. Is that basically where it is coming from?

COMPANY REPRESENTATIVE:
Again Brazil does a lot of automotive industry and a lot of aircraft industry parts.

THE CALLER:
And is it just for both Weiss and QualMark type lines?

COMPANY REPRESENTATIVE:
Just QualMark, Weiss already has representation in most of these places.

THE CALLER:
And lastly, I noted the other day from a news release pertaining to, I believe, it was Sony, Motorola in particular about the handset sector beginning to rebound and then the release went into more depth as far as electronics companies in Asia and how business is picking up substantially. And I know you have a number of clients, customers that you deal with over there. And you mentioned earlier as far as you are waiting on the recovery here in the US. Don't these particular companies in Asia serve as US−based companies, the larger companies such as, you know, Dell and Compaq?

COMPANY REPRESENTATIVE:
Sure, most all of the Asia−Pacific business in general is driven by the US and a lot of that by the telecom. We are and there is a lot of quoting activities. There are a lot of things going on.

THE CALLER:
About defense−related business here in the US?

COMPANY REPRESENTATIVE:
You know, we have Harris and Lockheed are the closest. Nothing else, we should know within a few weeks of some developments there.

THE CALLER:
Thank you.

COMPANY REPRESENTATIVE:
You are welcome.

THE OPERATOR:
Thank you Mr. Thompson. (CALLER INSTRUCTIONS). Our next question comes from Steve Wings of Epic Financial Group (phonetic).

THE CALLER:
Yeah, Charles I had one other question. You know, when you look at your pipeline, you know, your sales pipeline and so forth. Do you basic look is the top end business that you quoted and if so how does your, you know, could you compare what that looks like, what your overall pipeline might look like now compared to a quarter ago or two quarters ago?

COMPANY REPRESENTATIVE:
Well, I think as far as I have been here and that's only about a year and a half we virtually go into each quarter with nothing in the backlog and this time, we have $400,000 going into the quarter. And that's very unusual for us. And so I hope that addresses the most. Well, I think the pipeline is fuller than it has been and we also had more quoted here than we have. That 2 million is just Weiss so we are not putting the number on what we quoted for everything else. So, things look much better to me. I am still concerned about the US.

THE CALLER:
Okay, thank you.

COMPANY REPRESENTATIVE:
Yes.

THE OPERATOR:
Okay Mr. Wings. And Mr. Johnston at this time we have no further questions.

COMPANY REPRESENTATIVE:
Okay, thank you very much and thank you for your call and attention today and we look forward to a good second quarter. Thank you. (CONFERENCE CALL CONCLUDED)

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04/17/2002 07:00 pm	PYPL	PayPal, Inc (PYPL) − Q1 2002

THE OPERATOR:
Good day everyone and welcome to this PayPal first quarter 2002 earnings release conference call. Today's call is being recorded. For opening remarks and introductions I would like to turn the call over to the co−founder and Chief Executive Officer Mr. Peter Thiel. Please go ahead Sir.

MR. PETER THIEL:
Good afternoon. Yeah, I am Peter Thiel and I am here with our Chief Financial Officer, Roelof Botha. I would like to thank all of you for joining us on PayPal's first earnings conference call. Today we are going to report/discuss the company's financial results from the first quarter of 2002 and provide some guidance for upcoming quarters. I hope that all of you have a copy of the press release we just issued containing this information. In the event you do not, the release is available on our web site in the press release section linked off the ``about us" footer. Before we go any further, I would like to call your attention, note at the end of the press release about forward−looking statements contained therein and to note that such Safe Harbor language also applies to any forward−looking statements contained in this conference call. These forward−looking statements involve risks and uncertainties that could cause our actual results to differ significantly from those projected and for a description of risks and other factors which could cause or contribute to such differences I would refer all of you to our recently filed 10−K. Okay, with that let me go into the substance of our call today. We are thrilled to report today that in the first quarter of 2002 PayPal achieved profitability according to generally accepted accounting principles. Continued strong growth of our payment network led to record payment volume, which led to increased revenues and which in turn grew GAAP profitability. Revenues for the first quarter of 2002 totaled $48.8 million,

an increase of 248 percent over the $14.0 million in revenues in the first quarter of 2001. PayPal reported $1.2 million of net income for the quarter or 2 cents per diluted share on a GAAP basis compared to a net loss of $29.3 million or $5.39 per share for the same period last year. For the quarter, PayPal's pro−forma after tax net income, which excludes non−cash expenses related to stock based compensation and the amortization of intangibles amounted to $4.3 million or 7 cents per diluted share compared with a pro−forma net loss of $10.7 million or $0.97 per share for the first quarter of 2001. Let me say a few words on our business overview and strategy. PayPal continues to diversify the range of product and services offered to its small business customers. Beyond our core auction business, we have achieved robust growth for the payments −− for payments involving fixed price sale of goods, the sale of services, and other cash transfers. Our overall payment volume grew by 21 percent on a sequential quarter−on−quarter basis. This growth in turn was driven by 31 percent sequential growth in our non−auction related payment volume and by 16 percent sequential growth on our auction related payment volume. As a result, the non−auction related share of PayPal's total payment volume increased to 39 percent for the first quarter of 2002 from 36 percent for the fourth quarter of 2001, while the auction related share of our total payment volume decreased to 61 percent from 64 percent over the same period. PayPal increased its support for the eCommerce market by launching the PayPal developer network, which encourages the creation of eCommerce application and their adoption by small businesses and merchants. To date, over 22,000 web developers and designers have joined the PayPal developer network. These developers have created PayPal based applications for Microsoft FrontPage and ASP.NET as well as for Macro Media's popular Dream Weaver and Ultra Depth (phonetic) Software. PayPal also formed a merchant services team to target sales and marketing efforts at the small business market. At the same time PayPal achieved further penetration of the online auction market and estimated 72 percent of the auctions on eBay listed PayPal as a payment option in the first quarter of 2002. We also created an Auction Seller Advisory Board, which includes the top seller by dollar volume eBay so as to advise PayPal on practices and features desired by the auction community. On the international front, PayPal saw continued strong adoption in the 38 countries we serve outside the United States. In the first quarter of 2002, 20 percent of our total payment volume involved at least one party outside the United States compared to 8 percent for the same period last year and 17 percent for the fourth quarter of 2001. On the regulatory side PayPal has received money services, business licenses also known as money transmitter licenses in seven states. We have applied in 16 other states and we are preparing applications for a further four. As previously disclosed, the company received an advisory opinion from the Federal Deposit Insurance Corporation, the FDIC, in February of 2002 stating that when PayPal acts as an agent for its customers and deposits customer funds on their behalf in FDIC insured institutions, these funds qualify for FDIC insurance on a pass through (phonetic) basis in the event of a failure of the bank in which such funds are placed. Acting as an agent for its customers in this way has two key implications for PayPal. First the company's balance sheet reflects reduced customer funds and their associated liabilities as these funds are now held at FDIC insured institutions and are not assets of the company. Second, the company's income statements reflect reduced income from interest on funds held for others. Although PayPal no longer will benefit from interest on customer funds, the company expects reduced expenses as a result of compensating balance arrangements. With that let me turn it over to our CFO Roelof Botha, who will talk a little bit about some of the key metrics for the quarter.

MR. ROELOF BOTHA:
Thanks Peter. I will summarize PayPal's key operating and financial metrics for the first

quarter and present our business outlook. First, our key operating metrics. First quarter revenues of $48.8 million represent a 21 percent sequential increase from $40.1 million in revenues in Q4 2001. These increased revenues resulted from 21 percent growth in PayPal's total payment volume from Q4 2001. First quarter 2002 total payment volume grew 127 percent year−on−year. For the first quarter of 2002, the payment volume sent to business and premier accounts, which we refer to as gross merchant sales or GMS amounted to 90 percent of total payment volume. GMS increased to $1.31 billion for the first quarter of 2002 representing 23 percent sequential growth and 140 percent year−on−year growth. In turn, accounts growth increased total payment volume. In the first quarter of 2002 our registered users grew by 2.6 million to 15.4 million accounts, an average of 28,000 new accounts every single day. Business accounts grew by 547,000 to a total of 3.18 million and international accounts grew by 370,000 to a total of 1.37 million. Let's turn on to PayPal's financial metrics. For the first quarter of 2002, PayPal earned an average transaction revenue rate of 3.31 percent of total payment volume. And we incurred an average transaction expense raise of 1.16 percent. The percentage of payment volume funded by credit cards declined to 48 percent in the first quarter of 2002 from 49 percent in Q1 2001 and 52 percent in Q4 2001. Transaction revenues lists transaction processing expenses and lists the provision for transaction losses, which amounted to 0.47 percent of total payment volume resulted in a gross margin of 51 percent for the first quarter. In February 2002, the company completed its initial public offering netting approximately $69.9 million. At March 31, 2002, the company has corporate cash, cash equivalent and investment securities totaling $140 million, which includes $40.3 million in restricted cash and investment securities. Interest on funds held for others decreased from Q1 2001 to Q1 2002. As mentioned earlier, this decrease was as a result of us depositing customer funds in FDIC insured accounts starting in February 2002. Our customer's business in operations expenses increased mostly due to a 10 percent increase in headcount over the past year in support of our growing customer base and payment volume. The increase is substantially less than the increase in our payment volumes reflecting continued benefits from operating leverage. Depreciation and maintenance costs associated with the redundant data center we established in Q4 last year also contributed to the increased expense. Earlier this month PayPal announced that it would be leasing a second building in Omaha, Nebraska, to support the additional 150 customer service and operations personnel we plan to hire in 2002. PayPal plans to move its California Headquarters from Palo Alto to Mountain View in the second quarter. Upon exiting the Palo office facility, we will seek to sublease the property. Any non−occurring charge for this lease which extends through 2007 with total lease commitments of approximately $8 million will be recorded upon exiting the facility and determining any such loss. I would also like to call out the decrease in our amortization expense, which resulted from our adoption of FAS−142 this year. Finally, I want to take this opportunity to provide with PayPal's business outlook for 2002. PayPal estimates second quarter 2002 revenues could range from $52 to $53 million resulting in pro forma aftertax earnings of approximately 7 to 8 cents per share assuming between 63.5 and 64.5 million fully diluted shares. PayPal also estimates 2002 revenues could range from $220 to $230 million with pro forma aftertax earnings of approximately 34 to 36 cents per share assuming between 63 and 64 million fully diluted shares for the year. PayPal has no duty to update its business outlook to reflect future developments and currently expects not to update its outlook until the next earnings release. This outlook should not be relied on as having continued accuracy beyond the date of its release.

MR. PETER THIEL:
Thanks Roelof, well this is Peter again. I think we are just about ready to take some questions.

But before we do I thought I should go ahead and address one topic that has seen a lot of market speculation as we −− namely eBay and PayPal. Obviously these two companies share quite a few customers and there could be some interesting synergies. PayPal at the same time is a standalone business that makes sense and quite a bit of money as a standalone business. In the end, we will always do what makes the most sense for the company's shareholders and beyond that I will not have any other comment on this topic. And also perhaps I should take a minute to let folks know that this company still faces many challenges on regulations, litigation, competition, and more. We have achieved tremendous success to date and just having this call of public (indiscernible) company is testament to that. But much work remains to be done if PayPal is to meet the goals that it has set for itself and some continued good luck would not hurt either. And with that let me open it up to some questions.

THE OPERATOR:
(CALLER INSTRUCTIONS). And our first question will come from Tony Weibel (phonetic), with Salomon Smith Barney.

THE CALLER:
Good afternoon and congratulations on a good quarter. I wanted to focus the first question on the new move to eliminating interest on funds sold rather than getting the FDIC insurance. I am curious if you have seen any material movement to people funding transactions with ACH sources and then I have a couple of other questions as well.

MR. ROELOF BOTHA:
Sure, this is Roelof here. In the course of Q1, the average amount of our payment volume which was funded from existing balances was about 23 percent compared to about 22 percent in Q4 last year. So we have not seen a substantial change as a result of the adoption of the FDIC structure.

THE CALLER:
And as it pertains to the general −− to the expense rate, it was significantly lower than at least what we were looking for. Do you expect that to continue to head down and do you expect to get some traction with the fact that you do have the FDIC insurance and psychologically consumers might hold more balances?

COMPANY REPRESENTATIVE:
Yeah, we saw the credit card of funded percentage go from 52 percent to 48 percent from Q4 to Q1 and the balance was made up to a combination of increased balance funding which changed only slightly and increased ACH funding which actually increased by a larger margin. The BACH funding moved from about 25 to 29 percent and the balance funding from about 22 to about 23 percent. So balance funding which would have perhaps been facilitated by the FDIC only increased a small amount, ACH funding increased more significantly.

THE CALLER:
Okay. And then on the multi currency platform is there any updates there or in the international front, are there any new regions where you have added functionalities such as being able to withdraw through a bank account? And then as a last question, any metric that you could provide us as far as the transactions per account or total transactions?

COMPANY REPRESENTATIVE:
On the international side the total international volume increased from 17 percent to 20 percent. And again this is measured by the percentage of dollars in which at least one of the counter parties to a payment is outside the US. About 20 percent of the transaction dollars involved at least one counter party outside the US. Most of the international payments still involve payments to and from the US, but we are working on rolling out a multicurrency product, which we hope to get launched around the third quarter of this year and we believe that will facilitate the significant international payments within all of these jurisdictions outside the US. And I would just like to add that in the sort of −− in the course of the first quarter we have continued to roll out the number of countries where customers can have funds deposited directly into their bank accounts through their local ACH network. I think the last time I checked this in excess of 15 countries at this stage where we have enabled that and we will continue to roll that out (indiscernible). And in terms of your other question Tony, in terms of the number of transactions, we have actually provided that as a part of the fax sheet that was distributed. So the average number of transaction per day during the first quarter was 295,000 and so from that you can figure out that the average transaction price is about $55 in Q1, up slightly from $54 in the fourth quarter.

THE CALLER:
And of those transactions, total transactions or just GMS?

COMPANY REPRESENTATIVE:
Those are the total number of transactions.

THE CALLER:
You have the GMS number by chance?

COMPANY REPRESENTATIVE:
I do not have that with me immediately.

THE CALLER:
Okay, thanks.

THE OPERATOR:
And our next question will come from Jim Khasin (phonetic) from Bear Sterns.

THE CALLER:
Hi, this is Christen Barr (phonetic) checking for Jim Khasin. Can you discuss the build out of the customer service operation. Have you seen improvement over the past couple of quarters in client satisfaction and cost of customer service? Thank you.

COMPANY REPRESENTATIVE:
Yes, we have continued to reiterate on the customer service side. We think this is an area where the company can still do better, at the same time we believe that we have steadily been improving the operation on that score. We have consolidated the customer service to Omaha, Nebraska, which helps us with a lot of the operational things in terms of having it all in a single place. We believe that it has gotten to be significantly more responsive, the response times are faster, especially in the appeals contacts where things go badly wrong, customers have serious issues. We believe that part of it going faster. It is something we are still

working to improve but we feel that we are definitely on the right trajectory on that score.

THE CALLER:
Okay in terms of followup question. Longer term, do you have any thoughts on normalized growth in margins for your business?

COMPANY REPRESENTATIVE:
In terms of the net income margin?

THE CALLER:
Operating margins?

COMPANY REPRESENTATIVE:
Pre tax operating margin?

THE CALLER:
Right.

COMPANY REPRESENTATIVE:
I think that −− basically think of it is in terms of the guidance that we have issued in terms of the earnings per share.

THE CALLER:
Okay.

COMPANY REPRESENTATIVE:
So I guess that implies a margin of about 10 percent or so for the remainder of 2002 and given the operating leverage in our business model, we would see that continue to rise over time and just given that there is a (indiscernible) launch fixed cost component to running this business.

THE CALLER:
Excellent. Thank you.

THE OPERATOR:
And our next question will come from Frank O'Turnelly (phonetic) with William Blare Co.

THE CALLER:
Peter and Roelof good afternoon. How are you?

COMPANY REPRESENTATIVE:
Good, thanks.

THE CALLER:
Two quick questions for you. First of all, this is an extraordinarily good quarter. The shift in credit card percentage I think is particularly striking and we all know how sensitive the model is to that. What can be going on there Peter? Have you done something in terms of changing your user terms and will this continue to effect previous changes, give us a little bit more color on that?

MR. PETER THIEL:
I think there were two major factors, which drove the credit card piece lower in the quarter. The first piece is that we changed the terms what customers became fee−paying at a (indiscernible) dollar limit instead of a $100 credit card funded limits. So as soon as people get the first credit card payment, they become fee paying, and that goes into the GMS bucket. We had originally thought this would increase the GMS percentage, it actually had the opposite effect of reducing the credit card percentage. Because basically what is going on is that some of our customers are extremely resistant to being upgraded to fee−paying account. And they in turn encourage other users to drive payments through bank accounts, which of course benefits the entire network. So I think that was the first part of it. The second part was basically driven by some continued improvements in our fraud model, where one of the things that we had been doing before was that when customers had suspect credit cards we just would not let them make payments. At this point, we are simply shifting some of those customers to bank account or stored value payments. And so we are actually able to keep some of these higher risk customers albeit not up to the credit card base payment. So it is basically two components, one is a change in the pricing structure, that incented people to use bank account more than credit cards, and secondly the change in the fraud model that have total things slightly more towards bank funded payments.

THE CALLER:
One other question for you then I will hand this line back. The 28,000 new users per day is a very significant step up from the, you know, third and fourth quarter experience of last year. I am curious if you have any insight into why that might be and I am also wondering if you can shed any light on the patents during the quarter? I mean obviously there was a very well publicized and high profile IPO, you know, did that coincide with some new sign ups. Can you just give us some additional thinking on that, Peter? Thanks.

MR. PETER THIEL:
Let me say one thing and then I will turn it over to Roelof. You know, throughout this quarter and indeed throughout the last few years, the single biggest growth driver has been this grassroots word−of−mouth effect, where people send payments to other people, they encourage them to sign up or request money from other people, and in effect pull full new members into the PayPal network. And even though we had quite a high profile IPO in the quarter, we did not see any co−relation between that and increased signups instead. The signup is basically tracked steadily higher throughout the quarter. You know, there is a little bit of a depth (phonetic) during the holiday season in late December, early January, after that they moved up at a fairly brisk pace. It seems that by and large it is very heavily driven by word of mouth, grassroots (indiscernible) growth and that is what we continue to see.

MR. ROELOF BOTHA:
I'll just point out that over the past four consecutive quarters the total number of accounts we have added in each quarter has increased from about 1.6 million new accounts in Q2 last year, 1.8 million in Q3, 2.2 million in Q4, and then about 2.6 million in Q1 this year. So I think it is just continuation of the trend of increased absolute growth of the PayPal system.

THE CALLER:
Thank you. Thanks Peter, thanks Roelof.

THE OPERATOR:
Thank you, our next question will come from Wayne Johnson (phonetic) with (indiscernible) Robinson Humphrey (phonetic).

THE CALLER:
Yes. Good afternoon guys. I was wondering could you shed any light on how the bill payment option is going on your service and how do you see that playing out, and is that something that has received a lot of attention by the customers or the new subscribers?

COMPANY REPRESENTATIVE:
Thus far it is not really contributed a significant amount to either the payment volume, in which it is not actually included. And so (indiscernible) revenues because of the free service. It is something that we are basically largely experimenting with. We are seeing, you know, what the adoptions are likely to be, and then overtime we are going to iterate and improve on that service. You know, there are large number of features that we rollout for our customer base that basically −− and we look at, you know, how much do people use them, what is the adoption like, and then overtime we either iterate and improve on those features or if there is not that much demand, we do not push them too hard. I would say the jury is still out on the bill payment piece.

THE CALLER:
Okay. And can you touch base on all −− on the Circo (phonetic) litigation. Can you give us an update there?

COMPANY REPRESENTATIVE:
Most of the substantive developments have already been disclosed in our 10−K. We have filed our response, we are waiting the first status conference set for May 6th and, you know, I think it is just going to be a very long drawn out process. We continue to be quite firm in our view that the lawsuit is without merit and we will contest it quite vigorously.

THE CALLER:
Okay, and last question, I know you guys have been making strides on the money transfer licenses around in different states. Can you just refresh my memory and some of the investors as well as why you guys didn't prepare for this prior to the offering?

COMPANY REPRESENTATIVE:
Well, you know, there are several whole number of different reasons. We basically, we have been working on a number of these licenses even before the offering. There are a number of states where we would not have actually been allowed to have licenses, until we had a public company. This is fairly complex. If you have a negative total number of assets, which we are deemed to have pre−IPO, a number of states do not allow you to have the money transmitter right. So it was actually not an option, pre IPO first to get these licenses. And we are basically −− and once we are a public company, we are able to get the number of proceedings do that with all delivered (indiscernible).

THE CALLER:
Okay, terrific, congratulations on a great quarter.

COMPANY REPRESENTATIVE:
Thanks.

THE OPERATOR:
And our next question will come from Scott David (phonetic) from Meg Mason (phonetic).

THE CALLER:
Hi, thanks. I have two questions. The first one is related to the ATM debit card. I was wondering how much of the payment volume exited the system via the debit card in the quarter?

COMPANY REPRESENTATIVE:
It was approximately 17 percent of the total withdrawals from our system left (phonetic) by the debit card, which is pretty in line with what we saw in Q4 last year as well.

THE CALLER:
Okay. And then on non−auction payments, do you have the ability to break that down in any way to give us key metrics as for as off line merchants versus online or may be even individual account users, that are accepting non−auction or auction payments, or is the fund flow coming through the same accounts or are they coming through different accounts?

COMPANY REPRESENTATIVE:
It is in many ways −− it is similar to the auction component that is a very distributed user base, lots of different people −− the target −− the core market are small businesses. Most of the 39 percent of the payments that are non−auction related involve purchases of goods that are being sold by small businesses. We have a PayPal shop section on our web site, which lists about 25,000 of these small businesses at this point. And they will give you a representative sampling of the kinds of the companies we are talking about. It is a very distributed universe of people.

THE CALLER:
Okay, and last question. What −− is there any thing in particular that drove the provision after transaction losses up slightly in the quarter or was it just the volatility from quarter−to−quarter?

COMPANY REPRESENTATIVE:
A little bit of it is the way we approach risk within the company is to continuously strive to make decisions at the margin that are profitable as well as in loss minimizing. And so there is a continuous processes within the company where we review how we make risk decisions and that will involve some fluctuations quarter−to−quarter. Is that a satisfactory answer?

THE CALLER:
Yeah, thank you.

COMPANY REPRESENTATIVE:
So our goal is not necessarily to minimize fraud−related losses, it is to maximize profitability. And, you know, we did make a few changes, during the quarter, we increased descending limits on transactions domestically from $1000 to $2000 for new users. On a number of international transactions, we increased from $250 to a $1000. So basically, one of the things

we are always striving to do as a company is strike a balance between a convenient and seamless payment service and one that at the same time is secure and keeps out all the bad people. And, you know, which we think we have continued to strike a very good balance in the last quarter.

THE CALLER:
Do you have a range in mind? Cap on new initiatives versus the increase in the PTL rate, meaning 0.5 percent 0.55, that you are targeting?

COMPANY REPRESENTATIVE:
I don't think we have an explicit (indiscernible) like that, but part of what I would look at is the variability in the transaction loss rate (phonetic) historically. In Q1 last year we had a loss rate of about 48 basis points. The loss rate for the year as a whole was about 42 and 47, so that fits in pretty well with that pattern. And I don't think we would see a substantial variation from that current level.

THE CALLER:
Thank you.

THE OPERATOR:
And we will now hear from Sean Milnay (phonetic) from Donhieu Tech Group (phonetic).

THE CALLER:
Thanks a lot. Congratulations Peter. Just a couple of quick questions. In terms of the auction growth sequentially in the quarters, I wonder if you could add a little color to that. It was 16 percent in terms of -- you had a little bit of a bump up in average selling prices, do you have any market share number from the fourth quarter? Was it driven over all by would you say total volume or a combination of volume, little bit of share growth and a little bit of ASP?

MR. ROELOF BOTHA:
This is Roelof here. I think it is primarily the first year that there is a combination of increased penetration and obviously the auction market itself continues to grow. I don't think much of the growth again is a result of the ASP changing significantly.

MR. PETER THIEL:
Certainly all the indications are that eBay itself had a very solid quarter and they saw the auction volume grow a fair bit and we grew with that.

THE CALLER:
Right, and do you have the share number from the fourth quarter handy?

COMPANY REPRESENTATIVE:
I believe we were about, it was about 70 percent.

THE CALLER:
Okay. So there was a little bit of a share gain as well.

COMPANY REPRESENTATIVE:
Yes. (Multiple speakers) percent in eBay. Yes.

THE CALLER:
Okay. And then just looking forward, you know, you're guiding to 7.5 percent sequential revenue growth, if I use the middle of the range. Historically, base auction business has, you know, been a little bit more sluggish in the Summer, is that reflected in your guidance in terms of −− it looks a little bit con conservative is what I am getting at. Or are you seeing any changes in the metrics in April or is this just pure conservatism?

COMPANY REPRESENTATIVE:
I think partly what we see in Q2 and Q3 is slower growth than we would see in Q1 and Q4 due to some seasonality and obviously a substantial portion of our payment volume is co−related to all our auctions and events in particular. So we are similarly influenced by these seasonal patterns. I think the other point is just that, you know, we are going to have to measure off sort of prudence in the way that we manage our, you know, the financials of our company given the risk that Peter outlined earlier in terms of comparatives in particular.

THE CALLER:
Okay, and lastly you talked a little bit about your new merchant team and expanding the customer service facilities, which was talked a little bit about previously. Are those numbers fully embedded in the run rate of the customer service expense line or should we expect that to bump up a bit heading into the summer months?

COMPANY REPRESENTATIVE:
I think some of that is already reflected in what we have seen in Q1 but obviously the recruiting that has been taking place has happened during the quarter. So the full effect is not reflected in the Q1 customer service expense line item. So I think we −− you should expect that number to increase in the course of the year.

THE CALLER:
Okay great. Thanks.

THE OPERATOR:
And we will now hear from Chris Kenigson (phonetic) (indiscernible), excuse me.

THE CALLER:
Hi, thank you very much guys. Couple of questions, your GMS account base was up about 21 percent quarter over quarter. Can you tell us of that growth, how much actually came from converting people to that account −− to GMS account or how many came from new accounts?

COMPANY REPRESENTATIVE:
I don't think we have that number on hand right now. But I think we have seen a slightly different pattern from what we saw last year. Last year we changed the receiving limits where personal customers could no longer receive any credit card based payments. So there was a very high rate of conversion from personal customers to business or premier customers given that that limit has been enforced since November last year. My sense is that the majority of business customers that we have gained this quarter have been from new signups.

THE CALLER:
And in your release you broke up the number of active accounts, (indiscernible) more than once in the quarter, are you, or at least once?

COMPANY REPRESENTATIVE:
Yes.

THE CALLER:
Can you give us the sense as to what was the average number of transactions and the average payment size for those active accounts?

COMPANY REPRESENTATIVE:
Well, the average payment size would be the overall average (multiple speakers).

THE CALLER:
(Indiscernible).

COMPANY REPRESENTATIVE:
Yeah, the total number of transactions in the quarter was about I think 26 million. And the total number of active accounts was about 5.2. So the average number of transactions per active account is in the order of about five.

THE CALLER:
Five? And can you talk a little bit about international -- about the sensitivity of pricing there. Do you expect to see over the next couple of quarters as you increase your customer based that the pricing still continues to walk up a little bit?

COMPANY REPRESENTATIVE:
Are you referring to the average transaction revenue right?

THE CALLER:
Yeah.

COMPANY REPRESENTATIVE:
I think just sort of by the definition as international continues to grow a little bit more quickly than our domestic customer base, you would expect that. I do not think the change would be that material though. And I would not see that the revenue rate going from, you know, changing by more than about, you know, 5 or at the most 10 basis points.

THE CALLER:
And would you not envision any price increase in the near term?

COMPANY REPRESENTATIVE:
Yeah, it is just the change a slight change of mix.

THE CALLER:
And one last question, you guys have always been very good about monitoring, you know, PayPal's as well as eBay, can you talk about if you have seen any operational changes ever since, you know, eBay bought back (indiscernible). Can you just talk, not necessarily market share, but just operationally any changes you have seen over there?

COMPANY REPRESENTATIVE:
We have not seen any significant change.

THE CALLER:
Okay.

THE OPERATOR:
And we will now hear from Rick Singh (phonetic) from Hursch Capital (phonetic).

THE CALLER:
Hi, I just wanted to ask you and I know you talked about briefly, but you talked about the synergies between eBay and PayPal. Just how do I think about what could be the possible revenue or cost synergies between the two companies?

COMPANY REPRESENTATIVE:
Well, I think, you know, the obvious area of overlap between the two companies is that we both, we have many of the same customers, we basically enable eBay to have smoother faster transaction because the most common alternative to PayPal and eBay are checks, CODs, various forms of delayed payments. And because people are able to pay electronically through PayPal, it in effect clears things through the eBay network, much more quickly and increases the overall velocity. At the same time eBay has clearly been a great growth driver for our bases. It is in that sense, the two companies have had a very synergistic relationship.

THE CALLER:
Is there a way to think about how sales could be accelerated or cost could be tied up (phonetic) if the two were combined in some sort of way?

COMPANY REPRESENTATIVE:
I would I prefer not to speculate on that. I think what we have learnt, we believe that the core payment products that we offer is a fairly challenging product. You have to basically combine a lot of operational complexity, our risk management, especially given the existence of significant internet fraud, and then product and engineering have to work very much in hand with all of that. And we believe that the wait for our company to deliver the best is for us to just stay manically focused on offering the best of product we can to our customers.

THE CALLER:
Great, now you said that there are possible synergies between combination between you and eBay, but you also said that you are a standalone company. How do you think about when you decide what is best for shareholders as you mentioned. what your decision criteria is for making that decision?

COMPANY REPRESENTATIVE:
That would be basically as in, you know, any other company. You would have board meetings and different people on the board would have different perspectives and you discuss them and at that point figure out what is best for the company.

THE CALLER:
So this is not necessarily saying that you have walked away from any further negotiation with eBay. It is just saying that you would have to go through further decision criteria to be decided on?

COMPANY REPRESENTATIVE:
I really cannot comment on that.

THE CALLER:
Okay, thank you.

THE OPERATOR:
And due to time restraints that will conclude today's question and answers session. I will turn the call back to Peter Thiel for closing remarks.

MR. PETER THIEL:
Well, I think that we have actually covered just about all the ground that we set out to. Thank you very much for being investors in PayPal and we will continue to do the best we can to earn the trust that you put in us. Thank you.

THE OPERATOR:
And that does conclude today's conference. Thank you for you participation.
(CONFERENCE CALL CONCLUDED).

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04/17/2002 04:15 pm **OSTX** **Ostex International, Inc. (OSTX) − OSTX Q1 2002 Earnings Conference Call**

THE OPERATOR:
Ladies and gentlemen, thank you for standing by. Welcome to the Ostex International first quarter 2002 earnings results conference call. During the presentation all participants will be in a listen−only mode and afterwards we will conduct a question and answer session. (CALLER INSTRUCTIONS) I would now like to turn the conference over to Mr. Hans van Houte, Vice President of Finance. Please go ahead sir.

MR. HANS VAN HOUTE:
Thanks. Good afternoon and thank you for joining us today for the Ostex 2002 first quarter conference call. By now you should have all received our press release and if you haven't, please feel free to contact Ostex at 206−292−8082 and ask for Investor Relations. As a reminder, this conference call may contain forward−looking statements, the risks of which are outlined in Ostex's SEC filings. With us today is Thomas A. Bologna, Chairman, President, and Chief Executive Officer. After Tom's opening remarks, we will open the call to questions. Now let me turn over this call.

MR. THOMAS BOLOGNA:
Thanks a lot Hans. Okay. Let's first start with the financials. The first quarter of 2002 was challenging and it clearly tested our ability to scale up production of the NTx Point−Of−Care device and scale up rather aggressively. Quite honestly, we had hoped to ship devices with Ostex manufactured sub−components in the first quarter but, as you can see from our press release, that did not occur. I will talk more about the POC manufacturing program after I reveal the financials. For the first quarter of 2002, sales were $923,000 versus Q1 2001 sales $ 1,529,000. Now this decrease in sales was largely the result of not shipping POC devices

with Ostex's manufactured sub−components and delayed shipments of an NTx serum kits. Sales of our urine kit were below the first quarter of last year, but those of you who have followed our company know our urine and serum kits are to a very large degree based on the timing of orders from our larger customers such as Johnson Johnson and Mochida Pharmaceuticals. In other words, the bottom line is, the lower sales were largely the result of manufacturing not demand challenges. I should also note that we did not put the $500,000 payment from Mochida for exclusive rights to our NTx serum test for the Japanese market as a one−time event. Those revenues will however be realized over the life of the agreement and based on that approach will be relatively insignificant on a quarterly basis. However, the cash is in the bank and on our balance sheet, which at least from our point of view, is the more important point to be made. Let's talk a little bit now about the bottom line. We recorded a first quarter 2002 loss of $1,292,000 or 10 cents per share versus a loss of $858,000 or 7 cents per share for the corresponding quarter in 2001. Contributing significantly to the increase in loss were the activities related to the start up of the new Point−Of−Care manufacturing facility, which, as you will note, are broken down in our financial statements. Start−up costs for that facility totaled, in the first quarter, $431,000 versus a corresponding start−up cost of only $80,000 in the first quarter of 2001 or an increase of $351,000. As you look at our Pit should also be noted that all other below−the−line expenses, SGAetc. for Q1 decreased relative to the first quarter of 2001, thereby confirming that we are indeed focusing our resources and that we believe in managing our expenses rather well. Another key point to note is that when we resume shipping Point−Of−Care devices, the below−the−line Point−Of−Care start−up costs will go away and will actually be replaced with profits carried from shipments of those devices, which is really important. Okay. Now that we have the financials out of the way, let's get right down to the bottom line and let me comment on the Point−Of−Care program. Let me first start by saying there's probably no one or a group of people more disappointed at not being able to ship against the sizable back order Point−Of−Care devices than the people here at Ostex. While disappointing, we are making significant progress in setting up our plant and getting it running. More specifically, we have all of the equipment in place. All of that equipment has been validated. We have the people on−board; we have the materials to build the product, and we have already built two successful lots with one of those lots ready to ship upon completion of at least one more lot. So, the bottom line question is, what is left to be done? What do we need to do to get products out of the door? Simply put, we need to validate at least one more lot. And, a little bit more of an intangible is, we need experience, and in fact, we are really getting it under fire for a pretty good reason: we have orders to ship. We hope to ship products in the second quarter. The next obvious question is, ``Why has this been such a challenge?'' And, going back and reflecting on what we've done I could say it's really been a challenge for two fundamental reasons. First, Point−Of−Care device is a complex product that incorporates sophisticated chemistry, proprietary software, and optics and electronic components. In other words, it is rather different from our microtiter plate kits that are essentially a set of chemicals that (indiscernible) microtiter plate that are boxed and sold to centralized laboratories. In other words, this company has changed considerably since were really took on the POC. Secondly, we took on the challenge of doing the validation and scale up simultaneously. That approach was aggressive, and clearly had its risks, and it still does. I am not sure, quite honestly, we would have taken that approach if we did not have customers that wanted so much product now. In other words, the demand is really driving us to push so aggressively as we are. In looking back, a question that I continually ask is, ``What are we not doing that we should have done or what should we be doing?'' and quite sincerely, the answer is always the same. Our approach and activities appear to be right on the money. I should also add, that answer was acknowledged when Procter Gamble and Aventis Pharmaceuticals' supply people visited our facility, our Point−Of−Care facility that is, in the first quarter of this year and concluded that we have and are making the right decisions to get this new production facility up and running, and running as soon as possible. They left with a full appreciation for the device and its capabilities. Quite honestly, before this business, I was not sure that PGand Aventis products supply people appreciated the complexity or power of the device. The fact that they came out here to look at our facility, understood what we were doing, clearly shows −− I should say is rather indicative of their interest in the product line. I might also add that they are scheduled to come back out here and visit us again. While they too were disappointed with the sizable back order situation, they appreciate what we are doing and they realize that we have (indiscernible) push to deliver products sooner as opposed to later. So again, our problem right now is not demand; it is simply getting devices. Now let me briefly comment on the NTx serum product. As I know that we are in a back order situation with that product, and the reason we are in a back order is we're experiencing some production difficulties, but that we are not too worried about because we know that process very, very well. Just a question of analyzing a well−defined and well−understood, and proven process that we have always had in place as we introduced that product, which I believe was in the 1999 time frame. So, disappointed clearly. Does the future still look very, very good? Soon as we get production up and running it will look even better. So now let me open this up to any questions you may have.

THE OPERATOR:
Thank you, sir. (CALLER INSTRUCTIONS). The first question comes from John Boer with Rodman and Renchart (phonetic). Your line is now open, please go ahead.

THE CALLER:
Hello Tom and Hans. Two questions if that's okay. One is, there was a reference in the release about discussions with, you know, other potential customers like Pand that's the first one and just if you could have any comment on that would give any clarity. The second thing is, we're half way through the first month of the second quarter, and I assume you have some idea in your head as to when these delays will start to cause, you know, not just slippage, but losses of the orders that you've already got in hand. If you think you can just make a comment on that I and as to whether they're going to stay around or if they have any other choices. COMPANY REPRESENTATIVE Okay. Let me first talk about discussions with other companies. Because of confidentiality agreements, I can't really disclose right now. I can't disclose the names of the companies. But, what I can tell you is, we are talking to other companies that have osteoporosis drugs and it's very, very clear that they know what's going on, in the sense of what's happening in the marketplace as our relationship with Aventis and Procter Gamble. And, those are pretty ongoing discussions. We have been going a little bit, from our point of view, we have been going a little bit more slowly than we would normally go, primarily because we don't have devices. But we feel quite good about that. Regarding the delays, our goal is to get product out in the second quarter and to date, you know, we have not received any cancellations from Procter Gamble or Aventis, you know, from the orders that we have had in−house in the December time frame. Now, going forward, that remains to be seen. I do know for a fact that there are several countries within PGthat have said you know, that they're going to hang in here with us but obviously we've got to get this production up and running.

THE OPERATOR:
(CALLER INSTRUCTIONS) Don Littlered with Littlered Burke and Company (phonetic). Your line is now open. Please go ahead.

THE CALLER:
What is your relationship with either the previous manufacturers of the POCs? Are they still manufacturing for you or not?

COMPANY REPRESENTATIVE:
No. The company that manufactured the devices for us is now turning their production into manufacturing the device for themselves which is for a different application −− it is for HbA1C. Our relationship with them is extraordinarily strong, very much in the sense that we order components together, they've helped us trouble−shoot some problems, it's a very free−flowing vert continual relationship.

THE CALLER:
But they're in no position to help you product manufacturing?

COMPANY REPRESENTATIVE:
No. Not at this point. What they are helping us with is trouble−shooting some events and some questions that we have but quite sincerely, what we really learned over the last few months is, we probably know more about this device, I should say, that we do clearly know more about this particular device from our particular application and they have acknowledged that.

THE CALLER:
You said you have two lots of it manufactured. One of those has been validated?

COMPANY REPRESENTATIVE:
No. Two validated lots.

THE CALLER:
Two validated lots. So you got one other lot that is −− has been manufactured or is being manufactured now?

COMPANY REPRESENTATIVE:
We're in the process of manufacturing more lots and then once we get another validated lot we will be in a position to ship provided we feel comfortable that we think can continually ship in a, timely and efficient manner. (multiple speakers). Just can't rule the indiscernible) when we have setup as a procedure as we want at least minimum three validated lots before we will release for shipment.

THE CALLER:
Okay. Is there any particular part of this product that's giving you the biggest problem?

COMPANY REPRESENTATIVE:
One part in particular. This particular product has some pretty sophisticated chemistry involved with it, what we call chemistry strips, the process by which all reagents and everything are laid down and how it's done is very, very complex and that's been the biggest

gaining (phonetic) factor. So what we're actually doing now, just to put it in over−simplified terms, let me just give you an example. Some of the components for this particular device are batteries. So what we are doing is we are really gearing up production even more now, we are literally making twice the amount of what we call chemistry strips than we would normally make and we're doing that for the following reason −− we want to be in a position to make chemistry strips very similar to what we are doing with batteries. So, then when we go to pull up the assemblies very, very straightforward because we know once the chemistry strips are in place, the rest is pretty straightforward because we have assembled these devices in the past.

THE CALLER:
Okay. All right, we'll just keep our fingers crossed.

COMPANY REPRESENTATIVE:
You know. What I should also add is the following: Our point of view, it's not a question of can it be done, it's a question of will we be able to get it done now within the second quarter, that to me is the big question. We feel very, very good about it but can this device be manufactured −− yes. Can we −− and we have demonstrated that we can manufacture it −−yes. Has the company that has manufactured for us also proven that it could be manufactured, yes. What we lack more than anything else is experience and that's why we are gearing up production till we are (indiscernible). Because, everyday you know, when a lot has not passed to our satisfaction we've learnt an awful lot in the process.

THE CALLER:
Okay. Thank you.

THE OPERATOR:
Next question comes from Sanjay Jain with Donald and Company (phonetic). Your line is now open, please go ahead.

THE CALLER:
Hi Tom, my question, obviously short−term everybody has their fingers crossed about this manufacturing issue in the second quarter. My question relates more to the longer−term demand picture. What can you foresee? Can you put some color on it? Where is Procter and Gamble with their rollout in various markets? I gathered that whatever backlog you have now relates mostly to the European market. And just if you could throw some color on the volumes and your pharmacy Rx side and what happens in the longer run, after the short−term hiccups have been managed?

COMPANY REPRESENTATIVE:
Sure. Where we are with Procter and Gamble. They are rolling the product out in Japan, I am sorry, not Japan, in Europe, in the Asia−Pacific region, and obviously, we are equipped (indiscernible) also here in the States. Clearly, before we are going to Procter and Gamble and expand on that program, we have to give them some devices up front. Regarding the other pharmaceutical companies, we are in very, very active discussions with them and some very interesting concepts on how to use this device to sell more of their products and get more and more of business. And clearly everyone is aware in the marketplace of what the results have been with Procter and Gamble and Aventis, because all that data readily available through the market research firms. So, it is a tight little industry. Regarding the pharmacies, where we are

from there is as follows: we clearly have everything in place to begin working with the pharmacies, with the first area being in Canada and that will be with Procter and Gamble. At the same time, what we are doing is we are now starting to get into more and more of a planning process for penetrating the pharmacies here in United States, and in fact, we have retained couple of people to help us with that because obviously, the planning process can't take place right now. So, we are not sure and this follows we are doing everything that can be done and that should be done with Procter and Gamble, so that's well on its way. We are well into discussions with other companies with pharmaceutical drugs and obviously, until we have products, it is going to be difficult to move that a whole lot further. And then thirdly, in the pharmaceutical, I am sorry, in the pharmacy arena, we are pretty excited about that in the sense that now is the time to get that planning in place so we could be in a position to implement those programs, you know, in the second half of this year.

THE CALLER:
So, once the production problem is taken care of, then a lot of things could get triggered as far as the distribution and other marketing stuff is concerned?

COMPANY REPRESENTATIVE:
Absolutely, because right now, let me give you a perfect example, Sanjay. You know, we have people who call up and ask for quotes for x amount of devices and of course they want to know when delivery is. Well, what we have done is, you know, we have given them an estimated delivery date but we are obviously a little bit cautious because Procter and Gamble and Aventis, you know, have been very, very big customers for us, and we have a good anticipation of what their demand can grow to and it is only appropriate that we make sure we keep them, you know, in the beginning of the queue here. But, once production starts gearing and rolling, then, of course, we can open these gates pretty aggressively.

THE CALLER:
Thank you.

COMPANY REPRESENTATIVE:
I should also add that while we are in the process of scaling up all this production, we are also in the process of scaling up the whole process whether it's the, for example, in the process we have a couple of (indiscernible) what we call a demand flow line, that puts us much more in what I would call as an assembly line process. We are also in the process of putting in new procedures and new software in order to upload all the devices and all the software to devices literally at twice the rate that we are doing it now. So, there is just so much activity that is ongoing in parallel here and obviously we are doing that because at least today, demand is not a problem.

THE CALLER:
Thank you Tom.

THE OPERATOR:
Our next question comes from James Drew with Often Asset Management (phonetic). Your line is open please go ahead.

THE CALLER:
Hi, Tom and Hans. My question is actually partially answered but could I get a little

(indiscernible) flavor on the manufacturing because that has been the issue, as everybody knows. Tom, did you find any, you know, additional problems along the line and also that additional (indiscernible). What kind of problems can you foresee, I mean. What kind of problems could create this additional delay going forward?

COMPANY REPRESENTATIVE:
Well, the obvious problems that we encountered in the beginning were, you know, getting some of the equipment in the time frame that it was scheduled to come in and for the most part we really didn't have much problems except one or two pieces of equipment. As far as the facility build−up, that went pretty much on schedule. I think where we have started incurring some of the problems were just, you know, bringing the people on board, getting all of their training done, you know, understanding the little nuances of putting together a product like this because this is a totally new product. And again, it is very, very different than anything that we have ever manufactured before. In hindsight, what I could say without any reservation whatsoever is probably the one −− I am not sure many people will not agree with this −− but probably one of the smartest decisions we made was to bring this product in−house to do the manufacturing because it is really put it at the forefront of what needed to be done and its importance to us as opposed to a third party vendor. And in the process of bringing it in, we have also learned a lot more about it and frankly our strength to a large degree here is the chemistry. Resources that we are able to bring to bear on in almost nonstop buying, you know, on a daily basis has clearly helped us to bring thisto be a little bit better. So, as far as going forward, I have no doubt in my mind, you know, that this is going to get released, but (indiscernible) everyday we are learning a little bit more.

THE CALLER:
Well, I mean the obviously, you know, (indiscernible) something that is very different but this is exactly the question, I mean, are you, I mean, how much handle do you have in terms of whole manufacturing, I mean, are we going to continue to see, you know, new problems coming up and I just don't know where you are in terms of getting a handle on the whole issue. It is, you know, pretty much clear that, you know, you have encountered the problems that you could think of or that could come up with it. Now is the time to validate the process.

COMPANY REPRESENTATIVE:
Well, may be the best way to answer that is what we have done. In the fourth quarter of last year what we did is we assembled product, all the electronic components, uploaded all the software into all the devices etc. were all the components that we brought in−house plus we had a whole lot of these chemistry strips manufactured for us by the company that developed the device. So, we knew we could put it all together. Then the next step was to actually build quality chemistry strips ourselves. That is where we started riding into some difficulties. So, we know that once we got that down pat,, the rest was fairly straightforward. The next obvious question was how do we make sure that we have all of the parts and the components etc. because we are (indiscernible) lot of parts and components. So, we set up a pretty good system in order to handle that. So, I don't foresee any real problems in the future, except, this is a product line that is like any other product line in the world. It's constantly being improved, whether be it the manufacturing processes or the actual product itself, and we are doing all of this simultaneously. The validation is essentially behind us; components are all in, we are scaling up and at the same time we are improving the processes to make the whole process more efficient. But, from time to time, I am sure we will have some difficulties here. But, once we get through at least the third validation lot, you know, we may have a failed lot

from time to time. But, that should not preclude us from shipping all of those lots that haven't been manufactured okay. The second timesecond key point is our yields on this product line. We have some real good programs in place to increase the yields rather significantly.

THE CALLER:
In terms of the yields level is it (indiscernible) you want to talk about little bit about, you know, where you are in terms of the yield and where you want to be.

COMPANY REPRESENTATIVE:
Well, obviously, we want the yield to be at 100 percent. I think it will be premature to talk about the yields now. What we have always done with our yield is we say `` we want this many devices to come out of a lot, so therefore we produce x amount".

THE CALLER:
Right, the key to that are you going to that yield level pretty quickly where are you are able to, you know, say that this is the yield that I can be comfortable with and manufacture products.

COMPANY REPRESENTATIVE:
Oh, yes, you know, we are not worried about that. Again, the yields only become a significant problem as the demand keeps increasing and the problem is that as this demand keeps going up higher and higher, obviously we are going to keep running faster and faster.

THE CALLER:
Okay, is it, the last question and next question is that the (indiscernible) you have been interesting talking to different, you know, pharmaceutical companies except, I mean, in addition to Pbut it seems to me now you have given the press release and seems to me that you are now opening up a little bit more to different company. Is it the change of attitude over anything, I mean, of any significance, I mean, because basically we understand where you are today. You are basically working with PGand that should be if you work well I mean that should be a significant relationship in the next year or two. But, now it seems that there is some degree of change in terms of focus, I mean, I am just not sure about that.

COMPANY REPRESENTATIVE:
Probably the best way that I can answer that question is as follows: When I took over running the company five years agoalmost five years ago, we said we'll have to wait for the pharmaceutical companies to talk to us. Now, they call us, so to me it is just good business that if people call and they are interested in what we have, we sit down and we listen and we will do whatever is best to maximize the value for this company. Now, whether that means going exclusively with one company or going exclusively with a couple of companies or opening it up that all remains to be seen.

THE CALLER:
Okay, so it's basically a continual processes; it's not anything new or−−

COMPANY REPRESENTATIVE:
I mean −− lets assume a company wanted to do an exclusive with us there is two key verticals, price and volume. Our goal is pretty straightforward. We know that like this business is like any other business, you know, decisions will change as a function of time. For

example, you know up until we had the Point−of−Care Device, we essentially sold all the centralized laboratories, now we have this pretty nice product line, so, that is changed and pretty soon, when I say pretty soon hopefully sometime in the second half of this year, we will start selling it to pharmacies. Then, that's a whole other strategy. What impact does that have on our distribution relationships with big pharma. So, all that is being worked out as we speak. And our goal is very, very simple: to maximize profitability for the company.

THE CALLER:
All right, thank you. Good luck.

THE OPERATOR:
(CALLER INSTRUCTIONS). Mr. Bologna I am showing no further questions at this time sir. Please continue with any presentation or closing comments.

COMPANY REPRESENTATIVE:
Well, let me just say that I would like to thank everyone for, you know, for their continued support. And if you have any questions or, you know, feel free to give us a call. Again, thank you very, very much and we are looking forward to getting through the next quarter also, thank you.

THE OPERATOR:
Ladies and Gentlemen, that does conclude our conference call for today. You may now disconnect and thank you for participating. (CONFERENCE CALL CONCLUDED).

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04/17/2002 10:00 am	**RAZF**	**Razorfish Inc (RAZF) − Q1 2002 Earnings Conference Call**

THE OPERATOR:
Good morning and welcome to Razorfish Q1 Conference Call for April 17, 2002. Your host for today will be Jean−Philippe Maheu, Chief Executive Officer and John Roberts, Chief Financial Officer. Mr. Roberts, please go ahead. MR. JOHN ROBERTS, Thank you. And thank you to everyone for joining our conference call today to discuss Razorfish's First Quarter 2002 Financial results. Before I begin, I would like to draw your attention to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. And remind everybody that remarks made by the company about future expectations, plans and prospects, future service offerings, sales, operational capabilities, and client relationships involve risks and uncertainties. All statements that are not statements of historical facts may be deemed to be forward−looking statements under the SEC Safe Harbor Provisions. Actual results may differ materially from those indicated by forward−looking statements as a result of various risks, uncertainties, and market factors, which are discussed in the company's press releases and filings with the SEC, including its Form 10−K and other filings made from time to time. Copies of these filings are available from the company if you are interested. Now, the agenda for today's call. Jean−Philippe will provide a brief overview of the financial results and our operations, then discuss the state of the market and our customers. Then I will give some more details on the quarterly financials, the head counts, the cost structure, as well as some outlook for Q2. Then we will open it up for some questions. Jean, please. MR. JEAN−PHILIPPE MAHEU Thank you, John, good morning everyone, I am happy to report that Razorfish is generating profitability and cash flow from operations for second quarter in a row. Our revenues were $10.8 million for the first quarter 2002, which compared to $11.1 million for the fourth quarter of 2001 on a pro forma basis. For the quarter, we had net income of $2.5 million or $0.02 per a share, and pro forma net income before non−cash

compensation and certain nonrecurring expenses of $0.9 million or 1 cent per share, which is inline with the guidance we gave in our last call. This compares to a pro forma net income of $0.6 million or $0.01 per share for the previous quarter. So I want to publicly say thank you again to all our clients for keeping the confidence in Razorfish and (indiscernible) building breakthrough internet based solutions and to our employees' further commitment to client satisfaction and that whatever−it−takes attitude. So we continue to build Razorfish 2.0, a company composed of roughly 270 people, located in Boston, New York, San Francisco, Silicon Valley, and Los Angeles, which is focussed on client satisfaction, operating profitability, and on being the leading architect of extended enterprise portals. I will now speak about those three core dimensions of our business. Let me first state about our client relationships. In the first quarter 2002, we were very fortunate to add several new clients to our roster, including John Wiley and Sons, Microsoft, and Sabre Company, Fortis Inc., a leading family−focussed entertainment company, and a leading specialty chemicals manufacturer. We also continue to win additional business from our ongoing engagements with Cisco Systems, Legg Mason, Genentech, GlaxoSmithKline, Ford Motor Company, Western Union, Manulife Financials, and Avaya. Our partnership with Microsoft on .NET continues to support our client attribution activity. As you know, we are part of a select group of companies who have access to fully funded .NET programs. These programs focus on new client acquisition activity and case studies and on company users of .NET technologies. The partnership continues to offer greater possibilities for clients and we are delighted to work closely with Microsoft in the design and development of value−added digital solutions. Let me now come back to operational performance that is showing signs of stability in an economic environment that remains challenging. Our revenue in Q1, 2002 is down by less than 2 percent versus the pro forma revenue in Q4 2001. This is the smallest sequential revenue decline we have experienced since the first quarter of 2000. We continue to improve our operational efficiency to reduce operational cost structure by 6 percent from $10.2 million in Q4 2001 to $9.6 million in the first quarter of 2002. We increased our gross margins to 45 percent. We improved our operating margin to approximately 11 percent in the first quarter from 8 percent in Q4, 2001. We maintained our annualized revenue (indiscernible) at a healthy $200,000 in Q1. Finally we continue to manage (indiscernible) collections with DSO at 47 days. We are pleased with the performance of the company and the signs of stability we see in our business. However, the environment continues to be challenging and we plan to continue to operate with utmost focus on client satisfaction and proper acting profitability. John is going to go through the details of Q1, 2002 financial results in a few moments. Now let me speak about our focus on what we call the extended Enterprise Portal. Currently, Fortune 1000 companies are looking at rationalizing their web investments and their web infrastructure and it generates some outer efficiency gain for the use of internet technologies and that generates some revenue and higher personality (phonetic). Most efficiency and revenue enhancement will be realized to improve communications and collaborations between internal and external stakeholders, i.e. employees, supplier, channel partners, and customers. So what we see is that a lot of the IT spending right now, is focussed on integrating various existing internet systems to achieve a more fluid access to relevant information for these key stakeholders. We see IT spending on brilliant (phonetic) portals that we see for the Signet communications between an enterprise and its external key partners. At Razorfish, we call this portal extended enterprise portal as they target internal and external users. We are positioning the company, Razorfish, as the leading architect of external Enterprise Portals. An external enterprise portal is a technology infrastructure that offers furthermore specific interfaces, which basically serves as a platform for information delivery between an enterprise and a traditional (indiscernible). So that employees, customers, channel partners, and suppliers can access enterprise information that are relevant to them. To build the extended Enterprise Portal with our time, we are leveraging our competencies in three areas. The first area is information management and (indiscernible). Most enterprises have a rare ability to collect data than to filter aggregates, analyze the data, and even lesser ability to (indiscernible) that analysis while interacting with users. As a result, users are flooded with unfiltered content, while enterprises fail to realize the benefit, the business benefit of knowing their competency. Razorfish has six clients in processing data, system data, and (indiscernible) into information and presenting that information to the right users, at the right time, in the right format, and on the right device. The second area of competency we are addressing is in the user interface. We believe that the adoption and uses of technology solutions is proportionate to the quality of experience the user has while interacting with that particular Internet solution. Razorfish operates best of class (indiscernible) in the design and building of user interfaces that drive high levels of user adoption in royalty. The third area of competency we are leveraging, is Internet technology. Internet based solutions need to be fully integrated with enterprise systems and databases. Razorfish operates strong skills in the architecting, designing, and building of Internet based technology solutions. In addition to Microsoft .NET technology, Razorfish has developed solutions of a wide range of application software, including AVG, Interlivin (phonetic), ZNET, (indiscernible), VA WebLogics, and WebSphere (phonetic). While we are not alone to target the extended enterprise portal space, we believe we are uniquely qualified in succeeding. We believe that we have two tangible advantages versus our competitors. Number one, we offer the best combination of skills in the design and the development of user interfaces at (indiscernible) and in the design and development of Internet based technology solutions. Number two, we have become core effective in assisting our clients in bridging the gap that often exists between their internal marketing and customer service departments and their IT department. So while we compete against the large IT Internet providers, like IBM, EGS, and Accenture in the world, with (indiscernible) stronger user (indiscernible) and marketing efforts. And when we compete against the interactive and direct marketing agencies, the digitals would have made (indiscernible) web colleagues. We leverage a stronger technology offering. These Razorfish 2.03 is getting very good attraction in the marketplace as evidenced by our ability to retain blue chip clients and as evidenced by our continuous improvements in our production performance. Hence, while the economy remains challenging, and IT spending will probably not pick until 2003, we remain confident in Razorfish, the strength of our brand, the strength of our client relationship, the quality of our people and the relevance of our portal on extended Enterprise Portals. Now, let me hand it over to John for a detailed review of our first quarter financials.

MR. JOHN ROBERTS:
Great, thanks Jean−Philippe. I will talk about our first quarter financial results, give an update on our restructuring activities, our current file structure, our balance sheet and then give some guidance for Q2. The results, which I will talk about will include both actual GAAP results and pro forma results. For Q1 2002, the only pro forma adjustments, which we have made to the actual GAAP results are to adjust for non−cash compensation, which is related to the amortization of compensation for options and to adjust for the reversal of approximately $1.7 million of previously recorded restructuring charges. Pro forma results for the first quarter of 2001, include the same adjustments, plus the adjustment for amortization of goodwill, which we had at that time and the adjustment for our former European operations, which were included in that quarter. Just as a reminder to everyone, all of our European divestiture activities were completed in 2001, so Q1 2002, and the rest of 2002 is a US only business.

You also noticed in the press release that we adopted a new accounting announcement, which requires that we report out−of−pocket expenses, both as revenues and as cost of services and to request (indiscernible) such amounts for our prior periods, which are presented. Therefore, essentially, it would be a new caption titled, Revenues Before Reimbursements for Direct Cost, and then full (phonetic) of revenues. My comments on the financial results will primarily focus on revenues before reimbursements of direct Cost. So with that, revenues for the first quarter of 2002 was $10.8 million compared to $11.1 million for the fourth quarter 2001. Again, the fourth quarter is the US only business and excludes the European operations. Our net income for the quarter was $2.5 million or $0.02 per share. We've also presented the pro forma numbers for Q1, since we presented those numbers in the past. So on a pro forma basis, we generated net income of $900,000 or $0.01 per share, which is up from pro forma net income of $600,000 in Q4 2001, and compared to a pro forma loss of $0.05 per share in Q1 of 2001. In terms of the restructuring update, during the quarter we reported a reversal of our restructuring reserves of $1.7 million. This is related to the settlement of some real estate obligations for less that we had initially accrued, so we reversed the excess reserve in the quarter. At this point, we have successfully restructured all of our excess real estate obligations. Assuming that our current headcount and operations do not change, we do not anticipate any future restructuring related to real estate. A few highlights on our cost structure and our headcount as of March 31, 2002, our headcount remains fairly stable during the quarter. There was some natural attrition in the quarter. The total headcount was reduced to approximately 269 employees and contractors, versus 275 at December 31st. Of that 269, approximately 77 percent are billable project people and 23 percent are non−billable. In terms of our cost structure, Jean−Philippe mentioned that our cost structure came down by about six percent in the quarter, most of that is in the, what we call, Project Personnel Product Line, which is our cost of services. Now it is achieved primarily by improved project management and delivery. Our sales and marketing and our GAexpenses stayed relatively flat from Q4 to Q1. In terms of our balance sheet, DSO at the end of the quarter was 47 days, which is up two days since December 31st, quarter but still well within our target range of 45 to 55 days. Our liabilities, we have reduced our total liabilities from December 31 by over $5 million in the quarter, due to two things. Due to reversal of the 1.7 million of restructuring reserve I mentioned, as well as payments of approximately $3.5 million due to restructuring payoffs and other items that got paid during the quarter. In terms of guidance for Q2, we anticipate revenues in the range of $10.3 to $11.3 million, the midpoint of that range is $10.8 million, which we are reporting this quarter. We anticipate gross margins and operating margins in a similar range to Q1. So 43 to 45 percent of gross margins and 8 to 12 percent for operating margins. We also expect that pro forma net earnings will be in a range of half million dollars to a million dollars. With that operator, we would like to open the call up for questions. Operator?

THE OPERATOR:
(CALLER INSTRUCTIONS). There is no question at this time. Thank you for this conference. Kindly disconnect your line and have a great day.

MR. JOHN ROBERTS:
Thank you very much. (CONFERENCE CALL CONCLUDED).

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04/17/2002 05:30 pm	**INPH**	**Interphase Corporation (INPH) − Q1 2002**

THE OPERATOR:
Ladies and gentlemen, thank you for standing by, welcome to the Interphase, First Quarter Earnings Release Conference call. (CALLER INSTRUCTIONS) I would now like to turn the conference over to Greg Cullose, Chief Executive Officer with Interphase. Please go ahead Sir.

MR. GREG CULLOSE:
Thank you. Good afternoon, this is Greg Cullose. I would like to welcome you all to the Interphase First Quarter 2002 Conference Call to discuss earnings. With me is Steve Cobart, our Chief Financial Officer and he will begin with a short discussion on the financial performance and then I will conclude with a discussion on some of the events from the first quarter. Steve.

MR. STEVE COBART:
Thanks, and thanks everybody for participating and your interest. Before we begin, I would like to remind you that we do not make financial projections to the public; however, some of our discussions may contain forward−looking statements about our business, financial condition and prospects of the company. The actual results of the company could differ materially from those indicated by the forward−looking statements because of various risks and uncertainties, including without limitation, changes in product demand, the availability of products, changes, and competition, economic conditions, various inventory risks due to changes in market conditions and other risks indicated in the company's SEC filings and reports. All the foregoing risks and uncertainties are beyond the ability of the company to control and in many cases the company cannot predict the risks and uncertainties that could

cause its actual results to differ materially from those indicated by the forward−looking statements. When used in this call, the words believes, plans, expects, intends, anticipates, and similar expressions as they relate to the company or its management are intended to identify forward−looking statements. So now I will review the first quarter. Revenues for the quarter were 6.3 million versus 10 million in the first quarter of 2001. The decline was attributable to approximately $2 million decline in our storage products and a $2 million decline in the older legacy products that was offset by 133 percent increase in our combo slot optimizing products. Our traditional networking products, mostly FDDI, TM, Ethernet and WAN were $884,000 versus 3.3 million in the first quarter last year. Storage products revenue was 438,000 for the quarter versus 2.5 million in the first quarter of 2001. Our broadband telecommunication controllers revenue was 2.2 million versus 2.6 one year ago. However, it was up sequentially 82 percent. The recent recession in the telecom equipment spending has had a large impact on these revenues; however, we expect the industry to begin improving in 2002 and therefore expect production level orders from some customers beginning in the third quarter resulting in increases in this revenue category. Gross margins were 40 percent versus 51 percent in the first quarter of last year. Margins are expected to be in the 50 percent range as revenues approach the 8 million mark and above. Operating expenses for the quarter totaled 3.8 million versus 5.4 million in the prior year's quarter, a reduction of 30 percent. RDspending for the quarter was 1.6 million versus 2.2 million in the 2001 first quarter. Sales and marketing expenses 1.4 for the quarter versus 2.1 million in the first quarter of 2001, which is due primarily to variable costs related to revenue levels. GAfor the quarter totaled 800,000 versus 1.1 million in expenses during last year's Q1. Our first quarter net loss was 566,000 or 10 cents a share versus our last year's first quarter loss of 188,000 and 3 cents a share. Our break−even based on our current infrastructure run rate is estimated at about 7.5 million per quarter in revenue. Although Interface posted a book loss, we again generated cash during the quarter from continuing to manage our inventory levels down and increasing our turns as well as keeping our day sales outstanding and accounts receivable low. Cash and securities rose during the quarter to 19.3 million, up from 19.1 million at the beginning of the year. Accounts receivable, day sales outstanding are 52 days at the end of the quarter. Our total debt representing a floating line of credit from the bank stood at 3.5 million at the quarter end. Total liabilities, which included debt stood at 7.2 million. Also during the quarter, we purchased and retired approximately 41,000 shares of Interface common stock from Motorola at $6.25 per share under a 1998 repurchase agreement, thereby reducing common stock redeemable by 254,000. Since 1998, we have repurchased approximately 579,000 shares of a total of 660,000 shares under the agreement and the remaining 81,329 shares will be purchased in the second and the third quarters of this year. We continue to generate cash in spite of the recent book losses as we turn to exciting new products that will become a part of our next generation data and voice networks. We do plan to use some of this cash to grow our business over the coming quarters, but it should be clear that your company is financially healthy as it has navigated almost two years of downturn in its target markets. I now will turn it over to Greg who will add some perspective to this as well, and update you on some of the plans for the upcoming year.

MR. GREG CULLOSE:
Thanks, Steve, well this quarter is beginning to mark progress for Interface, and we are anxiously −− obviously and anxiously as I am sure you are awaiting the revenue growth that we worked so hard to achieve. I think the team has accomplished quite a bit this quarter and I would like to profile some of that for you in the next few minutes. The last time we talked, I outlined three major focus areas or themes that I think I would like to report the progress on

today, and I think they are very important to our company. The first is our continued focus on design wins. In January, we announced a major design win, an additional design win at Errickson, this is the first one at Errickson that is an addition obviously to the Nortel, Lucent announcements that we made last year for our company. These three companies, we expect to be major forces in the telecommunications equipment supplier market, so we are very excited about the prospect of working with them. We are also very pleased with the progress that we have made not only in securing initial design wins but each of those design wins have led to additional business, or additional business opportunities for Interphase over the course of the last six to eight months. And obviously that is pretty exciting for us and it really hasn't come as much of a surprise to us because the quality of our product offerings and certainly the level of customer support that we provided during the design win stages has opened many new doors. (Indiscernible) we have a good reputation in many of these accounts, you know, that's what carries you through to many new opportunities within those accounts, so we are pretty excited about that. Also as many of you probably know, Interphase has sold legacy technologies into the US Government for many many years. During this quarter, we also announced that we established a partnership with Ciprico to provide our gigabit Ethernet and fiber channel slot optimizer product we call the 5570 to the US Navy, at the Station Naval Warfare Systems Command, which will be used on board their tactical system applications. We are very excited about these design wins; we are really excited about the quality of these wins because the customers we are serving, we expect to command a substantial portion of the markets that they are serving and they are very pleased at the prospects of expanding within these accounts. The second area I outlined on our last call was the need for interfacing our standard partnership base, so that we can offer much more comprehensive and complete solution offerings for our customers. Obviously, we are trying to transition from a circuit board I/O background into a solution offering and that's pretty key because as our customers have reduced their resource bases and our focus on bringing products to market a lot faster, obviously the more we can integrate our solutions in terms of boards and software and services into a neat package, the faster and easier it is for them, so it is absolutely important for them. Early in March, we announced a strategic partnership with a company called Integra (phonetic); they are a new entrant into the semiconductor market and they are doing next generation access products. We are developing a new product line featuring Integra's Wintap (phonetic) processor, which provides us with a very robust multi−protocol and internet working feature capable to meet the needs of access network equipment providers. In simple language, this technology allows carriers to more easily migrate from traditional voice−based circuit switch legacy telecom equipment to newer, cheaper, more flexible standards based platforms, which obviously save them not only a lot of money on the capital, but also a lot of money in the provisioning and a lot of money in the administration and maintenance of those systems. So we believe that that is going to be a pretty hard ticket, we are focused on developing systems (indiscernible), which will allow for very high performance multi protocol processing for those platforms. We expect to see the devices show up in things like radio network controllers of RMCs, base stations, media gateways and access multiplexers. Another significant partnership that we announced during the quarter was done with Hughes (phonetic) Software Systems. Hughes is one of the top two providers of SS7 and ATM protocol stacks to the wireless and soft switch markets. And we are pretty excited because we took our lower level stacks and integrated with their upper layer stacks, obviously offering a seamless SS7 and ATM solution with our board products, which we expect our customers to more easily be able to deploy and obviously during that integration process we optimized performance for this particular protocol stacks, we are pretty excited about that. The third area I commented on during our last call was one of fiscal management and as Steve touched on it, we have got one of the strongest balance sheets and cash positions we have had in the company's history. Obviously, our goal isn't to manage balance sheet exclusively, but to drive towards the top line and we are working on doing that. But I want you all to take a deep breath and realize that while we are managing for future growth, we are also keeping the resources of the company strong so that when these returns do come in, we are in a position to take advantage of it. As you know, we were very swift to react to the industry slowdown and we have resized the company quickly and began working to secure what we believe would be stable engagements as we move forward. And we think that much of this will bear fruit when this market turns around. Now let me just comment and besides the market for us could turn around kind of in advance (phonetic) when we see telecom in general turning around. And the reason for that is, as a lot of these large network equipment providers are migrating from proprietary systems to the slower platforms, the revenue yield on these slower platforms for them is probably going to be substantially smaller than it was on the proprietary equipment. Since we command a much greater portion of the new equipment than we did in the old, and obviously it is going to accelerate for us, from a much smaller base and much faster than it will for them. So we kind of expect to see the embedded enablers like us, to begin to accelerate in revenue far before we'll see the telecom equipment market and accelerate in the aggregate. So while many of the companies in our industry are still trying to regroup and in some cases looking for cash, Interphase has been able to move forward pretty rapidly, despite our book losses we continue to generate cash for future investment. Moving forward, I expect our business to look progressively better. Starting in the latter half of this year and you all know it is now our policy not to make a lot of forward−looking projections. With the volatility in the markets that we serve and the customers going through severe turmoil, it is very difficult for us to be credible in providing you much in the way of outlook. And unfortunately our backlog is not usually a very strong indicator because the book−to−bill ratio for us is generally pretty small. But I can simply tell you that the outlook for the latter half of this year from all of the customer engagements, the feedback we are getting looks much rosier than the first half of this year. Nonetheless, during the first quarter, we have seen a great deal of activity for new projects and as I mentioned earlier, a lot of that is coming off the same customers initial engagements that we have won, they are just offering a bunch of new engagements and we are pretty excited about that because it is a testimony to the success we have had in those accounts. So assuming the capital spending begins to improve in the second half of this year, particularly in the telecom sector, we expect to end this year having more revenue and returning to a profitable condition on a quarterly basis. The level of evaluation units we've shipped, the number of field trials we were involved in, and the number of our (indiscernible) responding to is an all−time high. So our focus is as I'm sure I've mentioned at least once before is (indiscernible) the top line. And we are confident we will be able to do that and we are doing the right things to make that happen. So hopefully our due diligence and our patience will pay off. Interphase's future products are growing much for intelligent as we look forward. We're aiming from growing from intelligent I/O products to really subsystem on board kinds of products of sub system on blade (phonetic) products. We are investing heavily in software capabilities partnering with protocol suppliers. So that when we go to our customers we have got a much more integrated solution that feels much easier to implement within their systems offerings and obviously that is (indiscernible) in the market and costs −− than little, saves them hundreds and thousands of dollars in development time. Last year as I mentioned to you on our last call, we invested in a professional services group, which has been merely a strategic investment for us. And what we have learned is through the level of dependence our customers have during the integration process, this team has really been an invaluable resource for us to prove ourselves as a higher capable suppliers in this very fast growing industry. We are proud of the accomplishment this team has made, the energy and enthusiasm and the dedication of our employees when times are good as well as when times have been difficult. And I also wish to thank the shareholders for your commitment to the company and at this time I will open the call up to any questions that you might have.

THE OPERATOR:
Thank you. (CALLER INSTRUCTIONS). One moment please for our first question. Our first question comes from Dean Williams (phonetic) with Wells Fargo. Please go ahead with your questions.

THE CALLER:
Hello gentlemen.

COMPANY REPRESENTATIVE:
Hi Dean.

THE CALLER:
How are you?

COMPANY REPRESENTATIVE:
Good, how about you?

THE CALLER:
Good, thanks. I just wanted to go through a few things here. It looks as though we have got the break−even level like you have said down around 7.5 million on per quarter sales. And do you like 2? years ago when sales were running around 20 million, do you have any idea what the break−even level was at that point?

COMPANY REPRESENTATIVE:
It would be a best judgment on my part, but I am I would tell you was probably around 15.5 to 16 million in that range.

THE CALLER:
Okay, so it is almost cut in half?

COMPANY REPRESENTATIVE:
Yeah.

THE CALLER:
Okay, well that is certainly good news. What about in storage? Do we still think that we can recover the RDmoney that we spend on storage over time?

COMPANY REPRESENTATIVE:
Yeah, but it will probably be more in the specialized products arena, meaning ?.

THE CALLER:
Gigabit Ethernet and slot optimizers?

COMPANY REPRESENTATIVE:
Yeah, but it is really a question of the form factors, which obviously is not hard for us to re−spend, but a lot of our PCI stuff is going up against guys that have got a lot of more market momentum behind them. What we are finding is in the embedded market space, the need for small PMCs is pretty significant and we are getting asked to do fiber channel and combo products in the that arena, and in fact are responding to that. The navy thing that I mentioned earlier in the call also takes advantage of our combination product, which uses our fiber channel and gigabyte Ethernet combo products. So we expect to see some redemption in that. Those are not small deals that we are working on, there won't be the kind of household OEM names that we have enjoyed in the past and expected to enjoy when we embarked upon that endeavor.

THE CALLER:
So basically there is no chance of any big name OEMs, it is going to be really more in the smaller kind of piecemealing it out?

COMPANY REPRESENTATIVE:
Well, I would never say never, but you know, the likelihood seems more remote now than we thought couple of years ago and we are working hard on it.

THE CALLER:
The Ciprico deal, is that a do you think that is going to be a material quantity of revenue overtime or?.?

COMPANY REPRESENTATIVE:
Well, we believe so and we have been given enough cues from the Government accounts as well as Ciprico as to the quantities. I cannot comment on that though because of proprietary information. But we believe it is going to be significant enough to help us enjoy a pay back on that development investment for storage products.

THE CALLER:
Also we have the new global VP of Sales. Has he come up with any ideas since he has been aboard as far as better marketing Interphase products?

COMPANY REPRESENTATIVE:
Yes, but we are working right now to kind of look through the rebranding exercise and new messaging process.

THE CALLER:
Okay.

COMPANY REPRESENTATIVE:
He is now board for I think less than two months right now but yes, the answer is he is working on that very diligently.

THE CALLER:
Okay. And kind of trying to keep track of these design wins in telecom, I remember at one point we had said we had 30 wins and then we had some that were lost and some new ones that have come in. I mean are we still −− are we kind of flat with that number or have

increased? It sounds like there was a little bit of increase of activity last quarter?

COMPANY REPRESENTATIVE:
Yeah, it is a little bit of increase; but as some increase, some have fallen away, some have been put on perpetual hold. And, you know, that is the hard thing with us is you work and fight your way into them and then because of budget conditions and your customer accounts, some of them just kind of get stuck on hold. So I guess a good figure of merit would be this, you know, to stick with the 30 or, you know, 31 32 number. But it is not growing sizably, but I would say that the potential revenue yield from the ones that we are feeling more and more comfortable about are looking more optimistic, meaning ?.

THE CALLER:
That is good.

COMPANY REPRESENTATIVE:
Yeah, I mean so fewer is not necessarily good at the same number but the size of the ones that are now in the mix appear to be stronger with shorter term revenue. One of the things that I meant to say in the earlier portion of the call was a lot of the stuff that we originally embarked upon was aimed at a next generation access equipment and next generation networks, and 3G wireless. I will tell you that a lot of the wins that we are experiencing right now are not dependent upon 3G wireless. They are going to be deployed on GPRS and 2.5G wireless systems, which are right around the corner. So the good news is as these deployments occur, you know, it is not an ``if'' because there is a market consumption of those types of products today. And so there is a lot of a risk in it than it would be if it were waiting for a 3G to show up in the US or in Europe for example.

THE CALLER:
Well, that is good because that was one of the things that some people I think were scared about with the postponement in 3G.

COMPANY REPRESENTATIVE:
Yeah, now the good news you make the investment once and these walk to 3G.

THE CALLER:
Great.

COMPANY REPRESENTATIVE:
But that was one of the reasons that, you know, we were selected in some of the larger accounts like Lucent. It is because the products have full ATM capability, full Ethernet capability. And so if you want to go with a PICMG 2.16s, which is the Ethernet backplane band, you got the product that will do it if you want to go ATM band, you have got the product that will do it. Ours is the only product on the market that runs all full protocols. So we feel, you know, SS7 ATM, Ethernet, and basic TDM and things of that nature. So we feel very confident that (indiscernible) approved this solution selections for our customers and now we trying to move ourselves up the food chain.

THE CALLER:
Great, now, you know Lucent has laid off about half their work force to various means, spin−offs, whatever else and Nortel is obviously downsized, I mean is this going to benefit

this outsourcing? Is that going to benefit Interphase and these big guys?

COMPANY REPRESENTATIVE:
Absolutely, because they are not going to move their proprietary platforms forward, they have to move to a standards based alternative, that means outsourcing. And quite often we will have large meetings with them and, you know, there is not a lot of hardware guys in the room if any. They are counting on us to deliver these solutions for them and obviously that is where we shine because we have tried very hard to become the best partner we can. So the trust factor, the neutral reliance is very well understood, and it is a very strong relationship.

THE CALLER:
And they have come and seen your manufacturing facilities, they are very comfortable with your ability to produce?

COMPANY REPRESENTATIVE:
Absolutely.

THE CALLER:
Okay. And in the meantime while we are kind of going through this downturn, I think I mentioned it before in another call that, have you thought about taking on any kind of contract manufacturing or any other kind of thing just to kind of, you know, help out during the downturn or is it too late for that now?

COMPANY REPRESENTATIVE:
Well, you did mention it and frankly, we have thrown the idea around here and frankly that is a difficult one because the last thing I want to do well at our resource level. Because we have taken our resource levels down pretty substantially is to begin to deflect the tension and focus from our primary goal.

THE CALLER:
Yeah.

COMPANY REPRESENTATIVE:
Well, I mean it will be absolutely awesome to try and delete out some of that excess, unabsorbed overhead or excess capacity, we believe that we will see a return in growth of product flow through the factory here in the next quarter or so. So we are just going to hang on, we don't think that will solve the problem.

THE CALLER:
Yeah, it is probably too late now.

COMPANY REPRESENTATIVE:
Yeah, they are not exactly doing all that well themselves, if you know what I mean. No, obviously. There is a lot of surplus capacity right now there.

THE CALLER:
I am sure there is in the industry, yeah. We are still convinced that our telecom products are competitive with RadiSys and Performance Tech (phonetic) and everybody else we are competing with?

COMPANY REPRESENTATIVE:
Yes, absolutely.

THE CALLER:
Okay, we kept up on R

COMPANY REPRESENTATIVE:
Yup.

THE CALLER:
Okay, great, and so we are going to talk on revenues up to about a third and when do we think that the telecom is going to be, you know, 70 or 80 percent of total revenue, is that by year ender or?.?

COMPANY REPRESENTATIVE:
I think, I do not know if I can qualify 70 to 80 percent, but I except the substantial second half of the year growth to come from the telecom sector. The reason I am hedging a little bit is the shipments for that Ciprico partnership will also begin, you know, towards the end of the year, early next year. And it is kind of hard for me to put a size on that at the moment. But I think it could be substantial enough that if, you know, that 80 percent might be overstating what telecom will do because of the growth.

THE CALLER:
Legacy is pretty much going to be gone by yearend?

COMPANY REPRESENTATIVE:
Yeah, I would say so. I would say so, we will have some residual, you know, nits and lice here and there, but it is pretty much gone.

THE CALLER:
Okay, and the goal for the company is to be profitable by yearend. And we have our bank credit lines still in place, no problem there?

COMPANY REPRESENTATIVE:
Right.

THE CALLER:
I noticed we had restricted cash in the balance sheet; is there any restricted cash, or is that just a catch on?

COMPANY REPRESENTATIVE:
Well, no, no, no, it is −− technically it is restricted because we had a bunch of bank covenants. We had a just, you know, a net worth and changes in assets and all kinds of restrictive covenants. And what we did was, we got them to give us that debt at 1 percent over, so we have got most of our cash invested in various, you know, shorter term instruments −− big instruments in that bank. So we gave −− they gave us the debt for 1 percent more than we were earning. It is floating. And they just charge us 1 percent basically, and it is sort of like borrowing your own money, but of course we got −− we don't want to have to go do a complete new line of credit and all the paper work that goes with it. We want to keep that line

in place. So we are borrowing our own money for 1 percent, for that we have to, you know, it is essentially collateralized by cash. So in our financials, we have to call it restricted cash, but it would be sitting there in their bank anyway.

THE CALLER:
Yeah, and basically out of 19.3 million, it represents about a 3? or something?

COMPANY REPRESENTATIVE:
Right. It is 3.5 (inaudible).

THE CALLER:
So it is essentially the other, you know, 15 whatever it is unrestricted?

COMPANY REPRESENTATIVE:
Right.

THE CALLER:
Okay, and this recent new 5 percent investor, I mean obviously he has not expressed any plans to try to take over the company or anything?

COMPANY REPRESENTATIVE:
None.

THE CALLER:
We have the poison pill sill in place and the employee retention is still good?

COMPANY REPRESENTATIVE:
Very good.

THE CALLER:
Okay, and do most of our key employees have stock option incentives?

COMPANY REPRESENTATIVE:
Yes.

THE CALLER:
Okay, so every one has revenue growth?

COMPANY REPRESENTATIVE:
Everybody is motivated the same way.

THE CALLER:
Okay, Great.

COMPANY REPRESENTATIVE:
And we have got handcuffs to kind of keep him from chopping around too much.

THE CALLER:
Okay, great. Good. Okay well good gentlemen. I think we have made some progress here in

the last quarter, and we look forward to seeing some more progress.

COMPANY REPRESENTATIVE:
Thanks Dean. Thanks a lot Dean.

THE CALLER:
Sure.

THE OPERATOR:
(CALLER INSTRUCTIONS). I am showing no further questions at this time. Ladies and gentleman that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. (CONFERENCE CALL CONCLUDED)

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04/17/2002 04:30 pm	INKT	**Inktomi Corporation (INKT) − Q2 2002 Earnings Conference Call**

THE OPERATOR:
Ladies and gentlemen, thank you for standing by. Welcome to the Inktomi second quarter fiscal year 2002 results call. At this time, all participants are in a listen−only mode. Later we will conduct a question and answer session. At that time if you have a question, you will need to press the ?1? followed by the ?4? on your telephone. As a reminder, this conference is being recorded Wednesday, April 17th, 2002. I would now like to turn the conference over to Shernaz Daver from (technical difficulty). Please go ahead Ma'am.

MS. SHERNAZ DAVER:
Good afternoon and thank you for joining us today. This is the Inktomi conference call to announce results for the second quarter of fiscal year 2002 ended March 31, 2002. The press release is available on our website at www.inktomi.com and over (indiscernible). The participants in the call with me today are David Peterschmidt, President and Chief Executive Officer of Inktomi, and Jerry Kennelly, Chief Financial Officer of Inktomi. The call will be divided into two sections. First, David will give a brief overview of our financial results and discuss our business. Next, Jerry will go over detailed financial results and talk about our outlook going forward. We will then open the call up for QThe prepared remarks will take approximately 15 minutes. Before we get started, we would appreciate your attention as we go through the following. This call contains forward−looking statements. In particular, references in this call may contain forward−looking statements regarding (indiscernible) special operating and financial results for future periods, performance of new products and alliances, size and outlook for our new and current markets, and customer and prospective customers buying behavior. A number of factors and uncertainties could cause results to differ materially from those projected in the forward−looking statements. For factors that

could cause actual results to materially differ see the section titled Factors Affecting Operating Results contained in our quarterly report on Form 10−Q, filed with the Securities and Exchange Commission on February 15, 2002, and other reports filed by Inktomi with the SEC. We caution you not to place undue reliance upon any forward−looking statements and further we remind you that statements made during this call speak to management's view as of today. In addition, we expressly disclaim any obligation to publicly release any updates or revisions to any such statements. With that, I will turn it over to David.

MR. DAVID PETERSCHMIDT:
Good afternoon and thank you for being here with us today. I will cover three areas on the call. Final results for our second quarter, a summary of our company's business, and then finally our outlook going forward. With regards to the numbers, revenues for the quarter were $31 million. Pro forma net loss for the quarter was 12.1 million or 8 cents per share. Pro forma operating expenses were 35.4 million, now that's lower than the December pro forma operating expenses at 38 million, and this is due to good careful fiscal management on our part. Revenues for our web search business was 13.2 million, and that's a 13 percent increase over the prior quarter. License revenues were 11.2 million, and services revenues were 6.5 million for the quarter. These pro forma results exclude amortization of goodwill and other intangibles, restructuring charges, all commerce (indiscernible) activity, and non−cash preferred stock compensation cost. Our balance sheet remains healthy. At quarter end, unrestricted cash equivalents and short−term investments totaled $110 million, and total cash and cash equivalents, short−term investments and restricted cash was 239 million. Now that's down about 13.8 million from the December 31st quarter. For the March quarter, DSO was 51 days, obviously incredibly good. The net loss (indiscernible), including the restructuring charge for the abandonment of our unoccupied office lease was 104 million or 72 cents per share in the quarter. Let me turn to Inktomi's business. As we discussed on our call earlier in this month, technology spending in the global carrier and enterprise markets continues to deteriorate. This affected our business adversely during the March quarter, both in the United States and overseas. Yet, during this very severe quarter, Inktomi demonstrated modest, what I consider very noteworthy progress in it's business. In our web search business, we continue to service search queries at AOL and MSN, two of the most trafficked sites on the internet. In the quarter we reached a milestone of serving more than 100 million queries per day across all of our portals. Our modest increase in overall web search revenue was primarily due to our monetization efforts which continued to pay off. In the March quarter, Inktomi and its reseller networks signed on over 100 new customers, including FTD, CompUSA, and Ann Taylor (phonetic), and they drove over 100,000 new customers to sites such as Amazon, eBay, and Eddie Bauer (phonetic). In our software license business, we saw repeat business and added new customers, both in the service provider and the enterprise base. Still, the continued weakness in the carrier space (indiscernible) affected our license revenues in the quarter. However, we (indiscernible) pleased with the results of our enterprise business. In the March quarter, 51 percent of license revenues came from enterprise accounts. Our enterprise search business which is a component of this business alone grew approximately 18 percent over the previous quarters. Now, companies such as GE Medical Systems, In−Q−Tel, MassMutual, McGraw−Hill, Princeton Review, SoftChoice, Virgin Mobile, and Europe's UBS AG and (indiscernible), and Asia's Fuji Xerox and Samsung Electronics purchased our software to retrieve, manage, and deliver large amounts of digital content across their networks enhancing their employee communications and productivity. We saw purchases from John Hancock Mutual Life Company, Motorola, and SAP America demonstrating a modest amount of repeat business on the enterprise side. Last week we signed on Cable Wireless as an enterprise

search customers through our partnership with Yahoo!. The March quarter was marked by significant product introductions. We introduced our new Personal Edge product designed to dramatically speed up delivery of content to the desktop. The product has already been selected by America OnLine for its worldwide network, and we are seeing traction from other carriers. In addition, we are seeing an early interest for Personal Edge from enterprise companies which we believe holds great promise for us in the coming quarters. Just last week we introduced our new content networking security bundle which features integrated web−based virus screening, content flow screening, and access control capabilities enabling enterprises to protect their networks from both internal and external security threats. Last week for our enterprise search customers, Inktomi introduced new connector software to be used in conjunction with products from our partners Documentum and Interwoven. These products with their tight integration of content management and search allow users to quickly locate and retrieve information contained within the numerous applications by the enterprise. The products resulted in sales at both John Deere (phonetic) and Nokia. Our OEMs comprise of Compaq, Dell, F5, Fujitsu, HP, and 3Com continue to penetrate the market with Inktomi−powered server appliances. In the quarter these partners added approximately 120 new customers. On the partnership side, and I consider this important, we extended our relationship with IBM Global Services under which they will now offer all of our content networking software in addition to our enterprise search products to their enterprise and carrier customers worldwide. We also just entered into an agreement with Hewlett−Packard for HP Consulting and Services to resell Inktomi's enterprise search and content networking products on a global basis effective immediately. Last week, Inktomi signed an agreement with Compuware (phonetic), to gathering and resell our enterprise search products. These partnerships are important to us as we extend the reach of our technology into the broader market, and you should expect to see us gain greater traction with these alliances. Now let me take a few moments to talk about the outlook going forward. I believe global technology spending will continue to be weak in the coming quarters. Having said this, I believe the March quarter will prove to have been the low watermark for Inktomi. We do see modest growth in our business in the coming quarters, and Jerry will lay out guidance accordingly. In the coming quarters you should expect to see the following. First, in the transition in our sales revenues. We expect revenues for the upcoming quarters to be comprised of multiple smaller deals as we increase our penetration into the enterprise. In the carrier space, we also believe the deals will be smaller in total volume and will be spread across multiple quarters as customers purchase what they need for the short term. This is optimal for Inktomi as we steer the business to become a stable run rate business that is not heavily dependent on big deals every quarter. We believe we will continue to get traction in our web search business. Our traditional web search business continues to grow as we constantly maintain and enhance our technical leadership and service to large portal customers. We have demonstrated the viability of the new revenue streams with monetization, and we expect to announce new customers for our service in the June quarter we believe in the content management area. In the enterprise space, we clearly see the content management area as a strong market for our enterprise search and associated connector products. We believe Inktomi's products are seen as a key component for content management, and we expect to continue to see traction for our offerings in this market. And finally, we see early signs, and I believe clear signs of an emerging enterprise CDM market. A few years ago, the CDM area was crucial for service providers, and we are now seeing it move over to enterprises who are running large networks across multiple continents. We believe our infrastructure products that were critical to the service providers for CDM will become equally critical to enterprises to increase their business productivity and their competitive edge, and we have seen validation of this in the alliances that we announced with IBM Global Services and with HP Consulting Services. We believe Inktomi will be a direct beneficiary as this enterprise market takes off. To close, as I have said before, the opportunity ahead for Inktomi is significant as we develop products that are essential to running global businesses. We continue to build new products as demonstrated this quarter. We strengthened our market penetration and our alliances with major corporations, and we are managing our financials as we steer through the current environment and position ourselves for the growth in the coming quarters. With that, let me turn it over to Jerry.

MR. JERRY KENNELLY:
Thank you David. I will review the financial results for the quarter and finish with our financial outlook. Revenues for the March quarter were $30.8 million compared to $40 million in the December quarter. Although our web search and enterprise search businesses posted modest sequential quarterly growth, a decrease in overall revenues from the last quarter was due to reduced spending from carriers and ISP customers. North America generated approximately 80 percent of total revenue while 20 percent came from our international operations. This trend (indiscernible) is consistent with recent quarters. Web search revenues grew 13 percent quarter on quarter, posting revenues of 13.2 million compared to 11.7 million in the first quarter. Two web search customers, each accounted for greater than 10 percent of total revenues for the quarter. Our traditional web search (indiscernible) revenue was up fractionally over Q1. Our monetization efforts grew 36 percent quarter on quarter, and we expect this area of the business to continue to grow. License revenues were 11.2 million compared to 21.1 million last quarter. We were pleased to see that approximately 51 percent of our license revenue came from enterprise customers. Growth in our enterprise business was primarily driven by strength in enterprise search and also by increased enterprise revenue in the concept networking group (indiscernible). Our traction in the enterprise markets, while modest, is encouraging. Additionally, the increase in the number of transactions with enterprise customers is also up quarter on quarter. We believe Inktomi is positioned to expand on these accounts as well as penetrate others with technology that continues to be regarded as critical. These wins (indiscernible) are beginning to develop into a revenue business which is helpful in this uncertain economic climate. Service revenues were 6.5 million compared to 7.3 million in the December quarter. As we discussed last quarter, services revenue typically lag license revenue. The services drop logically reflects some of the downturn in licensing (indiscernible) that took place over recent quarters. On the expense side, we continue to look for ways to maximize efficiency and cut costs wherever possible. I am pleased to say that our efforts had a positive impact on our bottom line in the quarter. First (indiscernible) constant revenues which comprise product cost, royalties, technical support, and professional services organization. Constant revenues represented 27 percent of revenues similar to recent quarters. Operating expenses on a pro forma basis decreased to $35.4 million, down $2.6 million from Q1. The savings came partly from variable expenses associated with revenues and partly from our continued attention to strong fiscal management. We finished the quarter with 687 employees, up marginally from 674 at December quarter end. As we announced several weeks ago, we are taking a one−time restructuring charge of $74.6 million in the quarter reflecting the abandonment of the lease for our new unoccupied office space at Foster City, California. This real estate restructuring charge is an estimate for the difference between the expected expense associated with the lease, versus the amount we anticipate receiving from subletting the property over the 15−year term of the lease. The pro forma expenses we excluded certain expenses. In the quarter we excluded 1.5 million of non−cash charges for deferred stock compensation, 16.7

million related to amortization of acquisition, goodwill, and the restructuring charge of 74.6 million for the lease. Additionally, we exclude (indiscernible) all activity related to last year's disposition of the commerce division including this quarter one time gain of $800,000 from other income, as well as $100,000 in the lease liabilities from the commerce division. Now, for our balance sheet. The balance sheet remains strong at the end of Q2. We finished the quarter with $110 million in cash, cash equivalent, and short−term investments compared to 123.7 million at the December quarter end. Total cash including $129 million of restricted cash was 239 million at March 31st. Accounts receivable totaled 17.4 million representing 51 days of sales outstanding. Consistent with the last couple of quarters, we continued to do a great job for the accounts receivable collection. For (indiscernible) accounting purposes, however, we anticipate DSO will fall within our targeted range of 60 to 80 days on an ongoing basis (indiscernible) to our industry. Capital expenditures were $1 million primarily for facilities and equipment for our research and development teams. The depreciation and amortization $6.4 million. Finally, I'd like to close with an outlook and guidance (indiscernible) coming quarter. We expect total revenues to be in the range of $30 to $34 million for the June quarter. We are committed to continue to (indiscernible) watch expenses and maximize operating efficiencies. Based on these revenue estimates and our cost structure, we (indiscernible) we will incur a pro forma net loss between 9 and 6 cents per share for the June quarter. We expect our average share count to be approximately 146 million shares next quarter. In closing, while information technology spending remains sluggish, we are continuing to invest in each of these technologies and to win new customers. Those accomplishments coupled with our strong fiscal management will be our foundation for long−term growth in profits. With that, let me turn it back to David.

MR. DAVID PETERSCHMIDT:
Okay. Let's now open it up for your questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) Chris Kwak with Bear Stearns, please proceed with your question.

THE CALLER:
Okay guys, can you hear me?

COMPANY REPRESENTATIVE:
Yes Chris. Go ahead.

THE CALLER:
Just actually, two pretty quick questions. The first question is, how shall we look at the web search business in terms of its growth? You guys are clearly doing a good job in monetizing that. What about the course of the (indiscernible) search business outside of the monetization? Secondly, on the enterprise search side, is the sales force sufficiently trained to attack that market? And lastly, could you just reiterate what the loss per share guidance is. I don't think I caught that. Thank you.

MR. DAVID PETERSCHMIDT:
Okay, Chris, I'll take the first two, and I'll let Jerry give you the loss guidance. So (indiscernible) web search business, that does have seasonality to it. We're entering into the quarter now, this quarter and the next quarter when traffic will start to slow down a little bit.

This is frankly because students are not in school and web traffic in June starts to moderate through the August period. But that business is growing based on monetization, and that's what I was pointing out. We've clearly now validated the monetization model of this. We expect more and more of the revenue from web search, and by the way, we expect that to grow, but we expect more and more of the web search revenue to come from monetization not from the basic fees that we get for providing search as a function. We actually think that starts to moderate itself and all the growth comes from monetization. With regards to the sales force on enterprise search, they have all been clearly trained on that, and I will go back and revisit with you for a second. Back in October while we began the business year, we basically (indiscernible) a sales force that carried all of our products as opposed to an enterprise search only or network products only, and that the sales force was then stratified based on either a (indiscernible) enterprise only sales force with all of our products or they were a carrier ISP sales force with all of our products. What's interesting is even a carrier ISP sales force has the enterprise search product in their bag so even that sales force is trained on enterprise search. Now I'll let Jerry give you the guidance on the loss.

MR. JERRY KENNELLY:
(indiscernible) guidance for the loss was between 9 cents a share and 6 cents a share (indiscernible).

THE CALLER:
Thank you.

MR. DAVID PETERSCHMIDT:
You bet.

THE OPERATOR:
Our next question comes from Thomas Berquist with Goldman Sachs. Please proceed.

THE CALLER:
Thank you. A couple of questions for both of you as well. First, David, just in terms of the enterprise search market, can you talk a little bit about competition in that market, and how you're going to think about what companies are going to be doing (indiscernible) size going forward? And then Jerry, could you just comment on the large deal pipeline and what you think the sequential growth will be including the enterprise search business?

COMPANY REPRESENTATIVE:
Okay. So the competition in this town (indiscernible) is predominantly Verity. I mean, they are the number one market share guys out there, and the way that we've seen this working is we believe enterprise search is all about the whole content management and the management of a lot of unstructured data, and that's why you saw the agreements between us and Documentum and also Interwoven. Where Verity has a revenue size larger than us, quite frankly is against OEM agreements that they have. While we get just license revenue, we think we are pretty close. But again, we don't look at search by itself. We believe it is truly all about content management and all the things going on there, and I think, you know, the other thing is you're seeing us extend our reach. The agreement that we signed with Compuware is just one of multiple ways we're increasing the sales channels here. And, Jerry, I think the other question was (indiscernible) it was about the large deal flow for −−.

THE CALLER:
Large deal pipeline for the next quarter as well as expectations on sequential growth in the enterprise search business.

MR. DAVID PETERSCHMIDT:
Okay. Let me go ahead and take that. I am probably closer to it than Jerry is. The large deal pipeline flow (indiscernible) quite frankly is really against our Personal Edge product, and there are other IFCs right now that are testing and looking at that. But any large deal that occurs this quarter is going to be in our minds plus to the guidance we gave. That is, the guidance that we've −− the total guidance we've given assumes no large deals anymore. We feel that that's the prudent way to give guidance. The second thing, the enterprise search, we expect to see that to continue to grow quarter on quarter as quite frankly we expect to see the content networking products in the enterprise grow quarter on quarter. And I think that's the thing that is encouraging for us. Obviously, we didn't like the mess, but we can clearly attribute that mess to the lack of a large deal in the carrier market, that if we look at the enterprise business, it grew sequentially. All enterprise licenses sold grew by about 27 percent over the previous quarter. So that program is truly working for us. That strategy is going to be effective.

THE CALLER:
Great, thanks a lot.

MR. DAVID PETERSCHMIDT:
Yes.

THE OPERATOR:
Our next question comes from Suji de Silva with CF First Boston. Please proceed.

THE CALLER:
Hi Dave, hi Jerry. (indiscernible) Once again, 51 percent revenue from license revenue from enterprises. (indiscernible) a comparable number for the prior quarter?

MR. JERRY KENNELLY:
It was in the −− almost 20 percent last quarter.

THE CALLER:
Okay. And now that you say that the smaller deal (indiscernible) occur, do you have some either explicit or implicit visibility to backlog going forward? Is that a concept you will be talking about more formally going forward.

COMPANY REPRESENTATIVE:
I think it will be, Suji, in another couple of quarters. I mean, we obviously have, you know, pretty detailed sales tracking system that we follow, and now that we are looking at this is don't assume any large deals, assume the run rate business. We can start to see it. I mean, you know, if we look at the guidance we just gave you, we think that we can clearly identify and predict about 85 to 90 percent of that guidance at the beginning of each quarter which takes a lot of the uncertainty out as we go forward.

THE CALLER:
(indiscernible) last question on the −− these resellers now with the content network (indiscernible) the timing of this, or you haven't really stressed that kind of strategy before. Was this a sort of a push from your side because your customers were coming through with partners or with IBM and those guys saying, you know, our customers are asking for this (indiscernible).

MR. DAVID PETERSCHMIDT:
Yeah, actually, we saw −− obviously, we started working with −− stalking IBM, but all (indiscernible) for you. This is actually coming from IBM. They are starting to see their customers ask for it. In fact, in one case IBM came back to us. They had partnered −− Global Services had partnered with another one of our competitors in content networking and lost and Ken Gutterson (phonetic) said, you know, we really need to start thinking about ways that we can do things with you, and so that's resulting now in a very serious relationship for the first time.

THE CALLER:
Great, thanks guys.

MR. DAVID PETERSCHMIDT:
You bet.

THE OPERATOR:
Our next question comes from Brent Bracelin with Pacific Crest. Please proceed.

THE CALLER:
Thank you. You know, (indiscernible) want to follow up on the IBM Global Services front. You also mentioned a new relationship with HP on the consulting front. Question one would be, you know, when do you expect to start to see, you know, lead generations building through that channel? It seems like a new channel for you. Question two would be with consultants with some of the newer partners out there, Compuware, Documentum, Interwoven, do you think there is any additional savings or that you can actually realize with (indiscernible) the sales and marketing line item, you know, head count reductions with the change in model, if you think there might be a change in model, are there any opportunities for additional cost savings, you know, as you start to see more traction through third−party vendors?

MR. DAVID PETERSCHMIDT:
Yeah, Brent, I think that over time maybe, but in the short term, the rest of (indiscernible) this year, I don't think we get cost savings from those partnerships, and that's primarily because we are going to have to spend our money to train them and to give them the promotional materials to sell our products. So actually, I think it's an investment that we have to make now. Now, once we get going, but I think that takes a couple of quarters, there may be some leverage there, but in a current run, I don't see it as much savings opportunity.

THE CALLER:
The benefits really probably start another six months out before you see the benefit of that. I guess, the other question I had for you, you did mention, you know, Verity, you know, as a competitor in the search side, you had mentioned that they actually do have, you know, some

OEM agreements. Have you considered, you know, OEMing your technology or is there any interest out there on the OEM side? Clearly you have some OEMs on the hardware front, but are you evaluating any OEM opportunities on the content management front?

MR. DAVID PETERSCHMIDT:
Yeah, that's pretty −− quite frankly, that's pretty much what we are doing with Documentum and with Interwoven. You can think of them as OEMs for this product. We think that we will continue to find other companies who want to do the same thing.

THE CALLER:
And I guess, perhaps you could add a little bit more clarity there. What is the difference between a connector and a (indiscernible) OEM relationship?

MR. DAVID PETERSCHMIDT:
Well, the connector is what, through our circle, allows us to go into those companies' applications and actually call and index their information. So, the connectors, if you will, are almost like the middleware that links the two applications together. So, everytime we release a connector, we are actually broadening the available market that the enterprise search product can participate in.

THE CALLER:
And the next question would be, is that, you know, is that something where your direct sales force will have to actually go in and try to pitch that, or is it something that you know, the Documentums and Interwovens of the world will actually pitch for you?

MR. DAVID PETERSCHMIDT:
Well, it goes both ways. Our sales force will be pitching it, and the Documentum sales force will be pitching it. So, we are actually getting leverage. In fact what we are finding is there are accounts that we're in on the content networking side and the enterprise search where the company is saying we think we are going to go with Documentum. At that point, we'll pick up the phone and talk with the Documentum team and vice versa where they've been involved and people saying, look we need the search capability, and Documentum now says we've got that, we've got that with Inktomi.

THE CALLER:
Great, fantastic. Thank you.

MR. DAVID PETERSCHMIDT:
Yes.

THE OPERATOR:
Our next question comes from David Raezer with Morgan Stanley. Please proceed.

THE CALLER:
Just one sort of high level question, I guess, with a few parts, and that is, I am just trying to drill down on your carrier revenues to get some insight into what trajectory this business is going to be on into the June quarter. I mean, if you take your guidance of roughly 50 percent where your statements are roughly 50 percent of the business of your license being carrier in March and roughly 80 percent of it being a carrier in the December quarter, that is roughly,

you know $17 million in December going to 5.5 million roughly in March. So you saw a big step down, you know, I guess in your traffic server product sequentially, but part of that 5.6 million I guess has Personal Edge in it. So, what I guess, really I guess the (indiscernible) falling knife here is traffic server, you know, it's got to be less than 5.6 million. I don't know how much, but I mean (indiscernible) that basically traffic server is almost as washed out as it can, and that explains why you are not expecting −− you're basically expecting that business to stabilize into June and that really underlies your guidance for an up sequential. Am I thinking about this right?

MR. DAVID PETERSCHMIDT:
Well, I think you are thinking about it, you know, pretty accurately. I mean, the way to think about the carrier market with regards to traffic server right now is that they have got so much capacity that they've built into their networks, and that due to what's happening in that whole sector, they are now going to where they are only buying as they absolutely have to, to support traffic increases where they used to buy uniformly for a 12−month provisioning cycle. And so, what you are seeing with traffic server, and you are right to assume this, the traffic server should be at its low (indiscernible) end mark with regards to the carrier ISP market because it's now down to only being bought on a quarterly basis in small amounts as is needed.

THE CALLER:
Could you give us some idea of maybe what Personal Edge −− I mean, I guess Personal Edge is in this 5.6 million.

MR. DAVID PETERSCHMIDT:
No it's not. So what you are seeing is traffic server.

THE CALLER:
That is exclusively traffic server.

MR. DAVID PETERSCHMIDT:
That's right. We are assuming that anything that happens with Personal Edge in the carrier and ISP market is probably going to be ?what we think of as a large deal?.

THE CALLER:
So, where did AOL flow in to your −− what line item did AOL flow into your PLthis quarter?

MR. JERRY KENNELLY:
AOL was in December, David. (multiple speakers)

THE CALLER:
In the March quarter.

MR. DAVID PETERSCHMIDT:
That's right. There was no AOL and no Personal Edge in the March quarter.

THE CALLER:
Got you. So, I guess what are you are thinking here is that now that the purchasing is regularized, we are back to quarterly purchasing in line with demand. You have digested that,

and that's the rationale for sort of a flash outlook for this business into June?

MR. DAVID PETERSCHMIDT:
Right, well, actually we've said, you know, we think we can now start to show modest sequential growth coming after this quarter.

THE CALLER:
So, I'm going to see modest sequential growth not in traffic server though?

MR. DAVID PETERSCHMIDT:
Well, across the license revenue.

THE CALLER:
Okay, so, you think traffic server will be back to sequential growth in June in line with, you know, obviously these other businesses are already growing, but traffic server you think you have seen the inflection?

MR. DAVID PETERSCHMIDT:
Well, traffic server, yes, but remember what we are saying is we think all license revenues and so license revenues has now got lot of products (indiscernible). First you've got Personal Edge, you have got enterprise search, you have got traffic server, you have got the appliance royalties from the hardware OEMs. So there is a lot in there that's dealing with licenses, but your general thesis about what drives revenue is correct. We think we've hit the bottom with regards to traffic server. We think whatever happens with Personal Edge will be upside potential.

THE CALLER:
Could you also just give us some visibility into the cash balances in June? You know, what do you expect the bird's going to look like in June?

MR. JERRY KENNELLY:
June should look similar to March. The cash will be probably up slightly because we've been a little more careful spending this quarter. We have a chance to extend the web search. It may need some more hardware to drive that part of the service. So we are still finalizing that capital budget.

THE CALLER:
Yeah, thank you.

THE OPERATOR:
Our next question comes from Drew Brosseau with SG Cowen. Please proceed.

THE CALLER:
Take (indiscernible) from that last comment, Jerry, it's nice to know somebody is buying hardware out there. I have a simple question, on the enterprise portion of the license business, how roughly is that breaking out between the content management −− content networking, pardon me, products and the (indiscernible) search part?

MR. DAVID PETERSCHMIDT:
Our search is −− it's probably about two−thirds −− one−third right now. Two thirds going to the enterprise search product, a third going to the content network.

THE CALLER:
Okay, and I think this may have come up earlier, but your sequential growth although minus, what futures (indiscernible) can you expect to shrink sequentially?

MR. DAVID PETERSCHMIDT:
No, in fact, Drew, here is the way I think about. I think about this in web search is going to grow sequentially. The enterprise search is going to grow sequentially, and contact networking in the enterprise is going to grow sequentially. What is not going to grow in our estimate is the carrier ISP market unless there is a Personal Edge deal, and that's where −− that would be the one product that would drive sequential growth in the carrier ISP market. Otherwise, we think that market is flat to some contraction still, with all the other pieces growing sequentially.

THE CALLER:
Okay, great. Thank you.

MR. DAVID PETERSCHMIDT:
You bet.

THE OPERATOR:
Christopher Russ with Wachovia Securities. Please proceed.

THE CALLER:
Good afternoon guys.

MR. DAVID PETERSCHMIDT:
Hi Chris.

THE CALLER:
Tremendous progress, I guess, over the last couple of quarters in reducing cost, but even today with the lower revenue base, the sales and marketing as a percentage of revenue is still I think about 55 to 60 percent or so. Obviously, that whole decline is as revenue starts to pickup, and RDI think is about 35 percent or so of revenue, 35 to 40 percent. Would you contemplate any further, you know, cost cutting initiatives? Would they be incremental in nature, would you expect more significant restructuring in order to reduce the overall cost structure of the company to accelerate, you know, the breakeven point.

MR. JERRY KENNELLY:
No, I don't think it, you know, it will take away from that strategy that we are clearly executing on, Christopher. I mean we're clearly getting traction in the enterprise. We're clearly getting traction with new products coming into the market. I mean, the security product we introduced, the relationships and the connectors in the enterprise search base with Documentum and Interwoven. I don't want to come off with that stuff, and I don't think we can do anything more, quite frankly, from a headcount standpoint and stay on the agenda we have set for ourselves. So, I am sticking hard to the agenda we have now in front of us.

THE CALLER:
Okay. With regard to −−.

MR. DAVID PETERSCHMIDT:
Now, Jerry made another (multiple speakers). There is still a dollar or two to be found, but it's not a huge amount, but there's still a dollar or two. Jerry, still thinks he'll get us −− you know, having said that, Jerry and I had this very conversation earlier in the week, and Jerry feels he can still get more efficiencies into the business.

THE CALLER:
Okay, so you wouldn't, Jerry, in terms of absolute expenses in the June quarter, would you expect a flat or down tick relative to March?

MR. JERRY KENNELLY:
I would say (indiscernible) flat, maybe it will be a modest down tick.

THE CALLER:
Okay, and also the interest income went up a bit this quarter. Any reason for that? Did you term out some of the −− some of your debt maturities and what went on there?

MR. JERRY KENNELLY:
There was −−last quarter was abnormally low. There was some (indiscernible), but I can't remember what it was now. That's abnormally reduced last quarter's −− so this is more of a normal income.

THE CALLER:
Okay, alright great, thanks.

THE OPERATOR:
Sanjay Puri with Thomas Weisel Partners, please proceed.

THE CALLER:
Thanks. Just a quick (indiscernible) usual question for (indiscernible). I think you mentioned that a few customers represented 10 percent of web search revenues.

MR. JERRY KENNELLY:
No, I think it was total revenue.

THE CALLER:
Total revenues, okay. Great, and then you know, the margin degradation actually, you know, given the top line (indiscernible) mess was not that bad at all and actually you know services and web search trended up. Can you give a little bit of sense around where you think that's going? Do we get back to kind of December levels or, you know, how you kind of see the margin profile there on a go−forward basis? Within each one (indiscernible) at a line.

MR. JERRY KENNELLY:
I would say the gross margin, the cost of revenue lines are at a pretty stable run rate level right now. So the best (indiscernible) right now is I would expect the same in June.

THE CALLER:
And then, just within the content, you know, you've mentioned the enterprise content delivery initiated. Do you see a new set of competitors there that you can run up against and, you know, what's been the initial feedback in terms of effective penetration of that market?

MR. DAVID PETERSCHMIDT:
Well, I think it's what we talked about, the early stage signs now of enterprise content networking coming into (indiscernible) marketplace are starting to show up. And I, again I think that's most evidenced by big companies like IBM and HP saying, hey, we think we want to take this product line, or we want to train our people up because we are clearly seeing market requests for this type of product. So I am optimistic there, and I do believe, quite frankly, and we have gotten this from customers, as well as partners that we do have the optimum solutions set relative to the competition. (indiscernible) as I mentioned, IBM said to us, you know, they know they lost to us in one account, and they lost teamed up with one of our competitors. So, you know, that's why I feel bullish about our prospects in that marketplace.

THE CALLER:
And then just one last question, you know, you guys have obviously −− the last quarter was a great quarter for new technology and innovations for you guys. How do you see that kind of playing out to the rest of the year? Are you going to be fairly prolific in that area, or are you kind of done for the rest of the year?

MR. DAVID PETERSCHMIDT:
No, we're going to −− your first comment's was more (indiscernible) applicable. We have a whole string of products. I mean all this investment we've stuck with for the last four quarters is now starting to produce products.

THE CALLER:
And so that's going to continue going forward.

MR. DAVID PETERSCHMIDT:
Yeah, you are going to see more products every quarter now.

THE CALLER:
And is that going to be concentrated within the web search enterprise search arena, given slowdown in carrier ISP market or −−?

MR. DAVID PETERSCHMIDT:
No, I think it is just across a broad spectrum. I mean, the way we are organized, there are product teams in each area, and our goal is all product teams produce their products. So, we expect to see it across a broad spectrum.

THE CALLER:
Right, thank you.

MR. DAVID PETERSCHMIDT:
You bet.

THE OPERATOR:
Nitsan Hargil with Friedman Billings Ramsey. Please proceed.

THE CALLER:
Hi guys, just regarding the restricted cash. Now, (indiscernible) write down on the lease, does that change that in any way?

MR. JERRY KENNELLY:
No, Nitsan, (indiscernible) building. We intend to capture (indiscernible) with the associated (indiscernible) the write down, the special charges for Newscorp building that we never have occupied. So the two have really no connection.

THE CALLER:
(indiscernible)

THE OPERATOR:
Williams Slaughter with Robert W. Baird. Please proceed with your question.

THE CALLER:
Good afternoon, I just got a couple of quick ones. One, did your share count go up sequentially this quarter, and also could you, you know, would you like to provide anymore detail on what has happened with your OEM partners? You mentioned that they brought in, I think, 120 new customers, but in terms of revenue impact, what does that OEM channel look like?

MR. DAVID PETERSCHMIDT:
Yeah, let Jerry answer (multiple speakers).

MR. JERRY KENNELLY:
Share count, it's not (indiscernible) it's more the impact that's in the December quarter we did an (indiscernible) halfway through the quarter and issued 12 (indiscernible) million new shares. So when the weighted average stock calculations with December quarter you reach the full quarter impact for that and then in the March quarter, you got all three months worth of impact. So, it's more of a calculation impact than having issued more shares.

THE CALLER:
Okay, that's great. That's seems like a million years ago.

MR. DAVID PETERSCHMIDT:
Yes, so with regards to the OEM channel, it continues to seed, and this is what we've said all along that they would seed the individual appliances for us. In companies that we just wouldn't have the reach or breadth to get to (indiscernible) those seeds hopefully will grow and give us opportunities for harvesting larger content networking opportunities in the out−quarters. So, they continue to do that. They added, as we said, another 120 customers that we have never touched before. The revenue itself is not dramatic yet, and we don't think it will be dramatic for a few more quarters. Most of the companies that we have talked to that have deployed these strategies in the past, the software companies, suggest that this is, you know, an 18 to 24 month period to build these channels out to have high volume for you. We are tracking exactly where we thought we were going to track, but you know, we are only

about three−quarters into the program.

THE CALLER:
Right, thank you.

THE OPERATOR:
Our final question comes from Chris Kwak with Bear Stearns. Please proceed.

THE CALLER:
Hi guys just got a quick couple of followup questions. In light of license revenue having continued to be somewhat weak, shall we assume that services revenue should be soft going forward, and then, can you just comment on the streaming market that we are seeing and anything on the Google, Yahoo! front? Thank you.

MR. DAVID PETERSCHMIDT:
So, Jerry, you want to talk about the services or −−.

MR. JERRY KENNELLY:
(indiscernible) the service revenue has, you know, particularly the amortization of support renewals and some consulting work, we think it's sort of down at a run rate now, number one. Number two, our renewal rate of our licenses have picked up, and we started this year with the support and the maintenance on ISP and telecom companies who, you know, (indiscernible) are no longer among the leading (indiscernible) companies have trailed off. We feel we've reached a level we think is (indiscernible) on a go−forward basis.

MR. DAVID PETERSCHMIDT:
And Chris, with regards to streaming, you know, we had all hoped that was going to be one of the early stage applications in eCDN. It's turned out that that is not the case. There is a lot of interest around streaming, but quite frankly enterprises are just not expending funds for streaming. Rather, it now is pretty clear what they are expending the funds for, is all this content management and handling of unstructured data, and also the content management as it pertains to helping increase the performance of their mission critical apps. And we think their (indiscernible) is what's going to drive the eCDN market as opposed to streaming. In fact, I just read the other day where a number of the distance learning application companies have really fallen on hard times because they were dependent on streaming. Now, as regards to web search business Yahoo!, Google, all of that. Obviously, we continue to see Google participate in that OEM market. We believe that our technology and progress that we've made over the last 12 months has been very dramatic, and that we are highly competitive with Google. We will continue to, you know, go after every one of the major portals, Yahoo! included. You know, so that's about the best I can say right now. Just to tell you though that we are very competitive now with Google.

THE CALLER:
Okay, thanks guys.

MR. DAVID PETERSCHMIDT:
Okay, I want to thank everybody for being with us today, and we look forward to speaking with you over the coming months and thanks for your support of Inktomi.

THE OPERATOR:
Thank you ladies and gentlemen. A postview replay will be available for this conference beginning at 4:30 p.m. Mountain Time today, April 17th, 2002, and will remain till 4:30 Mountain Time, Wednesday, April 24th. The dialing number for postview is 1−800−633−8284. Please use reservation number 204−306−18 to access the postview for this conference call. If you would like to access a replay of the webcast, please go to www.inktomi.com/webcast. Again, that is www.inktomi.com/webcast. This does conclude your conference call for today. We thank you for your participation and ask that you please disconnect your line. (CONFERENCE CALL CONCLUDED)

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04/17/2002 04:30 pm	**VVUS**	**Vivus Inc (VVUS) − VVUS Q1 2002 Earnings Conference Call**

THE OPERATOR:
Good afternoon. My name is Amy and I will be your conference facilitator today. At this time I would like to welcome everyone to the VIVUS first quarter earnings release conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question−and−answer period. (CALLER INSTRUCTIONS) Mr. Walliser, you may begin your conference.

MR. RICHARD WALLISER:
Good afternoon, ladies and gentlemen. We would like to thank you for taking the time to attend our call today. My focus today will be on the financial results for the first quarter ending March 31st, 2002. Following my discussion Guy Marsh, VIVUS' Vice President of U.S. Operations, will provide an update on our U.S. sales. Then VIVUS' Vice President of Research and Development, Dr. John Dietrich, will provide an update on our RDpipeline followed by Lee Wilson, our CEO, who will summarize. There will be an opportunity for questions following Lee's discussion. In the event we are not able to respond to all questions, please feel free to contact me. I would like to remind you that this conference call and its transcript are available through the Internet at our web site, www.VIVUS.com. A phone replay will be available for the next 24 hours. Please call our California office at 650−934−5200 for details. This news release contains forward−looking statements about the potential commercialization of products in treating male and female sexual dysfunction and reflects management's current beliefs. However, as with any pharmaceutical under development, there are significant risks in development, regulatory approval and commercialization of new products. There are no guarantees that future clinical studies discussed in this news release will be successful or that any product will receive regulatory

approval for any indication. Further, even if the Company were to receive such regulatory approval for a product, there can be no assurance that such a product would prove to be commercially successful. Please see the Company's filings with the Securities and Exchange Commission, including without limitation the Company's form 10−K and forms 10−Q which identify these and other risks and uncertainties that may cause actual results or events to differ materially from those described in this news release. For the first quarter of 2002 VIVUS reported a net loss of $1.9 million or 6 cents net loss per share compared with a net loss of $4.9 million or 15 cents net loss per share during the same quarter of last year. U.S. product revenue was $6.6 million in the first quarter of 2002, a 23 percent increase over the previous quarter and compares to $5.2 million for the first quarter of 2001. The Company believes some of this increase is a result of targeted marketing programs implemented by the Company. International product revenue was $625,000 for the first quarter of 2002, a decrease of $793,000 over the same period last year which included shipments of product to Abbott Laboratories to support their launch of MUSE in Europe. Based on projected sales to its international partners, the Company expects international revenue will decline in the second and third quarters of 2002. Cost of goods sold was $3.3 million for the first quarter of 2002 as compared to $3.6 million for the first quarter of 2001. Gross margins for the first quarter of 2002 and the first quarter of 2001 were 47 percent and 43 percent respectively. The increase is a result of lower international sales. RDexpenses for the first quarter of 2002 were $2.8 million as compared to $6 million for the same quarter last year. Payments for licensing TA−1790 as an oral treatment for male erectile dysfunction were made in the first quarter of 2001. The Company expects that RDexpenses will continue to increase in 2002 as its products progress in development. Selling, general and administrative expenses for the first quarter of 2002 of $2.7 million were $451,000 higher than the same period last year due to increased investment in U.S. sales and marketing efforts and legal expenses relating to the Amson (phonetic) arbitration hearing that was held in mid−March. Unrestricted cash, cash equivalents and available for sale securities at March 31st, 2002 totaled $35.5 million, down $1.2 million from $36.7 million at December 31st, 2001. This decrease is due primarily to increased research and development expenditures. I would now like to turn the review over to Guy Marsh for an update on U.S. sales.

MR. GUY MARSH:
Thank you, Dick. I will provide some brief comments regarding the current performance of MUSE sales within the U.S. market. Net unit sales continue to show significant strength. For the first quarter of 2002 net unit sales increased, were 28 percent above the first quarter 2001 and were the highest of any three−month period since mid 1998. These results further extend the performance noted in the Company's March 14th press release, which reported a 26.5 percent increase in MUSE net unit sales for the three months ended February 28th, 2002, compared to the same period a year earlier. MUSE sales within the U.S. market are generally comprised within three sectors. Sales to U.S. government health−care agencies, sales to private health−care organizations such as Kaiser Permanente and sales by general retail pharmacies. Retail sales are those units dispensed and those prescriptions filled by retail pharmacies whose volume is mostly captured by the prescribing information services such as NDC Health. Starting with the full year 2001, government agency sales rose 35 percent compared to the full year 2000. For the six months just ended, fourth quarter 2001 through the first quarter 2002, government agency sales were 26 percent above the same period a year earlier. The Company believes these increases are a result of a focused product support program implemented by the VIVUS sales force. This program has now been presented and supported at more than 100 VA health−care hospitals across the U.S. Similarly retail sales

have shown a notable increase. In May and June of last year VIVUS implemented several highly focused marketing programs targeted at the urology and general practitioner markets. Comparing the six months just ended, fourth quarter of 2001 through the first quarter of 2002, to the same six−month period a year earlier, retail sales increased 11 percent. As noted in the VIVUS March 14th press release the Company believes that MUSE is being rediscovered by physicians as an effective therapy for patients who fail oral PDE5 inhibitor therapy. We also believe that MUSE is gaining greater acceptance as a first line therapy in patients with severe ED, such as radical prostetectomy (phonetic) patients. Sometime during the remainder of this year there is the possibility of a launch of one or two new competitors in the oral ED therapy market, both, like sildedefil (phonetic), are PDE5 (technical difficulty) inhibitor compounds. Should these events occur, VIVUS plans to continue our current and successful marketing programs. These highly focused programs demonstrate the benefits that MUSE offers to patients for which PDE5 inhibitor therapy fails. It is from this failure market, both the general PDE5 inhibitor failure patient and the severe ED patient, that the Company believes the current increase in net unit sales has been captured. To review, net unit sales from MUSE have shown a significant increase. For the first quarter of 2002 net unit sales were 28 percent above the first quarter of 2001 and were the highest of any three month period since mid 1998. The current success of MUSE, we believe, has come from physicians rediscovering what MUSE offers to patients who fail oral PDE5 inhibitor therapy, including being a first line therapy for patients with severe ED such as radical prostetectomy patients. Let me now turn the discussion over to Dr. John Dietrich, Vice President of Research and Development.

DR. JOHN DIETRICH:
Today I'd like to summarize the current status of our RDprograms, as well as tell you about the significant progress we've made in these programs during the first quarter of 2001. As we previously announced in the press release which was issued in March, we began dosing with topically applied alprostadil, or ALISTA, in women suffering from female sexual arousal disorder. This trial is designed to assess the efficacy and safety of ALISTA in a natural, at home setting. This study is being conducted at multiple clinical sites within the United States, and will evaluate the ability of ALISTA to improve sexual arousal and sexual satisfaction in comparison not only with placebo but also with baseline values. From this study we expect to illucidate the appropriate effective dose or doses as well as the onset of the effect of ALISTA and the duration of its action. In addition, subjects will be monitored for local and systemic safety. I'm pleased to say that recruitment in this study is going very well and we hope to be able to continue this excellent recruitment pattern. The trial that we are conducting now was designed using data that was generated from our recently completed single does in clinic study. As you recall, this study demonstrated that ALISTA significantly enhanced sexual arousal and sexual satisfaction. Data from this trial, which was summarized in a press release which we issued last year, will be presented at the American urological association meeting in Orlando in May of this year. This is the premier urology meeting not only in the U.S. but also internationally. We're pleased to announce that we have been informed that our abstract is one of a limited number of presentations that has been chosen by the urology association to be highlighted by the press. We believe that this speaks well not only for our study, but also for the interest that has been generated over the last few years in treatments for female sexual dysfunction. Our plans are to initiate a second pivotal Phase III at home study with ALISTA as soon as we are able to evaluate preliminary data from the current study. Also as announced, during the first quarter we began our first efficacy trial with TA−1790. This is our orally active phosphodiesterase 5 inhibitor that we're developing for the treatment of male erectile dysfunction. This single does in clinic study will utilize Rigiscan, which is a validated

instrument used to quantitate penile rigidity, in conjunction with visual sexual stimulation to evaluate the efficacy of TA−1790 in men with erectile dysfunction. Data that is generated from this trial will enable us to design an appropriate at home study with TA−1790, a study which we plan on initiating within the year. Our next program, that of developing VI−0134 for the treatment of premature ejaculation, is ongoing. We've completed dosing in a pharmacokinetics study and are presently developing protocols with a plan to be in Phase II trials later this year. To summarize the progress made in the research and development function in the first quarter of 2001, we initiated a pivotal at home trial with ALISTA in women with female sexual arousal disorder. We began a single dose efficacy trial of our phosphodiesterase 5 inhibitor, TA−1790, in male erectile dysfunction. And we continued the development of VI−0134 for premature ejaculation. Lastly, I'd like to comment on our patent situation. Lately we've received a number of inquiries regarding our patent position in the areas of transurethral delivery of vasoactive agents for the treatment of male erectile dysfunction, and topical delivery of vasoactive agents to treat female sexual dysfunction. As we reported many times in the past, we possess broad patent coverage in both of these therapeutic areas which coverage forms the basis not only for our marketed product MUSE, but also for our development programs in male erectile dysfunction and female sexual dysfunction. We have approximately 22 issued and pending patents for erectile dysfunction and 14 issued and pending patents for female sexual dysfunction. We will vigorously defend and prosecute our patents and will initiate legal action when appropriate. Thank you.

MR. LELAND WILSON:
Many of you are aware that I planned to be on vacation today, but due to civil unrest in Venezuela I postponed my trip. I'm glad to be here today and not in Venezuela for obvious reasons. I'm also glad to be here in order to be able to report on some of the significant progress that we've made during the quarter. It's nice to report that U.S. product revenues for the quarter were up 27 percent over the first quarter of 2001. And that the product revenues continued to more than cover all of our non RDoperating expenses. Our balance sheet remains strong with $35.5 million in cash and equivalents, and we continue to be debt free. In RDour first pivotal study for ALISTA has started and patient enrollment is going well. We started our first efficacy trial with TA−1790 and we're on target to begin our Phase II premature ejaculation trial this summer. We're also looking forward to this year's AUA or American Urological Association meeting, which John mentioned, which will begin in May −− May 25th in Orlando, Florida, and the release of our Phase II efficacy data on ALISTA. I'd also like to recognize and thank Dr. Place and all VIVUS employees and shareholders at this time. Yesterday was our eleventh anniversary. With that I'd like to open it to questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) Ken Trobobek (phonetic), C.E. Underberg Tobin.

THE CALLER:
I wanted to start with Dick and ask for some clarification on the international revenue guidance. Specifically, I think we were already guided to the fact that international revenues would be lower. I'm wondering how significant this difference −− or is this a significant difference that you're trying to reiterate your prior guidance or is this a change from even the level that we've seen? Because I know fourth quarter was perhaps lower than what we've seen here in the first, so I don't know if we're going to flip−flop now.

MR. RICHARD WALLISER:
Ken, I'll give you some general guidance on that. Sales on our international segments continue to decline. It just has not received the priority from international partner that we think it should have. And so the guidance that we're giving here is for further decline during the next couple of quarters. Beyond that I think that's about all I want to say about it at this point.

THE CALLER:
In terms of the −− specifically on the U.S. side, I guess I'm curious about Pfizer's announcement with regard to VA formulary status. Is that something that occurred during the period in which you've seen this increase in government health−care sales? That's a Guy question, I'm sorry.

MR. GUY MARSH:
Ken, Pfizer has had some level of coverage in the VA for some time now. And no, we actually −− our program in the VA hospital, as it has been elsewhere, has been to target the failures and to represent what MUSE can offer the failure market from the oral PDE5 inhibitor therapy. Whether Pfizer is on the VA formulary or not, it will be PDE5 inhibitor failures there and that is our approach, and that's what we look to capture.

THE CALLER:
Okay. In terms of the −− finally I guess in terms of the RDspend, I'm just curious −− I guess I had thought that the RDspending might have been higher. I know you've been guiding towards higher RDexpenditures. Could you give us some feeling as to how you expect those to play out through the remainder of the year? I know with clinical enrollment obviously the timing of those payments becomes a little challenging for us to look at from the outside.

DR. JOHN DIETRICH:
Ken, this is John. Dick mentioned that compared to Q1 of last year, most of that came from the payment to Tanabe for licensing TA−1790. The spend in RDwill continue to ramp up throughout the year as we continue enrollment, get more sites into the trials and initiate new trials as well.

COMPANY REPRESENTATIVE:
(indiscernible) quick addition in there. If you subtract out the Tanabe thing, it's more than double and almost triple what we spent in the same quarter last year.

THE CALLER:
That was my next question was is that a clean number if we do that −− if we subtract the five out?

COMPANY REPRESENTATIVE:
Yes.

THE CALLER:
Terrific, I'll go back into queue. Thanks.

THE OPERATOR:
Charles Ozoski (phonetic) with UBS Warburg.

THE CALLER:
John, I'm sure you're not going to disclose at this point how many patients have been enrolled in the ALISTA trial, but given the current pace of enrollment, by what part of the year would you expect enrollment to be complete?

DR. JOHN DIETRICH:
Charlie, if we continued at the pace we're going now I'd say we would become fully enrollment in this quarter.

MR. LELAND WILSON:
The early part of the patient enrollment has gone extremely well, and I'm not going to guarantee that the second part of it will go as well.

THE CALLER:
That was why I asked the question the way (multiple speakers)

MR. LELAND WILSON:
There's no reason to say that it won't, but at this point I think it's too early to get real optimistic about closing the trial earlier, but so far it's going very, very well.

THE CALLER:
What about the number of sites you plan on having in that particular trial? In the ALISTA trial?

DR. JOHN DIETRICH:
It will be between 20 and 30.

THE CALLER:
Okay. And what about the TA−1790 trial you're starting as far as patients and sites?

DR. JOHN DIETRICH:
The number of sites will be double figures.

THE CALLER:
Okay. As far as −− what's the, just for a quick review, the remaining schedule of milestone payments to Tanabe? Is it just upon ultimate approval or are there other milestone payments along the way −− for TA−1790?

MR. LELAND WILSON:
We have not released what the additional milestone payments are.

THE CALLER:
Oh, I meant more the triggers, Lee, than the absolute dollars.

MR. LELAND WILSON:
We haven't released what those are either other than to say that the significant milestones are triggered by marketing events −− approval and marketing events.

THE CALLER:
Okay. A question, Dick, regarding the legal expense in the quarter that was incremental due to the arbitration hearing, roughly how much are we talking about and is there any incremental spending in that fund going forward that we should expect?

MR. RICHARD WALLISER:
I would say that it's −− the wrapup bills and so on might come in, but I don't think it'll be significant. I don't think we're disclosing what the expenses were.

THE CALLER:
Okay. And one more quick question for Guy. I guess, specifically you talked about increased marketing spending and different kinds of targeted programs, are those mainly awareness type of programs, for example, in the case of the urologist and the GP, or are they different than that?

MR. GUY MARSH:
Well, I'm not exactly sure what you mean by awareness programs, however, we do have a program that was launched specifically by our sales force, which is kind of face to face information sharing with urologists, specifically (indiscernible) around oral PDE5 inhibitor failures and how that occurs and where MUSE comes into us as a different mode of action. So that's direct face−to−face. We also have a marketing program that reaches the GP sector with the same information but through a different vehicle. If you want to call it awareness as to saying MUSE is here and MUSE fills a gap where the oral PDE5 therapies cannot reach because of mode of action, then I would agree with you.

THE CALLER:
Okay. Thanks.

THE OPERATOR:
Craig Herringer (phonetic) with Benson and Associates.

THE CALLER:
Now that MUSE is showing some renewed vigor, don't some of the shortcomings such as the in office titration, etc., remind you of how much better it would be to have a (technical difficulty) an easier to prescribe product, i.e. ALIBRA which is my offhanded way of saying what's going on with ALIBRA?

DR. JOHN DIETRICH:
Yes, it would be (technical difficulty) nice to have a better labeling, if you will. For those of you who are unaware, the labeling for MUSE requires in office titration −− or titration under medical supervision. And what we'd like to do is to have a labeling which was more appropriate for a primary care physician to write a prescription when they fail the PDE5 inhibitor therapy. The hope is that we will be able to gain that kind of favorable labeling with the FDA. We have, as everyone knows, we had a very uphill battle in that regard. But we continue to prosecute that NDA (phonetic) and vigorously, and we are hopeful that we'll make progress on that and as soon as we have some progress we'll let you know.

THE CALLER:
Same thing for Europe I presume?

DR. JOHN DIETRICH:
Europe −− we've already made the decision that we're not going to do additional trials to meet the requirements necessary for European approval. So it's just a U.S. application at this point.

THE CALLER:
How hopeful are you there, Lee?

MR. LELAND WILSON:
In the U.S., one day it goes up and one's down. But I'm hopeful, Craig, and let's just leave it at that. I'm more bullish than some but I feel pretty good about it frankly.

THE CALLER:
Well it would be timely with the MUSE uptick, certainly.

MR. LELAND WILSON:
It would be nice.

THE CALLER:
Thanks a lot.

THE OPERATOR:
Shatell Botell (phonetic) with Ross Capital Partners.

THE CALLER:
Just a couple questions. One is relating to the Janson (phonetic) arbitration, since that has −− the hearing has been concluded now, when do you expect any results out of −− a hearing about the results from that trial?

MR. LELAND WILSON:
That pretty much is the −− up to the judges in this case when they make their decision. So I think we're completed with our presentation of the facts, both sides, and so we'll await their word on the subject. To give any kind of guidance here is kind of out of my realm of knowledge, but I think in general we should here within 45 to 60 days for sure.

THE CALLER:
Okay. Thanks. And for John, quick question on ALISTA. You mentioned that, looking at some preliminary data from the Phase II/III trial that you may be able to initiate another pivotal trial. Can you give me a timeline of when it is that you'll have enough data, not in terms of −− in terms of patient enrollment, etc., and also what you'll be looking for there to go ahead and indicate that you should start the next trial?

DR. JOHN DIETRICH:
What we'll be looking at is pretty much the response −− the primary end point which is very similar to what we looked at in our in clinic study. And as soon as we can break the blind and analyze the data, I would expect that we could begin the Phase −− the pivotal Phase III trial. We will have the protocol all ready to go −− and then insert the doses into the protocol so you know what the appropriate dose or dosing is. My plan is still to hopefully be able to begin the pivotal trial within this year.

THE CALLER:
Okay, great. And are you going to be looking for a specific response rate in order to make that decision?

DR. JOHN DIETRICH:
The first thing we'll look at is significantly different from baseline and placebo. And if we get that then we would move ahead.

THE CALLER:
Okay, great. Thank you.

THE OPERATOR:
Mark Robbins with (indiscernible).

THE CALLER:
I apologize if this is old news for some folks. Tell me about the arbitration, first of all, please. Just in very rough overtones.

MR. LELAND WILSON:
The issue was with one of our former partners with Jansin (phonetic). It was a dispute which I think is pretty well laid out in our 10−K here. And it deals with paying for a product which was ordered but not paid for at this point. I don't want to say too much more about it, but (multiple speakers) feel strongly. It occurred in 1998 and we feel strongly that we're owed money and we'll just have to wait and see what the judge says.

THE CALLER:
That's sufficient, now I remember. The other thing is, when you were chatting with Craig on his question, you kind of gave him an answer but I don't think it was the answer maybe he was really looking or maybe I have forgotten. Is ALIBRA "dead on arrival".

MR. LELAND WILSON:
No, ALIBRA is not dead on arrival. Matter−of−fact, we've put significant work into −− again, going back to the FDA again at this point to try to resolve any issues that may be remaining there. I don't know at this point the outcome for ALIBRA, but we continue to prosecute that and, as I said earlier, I'm optimistic that we'll get a favorable response at this point.

THE CALLER:
I guess I then did misunderstand because is not ALIBRA a different −− doesn't it use a different course of drug therapy rather than MUSE? And wouldn't that be a different route, even though it's similarly prescribed and differently labeled?

MR. LELAND WILSON:
No, ALIBRA is a combination of alprostadil with prasisin (phonetic) and it's delivered transurethrally through a slightly different delivery platform, if you will, but it's very similar in it's look and feel to what MUSE has. The benefit of the product is that there's a single those and therefore it does not require titration and we did our clinical trials so that the first dose could be given at home. And the issue that we're dealing with there with the agency is whether or not they're willing to allow us to have that kind of labeling, etc., and to gain approval for the product in general.

THE CALLER:
So it is a labeling factor. Thank you, gentlemen.

THE OPERATOR:
We do have a follow−up question from Ken Trobobek (phonetic) with C.E. Underberg Tobin.

THE CALLER:
Dick, I just wanted to clarify, or Guy perhaps, I was looking back over the income statement and was curious, are the returns −− the returns seem awfully high for the quarter and obviously the orders were up as well. Is that done on a fixed basis based on the current quarter's orders as a reserve for future returns, or is this a charge that's taken on the basis of what you receive back from distributors from things previously shipped?

MR. RICHARD WALLISER:
Ken, it's a little bit complicated but very simply, what it amounts to is that during the '97−'98 timeframe we shipped a lot of product out to the marketplace, and as that product came back in it distorted the returns that we saw for the individual periods that we were reserving for. As we got more and more experience into that, what we did was we started to allocate a fixed reserve of all revenue that was shipped, all units shipped out, for U.S. sales only of course. And in a review with the auditors at this last quarter, we determined that we would increase the reserve for safety's sake to make sure that we had adequate amounts to cover anything that came back in, even though this product will not come in four up to a couple more years.

THE CALLER:
Okay. And the product that you're saying won't come in is for the current shipments, because the shelf life on this is only what −− 18 months, two years?

MR. LELAND WILSON:
Two years.

THE CALLER:
Okay.

MR. LELAND WILSON:
And then they have a period of time after that to get it back to us −− a short period of time.

THE CALLER:
There seems to be a correlation here in terms of the returns and the order rate that we've seen in the first quarter.

MR. LELAND WILSON:
Right. And what happened is that we had to adjust for previous quarters to take it up to the higher levels. So that's why you see the distortion there.

THE CALLER:
Okay. And then one other question I guess on the patent side, this is for Dick. You mentioned the 22 I guess ED and 14 FSD patents either issued or pending, could you break those out between issued and pending so we have a better understanding as to how many of those are still outstanding?

MR. RICHARD WALLISER:
In the ED area, Ken, it's about 10 to 12 issued, and in the FSD it's about three to four issued.

THE CALLER:
Okay. So it seems like the bulk then have yet to be issued.

MR. RICHARD WALLISER:
The bulk in the FSD area have yet to be issued. We have quite a few pending. We also have the patents in the PE area, but that's not −− we haven't had questions on that.

THE CALLER:
Okay. And on the development of the VI−0134, I guess I had thought that some of the PK studies were done towards the end of last year or early part of this year. Are you still analyzing the data from that or what is it that you think takes place between now and the summer that gives you the confidence that you're going to go into a Phase II trial later this year?

MR. LELAND WILSON:
The question (indiscernible), are we going to release the PK data? No, we don't release data on a lot of trials that we give. And the answer that you're looking for is that, no, we are going into a Phase II trial this summer. That is only part of the decision there. And so we obviously feel strong about going ahead with our clinical development program here so don't interpret anything into that that's not there. We're not going to release the PK data which is just prudent business, and we are going into a Phase II study as quickly as we can get there.

THE CALLER:
Okay. And has there been anything that sort held you back from trying to enter into that study earlier? Are you still looking at formulation issues or you're completely satisfied with what you've seen in the PK thus far?

MR. LELAND WILSON:
I'll never be satisfied.

COMPANY REPRESENTATIVE:
We're still looking at the formulation issue.

THE CALLER:
Okay. And then finally, I guess, on the PE side, are the endpoints simply latency periods?

COMPANY REPRESENTATIVE:
That's correct.

THE CALLER:
And is there an established criteria by which you have to measure −− this gets into a whole cultural issue, I guess, of how long is enough and how long is too much?

MR. LELAND WILSON:
Basically if you can −− there's two points, one would be statistically significant increase from base line, and the other would be clinically significant. I don't think that anyone's defined

clinically significant. Basically the definition is a minute or less at baseline. I think that if we get a statistically significant increase we'd have to make the decision it was clinically significant, but going from one minute to two minutes can be very significant for an individual.

THE CALLER:
Okay. And given −− I'm trying to figure out also in terms of location of the trial, is it most appropriate in an at home setting or are you going to have to have the partners come into a clinical setting?

MR. LELAND WILSON:
No, that would be an at home study.

THE CALLER:
Okay, terrific. Thanks again.

THE OPERATOR:
You have a follow−up question from Charles (indiscernible) with UBS Warburg.

THE CALLER:
I guess this could be either the probably −− I guess this would be for you, Lee. Regarding international sales, and again, you've been through −− you've had a couple of partners or several partners on the international front, and I'm wondering in the case of Abbott, products can obviously not be at the forefront of their marketing program. Is the product available in enough geographies in Europe and elsewhere through the world and it's just a question of them not focusing on it, or are they still rolling it out in different geographies?

MR. LELAND WILSON:
I think it's more priority at this point, Charlie. So we're trying to address those issues internally. There's two points there. One is, as you well know, the earnings from sales in Europe to VIVUS are very, very slow. (multiple speakers) So it doesn't really impact our ongoing operations at all, first of all. And second, different markets around the world are different. Clearly the premier market for the treatment of ED is the U.S. Even the oral PDE5 market has not been well developed internationally. It's a tougher nut there. There's obviously more controlled medical systems in place, for example in the UK, etc., that limit prescriptions and reimbursements and things of this nature, so it's a tougher battle internationally than it is in the United States. To win that battle it takes superhuman commitment and high priority for it. And MUSE just has not justified that to this date.

THE CALLER:
Okay, great. Thanks.

THE OPERATOR:
We have a follow−up question from Ken Trobobek with C.E. Underberg Tobin.

THE CALLER:
I promise this is the last question. (multiple speakers) The question I have is again back to the U.S. government sales or the government sales to VA hospitals. I think if I recall correctly, you were added to the formularies in the first part of last year?

MR. GUY MARSH:
MUSE has been on VA hospital formularies since 1998 that I know of. You might be confusing that with the fact that Viagra was added to the formulary in 2000, late 2000.

COMPANY REPRESENTATIVE:
Around the third quarter of the year 2000.

THE CALLER:
Okay. And I guess I am confused because Pfizer did put out a release today and they indicated VA recently included it on its national formulary. And that's from this morning's release. And so I keep thinking somebody was added a year ago or a little over a year ago. What then explains this sudden sort of rebound I guess −− or I shouldn't say rebound, but the actual increases that you've seen at the VA? Are your reps physically going, I think as you specified earlier, and making these presentations at the hospitals?

MR. GUY MARSH:
That is correct.

THE CALLER:
Okay.

MR. GUY MARSH:
We've been doing that for a long period of time at this point in time. I think maybe, I'm not entirely sure, but I think the Pfizer release you just talked about talked about a national formulary, but you can also gain formulary status on regional VA hospitals as well. That started in the third quarter of the year 2000. There was some at that point in time −− significant use by the VA system during 2000 and the later part thereof. What we believe our success has been, Ken, is to put a program together that specifically talks about modes of actions, specifically talks about the difference in the mode of action of the oral PDE5 inhibitor therapy and what MUSE can offer. And I think that was first seen, or the success of that first realized and seen at the VA hospitals because we could provide a significant concentration there with our field sales force. We believe we're seeing the benefit of that at this point in time.

THE CALLER:
Does he message about the radical prostetectomy patients correlate with the VA hospitals as well? Is there any sort of correlation in terms of that message with those particular users of the product?

MR. GUY MARSH:
Yes, they have −− Ken, VA patients typically have more severe disease. And a generalization, if you will, I believe that MUSE is more appropriate therapy for a higher percentage of the patients in the VA population than it is out in the general population.

THE CALLER:
Okay. Finally on the pricing side for MUSE. Obviously that has not held things back, but have you had to −− are you offering discounts or is this just pure straight run−of−the−mill orders that you would normally expect to see from these sorts of distributors?

COMPANY REPRESENTATIVE:
That does not have anything −− volume has nothing to do with pricing or discounts, we have not changed that, in fact, what we had done and we put a price increase in −− and that has been effected even during this period. So, no, it's not due to anything in terms of pricing or discounts.

THE CALLER:
Was the pricing done at year−end? The price increase.

MR. GUY MARSH:
At the wholesaler level, yes.

THE CALLER:
Thanks again.

THE OPERATOR:
There are no further questions at this time.

MR. LELAND WILSON:
I would like to just make a couple comments and close. Again thanks to everybody here. Again as I said earlier, it's our eleventh anniversary yesterday so we're real proud of that. Doctor Clayson's (phonetic) actually in the room with us and I again recognize him for founding the Company and getting this whole thing off and running. It's been a wonderful ride for all of us at VIVUS and we really treasure every day that we have working here, and I can tell you that the morale is extremely high in the Company at this time. We've had our ups and downs over the last several years, as all of you are aware, but I can tell you the optimism here is quite high and we really appreciate your support during this time. Thanks to everybody and looking forward to talking to you again real soon.

THE OPERATOR:
This concludes today's VIVUS first quarter earnings release conference call. You may now disconnect. (CONFERENCE CALL CONCLUDED)

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04/17/2002 11:30 am	VTAL	Vital Images, Inc. (VTAL) − VTAL Q1 2002 Earnings Conference Call

THE OPERATOR:
Ladies and gentlemen, thank you for standing by. Welcome to the Vital Images first−quarter 2002 earnings conference call. During the presentation all participants will be in a listen−only mode. Afterwards we will conduct a question−and−answer session. (CALLER INSTRUCTIONS) As a reminder this conference is being recorded Wednesday, April 17, 2002. I will now turn the conference over to Jay Miller, President and CEO. Please go ahead.

MR. JAY MILLER:
Thanks, Jennifer (phonetic), and we are sorry for the brief delay. Good morning. This is Jay Miller, President and CEO of Vital Images and I want a welcome you to the first−quarter conference call for our company. With me this morning is Greg Furness, our CFO and Vice President of Finance, who will present the financial review. At the end of the call we will take your questions. Before we begin, I must preface all comments with the Safe Harbor statement. Some of the comments made today will be forward−looking and are made under the Private Securities Litigation Reform Act of 1995. Actual results may differ and factors that may cause such results to differ are identified on page 20 of the company's 2001 Annual Report to Shareholders and on page 17 of the Form 10−K for the year ended December 31, 2001. Now onto the quarter. We are proud to announce continued strong revenue growth, a better−than−expected loss for the quarter and progress on the partnership agreements we launched in recent months. I want to recap the highlights. Our numbers are strong. We generated 4.4 (technical difficulty) revenue in the first quarter (technical difficulty) increase versus first−quarter of 2001. Revenue from core revenue sources, software license fees and maintenance and services rose 51 percent, a significant positive impact on the bottom line. A net loss of 3 cents a share, which is nearly all attributable to severance costs, is an

improvement over the year ago net loss of 9 cents a share, and is better than the consensus analyst estimates of a loss of 2 cents per share, excluding severance. The market is robust. Vital Images is at the forefront of the large emerging 3D medical imaging market and we are well positioned to sustain our growth. The global markets for CT, MR and picture (indiscernible) and communications, also known as PACS (phonetic) our markets, our primary focus, just finished record or near record years. Our technology is fast, affordable and increasingly part of the everyday practice of medicine. Day in and day out Vitrea 2 is proving to be an invaluable productivity tool for radiologists and more and more other physicians faced with an ever increasing volume of images per patient exam. As we've noted before, the new generation of high output CT and MR scanners generate such a high volume of images that 3D software is becoming an absolute clinical necessity. Our partnerships are solid. In recent months we have launched several partnerships that are structured to support our short−term and long−term growth. Let me share our progress. In February, Vital Images signed an agreement with Toshiba, the international organization based in Japan. Under this agreement the Toshiba sales force will present Vitrea 2 as the imaging software of choice for CT scanner customers. This agreement has two major features. First, (technical difficulty) Vitrea 2 through its subsidiaries and distributors in more than 50 countries, not including Japan. This is an efficient way for Vital Images to answer overseas market simultaneously with Toshiba CT scanners (indiscernible) systems, the U.S. subsidiary. In late 2001, Vital Images modified the Toshiba agreement to focus on higher margin software sales and eliminate (technical difficulty) hardware sales. The overall result in the first−quarter, Toshiba's sales accounted for 45 percent of revenue and helped drive our 78 percent gross margin. In (technical difficulty) and to drive the therapy planning market into new applications. This is a terrific opportunity to bridge the gap between radiology and surgery and drive 3D imaging closer to the treatment of the patient where we feel strongly that we can add the most value by accelerating the time to diagnosis and the quality of that diagnosis and by helping the surgical planning process with the least invasive approach in therapy which should all lead to the most important outcome, a healthy, happy patient. To this end we are planning to invest in RDto advance product development with Medtronic SNT. In the first quarter we started to deliver some visualization technologies that will (technical difficulty) be incorporated into Medtronic SNT (technical difficulty) image guided surgery systems and we expect to recognize a small ramp up in revenues from this relationship later this year. Our distribution agreement with E−Z−EM, the leader in contrast agents for conventional (indiscernible), (indiscernible) for sale by E−Z−EM in the first quarter. CT colonography also known as virtual colonoscopy, is a less invasive alternative to conventional colonoscopy and has a potential to save lives by encouraging more people to be screened for colon cancer. The E−Z−EM sales force (technical difficulty) trained and is introducing (indiscernible) to its leading physician customers. These physicians will become reference sites as their sales force expands its reach. The true power of this relationship not (indiscernible) consortium is focused (technical difficulty) experience. From the patient preparation days before the exam, the patient comfort before, during and after the exam to very efficient, high−quality image visualization reported by the physicians, Vital Images with E−Z−EM's is in a unique position as the leader in the development of this application as it continues to develop and grow. On the expense side, first−quarter operating expenses rose 18 percent over prior year period. We are investing in RDand our sales and marketing organization to bring products to market faster. In addition, these investments are especially important to support our multiple partnerships to make the most of these opportunities. (technical difficulty)

MR. GREGORY FURNESS:
(technical difficulty) important to note that we are holding expense increases below revenue increases to sustain modestly profitable growth in 2002. Now I will discuss the financial results in more detail (technical difficulty) quarter for the company. Revenue for the first−quarter totaled 4.4 million, an increase of 33 percent over the 3.3 million in the first−quarter of 2001. Net loss for the quarter was $247,000 or 3 cents per share, which includes the cost of $230,000 or 3 cents per share related to severance for the company's former Chief Executive Officer. For the first quarter last year the company reported a net loss of $622,000 or 9 cents per share. During the first−quarter of 2002 revenue growth (technical difficulty) by the increase in our core revenue component, as Jay noted, software license fees and maintenance and service revenue. This is up 51 percent from $2.6 million in first−quarter of 2001 to 3.9 million in the first−quarter (technical difficulty) was driven primarily by sales from our distribution agreement with Toshiba, as Jay had mentioned. Revenue from Toshiba totaled $2 million or 45 percent of our 2002 first−quarter revenue. This compares to with 1.2 million or 35 percent of our first−quarter revenue last year. In addition, we also generated strong revenue growth with sale of options to Vitrea which include VScore, CT colonography and (indiscernible) measurement. Our maintenance and service revenue showed strong growth driven by several factors. The first, we had increases in maintenance revenue as added new customers and this has been a trend which we have noted for several quarters, increases in training revenue due to an increased number of training sessions that are being sold with the customer's initial purchase of software and in this quarter we had revenue from engineering services rendered under the product development agreement with Medtronics SNT. In connection with that agreement with SNT we reported $175,000 in service revenue during the first quarter of 2002 for the development of certain advanced digitalization technology that will be integrated into Medtronic SNT's image guidance surgery products. Hardware revenue was down 29 percent for the first quarter of 2002. This is the largest decrease we have seen to date in our hardware revenue, and as (indiscernible) us due to the change in the sales model with Toshiba that we made in the third quarter last year. While our hardware revenue has decreased as a percentage of total revenue, we continue to see an improvement in the gross margin rate. Overall the gross margin for the first quarter of 2002 increased 38 percent to 3.5 million compared to 2.5 million in the first quarter of 2001. The gross margin rate for the quarter rose to 78 percent compared with 76 percent for the same period last year. This increase in gross margin rate is attributable primarily to the increase in software only sales. (technical difficulty) 2002 totaled $3.8 million, an 18 percent increase from the same period of 2001. And as we outlined in our conference call earlier, we will be investing in our (technical difficulty) an additional $119,000 of RDexpense was reclassified to cost of revenue in connection with the revenue recognized under the Medtronic SNT product development agreement. As expected, the company occurred a small loss for the first−quarter 2002. The net loss for the quarter was $247,000 compared with the loss of $622,000 for the first quarter of 2001, a decrease of 60 percent. On a per−share basis this translates to 3 (technical difficulty) for 2002 and 2001 first−quarter, respectively. Turning to the balance sheet, our (technical difficulty) as of March 31, 2002, stands at $7.5 million. We announced our decision to redeem the outstanding redeemable five−year common stock warrants that we issued in conjunction with the December 1999 private placement. The warrant holders exercised all of the outstanding warrants in December of last year and January of this year, netting total cash proceeds of over $6 million, 1.7 million of which was received in January of 2002. In summary, we continue to achieve strong revenue growth on our key revenue components, software license fees and maintenance and services, in the first quarter for 2002. We significantly reduced our loss and we continue to divest in our sales and

marketing organization and began to invest aggressively in R We believe our financial performance for this quarter provides us with a solid start on our operating plan for 2002. I will now turn it back over to Jay.

MR. JAY MILLER:
Thanks, Greg. Let's recap. We are confident about the increasing demand among physicians for 3D medical imaging and Vital Images position in this market. For 2002, based on what we see now, we expect 40 to 50 percent growth in our core revenue, software license fees and maintenance and services. We are investing in the business, particularly in RDand sales and marketing to sustain growth over the long−term while managing expenses to generate modest profitability for the year. Now we would like to open the call up to questions. Jennifer.

THE OPERATOR:
Thank you. (CALLER INSTRUCTIONS) Your first call comes from Christian Schwab (phonetic) with (indiscernible) Equity Partners.

THE CALLER:
Congratulations, gentlemen on a great quarter given the potential for disruption in change of senior level management, Jay. Can you give me visibility or outlook regarding direct sales force sales?

MR. GREG FURNESS:
In terms of composition this quarter?

THE CALLER:
In terms of licensing fees in sale of units from your direct sales force.

MR. GREG FURNESS:
We don't give exact numbers, but I can tell you that for the first−quarter as you can see from the business we had with Toshiba, it was very much −− our sales force was working with the Toshiba sales force, and as a result most of the units that we shipped actually in the first−quarter were through Toshiba in terms of numbers of units. That would be different from normal quarters. And remember that the first−quarter for us is the fourth quarter for Toshiba. So they (indiscernible) and this quarter was a very active one. It certainly was the strongest quarter we have seen to date from Toshiba.

MR. JAY MILLER:
As Greg mentioned, Toshiba's last quarter like a lot of other companies, typically a pretty strong quarter for them. We also see at Toshiba and what we see in the markets, Toshiba is growing market share, which is good. I think as we go forward certainly based on prior history, we would expect the ratio to turn around and that units would be larger going through our direct sales force on a direct basis than through the Toshiba network.

THE CALLER:
Okay. So we shouldn't assume that Toshiba can continue at that type of pace quarter in quarter out, or we would all be pleasantly surprised?

MR. JAY MILLER:
(multiple speakers) That would be great, but we shouldn't assume that.

THE CALLER:
And then can you give −− I assume your maintenance and services gross margin or profitability, however you want to look at it, was perhaps due to the (indiscernible) Medtronic running through at a different margin?

MR. GREGORY FURNESS:
Right, that is a much lower margin. That is 175,000 with revenue compared with $119,000 worth of related costs. That is obviously below 50 percent and brought the overall margin in maintenance and service area to about 60 percent, between 60 and 70.

THE CALLER:
(indiscernible) onetime anomaly we can model −− that trend does not continue?

COMPANY REPRESENTATIVE:
I wouldn't say onetime anomaly. The total deal with Medtronic, the contract is $400,000 that will flow through PLover the course of the year. We've taken almost half of it here in one quarter and the rest of it will pull through the Pin the second and third there may be some small piece in the fourth but I would expect the bulk of what's left to go through in Q2 and Q3.

THE CALLER:
Great, and then can you give us any type of −− better clarify for us the revenue opportunity in the second half of the year with Medtronic either on a royalty basis? And then in addition, can you give us any type of unit expectations that E−Z−EM has shared with you that they anticipate for this year, as well as any type of potential outlook for the outlying '03 year?

COMPANY REPRESENTATIVE:
First of all, (indiscernible) Medtronic SNT there are really two phases of product development that we are working with them on. The first piece that we have been working on recently is integration of technology into their image guidance surgery systems, specifically the (indiscernible), their flagship image−headed surgery product. We expect royalties from that to ramp up throughout the year. The second piece of it is the development of new products, specifically for therapy planning. We don't expect to see any revenues from that until 2003. So we should expect to see some relatively low level ramp up of revenues from Medtronic SNT this year, and then see more of a ramp up next year in 2004. As far as E−Z−EM goes, they just announced a product. Their sales team is just ramping up. We don't have real hard numbers from them yet. They are working on their forecast and their forecasting system to help give a little better guidance from their side. But we would expect that as the year progresses we will see again a ramp up of business from InnerviewGI, from InnerviewGI sales from E−Z−EM. We also, an important part of this of course is we −− as their promoting virtual colonoscopy, there will be a benefit on the Vitrea side as well, we anticipate. So again, we expect that option sales will continue to rise, as well.

THE CALLER:
And one last question and then I will let somebody else asks some questions. In the −− previously Marconi has been −− was a significant customer or ramping to be one, if you will, before being acquired. Is there anything new on the opportunity of them reemerging as a customer this year?

MR. JAY MILLER:
Marconi as you know has been purchased by Philips. Frankly from our perspective I think they are still wrestling with that integration internally. And until that shakes out −− and they are very internally focused right now −− until that shakes out we don't know exactly what the potential opportunity will be for Philips.

THE CALLER:
Great, thanks again. Good quarter.

THE OPERATOR:
Your next question comes from Pamela Lunn (phonetic) with NKSK.

THE CALLER:
Let me ask you, on the Toshiba market share, which obviously was a big gain, I am assuming this was mostly the U.S. since the overseas only just really started going, no, or am I wrong on that that?

COMPANY REPRESENTATIVE:
You are correct. Most of the revenue that we saw in the Toshiba agreement was domestic. There was some international, but frankly most of it, the lion's share, was all domestic.

THE CALLER:
One would indicate that they are gaining share in the U.S. market, which of course is key for you. And if so where do you think those gains are coming from mostly?

COMPANY REPRESENTATIVE:
From Toshiba's competitors?

THE CALLER:
Yes.

COMPANY REPRESENTATIVE:
It is actual interesting in the timing of that question because our sense is again Philips, and again we don't have hard numbers but our sense is because Philips and Marconi are wrestling with internal issues, they've been less focused on the customers and again are (indiscernible) stand for people in the market is that probably where the market share is coming from.

THE CALLER:
As opposed to (indiscernible).

COMPANY REPRESENTATIVE:
It's tough to tell if there is much share from GE, but again we don't have any hard numbers yet.

THE CALLER:
Maybe you could give us a little bit of flavor on this, but you held a number of meetings I think in the last couple of weeks. One being a colonoscopy meeting and I'm interested to hear how the doctors are sort of responding to the virtual colonoscopy at this point? Is the demand coming from the consumer or how are they looking at it?

COMPANY REPRESENTATIVE:
I will give you a couple of data points. Clearly in terms of the science, and I'll focus on the academic community first. Clearly in terms of their science we are seeing a very steady trend toward acceptance both by radiologists and as importantly, a gastrologist of virtual colonoscopy. That has been steady on the science, just gets better and better, partly because the techniques for patient preparation are getting better. This is why it's important we are working with E−Z−EM by the way. The patient preparation, patient comfort, the scanning is getting better. The images are getting better, and just as importantly or maybe most importantly, the visualization starts getting better (technical difficulty) moving more and more the direction of accepting virtual colonoscopy on more of a day to day basis. On the nonacademic side, in the private sector (technical difficulty) virtual colonoscopy. So from the market (technical difficulty) the patient end, it seems to be moving faster and the academic centers are moving −− we see still this as a very robust market opportunity for this business.

THE CALLER:
(technical difficulty)

COMPANY REPRESENTATIVE:
The Medtronic SNT trion (phonetic) station showed capabilities from Vitrea in their workstation, and it was very well accepted not only by the sales force but also by the customers. It's exciting.

THE CALLER:
Okay great. Finally, just another question on the add−on options. I was wondering what you are seeing with the add−on, the uptick on the add−on options over this quarter, the Brain Perfusion, for example.

COMPANY REPRESENTATIVE:
The options, again very (technical difficulty) contributor. We came out with colonoscopy, perfusion and (indiscernible) measurement in the third quarter of last year. We saw (indiscernible) but not to the extent we are seeing on the others. It depends on where the unit is being placed. Perfusion most often is going to be sold into ER's that (technical difficulty) and so the natural markup is going to be a little bit smaller than potentially for some of the other option applications. But −−

THE CALLER:
(indiscernible) on the Brain Perfusion, (indiscernible) that what you expected? (technical difficulty)

THE OPERATOR:
(CALLER INSTRUCTIONS) Your next question comes from Christian Schwab from (indiscernible) Equity Partners.

THE CALLER:
What percentage of the sales were international this quarter, then?

COMPANY REPRESENTATIVE:
Still less than −− actually probably less than 10 percent this quarter, because of the strong performance by the Toshiba domestics sales force. Most of that activity was domestic and

most of our international revenue the last couple of quarters has been coming through Toshiba. So it was a smaller contribution as a percentage than what we saw for instance in the fourth quarter.

THE CALLER:
Great, and then is the average sales price, is continuously trending higher given the fact that by taking the two options that you just mentioned, then?

COMPANY REPRESENTATIVE:
I would say it was probably consistent to what we saw in the fourth quarter, which was again the first quarter where we have these options. The number of transactions probably not enough to spot any change on the trend. I think we will get a better feel for that when we get into 2Q.

THE CALLER:
Excellent (technical difficulty).

THE OPERATOR:
The next question comes from (indiscernible).

THE CALLER:
Good morning. Have you increased the sales force at all? I believe added 17 people at the end of the (technical difficulty).

COMPANY REPRESENTATIVE:
Yes, they do.

THE CALLER:
And then, I'm sorry if I missed this, but did you discuss the average sales price for the quarter?

COMPANY REPRESENTATIVE:
(indiscernible) Christian, and as I was explaining,in response to his question. Fairly consistent with what we saw in Q4 because we had less sales from a direct basis. Probably we will get a better sense of if there is going to be any change in that when we get to 2Q and see more transactions going through a direct channel.

THE CALLER:
Okay. And then, can you comment on total install base?

COMPANY REPRESENTATIVE:
Total install base, we shipped now in excess of 600.

THE CALLER:
600. Okay. Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) I am showing there are no further questions. Please continue with your presentation.

MR. JAY MILLER:
With that we will wrap up. Thank you very much for making the call. It was a very exciting quarter for us. Again, strong revenues, better−than−expected loss and our partnerships are continuing. Our strategy is set and we are going to continue to follow that map. So thanks again.

THE OPERATOR:
Ladies and gentlemen, this does concludes conference call for today. Thank you for your participation and ask that you please disconnect your lines. (CONFERENCE CALL CONCLUDED)

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04/17/2002 01:00 pm	**WAB**	**Wabtec Corporation (WAB) − WAB Q1 2002 Earnings Conference Call**

THE OPERATOR:
I would now like to hand the floor over to your host, Bill Kassling, Chairman. Sir, the floor is yours.

MR. WILLIAM KASSLING:
Thank you, Dan. I want to welcome everybody to our first−quarter 2002 conference call. We are joining you here from world headquarters in Wilmerding, Pennsylvania, a modest world headquarters that it is as it is located as you all know and one of our production facilities so we went welcome you here today. Joining me on the call is Greg Davies, our President and Chief Executive Officer, Bob Brooks, our Chief Financial Officer, and Tim Wesley, our Vice President of Investor Relations. I want to make comment about any forward−looking statement disclaimers here in the press release and with that, let's get into the first−quarter numbers and I will turn this over to Greg Davies when I am finished. First of all, we reported earnings per share from continuing operations of 6 cents for the quarter. Now that is in line with our expectations and really the same as the fourth quarter, although our revenues declined $11 million quarter to quarter. So we were able to overcome that and still achieve the same level of earnings. If you look versus last year, last year's first−quarter earnings (technical difficulty) 19 cents so we're down around 13 cents from last year but versus last year we had an 18 percent revenue of topline declined with $38 million. So in that sense when we look at the causes a little bit later, we did I think a pretty good job of overcoming the volume losses. In fact, freight car deliveries in the first quarter were 65 percent lower than the first quarter of last year. Our cash earnings per share was 8 cents and we produced an EBITDA of $17 million for the quarter. That puts us really pretty well on track to hit our target of $80 million of EBITDA for the full year as we committed. And that will given the

fact that we have done a good job of leveraging the company over the last 18 months will give us about four times interest coverage. The (indiscernible) outlook for the market remains weak, but we still expect our full year earnings per share to be between the 50 and 60 percent percent −− 58 and 60 cents guidance that we gave at our last meeting. Now Greg will spend a lot more time on details regarding the current market and the actions that we will continue to take as we go forward. But you can rest assured that we remain focused on generating cash and we keep positioning the company to benefit on the upside when the market turns and all of those things we're doing will pay big dividends on the upside. With that, let me turn it over to Greg Davies.

MR. GREGORY DAVIES:
Thanks, Bill, and good morning, everybody. I think it is kind of a good news, bad news story in a sense that some of the market numbers have continued to deteriorate a little bit but the good news side is that we are able to match the downside on the market with both some upside opportunities in some parts of our business as I will discuss. And continuing cost reduction activity is allowing us to sort of stay the course on the kind of earnings projections that we had given you before. And if you look at freight traffic, freight traffic is at lower levels, which really reflects the weakness in the general economy. Ton miles are down a little over 2 percent versus the first quarter of (technical difficulty) 2001 and they are down 5 percent since the fourth quarter of '01. And car loadings which are probably an equally important measure are down 3.8 percent versus the first quarter of '01 and down 4 percent since the fourth quarter of 2001. So overall freight traffic is at somewhat lower levels and that partly is reflected in the fact that our coal trains parked because we had a mild winter, so less need to haul coal to keep inventories where they need to be and as in most of these situations, we talked about this before, the good news in the underlying, the whole freight traffic market is that railroad reliability and service continue to improve. In the short−term, of course, as we have said before, that tends to mean fewer cars needed in the immediate future to haul the same amount of goods, but what it really does is provide for growth opportunity in the future as the railroads become a more competitive and more able to attract mobile share. Given those freight traffic movement numbers, the short−term outlook as I described and the general weakness in the economy, freight car build outlook is a little bit weaker than we had expected. The first−quarter orders are 2,600 units approximately versus 3,000 −− 3,200 or so in the fourth quarter and first−quarter deliveries of cars were 3,850 versus 7,000 in the fourth quarter so what you are looking at is now a backlog of only about 6,400 cars which is the lowest since the mid−1980s. Now given that number I think it is only reasonable to say that we have to expect that deliveries for the year will be a little bit lower than we had previously forecast. We were forecasting 20,000, as you know, in the past and that was predicated on a recovery beginning in the second half of the year. I think that will still occur, but given the lower order rates in the first quarter, it means that probably that turnaround will be just a little bit slower and a little bit lower ramp up than we had thought before. So something in the range of 15 to 20 still is the right number we believe but it's probably going to be a little bit shy of 20,000. An interesting thing to note, most of you follow Wabtec and think of the freight build number as a good indicator of Wabtec's business, it is interesting to note that sort of freight car OEM business of Wabtec now only represents about 10 percent of sales. We wish it worked like that. We wish there were build Rights of three or four times higher like they were a few years ago, but that is the way it looks right now. As I said, there is some good news as well. The locomotive order book still well below where it was. The locomotive build rate this year will still be (indiscernible) where it was last year. At this point, we talked a little bit about that last quarter and we do now see some possible upside to our forecast of 700

units. And there is a little bit of activity starting to come in terms of overhaul bid activity, things that we are out −− about to bid on for some of the regional markets and so forth that we see as a potential plus. On the transit side, nothing very new to report. The R142 build as you know is beginning to wind down this year and our general level of activity in the transit area continues strong and it will continue to stay strong, but there is that little rundown towards the end of this year because of R142 while we await word on the new follow on R160 order for New York City which we expect to receive word on shortly. The only two issues that we see in the transit activity that are a little bit unusual or a little bit of a concern compared to last quarter are the bus store business has been impacted by lower OEM production rates. The demand for buses is still where it has been but because of some quality problems not related us, quality problems and financial issues and so forth, (indiscernible) OEMs have build rates than we had expected and we should be able to catch that up at some point because the demand is there. And then finally H−factor is a little bit slower on the rail side and that has caused a little bit of a downward push on our sales in the first quarter. So what are we doing to respond as a result of that? As you know, we have a team with an action−oriented track record and that is continuing to produce results. QPS, our quality performance system and our other leading (indiscernible) we are working very aggressively on all of those to reduce costs and increase our productivity and continue to drive down inventory so that we can have a very strong positive cash flow. In fact, one thing to note is that 3 percent of our employment or about 130 jobs were taken out in the first quarter. A new program that we are going to go after though to make sure that we are responding to these slightly more negative market conditions in a very positive way is to really attack raw material costs and purchase service costs. We think we can take out as much as much as 2 percent of those costs in the second half. And, of course, anything that we do in the second half of this year reflects into next year as a full year affect so we are really going to go after that in a very aggressive way for the remainder of the year. Beyond that, if we need to we will take out further plants. We will do further plant consolidation. We're already closing the Burlington, Ontario break aparts plant in the second quarter. That will take out another 120 −− about half of that is already included but about another 60 or production support jobs yet to come out in the second quarter related to that closing and that should give us about a million and a half savings in the second half. As we have said, if we feel the need to further reduce plants, we won't shrink from doing that. Let's turn it over to new business because there's a lot of activity going out there that gives us good feelings about our opportunities as the year unfolds and as we move into the next couple of years. Before the joint venture in China to build bus doors. We expect dramatic growth in the bus door business for relatively sophisticated buses in China as China ramps up for the 2008 Olympics. Our intermodal ramp car that we talked to many of you about over the last year or two is now in−service. So that's a breakthrough for us. It's in−service on the Canadian national and we're starting to see increased interest on the part of the other railroads as a result of that milestone. We're performing field modifications on some of GE's most technologically sophisticated AC6000 locomotives. That is a relatively small piece of business, but what it does do is give us growing presence if you like or growing credibility in front of General Electric which, of course, is one of our largest customers. It gives us growing credibility as a company that is able to support them in the aftermarket so we are very pleased to get that business. We've also received a letter of intent from the Massachusetts Bay Transportation Authority, MBTA for an additional 12 locomotives. That's another $10 million worth of business and that letter of intent has just been received. And then on the electronic side, we have talked numerous times about our CBTM train control activity. We have now received a further contract for CSX −− from the CSX, which will help to prove out some of the savings that are available so that we could be able to go forward with a major rollout as early as next year. And finally, another CSX activity is engine control units, APU units which are aimed at reducing fuel consumption and lowering emissions on locomotive engines, not just on CSX property but elsewhere where we are going to provide the major subsystem to that product called ERM and that is a control unit for the engine itself and we are now seeing those first units going into service on the CSX. So a lot of activity. We can pedal fast, pedal hart, continue to take the right kind of action for the rest of this year as we hit the bottom and begin to ramp up. We are very optimistic about the opportunities on the upside as we come through the bottom of the cycle. So with that, we will turn it over to Bob and go through some of the numbers and then we will come back to answer any of your questions.

MR. ROBERT BROOKS:
First, let me talk a little that about cash. Last year as most of you know, we generated about $111 million from operations. Operations including earnings, working capital, and CAPEX. There was a significant portion of that in the fourth quarter. At the end of March this year, we have $28 million in cash as a cash balance compared to 54 million at the end of the year. Now that's a reduction in cash of 26 million, but it was primarily due to payments of $30 million for asset sales that we had in the fourth quarter. That $30 million when we done the fourth quarter we expect it to be $36 million. But we found ways to improve the state taxes by almost 2 million and additional taxable levels of the federal by 4 million due to certain reclassifications. So in addition to that, we've also generated in the first quarter 4 million in cash. And that primarily comes from earnings in working capital −− not working capital but CAPEX. Again, the first quarter continues on the trend of cash generation. Now our debt was 241 million, which is 49 percent of our total cap. That's just among the best levels that we have had for quite some time. And that debt level is essentially 175 million in bonds, 60 million in fixed debt and 6 million in industrial clients. That's the same level essentially as the end of the year. Important to note that that 175 million in bonds is currently at an interest rate of 9.375 and is callable at par in June. Our bank debt is somewhere between 4 and 5 percent. And we will be currently looking at this capital structure between now and the end of the next quarter very strongly. Working capital remained flat for the quarter primarily as inventories remained at the $105 million level. Receivables (indiscernible) of payables which is slightly short or lower than the year end level. We're confident that this level now has given us an established stability of the first−quarter working capital and is a level that we will consistently be chipping away at during the rest of this year. Sales, as Bill and Greg both said, were 18 percent lower than the prior year's quarter. Freight sales 22 percent lower and the OEM of those freight sales 65 percent lower. The transit sales from ongoing operations were about 7 percent and these were due to the lower bus doors due to the manufacturers production issues and HVAC within rail vehicles. Gross margin was 25.3. This compares to 28.5 a year ago and is due to the change in the lower sales, the product mix unfavorability within the Freight Group and pricing. Our gross margin was flat to the fourth quarter which was 25.0. Operating expenses were 5 percent lower this year than the prior year, but this was entirely due to the (indiscernible) of goodwill amort due to the adoption of the new FAS 142. We expect about $8 million annually to be reduced in amort, about 2 million a quarter. We also expect to have a non−cash charge to write down a portion of our goodwill which is a new program again that is sponsored by the FAS programs and this amount has not yet fully been determined but will −− and will be less than 25 percent of our goodwill. Interest expense is 51 percent lower than a year ago. Due to the lower debt levels that we spent during the year, this number has come down substantially. To try and give you an idea of the EPS change, we've gone from the 19 cents to the 6. So 13 cents lower in the first quarter of this year. We're actually 7 cents better

due to interest expense. We are 2 cents better due to goodwill and amort. We are 2 cents better (technical difficulty) of the salary layoffs that we did at the end of the third quarter and as a result that makes us 24 cents lower due to volume mix and price, which is roughly 15 million on 38 million reduced sales. Depreciation for this year was at 5.1 for the quarter versus 4.9, about the same level as a year ago. Amort was 1 5 versus 3 3. And our CAPEX was 3 million this year in the first quarter versus 5.3 last year. Now the 3 million level is a level that would be consistent with what we have said before was 12 million our kind of replacement CAPEX level for the year. Thus, I believe we're on target for our free cash flow commitment of the $40 million that we say we would do in 2002 (technical difficulty) The twelve−month rolling backlog is up this year. We're at corporate, for the whole corporation, 361 million at the end of March versus 300 million at year−end which is about 20 percent higher. Freight is a significant change. It is 193 million versus 147 million at year−end. It was about 45 million of that growth being the metra (phonetic) and locomotive rebuild contracts that have been taken at our Boise operation. Transit is 168 million versus 153 million or about 10 percent higher than year−end levels. With that, I'll turn it back to Bill Kassling.

MR. WILLIAM KASSLING:
Thank you, Bob. Just to summarize, first−quarter earnings and EBITDA are in line with the expectations that we gave you for the −− the last time we were together. We're still in the range of earnings for the year of 50 to 60 cents and 80 million in EBITDA and about 40 million of free cash or cash available to pay down debt and we're doing all of this despite a couple of freight car markets. It would just move south on us in the last few months in terms of our expectations, but during this process as we see the markets strengthen on us, we focus our generating cash and getting our breakevens down and getting our costs down and position us for the inevitable upturn as the surplus capital equipment and the rail industry gets worked off and it inevitably will. So that really is the end of our formal remarks. Dan, the three of us would be happy to take any questions that comes from our group.

THE OPERATOR:
(CALLER INSTRUCTIONS) (technical difficulty) Steve Volkmann of Morgan Stanley.

THE CALLER:
If you are successful in repositioning your debt from the higher coupon into more of the bank debt, is that factored into your guidance at all because presumably I guess that will be a good increase in earnings vis−a−vis lower interest expense.

MR. WILLIAM KASSLING:
You are right. It would be −− I don't think we really decided on that capital structure. yet and so as a result, that's definitely not in the low end of the range and it would certainly push whatever earnings we have up.

THE CALLER:
And then one just kind of more strategic maybe for the other guys. We're starting to see some companies who are in real cyclical end market businesses really sort of going back and kind of asking themselves whether these markets are really going to recover or not. And I am wondering given the philosophies you have in terms of lean manufacturing and so forth, what if we assume that rail cars just kind of bump along at 25,000 for the next ten years or something. What would you have to do to position the company to make what you would consider a reasonable return in that type of environment I guess (A) and then (B) is your

structure, your manufacturing structure that you're headed for is it sort of variable enough so that you would also be able to take advantage of some upside if it happened or would you really be kind of shooting yourself in the foot?

COMPANY REPRESENTATIVE:
(indiscernible) but seriously, Steve, I hear you. I think that there is an inevitable question about recovery. I think that we are going to see a recovery. This is a cyclical business and the bill rates are going to be higher in the future than they are now so I mean that I am confident of. I would think that the other interesting thing here is I believe and have for some time that the railroads have a very real opportunity to gain mobile share in the next cycle. So I'm concerned that the markets won't come back but nonetheless your question would still be relevant because everybody sort of asking the question what does comeback mean? Are we going to be at 40, are we going to be at 70,000 cars and things like that. And I think on the freight car side of our business alone you have to be thinking about variability so there is some work going on in that regard. I think maybe the best answer is not to give you specifics because quite frankly we don't have them. But if you just acknowledge that it is a good question, it is the kind of thing that our people are starting to think about, if you can drive your fixed costs down then you're much better able to deal with that kind of cyclical swing and that is the kind of thing that we're talking about. We talked about potential for plant consolidation, we talk about potential for overseas sourcing and things of that nature. Those are all part of that kind of a response, so I think the answer is yes, we are thinking about it and yes, we will be looking for ways to improve the sort of variability of our cost structure. The other thing to remember is that today only about 60 percent of our business is in the freight side of the business anyway. The rest is transits where the cyclical question is not as much of an issue. So we're also somewhat protected from that problem compared to many people in similar industries.

THE CALLER:
Freight cars are down 10 percent.

MR. GREGORY DAVIES:
Freight cars are to down 10 percent (indiscernible) but the freight business as a whole is still about 60 percent. But that that is the point, Steve, that Bill is reminding us of. We are −− here we are. Were able to stay profitable and we have made adjustments to our capital structure and we are able to survive and still throw out positive cash in an environment where freight car builders come down to 10 percent of our business and, you know, you think about where we were only a couple of years ago, that's kind of unthinkable.

MR. WILLIAM KASSLING:
I remember the mid '90s it was 35 to 40 percent. So it has come down. I agree with Greg, I think you can −− if you're going to do 7 to $800 million of revenue overall, you can position your costs to make money. That's not a bad top line to work with. It goes on for awhile and we can continue to get our costs down and make money at those levels.

THE CALLER:
Great. Where are we in that process do you think, what inning is this?

MR. WILLIAM KASSLING:
I think we're in the seventh inning. I think we're through the trough and maybe the

(indiscernible). I originally thought it would be a three−year kind of downturn in the recession. Maybe it is going to be more like four, but I think we're through the halfway point. What do you think Greg? Was that your question, Steve?

THE CALLER:
Actually I was sort of asking where you are in your process of sizing the business for this increased variability that Greg mentioned?

MR. GREGORY DAVIES:
(indiscernible). We have a lot of thinking to. We have a long way to go on that. So maybe it's a lot of upside opportunity. So maybe we're in the third inning in the sense that we've given it some thought, we have already take some action. I think there is a lot that still can still be done.

MR. WILLIAM KASSLING:
(indiscernible) cycle and the third inning by reaction to it. We've got lots to go. We've got lots (indiscernible).

THE CALLER:
That is great. Both of those are helpful. And then the final kind of detail here, one of you guys mentioned something about pricing pressure in you're prepared comments. Can you expand on that a little where and why and all of that?

COMPANY REPRESENTATIVE:
It is a tough market out there. And in any kind of down market, Steve, (indiscernible) as you know, people are always going to be driving −− your customers are always going to be trying to take advantage of price. I think one of the things that had always been in our favor compared to some other businesses that you might look at is the kind of (indiscernible) monopolistic structure that we have which has tended to mean that we have been less affected by downward price pressure than some other industries were. You know, There are five or six kind of players at anyone segment, you know, everybody's trying to struggle to stay alive. We haven't seen that. The other other thing is, of course, a lot of our products are proprietary customers specified products and again (technical difficulty) you see a much lower pressure kind of problem on that kind of product compared to commodities. So one of the things you heard me talk about a lot is how we want to be a tier 1 supplier. We want to get away from being considered a commodity supplier and the more we move along in that direction the more we are protecting ourselves against short−term price pressure and these cyclical troughs.

THE CALLER:
Any guesstimate of what it might have cost you in terms of margin in the freight business?

COMPANY REPRESENTATIVE:
That's kind of hard to guess. I won't hazard just a wild guess, Steve. I don't know that.

THE CALLER:
Thanks.

THE OPERATOR:
(CALLER INSTRUCTIONS) Our next question is coming from Robert (indiscernible) of

David Green and Company.

THE CALLER:
Good morning, gentlemen. Two questions, but I think they are related. First, could you give us some up date on what the status is of planning or discussions or anything concrete on (indiscernible) to beginning to break into (technical difficulty) European (indiscernible) market, freight and/or transit equipment. And secondly, what's the opportunities out there in terms of real accretive acquisitions, things that really would be strategically sound?

COMPANY REPRESENTATIVE:
Robert, I think the answer to the first and really to the second is that we must view our acquisitions as opportunistic. As you know, we have been through a period of having a very high debt to capital ratio, something that I think you and all of the other investors would be concerned about us returning to. So we're looking at the whole European market area and you're right to look at that as one of the major opportunities for us. That is certainly they way we would look at it. We look at that whole area as something where we see substantial opportunities, but we are not going to lever ourselves back up unless we can find the kind of acquisition that as you said would be strongly accretive, something that would be clearly relatively short−term plus for us and those aren't easy to find. There are opportunities out there for acquisitions. We are certainly working on it. It is hard to tell you concretely, as you know, because for a number of reasons it is really difficult to say anything about that kind of a strategy until you actually have something on the hook. But I can just tell you that if see the right opportunity, if we believe that it presents a compelling case to our investment −− to our investor community, we will make acquisitions. We certainly would like to. There is certainly no question that that is a group opportunity, growth area in all of our planning.

THE CALLER:
I suggest that the only way to break into the European market is through acquisition.

COMPANY REPRESENTATIVE:
I would suggest that it is not the only way, but it is certainly is a difficult market to gain traction in without the kind of volume and presence and distribution systems that an acquisition would bring, yes.

THE CALLER:
One final question. In terms of future planning, priorities particularly in light of the first series of questions by the gentleman from Morgan Stanley. In terms of priority, where are you putting Europe, 1, 2, 3, 4 −− in terms of really major projects that you see that change the Company significantly?

COMPANY REPRESENTATIVE:
Well, I think, Robert, unless −− I'm not sure I understood when you were wanting me to compare (indiscernible) against, but I may just have missed that, but I mean, first of all, the first thing we have to do is focus on internal profitability, internal growth. There is just no question. There is no substitute for that. It's got to be where most of our people are spending most of their time. When you look at growth opportunities you heard me talk about on both tier 1 supply issues, supply opportunities, those would be for our traditional domestic OEMs in the states. And then we talked about global growth. And I would say that global growth would come a close second to the tier 1 and both of those really after we're sure that we have

got our internal operations straight.

THE CALLER:
Thank you.

THE OPERATOR:
We're showing no further questions at this time, gentlemen. The.

MR. WILLIAM KASSLING:
Thank you for joining us and we look forward to meeting with you next quarter. Take care guys.

THE OPERATOR:
Thank you. This does conclude today's teleconference. Please disconnect your lines at this time and have a wonderful day. (CONFERENCE CALL CONCLUDED)

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04/17/2002 09:30 am	FLXS	Flexsteel Industries, Inc (FLXS) − Q3 2002

THE OPERATOR:
(technical difficulty) Welcome to Flexsteel Industries, Inc. Third Quarter 2002 Operating Results Conference Call. At this time, it is my pleasure to introduce your host for the call, Flexsteel Industries' Chief Financial Officer, Mr. Ron Klosterman.

MR. RONALD KLOSTERMAN:
Good morning and welcome to our conference call to review our March 31, 2002 quarterly results. We appreciate your participation this morning. Joining me this morning via telephone from our showroom in Highpoint, North Carolina at the International Home Furnishing Center is Bruce Lauritsen, our President and Chief Executive Officer. During our call today, we may make forward−looking statements that are subject to risk and uncertainty. A discussion of factors that could cause actual results to differ materially from management's expectations is contained in the company's SEC filings included for the most recent annual report to shareholders and 10K and the press release dated April 16, 2002 announcing the results of operations for the quarter in nine−month period ended March 31, 2002. Any forward−looking statements or opinion as of now and we take no obligation to update or revise any forward−looking statements to reflect events or circumstances after today's call. At this time, Bruce has some opening comments before we open up the session for questions from analysts. Bruce.

MR. BRUCE LAURITSEN:
Good morning everyone. What I'd like to do is go over −− just a brief restatement of our press release last night. A couple of items there and I'll give you a little current scenario of what's going on and where we're at in our three businesses. Net sales for the quarter ended March 31,

2002 were 73.7 million compared to the prior year quarter of 72 million, an increase of 2 percent. Net income for the current March quarter is $2 million or 33 cents per share, compared to the year earlier quarter of 8 cents, or 800,000 −− I'm sorry, or 13 cents per share. Net sales for the nine−months ended March 31, 2002 were 202.8 million compared to 215.9 million in the prior year nine months, a decrease of 6 percent. Net income for the nine months ended March 31, 2002, up 2.9 million or 48 cents per share decreased in the March 31, 2001 net income of 4.4 million or 71 cents per share. Now I'd like to tell you a little bit about what happened in the quarter that −− we're just reporting on. Orders really rebounded very nicely during the March quarters starting right after the January 1st holiday and various inventories were very good starting in January and continued on through most of the quarter. The recreation of vehicle seating business volume build−up during the quarter month after month and comparing to March 2000 quarter to the December 2001 quarter, residential shipments increased 10 percent, RV shipments increased 28 percent. And just as important, our backlog in the hospitality and the contract seating business increased, ended to the double−digit area. Things that we've been working on the prior nine−months with beds, and boats, etc., came to fruition during the March quarter. The cost of raw materials had little changed during the quarter, however, we may see some increases in the steel prices during the latter part of calendar 2002 due to the impact of just recently inactive import tear−ups (phonetic). Some other points of interest −− here in the recreation of vehicle business are −− during the Valentine (phonetic) over the last 18−months, net industry. We stayed true to our strategic plan and worked very hard in increasing our market penetration. And in fact, open up 14 new customer chairs in an area that we have a 60 percent plus market shares, so we're really, really happy about them. In the residential seating area, we have 350 comfort seating galleries opened and 45 additional signed contracts that we hope to get opened in the next four to six months. Our new Christopher Lowell collection, which debut in October of 2001, we have 40 completed and open and over 135 signed commitments to bring to fruition and get open this year. Our outlook for commercial seating business is as strong as I've seen it in the last 12 to 14 years. We have just been blessed with the number of clothes and beds on projects all over United States for re−dos (phonetic) in the hospitality business as Lowell's new properties. So, we're really thrilled with what's been going on for about the last four−and−a−half to five months and especially the business that we've received in the last 90−days and we're going into the final quarter with a real strong business backlog as well as prospects for continuation of running business. At this particular time, I'll open up the forum to questions that any of the analysts may have.

THE OPERATOR:
At this time, we will be taking questions from analysts. (CALLER INSTRUCTIONS) Penn Sincleton (phonetic) of Merrill Lynch.

THE CALLER:
Good morning. Bruce, could you talk just a little bit more about your utilization rate? How orders are trending in so far in April and what's your plan are for new introductions at the upcoming April market?

MR. BRUCE LAURITSEN:
Well, our orders continue. They soften a little bit in the residential area the last two weeks of March and I think it's a combination of many factors in early Easter as well as −− just the prior two months, there was a lot of buying going on and it's picked up as we came to the high point. We have enlarged our Christopher Lowell collection for five new occasional groups

and to the collection, which we didn't have in October; tables and some wall, wall units, etc., as well as some upholstery pieces. We've got new −− really across the board, we've got three fabulous leather sofa−loveseat chair combinations as well as some beautiful of Lowell style upholstery. We feel real good about this market. Our sales force is really very, very comfortable with our new introductions and they feel good about the customers coming here as well as what they take to peer it back going on the field. Going further, just a little bit ended the recreation of vehicle business. We feel real good of that business has re−solidified itself and its moving back into the range that we expressed a couple of years ago and the prospects for that, we feel for the next 10 to 12, 15 years are very good.

THE CALLER:
Did you mean 10 to 15 months Bruce? You said...

MR. BRUCE LAURITSEN:
No. Just looking out, as a demographics as to...

THE CALLER:
Really?

MR. BRUCE LAURITSEN:
Yes. Where we feel that the baby boomers are just entering into that first stage of possibly doubles and then motorized, etc. So, that industry is a −− we're really feel good about the future of that business. But right at the present time, we're just pleased that the consumers are back in the marketplace purchasing and taking us back to the levels that we experienced prior to the downturn.

THE CALLER:
Okay. I'll just have good couple of more questions 'cause I know there are others. I wanted to get an idea of what type of volume do you think is reasonable for the Christopher Lowell line over the next −− say, couple of years? And do you expect to add any new accounts, not Christopher Lowell but just Flexsteel in general −− at competing (phonetic) in general at this market?

MR. BRUCE LAURITSEN:
We do. (1) The volume PMI (phonetic) would be −− I'd be stabbing (phonetic) at a number that I wouldn't be comfortable with. Maybe by the time I see you tomorrow or the next day, I can give you a little bit better number. But we feel that, that has a potential of this market, just at this market of possibly signing up another 25 to 35, 40 additional retailers. We have experienced an interest on a Christopher Lowell collection from certainly some of our long−time retailers. But more importantly, or just as important is the interest that we picked at from people who we haven't done business with, and that's the exciting part. We thought that might happen but it's really reaching a different consumer, maybe a younger consumer or a consumer that's doing things on their own that they come in the store and the stores that are open right now or for the most part, really, really doing a nice job.

THE CALLER:
Okay. Last question. Just give us an update on your retail business, where it stands right now, and what it might have accounted for in the quarter you just released?

MR. BRUCE LAURITSEN:
Penn, I can tell you that right now we've got five stores just as we start the year with five, we have a lease expired in Chicago. We're down to one store in Chicago, that store was successfully converted to one −− two stores to one. And in Indianapolis, we have three and again the lease had come too, and we took it from three stores to two and that 's where we set right now. We have seen a nice uptick in the retail business as most people have a country and it's come into the stores. We're continuing to try to fine tune the footprint and we're not going to draw that particular segment of the business any further than over the years.

THE CALLER:
Was it profitable?

MR. BRUCE LAURITSEN:
No.

THE CALLER:
All right. Thanks very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) And gentlemen, I'm showing no further questions at this time.

MR. BRUCE LAURITSEN:
Thank you everybody. We appreciate your calling−in and thanks for all your support.
(CONFERENCE CALL CONCLUDED)

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04/17/2002 02:00 pm	FLBK	Florida Banks Inc (FLBK) − FLBK Q1 2002 Earnings Conference Call

THE OPERATOR:
(technical difficulty) at this time for opening remarks and introduction, I would like to turn the call over to the President and Chief Executive Officer, Mr. Charles E. Hughes Jr. Please go ahead sir.

MR. CHARLES HUGHES:
Thank you very much Melissa (phonetic) and thank all of you for joining us this morning. We are delighted that −− to have the call and I have some good news. Let me begin by telling you that our commentary and responses to your questions today may contain some forward−looking statements including the statement relating to the company's growth, asset quality, aims and strategic initiative initiatives. Information concerning factors that could cause actual results to differ materially from those contained in the forward−looking statements is available in our final prospectus, which is dated July 29th, 1998 and our most recent annual report on Form 10−K as filed with the SEC. In addition information contained that any rebroadcast or webcast to the conference call, is accurate only as of the date of the last broadcast on April 17, 2002. This call is a property of Florida Banks, Inc. Any redistribution, retransmission or rebroadcast of this call in any form without the expressed written consent of Florida Banks, Inc., is strictly prohibited. Now that I have gotten that behind me, let me tell you that as normal and as usual, we have with us this morning Ed Stinson, who is the Chief Financial Officer for Florida Banks, Inc., and Richard Kensler, who is the Chief Credit Officer. I'm going to make some opening remarks about the results that we gave last night and then turn it over to Ed, who will talk some about −− some of the issues behind the numbers. Richard with the spend some time talking a little bit about the credit quality of the company and the credit issues and then we will open it up for some questions.

I'd like to extend to say that we were pleased with the results that we gave out last night to the investment community. As you know, our assets increased to over $550 million during the first quarter and we think that we have come an awfully long way since we started this company back in 1998, when we're only about 40 or $50 million. So the growth continues to be what we have hoped it would be, although I will tell you that the 1st quarter was a little bit slow of growth than we had expected. And while it has really come out strong since the end of the 4th quarter, we think the slow down is a little bit of an operation, because our deals will −− is still extremely strong, our pipelines are very, very strong. And the first few days of this quarter have proven to be −− to show that the 1st quarter slowdown was a little bit of an operation. So we think our growth will continue to be very strong as we go forward and all of our markets are doing very, very well. So we are very excited about that. As you know, we showed earnings for the quarter of about 7 cents per share and unlike the original estimates −− ours as well as others was totaled for around 6 cents performance level. We are always glad to be −− to do a little better than that and it was good news as far as we are concern. There is nothing really new with respect to the company that can tell you this morning with the exception that, as you know, we issued some convertible preferred stock not too long ago and the conversion factor on that. Said that, it would convert the common stock at such time as the stock price stayed at an average of $8 a share or above the 30 consecutive business days. And I am glad to be able to tell you this morning that, that took place as of yesterday. So as of yesterday, that dividend ceases on that preferred stock and going forward, that will save us on our annualized basis, about a half −− a little over $500,000 a year. There's an issue with regard to the dilution of the additional shares that will be outstanding that will cause our earnings per share not to be nearer the increase the −− we will get from our return−on−assets standpoint, at least initially. But we will get a little bit of help on our earnings per share in clearly $0.5 million a year will help us considerably on the overall of our plan. So we are pleased with that. I know, some of the folks that held that stock, they will no longer get that dividend but we believe that it's a very good stock to hold from a common stocks standpoint and that they will continue to benefit as the company increases its earnings going forward. So I'll tell you that we are very pleased with what's happening with the company right now. We think we will continue, as I've said, to grow very, very rapidly as we go forward. We don't have any plans right now to open any new banks. We are still concentrating very, very strongly on insuring that the bottomline increases every quarter as we go forward and I think we will, without any doubt, will be able to continue to do that and all of us, I think, we'll echo those thoughts as we go forward. Now, I will turn it over now to Ed Stinson and let Ed get behind in some of the numbers for you. So Ed, would you please go ahead.

MR. EDWIN STINSON:
Thank you Charlie and good morning. As Charlie mentioned then (indiscernible) unusually, the company continues to benefit from strong growth and stronger assets and especially improve (indiscernible) our overall efficiency. With interest rates now, forecast arise in the future, we are now really beginning to focus on the diversifying our funding sources and some strategies to help improve our margins going forward. And for this reason, I'll primarily talk about the margins and some interest rate movements. Then, I'll also briefly touch on non−interest income and non−interest expense and the trends in this area and how they relate to our outlook for the rest of the year. First of all, between 4th quarter of last year and the 1st quarter of this year, we did see some improvements on our funding cost. Our total costs, (indiscernible) liability, decreased from 4.05 percent for the 4th quarter, down to 3.55 percent in the 1st quarter of this year. And that's primarily resulted from continuing opportunities we had in the re−pricing of maturing certificates of deposits, which were purchased last year and

then which matured in the 1st quarter of 2002. There's a same period (indiscernible) we did see our yield on earning assets decrease from a 6.99 percent, down to 6.31. And that is a result of lower rates on loan and lower−yield on our short−term investment such as (indiscernible) fund. You may recall that during the 4th quarter, the prime rate was still being −− still declining. However, that averaged about 5.5 percent in the 4th quarter and remained stable at 4.75 percent in the 1st quarter. So, we roughly saw about 75 basis point decline on about 50 percent of our loan portfolio and that was the primary reason why we did see reduction in yield. We also did have some non−recurring interest income as it related to some recovery on some not performing assets. That resulted in about 20 basis point increase in earnings on loan portfolio in the 4th quarter. So if you look at actual numbers quarter−to−quarter, we really only saw about a 48 percent or 48 basis point reduction on loan portfolio. And that was pretty much offset by about 50 basis point improvement in our earnings costs −− in our funding costs. Now really, most of what we saw I believe, at this point in the net interest margin, primarily was related to our continuing to leveraging our capital. As we did, our cap−to−ratio went from about 10 percent, down to about 9 percent from the 4th quarter to the 1st quarter. Net, before (indiscernible) all this impact of increase as in interest rates, currently our balance sheet structured so that when we have an increase in rates, we'll see almost an immediate increase in yield of our own portfolio. And this is followed by a more gradual increase in the cost of funds, as we re−price maturing liabilities. During the last two quarters, however, we've made some significant changes in the way we have structured the liability side of the balance sheet. We took advantage of some lower rates and booked some longer terms (indiscernible), which provided us with a more stable funding source for the fixed rate loans, which we already have in the book. And we also concentrated on some shorter term floating rate funding, which more closely matches our commercial loan portfolio, which is primarily floating in (indiscernible) to the prime rate. And we'll continue this process through the 2nd quarter and we believe once we complete this, and we have a more balance approach from the standpoint of (indiscernible) funding, then we'll be in a (indiscernible) position or maybe a slightly positive GAAP position by the end of the year. Now, looking forward to the 2nd quarter, we'll re−price about 60 million in liabilities. We expect to see an average improvement in cost on that of about a 100 basis point. And most of these are consisting of (indiscernible) and other longer term liabilities, which will be re−priced and most of these will be put back in the shorter term floating rate deposits, as I mentioned previously. As for non−interest income, I think the point of view to the look from on year−over−year basis, we have improved that. However, we did see a drop compared to 4th quarter last year to the 1st quarter of this year. Most of that is related to non−recurring income in the 4th quarter and we don't expect that trend to continue. I believe at this point that for each quarter going forward in 2002, we'll continue to see the increase in our non−interest income quarter−over−quarter. As far as non−interest expense, we did see continued improvement there especially in the year−over−year comparison and with comparison to 4th quarter. For example, our non−interest expense ratio declined from 3.5 percent of assets in March 2001 to 3.1 percent of assets in 4th quarter of 2001, which are at current level at 2.7 percent. And I think this is very significant, given the tightening of spread and the (indiscernible) operator efficiently as possible going forward. We do expect the ratio of non−interest expense to improve each quarter as we look very closely on opportunities to operate more efficiently and control our cost. With respect to capital, as you know, our goal has been to continue to leverage our capital through growth in earning assets, while maintaining the bank at the regulatory well−capitalized level. To accomplish this, you may recall in the 4th quarter, we participated in the $6 million (indiscernible) trust preferred issue and we add an additional 4 million (indiscernible) trust preferred in April this year. As far as our growth, we had the ability to add about another 4 million in trust preferred. Which should provide us with necessary capital to get through the end this year, into the 1st quarter of 2003, without the addition of any other capital. And finally, you'll notice that on the balance sheet, we have significant increase in demand deposit as of December 31, 2001 and that was followed by decline as of March 31, 2002. Now what this was is −− this resulted from the majority of our commercial refill customers who moved their deposits from Recol into a demand accounts to avoid having to pay taxes on these assets at the end of the year. This is a normal occurrence that happens every December, but I didn't want to explain that to you to bring that to your attention. All this balances has moved back into the Recol accounts, which is apparently low cost source of funding for the bank. And in conclusions of bank the trend was near to very positive, I think especially in the efficiency level. I think, we believe at this point that we're positioned very favorably in the future and we're gonna continue focus our funding cost, managing interest rates risk and special note in non−interest income opportunity. So with that all, I'll turn it back over to Charlie.

MR. CHARLES HUGHES:
Thanks Ed. And let me reiterate (indiscernible) one point that Ed had said. We have really pushed very, very strongly with our people throughout the state, that the need to sell all the products at low−cost deposits, and we have (indiscernible) in the first few days of this quarter, have been very encouraging with respect to the increase that we began to see in our daily average on non−interest bearing demand. So I think we're beginning to do a much better job there than we have done in the past and our people understand the importance of that and we will continue to do well. (indiscernible) reiterate today and talk about (indiscernible) as that's a fact that it's very important for this company to do everything we can to change the mix on the loan side to have lower floating rate levels. And we've got some pretty strong goals in that area and we are reaching those goals about −− not as well as we could expect to. And as interest rates go up, I think you will all agree, they surely will, we will end up doing better and better with that. We were a little disappointed last year with the decrease in interest rates and the fact that, that cost are in a situation that was not as attractive as we would like it to have been. So we will make sure that if the rates go back up, we'll do well with it. And the (indiscernible) cover that just a minute ago that I will cover very quickly with you right now is, kind of, the guidance with respect to earnings for the rest of the year. We have, as you know, got a little bit better 1st quarter than we expected, so therefore I think it's fair to assume that we will continue to do a little bit better. I think it's fair say that this company will earn 32 cents as oppose to the 30 we talked about early on. It's probably fair to say that we can expect to earn maybe even little bit more than that. However, we do intend to add lenders in the state this year, we're looking for new lenders now. We just recently added a new lender in our (indiscernible) office and we're looking to add some other lenders in some other chief parts of the state. And as we do that, that (indiscernible) will hit us before these people start bringing some of these income over the books. Now it's a question that the 30 cents is a fair number to be looking at and I think that's the guidance that we can give you today, that will make a lot of sense for us. Now, as to credit quality, we think the quality of the portfolio continues to be very strong. We've seen no disappointments there, whatsoever and to cover that in some depth for you, I will ask Richard Kensler to bring you up to date on that. Richard.

MR. RICHARD KENSLER:
Thank you Charlie. Thank you, Charlie. A lot of these numbers that I'll be going over −− and additionally, a nice low breakout of our portfolio mix can be found on the last page of the earnings release statement. Regarding some of those key indicators, past dues when a −− at

the end of the 1st quarter, past dues at 0.32 percent, which is a very, very strong number and even adding a better indication of the quality. About 65 percent of that was 100 percent fully guaranteed government loans. We just had a little administrative issue with the agent in getting the payments at all times. So that 32 percent, while a strong −− 0.32 percent is a strong number. It's even better than that when you factor out the 100 percent guaranteed loans. Non−performing assets have continued to decline. We're down to now 0.83percent of total loans in Oreo. And referencing the Oreo, we do have a contract that we expect that we'll close in the next 30 days on a −− on our large piece of Oreo. So if everything happens according to plan, we should see even a more substantial decrease on our non−performing asset. Our 35 classified assets continue to stay away long and under 2.5 percent and our net charge−ups for the 1st quarter were negligible, about a little over $7,000 or 0.002 percent of our average loans outstanding for the 1st quarter. Our allowance for loan losses, as shown on that sheet, will be 1.16 percent and that covers our total non−performing assets by 139 percent. When we factor out that Oreo, our actual non−performing loans are not covered 456 percent. So I'm very pleased with the way that we've −− whether the slowdown in the economy, we maintained our mix of our portfolio within the targets that we set out when we initially we founded this bank and there's nothing through the review process or the indicators among quality that (indiscernible) make believe that we shouldn't have another strong year, from a credit quality standpoint. Charles?

MR. CHARLES HUGHES:
Richard, thank you. I would like to add also, Richard and I both stayed very much on top of this loan portfolio and talked a great deal about it. Particularly, as he says, when you're looking at a slowdown on the economy, so it's doubly important to make sure that you know exactly what's happening. And the (indiscernible) right now, see anything that gives us any strong concern with respect to the portfolio (indiscernible). And I would tell you that these (indiscernible) have given very strong performances for this company and doing great job towards, and it goes beyond this room. The folks that we have gotten into. Today, I very carefully looked at, before we bring in the answer, make sure that the profile of the company particularly out in the communities that we're in. We make very sure that the folks know those communities that they're in before we bring them in here and can really add substantially to the growth of this company and all of that is going very, very well. Let me now −− that conclude our comments. Let me turn it over to you now for any questions that you may have.

THE OPERATOR:
Thank you. Today's question and answer session will be conducted electronically. (CALLER INSTRUCTIONS) And we'll go first to Sam Coldwell (phonetic) of Suntrust Robinson Humphry.

THE CALLER:
Good afternoon, guys. Congratulations on a solid quarter.

MR. CHARLES HUGHES:
Thank you, Sam.

THE CALLER:
I had a question about the number of shares and the conversion on the preferred stocks. Exactly how many shares is that?

MR. EDWIN STINSON:
It's about 1.1 million shares.

THE CALLER:
1.1 million. Great.

MR. EDWIN STINSON:
And it equals about 18 percent dilution.

THE CALLER:
18 percent dilution. Thanks, (indiscernible). What is the size of that large Oreo that you guys hope to have closed in the next 30 days?

MR. CHARLES HUGHES:
About 2.5 million.

THE CALLER:
2.5 million. Great.

MR. CHARLES HUGHES:
As (indiscernible) out, I think−− I'll say the same thing which we did. We do have contracts. That thing −− unless the world comes to an end −− I think it's going to close. I think we'll be in a situation that have a very, very strong number in that ORE area.

THE CALLER:
Great. Thank you, sir, very much.

MR. CHARLES HUGHES:
Yes, sir.

THE OPERATOR:
(CALLER INSTRUCTIONS) We'll go next to Ross Haverman (phonetic) of Haverman Brothers.

THE CALLER:
Good morning, Gentlemen. How are you?

MR. CHARLES HUGHES:
Good morning, Ross.

THE CALLER:
Could you discuss the general loan to me, in what you've seen in the various categories of loans and the −− and how successful have you been in terms of trying to bring in those accompanying checking accounts with those new loans? Or you have a point where you won't take a loan unless you bring in the accompanying checking accounts?

MR. CHARLES HUGHES:
(indiscernible) frankly, that's a very good question. And let me start by telling you that the loan demand right now of this company is extremely strong and I think that falls primarily

because as I've said earlier, we bring people in to these companies who have been in their communities for a long time. They come from other banks in the communities so they know where the loans are −− as many of the loans as you can imagine under that scenario come in (indiscernible) season that I think that also helps from a credit quality standpoint. So I think that there's a couple of double benefits from getting people in the communities who are already, have been there for some time. I think we do get a lot of −− as you know, we are almost exclusively a commercial lending bank. So, the 95 percent of the loans we do are commercial loans to small business, and another 5 percent follows on the retail side. We do get a tremendous amount of commercial lending done in this organization and we will continue to be able to do that. Now, it's about 55 percent/45 percent real estate −− real estate to get straight commercial loans. And I would say Richard may want to comment on this also, but I think probably (indiscernible) probably all −− well over half of that, may be 60 percent of that, is on an occupied situations where we know the companies extremely well. And if we do any kind of a development loan (indiscernible) we make sure we stress−test it very, very carefully to make sure that it would not −− that we're underwriting it extremely strong. So that's up and we pay a lot of attention, too. On the standpoint of the relationships that you're talking about the deposit side. I think it's fair to say that we came out of the box in '98 pretty strong and making sure that we led with the credit products so we can build the assets of the company as quickly as we possibly could because we felt that was important. We all now have over the past year, the year and a half, we've gone into double bank and very strongly solicit deposit relationships from these folks we've loaned money too, and have been extremely successful in doing that and of course that's the reason I demand that profits are beginning to pick up in such a −−− in such a strong way. And to the last project question, Ross, I guess it's fair to say that we don't do it long now in this company unless we either have that (indiscernible) relationship already on the books. We have some pretty strong assurance that we're going to able to get it. Rich, do you have any other comments about the demand from each area?

MR. RICHARD KENSLER:
Yes. I want to add to that. We will probably, probably see a little change in the mix on the commercial real estate. We'll probably sit a little more months and more of the investment properties side. And that we've hired, probably in the last three months (indiscernible) commercial real estate vendors into the markets. But we'll maintain a strict adherence to our philosophy. We'll only do construction−type loans in (indiscernible) properties, and we've never been to get into these speculative real estate end of things. And as you can imagine, (indiscernible) we're seeing a lot of pressure in demand for fixed rate loans. Again, the relationship banker becomes very much involved there because we have to be very sensitive based on our deposit structure, how we price those things. So, unless that relationship already has a low cost deposit relationship with it, we're not going to do it unless the yields allow it to make sense in what competitive bankers out there will generally not going to get those. So, a deposit relationship is going to be a very, very important and a very strong factor in how we price private loans going forward. So there's a lot more emphasis −− well, not more (indiscernible) this, this very strong emphasis on that probably over the last eight, nine months in getting our relationship deposits product to the bank.

THE CALLER:
Rich, I just want a final clerical number (indiscernible) throughout the 1.1 additional shares from the convertible. That brings the total performance shares in pro forma equity to what? (multiple speakers)

MR. EDWIN STINSON:
Let me give you the exact −− that number is 1.228 million shares. And (indiscernible) back to the outstanding which is listed on page 4, I believe, of the (indiscernible) financial highlights section, we have 5.69 million in basic −− that's the weighted average shares as of the 1st quarter.

THE CALLER:
So you'll have roughly about 6.9 million shares, you say?

MR. EDWIN STINSON:
It's about 6.7 million.

THE CALLER:
6.7.

MR. EDWIN STINSON:
Yes. 6.714, I believe.

THE CALLER:
Okay. And then the pro−forma equity will stay at roughly the (indiscernible).

MR. EDWIN STINSON:
That's correct. Because on the balance sheet that 6 million 955 in the preferred stock just moves from there down into the common stock category.

THE CALLER:
Okay. But you're saying that was already included in (multiple speakers) 46.88 number.

MR. EDWIN STINSON:
That's correct.

THE CALLER:
Alright. Okay.

MR. EDWIN STINSON:
But not included in there is that, is the preferred security (multiple speakers)

THE CALLER:
Okay.

MR. EDWIN STINSON:
(indiscernible) bank side is (indiscernible)

THE CALLER:
Great, great. I got you. Thanks, guys.

MR. EDWIN STINSON:
Sure.

THE OPERATOR:
Gentlemen, at this time there are no further questions in the queue. Mr. Hughes, I'll turn the conference back to you for any additional remarks.

MR. CHARLES HUGHES:
Thank you, Felicia. Thank you, all of you, for joining us this morning. It is always a pleasure to be able to talk to you on that (indiscernible) that this company is having. We will we feel very strongly that the successes will continue and we're very excited about the future of Florida Banks. Thanks very much.

THE OPERATOR:
That does conclude today's conference call. We thank for your participation. You may disconnect at this time. (CONFERENCE CALL CONCLUDED)

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FAIR DISCLOSURE FINANCIAL NETWORK

04/17/2002 04:30 pm	**CSON**	**Cohesion Technologies (CSON) − CSON Q3 2002 Earnings Conference Call**

THE OPERATOR:
President and Chief Executive Officer. Before we begin the call, I'd like to caution listeners that comments made today by Cohesion's Management will contain forward−looking statements. This statements relate to future events or our future financial performance that involve known and unknown risk, uncertainties and other factors that may cause our or our industries results, level of activity, performance or achievements to be materially different from those express or implied by this forward−looking statements. We encourage listeners to review the risks outlined in today's press release as well as those outlined in recent copies of Cohesion's filings with the SEC. Including without limitation its form 10−K and 10−Q, which identify specific factors that may cause actual results or events to differ materially from those describe in a forward−looking statements. The content of this conference call contain time sensitive information that is accurate only as of the date of the live broadcast, April 17, 2002. The company undertakes no obligation to revise or update any statements to reflect events or circumstances after the date of this conference call. This call is a property of Cohesion Technologies any redistribution, retransmission or rebroadcast of this call in any form with out the express or in consent of Cohesion Technologies is strictly prohibited. This conference call be archive for replay on the Internet through Friday in Cohesion web site at www.cohesiontech.com. With that said, I'd like to turn the call over to Bill Mavity, President and Chief Executive Officer of Cohesion.

MR. WILLIAM MAVITY:
Thank you Lisa. Pretty assumed the cautions regarding longer than the call. Good afternoon and thank you for joining us to review Cohesion Technologies financial results for the three−months ended March 31, 2002. For the first time in the company's history, we were

actively marketing two FDA approve products and we achieve product sales of more than $1 million. I am particularly pleased with the efforts of our dedicated US sales organization over the past few months. Resulting a successful US launched of CoSeal(R) surgical sealant are unique, completely synthetic vascular sealant in February. Our sales representatives are making excellent progress working through the new product approval channels at hospital depressed the country and feedback from surgeons who have CoSeal(R) has been exceedingly positive. In addition, our renewed Psycho−healthcare emphasis on our business in Europe is beginning to have a positive impact on both CoStasis(R) and CoSeal(R) sales there. We also believe, we made substantial progress toward raising additional capital funding for the company and we are actively involve in discussions with the number of high quality institutions and well respected PentreCabeler firms. I'll provide additional details on these topics and others following a review of our financial performance. As noted in the press release, revenues for the first calendar in fiscal quarter of 2002 increase 39 percent to $1.1 million compared with first quarter 2001 total revenues of $809,000 and increase 24 percent compared with fourth quarter 2001 revenues of $911,000. Product sales in the first quarter showed strong positive momentum, increasing 43 percent to just over $1 million compared with first quarter 2001 product sales of $722,000 and up 26 percent from product sales of $817,000 reported in an immediately preceding quarter. Cost days of sales for the quarter were $609,000 and increase of 55 percent from prior year first quarter sales of $309,000 is up 20 percent in fourth quarter 2001 sales of $509,000. Wholesale sales totaled 293,000 during the quarter and increase of 50 percent for the first quarter 2001 sales of $195,000, up sequentially by 83 percent compared to the $160,000 reported in the immediately preceding quarter. Gross margins were negative for the quarter and continued to reflect the high level of fixed manufacturing cost. However, we are realizing positive incremental gross margins and we are strongly focused on increasing this positive contribution level as product sales increase. RDexpenses in the first quarter were $1.2 million, a decreases of 46 percent compared with RDexpenses of $2.3 million in the prior year quarter and down 26 percent from $1.7 million reported in the fourth quarter of 2001. Reduction in RDspending is due primarily to the completion of the CoSeal(R) clinical trial and the reduction of head count due to a November 2001 restructuring. SGAexpenses in the first quarter were $3.1 million, up 92 percent from the $1.6 million reported in the year ago quarter. These totals reflect the expansion of Cohesion sales and marketing organization to support direct US sales of CoSeal(R). Cohesion reported an operating loss of $4.9 million for the quarter equal to the comparable period last year and reduced by 14 percent compared with the fourth quarter 2001 operating loss of $5.8 million, which included a $640,000 charge for restructuring and other cost. For the first quarter ended March 31, 2002, Cohesion Technologies reported a net loss of $4.9 million or 52 cents per basic and diluted share compared with the net loss of $3 million with 32 cents per basic and diluted share reported in the prior year period. As March 31, 2002, company has cash and cash equivalents of approximately $12.8 million. Moving on to non−financial issues, in mid−March pre−trial hearing on our patent infringement suit against Fusion Medical to Southern California to clarify the construction and interpretation of the specific patent claims. The court opted the majority of Cohesion's proposed claim constructions. However, portions of the courts disclaimed interpretation to support a position that Fusion wholesale product does not infringe patents hold by Cohesion Technologies. Following review on the strong recommendation from counsel, we have found an appeal of the decision on decision process covering the areas of disagreement. Our decision to appeal, we like to delay the overall process by up to a year. And as a result our related spending is expected to decrease for the balance of 2002. More importantly, we will retain the opportunity to prevail on those case and to protect our international property from an in appropriate infringement. I should also remind all listeners that the patent involve in this case and non−impact either CoStasis(R) or CoSeal(R). As I'm sure, you're also aware Cohesion filed its 2001 Form 10−K with the SEC at the end of March. The document, which included our going concerned opinion by Cohesion's independent auditors Preston Young Caroti (phonetic). Public accounting firms like generally required to issue a going concerned opinion whenever a client company has less than 12 months of cash available to support continuing business operations base upon historical burn rates, if any more was subsequently pickup and separately release by various news agencies including Dow Jones. The issuance of this opinion reflects absolutely no new information. In both quarterly filing and communications since I joined Cohesion, we have indicated that we were planing to conduct the financing this year. While other are obligated to remind stockholders of the current cash situation on operational needs of the company. These factors have not change unexpectedly and assuming we are successful in our funding efforts, the opinion will not affect our on going business. But the recent realignment of the company and the FDA approval on market launch of CoSeal(R) l, we continue to believe that Cohesion has an exceptionally bright future. Actually right now, I'd like to talk a little bit more about that future, we are really determined of the ultimate value of our company, our products. As you know, I must start with CoStasis(R), as you're aware CoStasis(R) is primary distributed by the US Surgical organization in the United States and assist the organization Psycho−healthcare in Europe and other countries. We continued to receive positive feedback about CoStasis(R) and we are actively discussing with our marketing partner the means to improve CoStasis(R) sale result. We're also beginning to generate some CoStasis(R) sale in the United States through our direct sale organization. So at this time, our dominant focus is to drive CoSeal(R) sales. Our European CoStasis(R) business has benefited from our renewed emphasis by Psycho− healthcare. However, we still feel that significant opportunities for dramatic growth remained, if we can simply broaden the number of countries actively generating customer address in sales. Sales of CoStasis(R) in Europe were up 61 percent sequentially in the first quarter and were more than double of the prior year quarter results. In the US, we realize a modest increase in CoStasis(R) sales to the surgical organization. It appears that the longer−term penetration and mortgage share growth of our ardent hemostat product will ultimately rush with our own organizations ability to effectively sale more than outstanding hemostat in the world's only synthetic vascular sealant for the appropriate clinical indications. For example, one of our clinical specialist was contacted about two weeks ago by international radiologist who wanted to use CoSeal(R) to close about this to them. Our specialist explained why CoSeal(R) would not be the ideal product, suggest the CoStasis(R) instead. The case was successfully completed with CoStasis(R), demonstrating what we can potentially achieve if we continue to fill a role of appropriately guiding positions to use the right products at the right time at the clinical in patient situation. Last quarter, I also mentioned that Dr. Jeffrey Yan (phonetic) and ENT surgeon of the Columbia Prostetirean Medical Center in New York submitted an abstract from the use of CoStasis(R) in sinus procedures. I'm please to report that his abstract was accepted for presentation at the upcoming National ENT meeting in San Diego in September. Cohesion also recently announced the receivable approval from the FDA as a matter of fact CoStasis(R) product labeling to permit product use in neurological procedures. Obviously, there's already been some off label use of CoStasis(R) in Neurology field. We are initiating further contacts with Neurologist to expand the use of CoStasis(R). To summarize, the advance hemostat market is still evolving and it's still have its numerous opportunity for sales growth driven by solid clinical results over a variety of procedures and positions specialist. Moving on to our second approve product, CoSeal(R) surgical sealant. International sale of CoSeal(R) decrease 37 percent from the December quarter. As I noted, a moment ago in discussing CoStasis(R), we are pleased with the renewed emphasis that our products are receiving from the Psycho−healthcare organization in Europe. However, again we feel the potential for substantial gains still exist if we get add to a number of companies −− number of countries reporting significant and newer sales. We will be working with Psycho−healthcare Europe in the next few weeks. In a meeting, discuss our opportunities and ways we can work together to better leverage, Cohesion's products and technology. In the United States, of course where are the CoSeal(R) was officially launched at the Society of Forensic Surgeons meeting at the end of January and the sales to our 15 person direct field sales organization begun in February. Recognizing that the selling process for a new product today involves not only trial to generate position demand for the product but presentation as to value analysis or product approval committees in each hospital to gain their approval to have another product of hospital inventory. We expected to generate between 50 and $100,000 of US CoSeal(R) sales in the first quarter. I'm please to report that goal wasn't that. I also want to note that sales in March, the three times the level of sales in February. More importantly, base upon the reported average daily sales for the first 10 sales days of April, second quarter US CoSeal(R) sales were more than triple the first quarter actual results. We are obviously expecting continued growth during the balance of the second quarter. In my conclusion is it the CoSeal(R) launch is on track to achieve our goal at positioning CoSeal(R) as the valued edition to the armamentarium of Vascular and Cardio Forensic Surgeons. I don't plan to review number of number of accounting, we iterate from the ongoing basis in future quarters, as this type of information could be quite useful to both current and future competitors. However, I want to get some other detail of this early stage to provide you with additional insight into how well our products launches really going. To April 10, we have received US CoSeal(R) orders from 28 customer accounts. Although, the counts that is placed our initial order prior to April 1, 62 percent have re−order the product at least once and every one of our sales persons had generated multiple product orders. As I noted earlier, certain feedback referred does far as been overwhelmingly positive. We've receive comments in surgeon indicating procedural time savings that range from 10 minutes to 45 minutes obviously, sufficient to justify product use at estimated average operating room cost. One of our sales person also received the comment from a surgeon indicating his belief that CoSeal(R) can significantly reduce a frequency of full surgical vascular bleeding that results in a return to the operating room. What she felt was as much as 5 to 20 percent surgery involving slow vessels and even larger numbers of large vessel surgeries. We will endeavoring to capture this type of information as we build our support story for CoSeal(R) over the coming months. Giving the positive initial response to CoSeal(R), I've recently authorize the expansion of our US direct sale organization by 20 percent adding three more direct sales person to our present 15 person team. We expect these added resources will support continuing CoSeal(R) growth in the latter half of this year. Looking forward, Cohesion will have a major presence at the American Association of Forensic Surgery meeting, which is to be held in Washington D.C. in early May. This will be the second significant Forensic Surgery Conference that we will exhibit since CoSeal(R) l was approve. The activities we have plan for this meeting, include direct mail pieces to attending surgeons and several and good presentation of CoSeal(R) clinical results by permanent surgeons. We expect to generate an increasing number of qualified lists at the meeting. Providing our sales organization with ample opportunities to continue to expand our account base over the balance of the year. In terms of new product development, Cohesion has a study underway in Europe, tracking the performance of CoSeal(R) on use as an artisan prevention barrier for pediatric cardiac surgery patients who are expected to undergo sequential surgical procedures. Today, 17 patients have been seen in follow−up surgeries. The surgeon have send us compelling photography of the cases fairly illustrating the success of CoSeal(R) as generated in this very, very difficult patient populations. Our number delimited by acquiring corresponding result as far. In terms of financial guidance for 2002, the outlook convey in our previous earnings release (indiscernible). In calendar year 2002, Cohesion expects to report revenues on at least $7 million more than double calendar year 2001 results. We expect the gross margin will turn positive during the year. RDspending is expected to range between 5 and $6 million, the decrease of 42 percent to 30 percent compared to 2001. SGAspending is expected to range between 12 and $15 million. Company expense to report in operating loss for the year of between 17 and $20 million and improvement of 21 percent, 7 percent in comparison to calendar year 2001. We get on our near term milestones over the coming months are two highest priorities are to grow our top line and to finalize a corporate financing. You're working along side US surgical to create demand for CoStasis(R) in the United States. Internationally, we will continue to monitor and support sales, which happen trending−up and rise the quarters. We are aggressively creating awareness of and demand for CoSeal(R) within the medical community and expect US CoSeal(R) sales to ramp up nicely in coming quarters. Finally, the number in qualitative investors interested in a Cohesion financing is very encouraging. We're certainly where the sum of this interest maybe reflected of a current valuation but it is obviously supported by large opportunities present within the company. We will communicate with shareholders when we have some thing definitive to report on the financing and we will like be seeking shareholder approval of the financing proposal At this time, I'd be happy to answer any question that may have arisen.

THE OPERATOR:
Ladies and gentlemen, if you'd like to ask a question (CALLER INSTRUCTIONS). Archie Smith with US Bancorp.

THE CALLER:
Hi, Bill how are you doing?

MR. WILLIAM MAVITY:
Good afternoon Arch.

THE CALLER:
How are those surgical excess products?

MR. WILLIAM MAVITY:
Still selling well but this will be better.

THE CALLER:
A quick question for you or actually three or four quick questions. You indicate that you are making progress with you adhesion product at least of any early clinical testing. What are the differences between that product and the conventional version of CoSeal(R)?

MR. WILLIAM MAVITY:
Actual there are zero differences. The CoSeal(R) chemistry with its ability to polymerize by in the tissue and then have low internal trunk. We think it as an ideal adhesive prevention barrier, essentially in its current configuration.

THE CALLER:
So, it's ideal to −− you done no modification of the product at all?

MR. WILLIAM MAVITY:
None at all. The only thing we expect to need to do long−term and this is the need to provide alternative delivery systems.

THE CALLER:
And what regulatory path or issues would there be before you could label your conventional CoSeal(R) product as an adhesion barrier.

MR. WILLIAM MAVITY:
We're actually discussing the approach that we will need to take in terms of the CE market in Europe. And we're hopeful that some of the data we have and a limited clinical study in this pediatric cardiac population might be insufficient to at least generate a limited indication on your CE market and perhaps a broad one. In the United States we know the large market for adhesion prevention is a different market and the primarily in the gynecologic and general surgery market. And that will certainly have a different regulatory path in the US. Once we can make sufficient position contact and we're sure of the pathway will be talking to the FDA about that.

THE CALLER:
So, you don't know what the path would be in the US if it would be a PMA or a 5 10−K?

MR. WILLIAM MAVITY:
I think we would expect it to be a PMA. Because they imbibe a PMA process as soon as −−− assuming our product its current configuration turns out to be adequate. Is that the safety profile of the product at least in the vascular system criteria is very, very well understood by the agency.

THE CALLER:
So, hopefully the PMA was out on the ombudsman review?

MR. WILLIAM MAVITY:
We will certainly expect that if we do our job well.

THE CALLER:
A couple of quick other questions. Despite a renewed focuses site type on your product line, which is very positive, are they hitting their minimums at this point or not?

MR. WILLIAM MAVITY:
No. I actually mentioned that renewed focus; primarily we're seeing it in Europe. They have missed their minimum on CoStasis(R) and they will have until later this year to establish to maintain our goal for CoSeal(R) by hitting minimum. They will have to work with us to ramp up sales really dramatically to let that happen and we're certainly hopeful that they're successful in doing that.

THE CALLER:
Okay. But you haven't −− so CoStasis(R) cause they have missed minimums, CoSeal(R) they

haven't had a chance to hit them if that's what you're saying.

MR. WILLIAM MAVITY:
That's correct.

THE CALLER:
Okay. What is the competitive waterfront that you're seeing right now on the surgical sealant? Front who seems to be getting traction that is not getting traction in the channel?

MR. WILLIAM MAVITY:
Most of the competition comes from two areas. One is Hemostat product positioned to sealant by competition. We believe the tortuous path we've used to most of those products will –– very solidly position CoSeal(R) do it, due to its very fast response time as a preferred product. Secondly we are aware that one of our competitors is aggressively pushing a product that seems to be –– originally studied as a more of glue than the sealant, we use it as a sealant. And again, we would feel these effect on the nature of our product that is its ability to be reabsorb into the body once it done its job will position itself advantageously in the regard also.

THE CALLER:
And who is the latter competitor of this?

MR. WILLIAM MAVITY:
ByGroup and their from Craile. Again, being position fairly aggressive for sealant applications right now.

THE CALLER:
And the idea, the big difference there is that their product is not reabsorbed?

MR. WILLIAM MAVITY:
That product is not reabsorbed it harden we think flexible product that rapidly reabsorbed to be far comparable in the long term. And will be collecting data to show that clinically.

THE CALLER:
Great. Thank you very much. That's all I got.

MR. WILLIAM MAVITY:
Thank you. Next question.

THE OPERATOR:
Matt Dunken (phonetic) with Stevens Incorporated.

THE CALLER:
Hi, Bill. Congratulation on some very good progress on the quarter.

MR. WILLIAM MAVITY:
Thank you, Matt. We still had a lot of work to do but it's feels pretty good right now.

THE CALLER:
Well, you're certainly doing all the things that you need to be doing at this point. First question for your sales force, your fifteen people now and you're looking to add three more. If you thought much about the timing, is it probably a back up half of the year, when you would start adding people?

MR. WILLIAM MAVITY:
No. We are interviewing anxiously and I'm hoping we have the next three on board before the end of April.

THE CALLER:
Great. So you might even add more on top of that then by the end of the year?

MR. WILLIAM MAVITY:
If our trend continue as I did it today we will definitely add more.

THE CALLER:
Great. What is your geographical coverage like right now for the sales force?

MR. WILLIAM MAVITY:
We are hitting about a third of major cities that involve cardiac surgery centers and obviously that's the reason to keep pushing.

THE CALLER:
Right.

MR. WILLIAM MAVITY:
People have more needs than they can possibly address in the time they are available. And we are also considering distribution alternatives for some of the areas where we know we would not likely to place a full time rep in the future.

THE CALLER:
Sure. Have you thought about how −− what kind of an end number is that you might need to be able to serve the market, you know the whole geographical market?

MR. WILLIAM MAVITY:
Yes. Based on prior experience in the cardiac surgery field, which I'm in four − five years and at length ten years ago. Twenty to twenty−five would be about the right number to address the open−heart surgery center in the United States effectively.

THE CALLER:
Okay, great. And then I guess most of my questions have really already been answered. The main thing I was kind of focusing on is the anti−adhesive capability of CoSeal(R) and at what point you may be able to have a product on the market there? I mean that's certainly a very attractive market and it's getting more and more crowded everyday, so I think the quicker the better. How soon would you hope to be in early −− in trials with that product?

MR. WILLIAM MAVITY:
I think it's a little dangerous for me to go on to that right now. I might be able to do that in the

next quarter or two. Certainly in Europe, we were successful in discussing expansion or substance of data through this same process.

THE CALLER:
Right.

MR. WILLIAM MAVITY:
It would be possible to file a regulatory clearance request this year certainly and who knows what the response time. We've been very fortunate in our dealings with the unified body in Europe.

THE CALLER:
Right.

MR. WILLIAM MAVITY:
And we have a great regulatory staff here at the company. So, I'm optimistic that it could come sooner than later.

THE CALLER:
Okay and then last question. In terms of funding, do you have a date in mind that you would like to have funding in place by?

MR. WILLIAM MAVITY:
I certainly, like to have it in the shareholders hand it's only the approval is what we need and expected will be before at the end of this quarter.

THE CALLER:
Okay, wonderful. Thank you.

MR. WILLIAM MAVITY:
And then one follow−up to your question, I should mention one thing. I was answering twenty to twenty−five sales representatives. Our sale organization does at time include the management and clinical specialist.

THE CALLER:
Right.

MR. WILLIAM MAVITY:
That sales organization would probably be closer to thirty by the time we started to do it.

THE CALLER:
So, what do you think then on the clinical specialist they don't need maybe 0.5?

MR. WILLIAM MAVITY:
We're trying to firm up the right ratio. They are extremely valuable people.

THE CALLER:
Yes. I've certainly one to one ratios between specialists and the sale people in other cases.

MR. WILLIAM MAVITY:
Their current thinking is in the long−term in the four to five to one type situations with them. Dramatically helping sales will be affected with cost basis (inaudible).

THE CALLER:
Right. Thanks a lot. I appreciate it.

THE OPERATOR:
Larry Heimelbeich (phonetic) with Heimelbeich Med. Tech. Consultants.

THE CALLER:
Good afternoon, Bill.

MR. WILLIAM MAVITY:
Hi, Larry.

THE CALLER:
Question for you relating to what level is sales volume that weight at the level of the business is currently configured that would get you to break−even and break−even cash flow? It's a two separate question. Break−even and break−even cash flow.

MR. WILLIAM MAVITY:
With the amount of passivity. I have right now, I'll answer it both together Larry. We're still sorting out the structure.

THE CALLER:
Probably pretty close anyway, I would think.

MR. WILLIAM MAVITY:
I don't think it will be too different. Probably amount of 30 million is my guess on the run rate basis. And again, the keys as issued are two−fold that we're wrestling. I have very good news on one of them. Selling price as we put our product out in the market we've established selling prices. And our products are being valued by Cohesions and we're not getting a lot of disagreements that our product is off to value equivalent of what they're being charged for. And we'd actually forecast that to be a more difficult issue. Hard to see, this is at early phase it may change. As we try to respond with that situation that we intend to do, that will certainly put some pressure on the selling price. But we're quite comfortable with the basis of estimates that made me comment on the 30 plus situation. Second piece is gross margin, and you know when you're a negative and if you look at our quarterly comparison year over year versus sequential almost creative results in the coming of gross margin. Created about a 100 percent year over year and then in the little 20 sequentially. We just don't know the answer yet. We have taken a long−term look of what we expect five year volumes but then we feel very, very good about CoSeal(R). Still pretty good about those bases. How fast we can get this sequentially I don't have the answer to it.

THE CALLER:
So, no predictions on when you hit −− start to get to work to a break−even quarter or you think that this is too far off?

MR. WILLIAM MAVITY:
I hope in the next three to six months we can do a lot better job of predicting that but it's a little bit too early.

THE CALLER:
So, fair to say then Bill that the funding you're currently contemplating, I know you're contemplating a reasonably good size financing obviously larger than a pipe otherwise you would need shareholder approval. Would that necessarily take it to the finish line? Finish line being of course break−even or making money.

MR. WILLIAM MAVITY:
We've mentioned last quarter that we were looking at a $10 million to $15 million financing. We certainly have interest from investors in a little bit larger transaction and we're certainly in the process of judging what the right thing to do on behalf of the shareholders. Both in terms of time separating funding and whether if we were able to get a bit larger we might have enough to make it all the way. That's in the current discussion and will be discussed by the Board tomorrow.

THE CALLER:
In terms of getting this financing transaction close, it sounds like it's something fairly imminent.

MR. WILLIAM MAVITY:
We expect it would be, although as we all know until the terms are on the table and sign we never quite have that billing. And of course I would expect shareholders would have the opportunity to decide if they think it's the right thing to do for the company.

THE CALLER:
Right. Okay, Bill thanks.

THE OPERATOR:
Lyn Piper (phonetic) with Thomas Lysol Partners.

THE CALLER:
Hi, Bill.

MR. WILLIAM MAVITY:
Hi, Lyn.

THE CALLER:
Just two things quickly. First, could you just quantify for me the US market opportunity in for both the CoStasis(R) and then CoSeal(R) and then splitting out the adhesion opportunity separately?

MR. WILLIAM MAVITY:
Certainly. On CoStasis(R) as we look at an aspect of all the surgical procedures that might be have diffused bleeding or in that effect might be applicable. We come out in the US margin in the $150 million range and I fully expect selling price to set a low today. I could estimate where that market is going the (indiscernible) product from Baxter the identical product from

Immosil been low I believe 98 and we would believe our run rate are north of 50 million right now. So the markets real, the change from fiber glue to more predictable performance with the hemostat is happening. We need to be more effective in selling our product and its benefit to capture more of that share. But you know the market numbers I've mentioned were pretty comfortable. If we look at CoSeal(R) we've identified about a conservative number of about 300,000 procedures where it would apply. And we were thinking the average selling price again based upon volumes of material used, we don't have that final answer yet. But at least in the equivalent market, probably somewhat larger and the primary procedures we see for the product are Euric and or −− excuse me forensic (indiscernible) on a graph placement, synthetics graphs. Detains from paper and glues to be more predictable performance but the (indiscernible). We −− depending upon how the market and the estamatic device is shaping they might be an opportunity there as well. So, that's the kind of size we see. And on the adhesion prevention side, I think the largest in that area of course is an effective product that could be use microscopically. In gynecology, we would estimate that market to be in the $0.5 billion range based upon public studies. And in addition, there is an open surgery market that's quite sizeable on both gynecologist and general surgery. So a huge market there.

THE CALLER:
Okay, great. And then just secondly, what's the reimbursement landscape like in the Novarious?

MR. WILLIAM MAVITY:
We would expect our product to be not separately reimbursed to fall under DRG codes that exist for our procedures, which is why we're so focused on. As I made my comment about time saving sufficient to justify cost. We're quite comfortable saying that surgeons were probably gravitating works of product. So we continue to hear the cut of anecdotal feedback we've heard concerning re−bleeding coming back on DOR and doctor is going home instead of waiting in the waiting room to see if the place starts bleeding again post−procedure. We think its a while to capture that part in the economics stories, so we really focus on time savings. At this far it looks pretty good. We will have to be at least pay for itself to be successful under DRG codes and in our view.

THE CALLER:
Okay, great. Thank you.

THE OPERATOR:
Tom Galesty (phonetic) with RBC.

THE CALLER:
Hi, Bill. In regards to Asia specifically Japan. How do things look over there?

MR. WILLIAM MAVITY:
We do not expect based upon the current classification post−basis the type of product to be taking that price to Japan. We have a partner who is conducting regulatory clearance for us in our behalf. And we will be discussing commercialization once reimbursements received with that company. They have filed suit and we are hoping to have a decision from the Japanese authority in the first half of this year. And if that would come on time we would be in the position to have reimbursements on there about. Again, under average timing with the Japanese authorities, which if you know is quite unpredictable by mid 2003. Will customers

there that are part of the good solid one. We look forward working with them and we think we'll do a lot of sell of CoSeal(R) in Japan, but again there is no way to beat the regulatory reimbursement timetable in that country that I'm aware of.

THE CALLER:
Will that could be a very big market for you?

MR. WILLIAM MAVITY:
To be quite sizeable, cardiovascular surgery is not as widely practice there but are a number of vascular surgeries that are virtually the same frequency or similar frequency to the United States as they have functioned the population. This could be a very attractive market and we're certainly looking for a boost. And whenever the fact received reimbursement and showed an approval and is actively being purchase for sale.

THE CALLER:
Thank you very much.

THE OPERATOR:
And ladies and gentlemen, we would just like to remind you that if you do have questions at this time (CALLER INSTRUCTIONS). Ron Seybell (phonetic) with Charlotte Capital.

THE CALLER:
Hi, Bill.

MR. WILLIAM MAVITY:
Hi, Ron.

THE CALLER:
I've got four questions. First, anything you can tell us on the financing? I guess it's kind of set shareholder expectations to the extent you can?

MR. WILLIAM MAVITY:
Probably a bit premature, Ron. But let me qualify and try help a little bit. We've been pleasantly surprised by the −− as I mentioned by the level and the types of these C−type firms that are interested in our company. If you step back a little bit and look out and it's very simple to see why. The chance to invest in a company is currently market valued at $25 million range and with two FDA approved product in the sales force. And a management team that continues to execute and get the job done. That's a lot lower risk profit, to our understanding once you step back a little bit. What you're seeing in terms of the PC mezzanine funds that are doing well in public companies is the discounts that range in the average that we picked up in about 15 percent range. I think that's the kind of things that we'll likely to see. The question becomes where do you taking from and what's the time frame? And we're still sorting that out.

THE CALLER:
You have said that there's renewed focus on US surgical, which is fantastic. Could you give us any feedback into how that occurred or why that occurred?

MR. WILLIAM MAVITY:
Again, I mentioned that we're seeing most of that evident in Europe more so in the US right now. Not that they're not interested in US but at this point in time we are launching CoSeal(R) on our own in the United States so that's obviously causing some -- all I say is challenges but we have sales organization as we wrestled it. All for that -- of course our people will start to see CoStasis (R) opportunities in the US as we imposition CoSeal(R). We're working hard to try not to compete with someone selling our own product. That will be a very dumb thing to do. We're trying to work with them not to do that. In Europe, we met in October when I first came on board and I had a long discussion about the relative success there or sales opportunities and execution both on in Europe and the US. My feeling is that the management decided this is an important product they have in Europe and they want to be in it. And we're certainly are seeing a lot of discussion in management report. Like one of our people just came back from the European meeting had very positive things to say about the status of our products has positioned in that conference.

THE CALLER:
Is it your sense that there was any customer potential -- customer pull through that may have encouraged them to pick up their focus?

MR. WILLIAM MAVITY:
I don't know it. I think -- one thing I did try to say in the call to be a little more explosive. We are not seeing uniform participation by all countries. And while in Europe as we all know every country's scheme is not necessarily a sure good opportunity. And generally, we should be present with the previous business as more than half of the countries in Europe we're there today. So what we're looking for from (indiscernible) will be discussing. At least we can cooperate with them and help them broadly the opportunity and be successful in more than a few countries. That's really what we're hoping to have happened as this year goes forward.

THE CALLER:
Okay. You have mentioned you have surgical in CoSeal(R). Any sense you can give us on US surgical roles in CoSeal(R) or something we can talk about that?

MR. WILLIAM MAVITY:
Well I can simply say we are discussing the possibility and it's too early to tell.

THE CALLER:
I think your quote will rely on internal efforts to expand CoSeal(R) on CoStasis(R) side in here of sales. And I think it could probably put CoSeal(R) in the US as you mentioned.

MR. WILLIAM MAVITY:
Yes, I think we're actually going to be -- I did mention the US but I think we're ultimately going to determining on our destiny on CoStasis(R). I just look at the sales effort required to position CoStasis(R) and the competition due to our surgical sales people have from other products, which they obviously they're selling. And I think it's going to take a stronger focus on average. Some of the group people are doing very, very well. But I think on average, it may take a stronger focus. That means that my hope would be that we positioned CoSeal(R) very effectively. We're going to territory and we begin to work on CoStasis(R) and place where we are involved today. We have lots of those, lots of opportunities. And I think overtime, I would hope that we're at least equal to the contribution made by US surgical in the

United State as well as the − obviously, cooperating with the sensibility of the European business.

THE CALLER:
Is there any chance that you'll just completely go to the long run with CoSeal(R)?

MR. WILLIAM MAVITY:
I think that would −− there's certainly a chance if we continue to do extremely well and there surely there is a possibility.

THE CALLER:
In any of the AMNA activity of your competitors is suspecting anything that's going on in the market?

MR. WILLIAM MAVITY:
No. It certainly which would affect our plans. If someone fix for that twelve enough by driving sales. No, I don't think it's on the short term. I think the only thing to play on were a little bit hard to understand in terms of valuation. I certainly don't expect. It is nice that people recognized the sectors that attract the inside value long−term. It goes down to great sales and execution to such a way of higher value and that's clearly our problem. It's not affecting our current financing.

THE CALLER:
Yes, my thought was when you're selling is that a positive or a negative or then is it just immaterial when you're gone out of the market and talking to people?

MR. WILLIAM MAVITY:
In the market, really immaterial. We just start most of the activity were really affected by these issues particularly. I think as the buying group situations around our products become more pronounced in this field I think we'll see more influenced. I faced that before in my last company and I think we have to also deal with the fact that they got −− start to be an impediment for us.

THE CALLER:
Okay, thanks. Great job.

THE OPERATOR:
Matt Dunken (phonetic) with Stevens Incorporated.

THE CALLER:
Hi, Bill. Just a couple real quick follow−ups. I think I got these sales number rights. But just to make sure with it 609,000 on CoStasis(R) and 393 on CoSeal(R).

MR. WILLIAM MAVITY:
It was 609 on CoStasis(R) and 293 on CoSeal(R).

THE CALLER:
293 on CoSeal(R). So the rest of that is just what's the rest of the product sales just understood?

MR. WILLIAM MAVITY:
(multiple speakers) Laboratory Front.

THE CALLER:
Right, okay, great. Can you talk it all about an ASP for CoSeal(R) and CoStasis(R) at this point? I know it's going to be difficult on CoStasis since −− there's obviously going to be a difference between what you sell at form or what you get from US surgical.

MR. WILLIAM MAVITY:
Again on CoStasis(R) because the honest answer is I really don't know. We are obviously starting to be sensitive to that as we start to sell. What we are finding it's fairly wide range among accounts in the US and again with the larger organizations it's very, very difficult to please pricing issues and we would hope to be a little more uniform at our years pricing guidelines. It is a fairly attractive and we're surprisingly what we are hearing but again we don't have any good visibility with what US surgical is doing across the board. And we'll certainly try to be very sensitive that we don't end up in price schemes in product and we end up in product versus competitors. But on CoSeal(R) I mean go back to that product. I'll just price it for 24 and 8 millimeters respectively or $265 or 55 and 795. And again we're seeing good response to devaluate equation represented by that those general types of prices. We feel quite positive about that.

THE CALLER:
Okay, great. Thank.

THE OPERATOR:
Larry Heimelbeich.

THE CALLER:
When you rank the market opportunities could you run to them for us some of the maybe top three or four in terms of the cardiac surgery versus last year surgery, etc.?

MR. WILLIAM MAVITY:
For again −− we'll do it quickly by product, CoStasis(R) is for every kind of surgery that purpose bleeding. It were indicated very special so it got a lot of room.

THE CALLER:
Which one or two would you guess would be your breakthrough?

MR. WILLIAM MAVITY:
I think we'll make that decision based on where competition is strong rather than put the opportunities are. We're behind it. We have great opportunity that we can focus on. Things like EENT for instance to make up a lot of ground. On CoSeal(R) are clearly for vascular we signed or if someone use synthetic graft situated to the national vascular structure. The structure bleed and we can help them make that go away very, very quickly and very effectively. And that's where really shine. So it's going to be a vascular procedure. That's why I've mentioned (indiscernible). I've not anticipated we'll see much interest there. We have a little bit already. It surprised me I know that market quite well. The only thing I see that would change is the estamatic device if become widely used and do not perform quite as conventional estamatic closures. We might have enough an opportunity there.

THE CALLER:
In other words, there'll be enough for those who does their sales well and they might be using them for sealant.

MR. WILLIAM MAVITY:
Yes. They bleed a while and make another stitch and if they use a stapling system to make another stitch it is usually is not an option. That maybe an opportunity for us, we're not counting that out in our minds at all. And obviously, the (indiscernible) with gynecologist is really the big market.

THE CALLER:
Well that sounds like the gynecology market sounds like spread the way given that you haven't began any clinical yet.

MR. WILLIAM MAVITY:
That's correct.

THE CALLER:
So, when you look at the fifteen sales that you currently have are they concentrating on certain market segments then?

MR. WILLIAM MAVITY:
The areas or position have been much of interest for them and does far have been in the (indiscernible) graph placements. That's what we hear the most, we have seen uses in all the types of procedure. I mentioned but that's really the shinning one right now.

THE CALLER:
Now, when you say (indiscernible) are talking conventional procedures or the newer triple A stein crust.

MR. WILLIAM MAVITY:
The stein crust were done in (multiple speakers) that is not going to be an opportunity for us.

THE CALLER:
Right, that is true.

MR. WILLIAM MAVITY:
It looks like maybe 20, 30 percent of the total 130−140,000 will be done that way −− about 100,000 procedures open and a nice market for us.

THE CALLER:
Okay, thanks Bill.

THE OPERATOR:
Tom Galesty with RBC.

THE CALLER:
Bill, most of your sales sold a lot of peel asking for your product you're going in and then also the learning curve when you go to the hospital, how long is that?

MR. WILLIAM MAVITY:
Do I have to answer both? With almost steady product today, we would find it wise to have clinical specialist to wonder where people going with the product in our sales be able can also to CoSeal(R). And demonstrate the use and we will that product in no charge typically. As soon as that one case has been done, we would want to expand case. We would generally try to get account to buy on what we call the sprayable and that were pretty successful above this low line, very good reception. But we are at this point in time putting a number of products for a trial and it's not −− I'd run business this way before, it's not enormous in any way she perform. In fact, it's a little bit less than I plan. So that it looks good. Your second question, I'm sorry Tom I lost it.

THE CALLER:
Are they the learning curve for this (multiple speakers). How is that time line?

MR. WILLIAM MAVITY:
Very correct. One case and the other thing we want to do on the case is show all of us the position of the nursing staff. How easy is it to prepare one that is involve is something two zero packages that empty in a (indiscernible) back and forth sometimes, which I can do in about 25 second each. Taking those −− putting them in a holder, putting a cap on it taking all excess air, pretty now going delivering it. And even I who are not very good at this compared our nurses and the doctors can do that much comfortable in less than three minutes every time.

THE CALLER:
On you exposure at the meeting coming out up in May. Are you looking for shut the arm in that regard?

MR. WILLIAM MAVITY:
We certainly are. I'll be bullet low cruder than I would normally on the call. It come time when launches −− when you say the time to kick button and take name is less time to show. This medium will be a great one for us; we are really looking forward to it. We're going to have a very good presence, I think we will be very well received and we have a lot of word on that playing around in the industry right now.

THE CALLER:
Already. Thank you.

THE OPERATOR:
Mr. Mavity at this time I'm going to turn the call back over to you for any closing remarks that you might have.

MR. WILLIAM MAVITY:
Again, I do want to reiterate that we have very enthusiastic and optimistic about our future prospects. We have taken staff to gain control of our own destiny. We have a very clear focus and we do have a team capable of delivering the goods. I do look forward to joining you through the rest of the year to report our success and thank you for your interest.

THE OPERATOR:
Ladies and gentlemen, this conference call will be made available for replay. If you would

like to hear a replay of this call, please contact Lisa Morgensai, Investor Relations Manager at (650) 320−5633; again that number is (650) 320−5633. And Mr. Mavity does that conclude our conference?

MR. WILLIAM MAVITY:
It does, thank you very much.

THE OPERATOR:
Very good. Ladies and gentlemen, our conference call has concluded we do thank you for your participation and for using ATTExecutive Teleconference. You may now disconnect. (CONFERENCE CALL CONCLUDED).

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04/17/2002 05:00 pm	**DAVE**	**Famous Dave's of America Inc (DAVE) − DAVE Q1 2002 Earnings Conference Call**

COMPANY REPRESENTATIVE:
Good afternoon everyone and thanks for joining us. We continued the profitable execution of our strategic plan during the first quarter of 2002. We did experience some slight challenges in a quarter in comparable sales and increased food costs that we were able to successfully overcome these and pleased to present earnings within the guidance we issued at the beginning of the quarter. The company−operated restaurants experienced their first negative comparable sales quarter in three years, that has been minus 0.4 for the quarter, which in real life is only $60,000. After a good start in January, we saw some softness in February that seemed to coincide directly with the major events of the Winter Olympics. Sales did rebound a bit in March until the final weekend with those Easter weekend and Spring Break weekend in most of our markets. Easter is traditionally a weaker holiday for us. And that weekend which occurred on the second quarter of 2001 helped us a full percentage point in comp store sales for the quarter. As would be expected, we saw a significant bounce back this past weekend, which was the Easter weekend of the year ago. We are confident that we had returned to positive same−store sales this quarter and expect to be in the 2−3 percent range for the year. First quarter marketing efforts centered around or bringing back rib promotions supported by direct mail in each of our markets and our targeted radio campaign in Chicago. We also saw good return from our IFS newspaper insert, but the timing of the offer is crossing the first and second quarters. Our second quarter product promotion includes a new product of barbecue (indiscernible) sauces and sandwich in plate (phonetic) and we are enjoying tremendous early success with this product. We continued our focus on restaurant−level profitability and we were able to improve our operating margins by 70 basis points. On the development front, as planned, we did not open any restaurants during the first quarter. We are on target to achieve our goal of 8 to 10 restaurants for the year, 3 of these will

be opened in the second quarter and Ken will take you into this in detail. Two new franchise restaurants are opening in the quarter, one each in Bellevue, Nebraska (indiscernible) the second one, and the first one in the upper East Coast in Mountain Side, New Jersey, besides the second franchise in the Omaha market and the first one for Famous Dave's in the New Jersey market. Both of these openings were hugely successful. As we previously communicated, we expect a total of 12 to 15 franchise restaurants to open this year. We signed a multiunit development agreement for an additional 61 franchise restaurants to be opened within the next five years. Progress continues for the two (indiscernible) clubs, we do not now expect this venture to be profitable during the seasonally slower first quarter, but we saw steady improvements in operating margins through the quarter. That means that the Memphis club continue to be very strong and our goal is for this venture to be profitable by yearend. Now, the first quarter did present some minor challenges in same−store sales and food costs. Our restaurant management teams led by our new COO, Michael Hufford (phonetic) maintained their focus on execution and helped produce the solid results we are showing today. We continue forward with our strategic plan, we look forward to additional success in the balance of 2002. At this time, I'd like to turn the call over to Kenneth Stanecki who will discuss the first quarter results in greater detail.

MR. KENNETH STANECKI:
Thank you, Martin. Revenue as reported increased 3.6 percent in the second quarter to 21.2 million versus 20.5 million in the year ago quarter. The increase in revenue was due to new restaurant openings during 2001 and increased income from franchise royalties offset by slight decrease in same−store sales and the sale of four company restaurants to franchisees. Revenue totals for the quarter include 569,000 in franchise royalties, 105,000 in franchise fees and 47,000 in licensing royalties. As was mentioned, comparable sales for the first quarter decreased 0.4 percent, the comparable sales decline is comprisable of 1.5 percent increase in average check offset by declining customer account. Average weekly volumes for company−owned restaurants was 45,140 during the quarter. Starting this quarter and going forward, we will be reporting average weekly sales volume at our franchise restaurants as well. For the first quarter, our franchise restaurants averaged $44,976 per week. We will not be reporting comparable sale results for our franchise restaurants this year; given the small number of restaurants in that base, it really isn't a meaningful number at this time. Earnings for the quarter were $809,000 or seven cents per share. Earnings included a gain from the sale of assets primarily from the sale of the three restaurants in Wisconsin. Excluding the gains, earnings would have been three cents per share. Prior year first quarter earnings were reported untaxed at 4 cents per share. If we had applied the same tax rate to last year's earnings, the year−on−year growth and net income would have been in excess of 30 percent and earnings per share growth would have been 50 percent. As a reminder, the company's tax position has not changed. We are still not a cash−tax payer and will not be for 2002 due to our loss carry forwards. This certainly reflects a change in the method of reporting our net income, which we commenced in the third quarter of 2001 to reflect after−tax results. As Martin mentioned, our operating margins of our company restaurants improved 70 basis points in the first quarter compared with first quarter of 2001. I would like to spend some time now discussing these operating margins in more detail. As we had previously communicated, we experienced an increase in food costs as a percentage of restaurant sales during the first quarter. Total food and beverage costs increased a full percentage point over fiscal 2001 as was expected. This was 60 basis points higher than the first quarter of 2001. This increase was due almost exclusively to a 20% increase in our price of ribs. We have taken a number of steps to mitigate the impact of this increase in rib costs. First, we have locked into a contract price that

will reduce the price per ton by 4%. Secondly, we had put extra emphasis with both our supplier and in our restaurants to ensure that we are serving the highest quality product and minimizing waste. Third, we have been successful in initiatives to reduce cost of other parts of menu to new purchasing contracts. And finally, we are focusing our promotional activity on higher margin products, such as the barbecue sauce sizzling, currently being highlighted in our restaurants. We are already starting to see the benefits of these efforts and expect total food and beverage cost to come down a half point to near 32 percent for the second quarter. Total labor cost improved 20 basis points versus the first quarter of 2001. We expect labor costs to remain essentially flat during the course of this fiscal year versus comparable quarters of 2001. Other operating expenses improved 150 basis points in the quarter versus the first quarter of last year. As we expected, this improvement came primarily in utility cost as we experienced a much milder winter and lower gas cost in most of the areas we operate. GAwas 8.4 percent of revenues for the quarter, which is about our target. With revenues at the lower end of our expected range in a seasonally slower time of year, GAwhich is mostly fixed cost, increased as a percent of those revenues. Our objective is to leverage these costs in line with prior year levels, which will be accomplished with increased revenues from new restaurants opened. Restaurant count at the end of the quarter was 34 company owned and operated and 24 franchise owned and operated for a system total of 58. Last year at this time, there were 35 restaurants in the system. As was scheduled, no new company restaurants were opened during the first quarter, we expect to open a total of eight to ten new company restaurants in 2002; three of these will be in the second quarter. Our new restaurant in Davisburg, Maryland is expected to open in the first week of May. Our second site in Richmond, Virginia is scheduled to open in the first week of June and Orland Park, Illinois, (indiscernible) Chicago is slated for opening in the last week of June. We expect an additional three sites to open during the third quarter, two of these will represent our entry into the Dallas, Texas market, while the third will be in Foster (phonetic), Oklahoma. We then anticipate two to four additional openings occurring in the fourth quarter. Sites in process for the fourth quarter and into the first quarter of 2003 include two in the Salt Lake City market, a third for the Richmond, Virginia market with others in final stages of review in Maryland, Texas, and the Mid Chicago area. As Martin mentioned, two new franchise restaurants were opened during the quarter, one each in Bellevue, Nebraska and Mountainside, New Jersey. We expect three new franchise restaurants to open during the second quarter including Florence, Kentucky; (indiscernible) Minnesota, and Fargo, North Dakota. Additional sites in process for the third quarter include Davenport, Ohio, and another in the Omaha market and also in Middletown, Ohio. The government (phonetic) agreements are signed for a total of 85 franchise restaurants including the 24 already opened. These are scheduled to be developed over the next five years. We continue to be pleased with the longer interest in our franchise program and expect to sign a number of additional agreements later this quarter. As we have mentioned, we expect a total of 12 to 15 new franchise restaurants to open in 2002. This past January, we completed a sale of the three Wisconsin restaurants to a new franchise group who simultaneously entered into an area development agreement for 60 franchise restaurants in the Milwaukee and Green Bay area. This transaction which we had announced in December generated over $3 million (phonetic) in cash to the company. Out other initiatives continue with the retail products, again this is not a material contributor to our earnings, but the company does not incur any cost while enjoying additional brand exposure and the licensing revenue. The company's results include losses from our unconsolidated subsidiary of 428,000 for the first quarter. This venture was formed to operate entertainment clubs under the brand Isaac Hayes MFP and included the contribution of the Famous Dave's Club in Chicago. Reported loss represents Famous Dave's obligation to fund the cash operating losses with certain limitations. We do not intend of any further investment in this venture and do not anticipate opening any additional clubs under the current agreement with our partners. This again will allow us to focus on our core competencies of great barbecue restaurants. We did not expect this venture to be profitable during the seasonally slower first quarter. The management team is very focused on proper execution during this very important second quarter. Our objective again is to record a profit in this venture for the year, but we also recognize the challenges ahead in accomplishing that. We are encouraged by the improving operating margins of the club and are especially pleased by the continued strong revenues in the Memphis location, which should escalate even higher during the month of May, a major tourist season for that city. Our estimates for 2002 remain at 97 to 102 million for the company with earnings per share between 27 and 30 cents and that excludes the gain on the sale of the restaurants reported this quarter. Second quarter revenues are expected between 24 and 25 million with earnings of 8 to 9 cents per share. The balance sheet is in great shape, with the successful private placement in November and the sale of the restaurants in January, the company was able to pay off some high−priced debt, while building a cash balance of approximately $10.8 million at the end of the quarter. The company will incur additional debt in the form of mortgages whenever we purchase some real estate for one of our restaurants. Four of the sites targeted for opening this year involve the purchase of real estate, while the balance of the openings will be on leased property. Two of our new openings this year will involve ground−up construction with the balance being conversion of existing facilities. Our strategy is to focus on the key trade areas and find the best sites available, whether leased or fee purchase, and whether ground up or conversion. It is this flexibility that helps ensure meeting our development objectives. We are pleased with the results for the first quarter and our outlook for the year. We look forward to introducing Famous Dave's to a number of new markets this year. We remain focused on our strategic plan and continue to be very enthusiastic about the future growth opportunities for Famous Dave's. At this time, I would like to turn the call back to our operator Melissa (phonetic) who will conduct the question and answer session.

THE OPERATOR:
(CALLER INSTRUCTIONS) your first question comes from Pat Tearney.

THE CALLER:
Good quarter, guys. Can you give us a sense of what the New Jersey office is doing on a weekly basis?

COMPANY REPRESENTATIVE:
Unfortunately, we cannot report on individual franchise restaurants; we can say that the franchise is very pleased with the volume there, but we cannot give individual restaurant results.

THE OPERATOR:
(CALLER INSTRUCTIONS) At this time there are no further questions.

COMPANY REPRESENTATIVE:
Thank you. This ends our first quarter conference call. We are entering into some exciting new territories (indiscernible) Texas, we look forward to the continued growth and we look forward to talking to you in about 90 days. Thank you very much.

THE OPERATOR:
This concludes today's conference. You may now disconnect. (CONFERENCE CALL CONCLUDED)

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04/17/2002 09:30 am **FLXS** **Flexsteel Industries, Inc (FLXS) − Q3 2002**

THE OPERATOR:
Welcome to Flexsteel Industries, Inc. Third Quarter 2002 Operating Results Conference Call. At this time, it is my pleasure to introduce your host for the call, Flexsteel Industries' Chief Financial Officer, Mr. Ron Klosterman.

MR. RONALD KLOSTERMAN:
Good morning and welcome to our conference call to review our March 31, 2002 quarterly results. We appreciate your participation this morning. Joining me this morning via telephone from our showroom in Highpoint, North Carolina at the International Home Furnishing Center is Bruce Lauritsen, our President and Chief Executive Officer. During our call today, we may make forward−looking statements that are subject to risk and uncertainty. A discussion of factors that could cause actual results to differ materially from management's expectations is contained in the company's SEC filings included for the most recent annual report to shareholders and 10K and the press release dated April 16, 2002 announcing the results of operations for the quarter in nine−month period ended March 31, 2002. Any forward−looking statements or opinion as of now and we take no obligation to update or revise any forward−looking statements to reflect events or circumstances after today's call. At this time, Bruce has some opening comments before we open up the session for questions from analysts. Bruce.

MR. BRUCE LAURITSEN:
Good morning everyone. What I'd like to do is go over −− just a brief restatement of our press release last night. A couple of items there and I'll give you a little current scenario of what's going on and where we're at in our three businesses. Net sales for the quarter ended March 31,

2002 were 73.7 million compared to the prior year quarter of 72 million, an increase of 2 percent. Net income for the current March quarter is $2 million or 33 cents per share, compared to the year earlier quarter of 8 cents, or 800,000 −− I'm sorry, or 13 cents per share. Net sales for the nine−months ended March 31, 2002 were 202.8 million compared to 215.9 million in the prior year nine months, a decrease of 6 percent. Net income for the nine months ended March 31, 2002, up 2.9 million or 48 cents per share decreased in the March 31, 2001 net income of 4.4 million or 71 cents per share. Now I'd like to tell you a little bit about what happened in the quarter that −− we're just reporting on. Orders really rebounded very nicely during the March quarters starting right after the January 1st holiday and various inventories were very good starting in January and continued on through most of the quarter. The recreation of vehicle seating business volume build−up during the quarter month after month and comparing to March 2000 quarter to the December 2001 quarter, residential shipments increased 10 percent, RV shipments increased 28 percent. And just as important, our backlog in the hospitality and the contract seating business increased, ended to the double−digit area. Things that we've been working on the prior nine−months with beds, and boats, etc., came to fruition during the March quarter. The cost of raw materials had little changed during the quarter, however, we may see some increases in the steel prices during the latter part of calendar 2002 due to the impact of just recently inactive import tear−ups (phonetic). Some other points of interest −− here in the recreation of vehicle business are −− during the Valentine (phonetic) over the last 18−months, net industry. We stayed true to our strategic plan and worked very hard in increasing our market penetration. And in fact, open up 14 new customer chairs in an area that we have a 60 percent plus market shares, so we're really, really happy about them. In the residential seating area, we have 350 comfort seating galleries opened and 45 additional signed contracts that we hope to get opened in the next four to six months. Our new Christopher Lowell collection, which debut in October of 2001, we have 40 completed and open and over 135 signed commitments to bring to fruition and get open this year. Our outlook for commercial seating business is as strong as I've seen it in the last 12 to 14 years. We have just been blessed with the number of clothes and beds on projects all over United States for re−dos (phonetic) in the hospitality business as Lowell's new properties. So, we're really thrilled with what's been going on for about the last four−and−a−half to five months and especially the business that we've received in the last 90−days and we're going into the final quarter with a real strong business backlog as well as prospects for continuation of running business. At this particular time, I'll open up the forum to questions that any of the analysts may have.

THE OPERATOR:
At this time, we will be taking questions from analysts. (CALLER INSTRUCTIONS) Penn Sincleton (phonetic) of Merrill Lynch.

THE CALLER:
Good morning. Bruce, could you talk just a little bit more about your utilization rate? How orders are trending in so far in April and what's your plan are for new introductions at the upcoming April market?

MR. BRUCE LAURITSEN:
Well, our orders continue. They soften a little bit in the residential area the last two weeks of March and I think it's a combination of many factors in early Easter as well as −− just the prior two months, there was a lot of buying going on and it's picked up as we came to the high point. We have enlarged our Christopher Lowell collection for five new occasional groups

and to the collection, which we didn't have in October; tables and some wall, wall units, etc., as well as some upholstery pieces. We've got new −− really across the board, we've got three fabulous leather sofa−loveseat chair combinations as well as some beautiful of Lowell style upholstery. We feel real good about this market. Our sales force is really very, very comfortable with our new introductions and they feel good about the customers coming here as well as what they take to peer it back going on the field. Going further, just a little bit ended the recreation of vehicle business. We feel real good of that business has re−solidified itself and its moving back into the range that we expressed a couple of years ago and the prospects for that, we feel for the next 10 to 12, 15 years are very good.

THE CALLER:
Did you mean 10 to 15 months Bruce? You said...

MR. BRUCE LAURITSEN:
No. Just looking out, as a demographics as to...

THE CALLER:
Really?

MR. BRUCE LAURITSEN:
Yes. Where we feel that the baby boomers are just entering into that first stage of possibly doubles and then motorized, etc. So, that industry is a −− we're really feel good about the future of that business. But right at the present time, we're just pleased that the consumers are back in the marketplace purchasing and taking us back to the levels that we experienced prior to the downturn.

THE CALLER:
Okay. I'll just have good couple of more questions 'cause I know there are others. I wanted to get an idea of what type of volume do you think is reasonable for the Christopher Lowell line over the next −− say, couple of years? And do you expect to add any new accounts, not Christopher Lowell but just Flexsteel in general −− at competing (phonetic) in general at this market?

MR. BRUCE LAURITSEN:
We do. (1) The volume PMI (phonetic) would be −− I'd be stabbing (phonetic) at a number that I wouldn't be comfortable with. Maybe by the time I see you tomorrow or the next day, I can give you a little bit better number. But we feel that, that has a potential of this market, just at this market of possibly signing up another 25 to 35, 40 additional retailers. We have experienced an interest on a Christopher Lowell collection from certainly some of our long−time retailers. But more importantly, or just as important is the interest that we picked at from people who we haven't done business with, and that's the exciting part. We thought that might happen but it's really reaching a different consumer, maybe a younger consumer or a consumer that's doing things on their own that they come in the store and the stores that are open right now or for the most part, really, really doing a nice job.

THE CALLER:
Okay. Last question. Just give us an update on your retail business, where it stands right now, and what it might have accounted for in the quarter you just released?

MR. BRUCE LAURITSEN:
Penn, I can tell you that right now we've got five stores just as we start the year with five, we have a lease expired in Chicago. We're down to one store in Chicago, that store was successfully converted to one −− two stores to one. And in Indianapolis, we have three and again the lease had come too, and we took it from three stores to two and that 's where we set right now. We have seen a nice uptick in the retail business as most people have a country and it's come into the stores. We're continuing to try to fine tune the footprint and we're not going to draw that particular segment of the business any further than over the years.

THE CALLER:
Was it profitable?

MR. BRUCE LAURITSEN:
No.

THE CALLER:
All right. Thanks very much.

THE OPERATOR:
(CALLER INSTRUCTIONS) And gentlemen, I'm showing no further questions at this time.

MR. BRUCE LAURITSEN:
Thank you everybody. We appreciate your calling−in and thanks for all your support.
(CONFERENCE CALL CONCLUDED)

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04/17/2002 04:15 pm **NSDA** **Nassda Corporation (NSDA) − Q1 2002**

THE OPERATOR:
Good day everyone and welcome to the Nassda Corporation 2nd Quarter Fiscal 2002 Earnings Conference. Today's conference is being recorded. For opening remarks and introductions, I would like to turn the call over to Ms. Tammy Loo (phonetic), Chief Financial Officer for Nassda Corporation. Please go ahead.

MS. TAMMY LOO:
Good afternoon ladies and gentlemen. Welcome to our Earnings Conference Call for the quarter ended March 31, 2002. Before we start reviewing the result, I would like to first make the forward−looking statement announcement. During the course of this conference call we will make forward−looking statements. Those forward−looking statements are subject to risks and uncertainties that may cause actual result to differ materially. These forward−looking statements may include but are limited to statements with words like expect, anticipate, target to, continue to, may, potential, will or the negative of those terms. For discussion of the relevant risks please refer to the Risk Factors Section of our most recent SEC filings Form−10Q for the quarter ended December 31, 2001 and the registration statement on Form−S1. I will start by reviewing the financial result and the common thing on the various components of the income statement and the balance sheet. Then Sam Weng (phonetic), our Chief Executive Officer will give you his views of the general economic environment, the status of our RDefforts, the growth of our organizations and the business outlook. He will then provide some specific financial guidance for this quarter ending June 30, 2002. Through today's discussions we will refer to the quarter ended December 31, 2001 as Q1 and the quarter ended March 31, 2002 as Q2. Now let us start by providing you with analysis of our bookings for the March quarter or Q2. Our geographic performance and license type, here are

the percentages. Geographically domestic accounted for 60 percent of our total bookings; Europe was 10 percent, Japan 17 percent and the rest of Asia 13 percent. Domestic bookings continue to be stronger as a result of increase penetration into several major accounts. Europe was weaker due to the economic environment. We also received our 2nd 3−year time base license order from Japan, which is an indication that the Japanese customers are starting to see the value in time base license. Rest of Asia came in strong as we successfully closed our largest perpetual license order with the major account in Taiwan. As potential total bookings by license type, perpetual are accounted for 62 percent of our total bookings, time base licenses was 21 percent and maintenance was 17 percent. As anticipated time base license percentage was lower because of the large number of time base license renewals that occurred in Q1. Thus the largest percentage of major account purchase in the quarter were perpetual license. This resulted in higher percentage for perpetual license. For fiscal 2002, we still do expect time base license to account for approximately 40 to 50 percent of our total booking. Revenue for Q2 was $8 million up 54 percent from the same quarter a year ago and an increase of 13 percent sequentially. Time base license revenue increase from 22 percent of total revenue in Q1 to 30 percent in Q2. This increase was the direct result of strong time base license booking in Q1. Fifty−five percent of the revenue was from perpetual license a decrease from the previous quarter due to increase in time base license revenue. We expect the increase in time base license revenue to continue as our mix continues to shift more to time base licenses. Maintenance is charged separately for perpetual licenses and accounted for about 14 percent of the total revenue in Q2 and an increase of 18 percent sequentially due to an increase installed base. Cost of revenue includes 3rd party OEM royalties and allocated application engineering support cost was 4 percent of total revenue in Q2 now within alliance with our historical trend. For operating expenses, please note that all my comments about operating expenses excludes stock (indiscernible) compensation, which is showing our income statement separately and with $252,000 for Q2. During the last quarter we had only added 1 employing GNA area which brought our total head count to 80. Overall operating expenses increased approximately 6 percent due to increases in payroll taxes, days of sales, travel and entertainment and expenses related to being a public company. RDexpenses absolute dollars were flat with an unchanged head count at 33. As potential total revenue, RDexpenses decreased from 18 percent in Q1 to 16 percent in Q2 as revenue increased. Sales and marketing expenses increased by 8 percent in Q2 from Q1 in absolute dollars primarily due to increase in (indiscernible) and travel expenses. As a percentage of total revenue sales and marketing expenses were 29 percent in Q2 down slightly sequentially due to an increase in revenue. GNA expenses were $1.9 million are flat at 23 percent of total revenue. This increase in absolute dollars from Q1 to Q2 was primarily the result of increase expenses related to being a public company such as DNL Insurance and professional fee. Pro forma operating income increase to a historical high of 29 percent on total revenue in Q2 compared to 24 percent in Q1. This was achieved by carefully managing our expenses or holding our head count flat for 2 important reasons: (1) is to make sure that we integrate the 15 new hired from Q1 into our organization and (2) was to be cautious as the economy recovered slowly. Interest income increase from quarter−to−quarter but was lower than expected due to lower interest rate. After deducting taxes at an effective tax rate of 35 percent, net income was $1.6 million or 20.5 percent of total revenue in Q2 another historical high and now with the earnings per share of 6 cents. Now I would like to comment on some of the balance sheet accounts that had material changes from the previous quarter. With the exercise of the over allotment option in the 1st week of January 2002 by our underwriters, which raise an additional $7.7 million in cash and a positive cash flow with $2 million for the quarter. Cash and short−term investments total $71.3 million as of March 31, 2002. Accounts receivable was $2.5 million as of March 31, 2002 but the DSL was 27 days. DSL increased slightly from previous quarters but it was still low. We expect our DSL to normalize to 35 to 40 days. Accounts payable and accrued expenses decrease primarily due to payments of IPL related costs. Accrued compensation increased primarily as a result of the accrual of DSPT purchases, which where laid down this month, the increase to commission. Accrued compensation includes primarily of $2.2 million of full bonuses plus other type of commissions and of vacation time. As of March 31, 2002, deferred revenue increased by $1 million sequentially due to increases in deferred time base license. We expected deferred revenue to fluctuate from quarter−to−quarter depending on the timing of invoicing of time base license, their maintenance and their respective payment terms. This concludes my comment about Q2 result. I will now turn it over to Sam to give you his views of the last quarter. With respect to Sam's comment regarding our outlook for the remainder of this fiscal year and 3rd quarter specifically, I would like to reiterate my earlier comments in our forward−looking statement about our certainties we saved and about our ability to perform as we have anticipated. We also want to communicate our policy regarding forecasts. In connection with SEC rules, on corporate disclosure regulation FD, we are establishing our procedures for publishing and updating our business outlook. In addition to today's discussion, we expect that during the 3rd quarter our corporate representative wells mean or discuss privately with investors, the media, the best managers and others. In these specials, we may reiterate the business outlook discussed publicly during our quarterly earnings conference call but we do not intend to give material guidance beyond that discussed entire public statement. We will keep our earnings release and our earnings conference call replay available on our website at www.nassda.com until April 24, 2002. Now, let us invite Sam to make his comment.

MR. SAM WENG:
Thank you Tammy. Good afternoon ladies and gentlemen. As Tammy has reported to you, we have achieved about our 10th consecutive quarter of revenue growth with record operating margin and the profitability. During the quarter our employees work very diligently and stayed quite focus. We managed our expenses tightly and held our head count steadily to achieve our consistent profitability. At the same time, 15 newly hired from the December quarters were smoothly integrated into our organization and has turned productive during the fiscal Q2. Looking back, we saw slightly positive signs of recovery for some accounts into the industry. And more importantly we are able to increase our penetration into quite a few major accounts in U. S., Japan and Taiwan. We have found that the business environment remained quite tough. We have stayed flexible in payment terms and discounts to accommodate our customers' budget constraint of financial requirement. On the other hand because our product deliver a leading edge solution in solving customers nanometer problems. Particularly in total raising on memory circuit and an increase in productivity for analog and the high−speed seasonal design. We were able to achieve that in an effective quarterly result. At the same time we manage to maintain our visibility going forward. For the next 6 months we expect the economic environment to remain challenging. Overall it is unquestionable that our business growth were hinged largely to the IC industry's recovery in the world. Nevertheless, we believe that we may outperform some other similar companies due to our superior solution for memory and the nanometer circuit verification and analysis. The memory effector has shown the first sign of recovery, which is encouraging. Equally encouraging is the $1 billion profit reported yesterday by the worldwide microprocessor leader who has been using more edge in license. In addition, we also strongly believed that leading edge semiconductor companies designing Point−1−3 micron product will soon begin

to make more investment in next generation too, including our product. The reasons are clear. First, if the economy recovers these leading edge companies need to bring their new Point−1−8 and Point−1−3 micron products to the market in order to gain their line in shares of the market. And secondly, they need to improve their Point−1−3 micron production yield because solving nanometer problems and the increase in design margin with net on solutions can be just as importing in improving yield as stabilizing the benefactoring processes by the foundry. What are the strategies to continue to grow our business in the 2nd half of this fiscal year? First, broaden our product penetration into major account. Last quarter along we will able to increase our prior license numbers in 9 existing major accounts and establish 2 new major accounts. Secondly, enhance the capabilities of our current product and re−shipped our new product. We believe that the best way to win more business for our users is to work with them closely and to solve their tough urging nanometer problems using our solution. That is what we did in the past and that is what we intend to do consistently in the future. Thirdly, continue to build strategic relationship with other EDA and IT panners. Panners such as cadence, canographics or various large logic, can open on many more new account in the business opportunity for us. Finally, continue to grow our sales in the support workforce. During Q2, we focused on training the new sales in the AE personnel. And has developed a new territory such as Israel and UK. The total head count in sales in AE organization is now at 37. We plan to do a total of 50 sales in AE organization by the end of this fiscal year. Productwise, we are in the process of shipping HM version 2.0 which was announced in February. Our RDteam invested a whole year to develop several important new features and enhancement in 2.0 according to our customers' request. Now they are fully implemented and delivered to our users as we speak. New features in 2.0 such as Monte Carlo capability extend HM to cover statistical analysis application. Several price compatibility features allow HM to better serve our analog circuit design user. Version 2.0 also provides IDDQ capability to enable crucial leakage current to be accurately calculated for Point−1−3 micron circuit. And that is very important for power reduction in the testing purpose. And HM 2.0, now supports more device models such as DC IV, Mach 11, SOI and the high−sync compact device model. Also Silicon Germania's, P−bic, Motorola's and Philip's internal models are equally supported. This will extend HM's applications into deep nanometer circuit across a broad process style. In version 2.0, we also released two new saleable options namely Circuit Check and Cadence General Artist Interface. Circuit Check option brings much improved knowledge in the circuit operation diagnostic for our users, which enable our users to understand their progress more effectively and thereby save precious time and allow them to focus on designing real circuit. Artist Interface carries a scene into a large analog design user community through a similar interface with Cadence dominant analog design environment. Our RDteam is currently working hard on several targets. Within this year we will be releasing two new products. The first new product has been in an intensive data testing for the last 6 months and we will be announcing this new product this quarter. The second product with more comprehensive nanometer effect coverage, allowing us to explain the post layout memory market solution with a synthesized way beyond to current HM limited capacity limit. As the performance of these products improves as planned we intend to increase this application to cover the microprocessor mixing or SOC market as well. Our second new product has also being developed for over a year now and it is targeted to be released later this year. This will be a high breed product with mixed static and a dynamic analysis capability to address timing power, synchronized integrity problem progress in very complex ICs. Initial target will be the high−end digital nanometer designs and then will be extended later to cover mixing in all design in a longer term. With only 34 steps on these departments there is a lot of development activities going on. We have an extremely talented group of developers. And we will continue to hire more developers to deliver broader product line in new generations solutions to contribute to our users. Traditionally, it has been important to establish strategic partners without other EDA company. In Q2, we announced virtual silicon and a stand walk relationship. We have held discussions with several other potential EDA and IT partners. And we will report to you when such relationships have materialized. In summary, we delivered fine Q2 result on a favorable environment by continuously pouring our physical conservatism policy and executing with great effort. As the IT industry is marching steadily toward Point−1−3 micron and of the low technology, we believed Nassda is well positioned and it can provide our customers and our prospects with much needed solution to achieve first time nanometer silicon success. So with that let me turn over to Tammy to continue the guidance for the year Q3.

MS. TAMMY LOO:
Thank you Sam, for the quarter ending June 30, 2001, which is our 1st fiscal quarter, we are targeting revenue of $8.8 million to $8.9 million with an EPS of 7 cents. With that comment I will open the call now for questions, Dyna.

THE OPERATOR:
Thank you. The question and answer session will be conducted electronically today. (CALLER INSTRUCTIONS). John Barge (phonetic) of Robertson Steven.

THE CALLER:
I wondered if you could tap just a little bit more about the mix of the bookings this quarter and how that related to the revenues? I did not exactly get the percentages when you were saying them.

MS. TAMMY LOO:
Sure, do you talking about the license type?

THE CALLER:
Yes.

MS. TAMMY LOO:
Okay, the perpetual license was 62 percent of our total booking, time base was 21 percent, and maintenance was 70 percent.

MR. SAM WENG:
I would like to add the 6 months total up today. The time base license was increased to 31 percent, as versus to last fiscal year wherein the deliver was over 20 percent. So we are in the right direction.

THE CALLER:
Okay. And then the revenue you said was 30 percent time based?

MS. TAMMY LOO:
Yes.

THE CALLER:
And 55 perpetual?

MS. TAMMY LOO:
Yes.

THE CALLER:
So is it fair to say that some of those perpetual orders that you received this quarter were not shipped and went into the backlog for the new quarter? Aor the 62 percentages greater than the 55?

MS. TAMMY LOO:
Yes, that I guess will be a serious statement to say that.

THE CALLER:
Okay.

MS. TAMMY LOO:
And also, just let me reiterate. Any point in time we are also has our rescue requisition policy, which is very, very conservative. I think, generally I have made a statement that if there is any kind of payment term in perpetual license, we do not recognize as revenue on full cash collection.

THE CALLER:
Could you explain that any kind of payment terms?

MS. TAMMY LOO:
Our revenue policy statement says that, if we have an order that has a payment term not longer than 90 days, the revenue recognition policy on that is cash collection.

THE CALLER:
Okay. And then one other questions that I had for you. Last quarter you mentioned that some customers had deferred their maintenance or had not taken on their maintenance agreements. Did you see some of those come true this quarter?

MS. TAMMY LOO:
Yes, we saw some of those come true. But we still have a very small number of customers that still have not done that. But that is a very small percentage of our discovery.

THE CALLER:
And would you expect those to come true on the next quarter?

MS. TAMMY LOO:
I expect some of them to will come true, yes.

THE CALLER:
Okay, thank you.

MS. TAMMY LOO:
You are welcome, thank you.

THE OPERATOR:
Roger Seth (phonetic) of S. T. Collins.

THE CALLER:
I wonder if you could expand a little bit on the comment that I think Sam made with regard to terms and discounts. I was trying to understand what you said about revenue recognition when terms are indignant. What is happening in terms of pricing? What is the implication of the statement in terms of pricing, if any, what was happening out there?

MS. TAMMY LOO:
I think in general as far as pricing, what we are seeing is that the customers are coming back and negotiate really very hard. So at any point in time we have to be flexible because the ultimate goal is to get the money off the table from the customer. So, I mean, traditionally, maybe if the economy was good we would not probably resort to such as discount. But now are thinking of building long−term relationships related to the customers.

THE CALLER:
Right, any way to quantify how that change over the last couple of quarters other than perhaps a bit greater?

MS. TAMMY LOO:
To quantify, I think it is jut a little bit greater. I think over time what we have found over the last couple of years, that if we are consistently being flexible with a major account, what comes out to be is actually beneficial on asset. We are able to get the additional purchases coming true later on. That is why I think we are working on the customer very closely and accommodating to as far as not only on our accounts. Also more importantly, is the payment terms. That they are very concern about it. A lot company is now, when they cannot deliver on profitability they are focusing more on balance sheet as well as expense. They want to make sure their balance sheet looks good. Therefore they are coming back, to say for example, some of our time base licenses are coming to us on a quarterly dealing.

MR. SAM WENG:
We make a concentious effort now to make sure that if we give a little bit more discounting, we are willing to, we may just get a one time deal. We are not creating a kind of precedence that later they can refer to this and we will just say: "Hey, we do not understand" or "This the situation, it is very tough. We want to help you and this is the one time deal where we can help out a little bit." But not imply it down on the road. They can be out of key ideas, same kind of discount level.

THE CALLER:
And Sam, maybe you can expand on this topic and talk a little bit about what you are seeing from your principle competitors. What do you see from synopsis in particular or especially in light of the pending acquisition of MRT? What do you see competitively out there in terms of a bulkier, both of those guys being very aggressive in prices that are contributing to the comment you made in terms of the discount dynamic? What is happening on the competitive front?

MR. SAM WENG:
I think we are all good not a lot different. Between this quarter versus last quarter in terms of

the competitive landscape out there. They are aggressive. We are still succeeding in winning benchmark, winning the customers commitment and to purchase and the winning the orders. So we have not see any erosion due to this merger or their efforts in terms of competing against us.

THE CALLER:
Okay and then finally, I guess as you look out over the next quarter to –– is your confidence, to the same, greater or less than as was 2 quarters ago looking at this quarter and last does that make any sense?

MR. SAM WENG:
Well, it makes sense that anyone had sense the pulse. And as I have mentioned in my earlier statement that certain vectors, certain industries seem to be doing better than the other is. And we did see the memory sector exaggerated a little bit over the last previous quarter. Also we can see that the microprocessor seems to be gaining some momentum there. So we see some good signs there but overall still it is pretty tough there as other EDA Company has probably shared the same kind of feeling. But we will some positive signs.

THE CALLER:
So you are as confidence having them in this quarter as you were last, is that a fair way to read that.

MR. SAM WENG:
I think so. We continue to improve internally so we can become more effective because this is a tough situation. It is a wake up call in us, for you to reveal the internal process, too see where they can be more effective and more productive in all. So we are doing all those kind of things right now.

THE CALLER:
Right, let me ask you one more if I might on a different topic. Cadence, Magma and some others have talked, and I think and they are increasingly exclusive about this. About analysis tools and obviously they intend to focus more on those that are used in the logic space. Analysis tools being integrated over time with place in rough physical synthesis and then the broader physical design solutions and suggested over time you will see lots and lots stand alone analysis tools, what is your view about that trend? How does that potentially impact you or not?

MR. SAM WENG:
I do not think so. I do not think that it will impair us. In fairness, they may need us more than ever going forward. The reason is when they have some kind of analysis to help in our physical design process the idea is very good. But when you get really deep into the nanometer those implicit analysis tools will not be sufficient. That is why people like Cadence and Magma have been talking with us. Finding out how can our tools help them to do a better job, to really analyze the tough nanometer problem or even the digital circuit for them. I think the trend should be to our advantage. That we provide the best, the most accurate and the efficient nanometer solution here and more and more how partners will need us to be successful.

THE CALLER:
Thank you, Sam.

THE OPERATOR:
(CALLER INSTRUCTIONS). Alex Donner (phonetic) UBS Warburg.

THE CALLER:
I was wondering if you could give us some color on greater than 10 percent cost or maybe how many of them will work? And also in backlog as well.

MS. TAMMY LOO:
I will comment on the booking portion. Some of bookings point of view will only have one customer who is greater than 10 percent from booking. Well, there is only one that is over 10 percent and no other. From a revenue point, of view we do not have any customer that is over 10 percent.

THE CALLER:
Okay. And then, I was wondering if you could make some comment with the release of HM 2.0. Did we begin to recognize revenue from that already in the current quarter? Is that already in the forward−looking basis? And incrementally, what could that mean in terms of product revenue or is something that just supports current average selling prices within the customer base?

MS. TAMMY LOO:
With the release of 2.0, it is to supply to all our customers who are on the main contract. So, all of our customers on the maintenance will get that without having to pay additional fees. And we are happy to recognize those maintenance revenue radically from other contracts period. However, most importantly, with the release of 2.0, as Sam has mentioned, it has a lot of enhancement, a lot of new features that are actually trends in our available market. That was the key.

MR. SAM WENG:
Also the two new options, which will carry the price tag with them. And we believe that those two options, the Circuit Check and the General Artist Interface should bring additional incremental income to Nassda.

THE CALLER:
Okay, you delivered an impressive quarter end and an even stronger guidance than you gave last quarter. What kind of industry trend are you seeing that bolsters your confidence in this kind of guidance?

MS. TAMMY LOO:
I think my guidance for this quarter is a little bit higher but not that much higher. Our feeling of visibility is still pretty consistent with what we have been seeing before. So, I think our commitment to our investors is that we will commit to deliver the top line and the bottom line that we have delivered before. That is our goal. We have not change from that.

THE CALLER:
Well, nice job doing at this quarter. Congratulations for a great quarter

MS. TAMMY LOO:
Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS). Roger Seth of S. T. Collins.

THE CALLER:
Just a quick one, Sam or Tammy. How much of your business right now or how much of the incremental business is actually coming from the memory sector?

MR. SAM WENG:
Historically, it was about 50 percent. And now, I believe, in our last quarter, it is probably less, you know it is only my guess. But as I have said the memory sectors are coming alive. So, I feel that going forward we could be coming back to 50 percent or even slightly more than 50 percent in the near future.

THE CALLER:
Okay. But it was not something that where most of the incremental business was coming from memory, driven by that up turn they were talking about, or is that −−

MR. SAM WENG:
No, no. Because we are pretty balanced in all customer base in our analog, mix signal or high−speed digital. We have a pretty good spread in terms of customers' types.

THE CALLER:
Yes, just want to thank you for all of that. Thank you.

MS. TAMMY LOO:
Thanks, Roger.

MR. SAM WENG:
Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS). John Barge (phonetic) of Robertson Steven.

THE CALLER:
I just wanted to clarify. In the past I think you have given us revenue by geography but I think this time you gave us bookings by geography?

MS. TAMMY LOO:
I can certainly give you revenue by geographic, just a moment. Here we go, for Q2 domestic was 57 percent on our total revenue, Europe was 16 percent, Japan was 19 percent and the rest of Asia was 8 percent.

THE CALLER:
Eight?

MS. TAMMY LOO:
Yes.

THE CALLER:
Okay. And Tammy, while we are on the details, how about CAPEX this quarter?

MS. TAMMY LOO:
CAPEX is okay. We actually are cautious. We have not added that many employees. There was only one addition in our employee. Our CAPEX was only $41,000.

THE CALLER:
Okay thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS). It appears there are no further questions at this time. I will turn the conference back over to Tammy Loo for any additional or closing remarks.

MS. TAMMY LOO:
Thanks Dyna. That concludes our conference call today. Thank you very much for your participation and have a great afternoon. (CONFERENCE CALL CONCLUDED).

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04/17/2002 10:30 am	**DTLK**	**Datalink Corporation (DTLK) − DTLK Q1 2002 Earnings Conference Call**

THE OPERATOR:
Welcome to the Datalink first−quarter earnings conference call. Today's call is being recorded. At this time for opening remarks and introductions I would like to turn the call over to the President and Chief Executive Officer, Mr. Greg Meland. Please go ahead, sir.

MR. GREG MELAND:
Good morning everybody. This is Greg Meland. Also I have with me Dan Kinsella, our Chief Financial Officer. Welcome to the Q1 conference call. I appreciate you guys taking time this morning to be part of the call. Hopefully you have had an opportunity to review our press release this morning. I'm going to first have Dan cover the specifics in the release and then I will make some comments on the business environment and some of our results. I'll turn it over to Dan at this time.

MR. DANIEL KINSELLA:
Let me start with the formalities of the Safe Harbor on forward−looking statements. The Private Securities Litigation Reform Act of 1995 provides a Safe Harbor for certain forward−looking statements. In this conference call, we will be discussing our views regarding future events and financial performance. These forward−looking statements are subject to certain risks and uncertainties, actual future results and trends may differ materially from historical results or those anticipated depending upon a variety of factors. We ask that you refer to Datalink's filings with the Securities and Exchange Commission for a full discussion of our Company's risk factors. Now I would like to briefly cover our financial results for our first quarter ended March 31st. In the quarter, we generated revenues of $21.8 million which is a decline of 46 percent from the prior year and a sequential decrease of 12

percent from our December quarter. For the March quarter, we incurred a loss of 15 cents per diluted share, a loss better (indiscernible) guidance that we gave on February 14th. At that time, we gave guidance of a loss of 16 to 21 cents per share and revenue guidance of 20 to $24 million. In the year ago period, we generated record quarterly revenue. Since that time the operating and economic environment has changed dramatically, Greg will expand on these factors shortly. In reviewing the details of our operating results for the current quarter, our gross profit for the quarter was 25.3 percent. This was approximately equal with our gross profit last quarter. For the last two quarters, our gross profit has been below our recent history reflecting smaller transactions and an increase in competitive pricing. We expect that these gross profit levels will remain at these lower levels for the near future. Turning to our operating expenses, we exceeded our internal plan for reduction of fixed convertible expenses for the quarter. Our quarterly fixed expenses are now running $500,000 per quarter less than they were in mid 2001. Our variable expense rate for the March quarter was also significantly lower. This was accomplished with a selective reduction in staff levels and elimination of discretionary spending. One item to note is that engineering expense shows an increase over the prior year. Keep in mind this is a function of the recovery of our engineering staff time for design and implementation services. In the March quarter the recovery of engineering time was lower than in previous periods due to smaller and less complex transactions. In our release this morning, we gave a range of guidance for our second quarter ended June 30th. We expect revenues to range from 24 million to $28 million, and a loss range to be between 8 cents and 14 cents per diluted share. Note that we included in our loss range a factor of conservatism in the event that current gross margins cannot be maintained. Turning to our balance sheet and cash flows, Datalink ended the quarter with $5.7 million in cash which was approximately equal with our year end levels. Our accounts receivable day sales outstanding continues to be at an exceptional level totaling 44 days at quarter end. This is a reflection of the blue−chip customer base that we maintained. We ended the quarter with no long or short−term debt. Looking forward, if we generate a loss in the second quarter within the guided range, we would expect to use approximately $1.5 million of our existing cash reserves. We continue to believe we have the financial strength and flexibility to fund our near−term growth initiatives. This concludes my comments and Greg will now continue our discussion.

MR. GREG MELAND:
I'm going to be brief this morning with my formal comments, not much has changed since we last talked to you on February 14th. The quarter kind of played out as we had expected. I'm proud of the organization. We came in on the positive side of the guidance that we had given while many other companies were not as fortunate in this competitive environment. Let me first make a few comments on the business environment that we saw during the quarter. As with many companies we continued to see a very cautious capital spending environment. This results in longer sales and higher scrutiny of projects by upper management. We continued to see many customers bandaiding or buying only what they currently need for short−term versus moving ahead with large scale implementations. What this means is that customer's attitude, whatever they had in place, they could have been continuing to build out a network storage infrastructure or adding to a direct (indiscernible) system. These types of sales are smaller and less value−add which impact both revenue and gross margin. Our gross margin remained basically consistent with last quarter, as Dan mentioned, at 25.3 versus 25.4 last quarter, but below our historical range of 26 to 27. I feel that we have fared relatively well compared to many in the industry who have seen dramatic reductions in gross margins. Competition remained very aggressive during the quarter. Each opportunity is being chased

by everybody. I believe this will normalize this economy and capital spending continues to strengthen which will result in an overall increase in the number of opportunities. On the positive side we continue to see increased customer activity almost every month and salespeople are more optimistic today as compared to the start of last quarter. This should indicate an improvement of our future order activity. Customer interest in activity was focused a little stronger in the business continuance and data protection areas, but we also continued to see activity in storage optimization. What has been encouraging through this difficult environment is the fact that we have not lost customers. The opportunity pipeline has remained solid. Customers continue to indicate that projects in the pipeline are strategically important and they will be implemented as management gives the go−ahead to spend money. Let me now give the statistical information about the quarter. We continue to have acceptance of our (indiscernible) across a wide spectrum of industries. Here are some the key wins. AON in professional services, BellSouth in telco, Meier (phonetic) and Anheuser−Busch in consumer products, InfoSpace (phonetic) as an Internet service provider, Eclipsys and GE Medical in healthcare, PacifiCorp in utilities and energy, Lockheed Martin in united defense and the defense contracting area and Motorola, Gateway and Advanced Financial Systems in manufacturing. The mix of the business by product category was 23 percent primary storage, 23 percent tape, 31 percent service, 7 percent software, 9 percent SAN infrastructure and 7 percent miscellaneous. What stands out if you compare that to last quarter is that SAN infrastructure returned to a more normal run rate of 9 percent versus 5 percent for last quarter. Another thing that stands out is that software was very weak, with software at 7 percent versus 12 to 13 percent historical run rate. I think software sales are a good example of the bandaiding that is going on by customers. Customers are adding client licenses to their current environments versus large−scale restructuring. Let me now summarize and I will open it up for questions. I'm obviously not comfortable with the current results of the Company, but I'm also realistic about the tough operating environment we are in. We are operating in an environment where customers are working with very conservative budgets that were set coming off a very difficult year. I think what is important is that we are not losing customers or market share, the economy is slowly gaining momentum and customer activity continues to increase and there are also a number of macro drivers that I believe positioned us well for the future. First, data growth is forecasted to be dramatic for the foreseeable future. Second, although IT spending is forecasted to be flat this year, each survey that I read indicates that storage, storage management software and business continuance are priority spending for most companies. These are all core competancies of Datalink. Third, network storage has a current adoption rate that is between 20 and (technical difficulty) percent depending on the size of the company and a market forecast that indicates over the next couple of years adoption by all customers will approach 80 percent, again this is one of our strengths. I believe Datalink is extremely well−positioned to take advantage of the market opportunity as the year progresses. I know the results are painful right now. The management team and myself are focused at keeping discretionary spending as low as possible and doing everything we can to reduce fixed expenses while maintaining our core value which are our people and our knowledge. I believe the best long−term value for our shareholders is to keep moving ahead by maintaining the organization, building our knowledge and working on processing tools to enhance our efficiency and be positioned to take advantage of the market opportunity as the pendulum swings back. I will now open it up for questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) Glenn Hanus of Needham.

THE CALLER:
Any ten percent customers in the quarter?

MR. GREG MELAND:
No. I think we had −− roughly a 6 −−.

MR. DANIEL KINSELLA:
We had one 7 percent customer and two 5 percent customers.

MR. GREG MELAND:
Yeah, that's what I was −− thought Dan was signaling something −− that's the data I was going to give you.

THE CALLER:
Last night Veritas talked about a declining trend in March and smaller deal sizes, whereas the beginning of their quarter, January/February, was fairly strong. You talked about software weakness in your numbers. I was just wondering if you are seeing this kind of −− it sounded like you were more hinting at increased customer activity and maybe a pickup. Did you see a downward trend towards the end of the quarter as they did and maybe you could comment a little bit more fully on this software weakness?

MR. GREG MELAND:
I don't think we really saw much of a downward trend. If we kind of looked at the business that was captured, January was the weakest and that's not surprising to me usually budgets aren't fully in place and it takes a while to get the wheels on. February was a slight bit stronger, but we kind of captured relatively the same amount of business in March. I guess what I would comment on is it's really not steady and predictable right now, it's more erratic. You'd have a really good weak and then a bad weak and it has kind of bounced around but overall it's fairly consistent. I think what Veritas said is kind of −− chimes what I had said. Moving to large−scale new implementations is just not on the plate right now for most companies. It is for some. We're continuing to see companies doing large−scale, but on average our customer base is much more conservative and waiting to see what happens. I really believe it's going to be company by company when it turns. There are companies that really did not have too much trouble last year. They had cash, but with the uncertainty they hung onto it. I think people in that mode are starting to spend a little bit. Companies that had losses and bad news are really waiting for profits to peak up before they start to spend their money. So I think what Veritas said probably is very accurate that the size of the software transaction is slower in general.

THE CALLER:
Can you give us any more color on the −− you talked about the customer activity increasing, can you elaborate on that? Is there any way to quantify that that you've been looking at?

MR. GREG MELAND:
A lot of it is just talking to our sales organization and looking at some of the opportunities we have out there. I personally have spent a lot of time with customers over the last quarter. I think we have had about 7 executive customer business where we have talked to their C−level people here at headquarters. Spent the evening before with them at dinner and had roughly a half a day with them. Basically, everybody is moving and looking at things and talking about

spending money where at the end of last year it was button down the hatches and not even think about it. It's kind of collection of inputs, Glenn.

THE CALLER:
Is it a situation where they have identified some projects and are waiting for some budget releases to actually do it? What is the hold−up if they've −− maybe you could elaborate on that.

MR. GREG MELAND:
I think, as I tried to indicate, I think it's really going to be a company−by−company, there's not a single solution that goes across the industry. People that are −− continued to do well through the downturn are continuing to implement and customers that had more difficult times are waiting to see their profits return before they let anymore expenses go out of the door.

THE OPERATOR:
Jim Poynter (phonetic) with Unterberg Toebin (phonetic).

THE CALLER:
Just to clarify on the linearity of the quarter, can you give us a percentage breakdown roughly of how the revenue went month−to−month in the quarter? Secondly, what sort of headcount reductions, explicitly, how many did you cut and what sort of impact are you expecting on the operating expenses here going forward? Finally, with the sequential increase in revenue that your forecast is calling for of at least 24 million, what would you say is the single biggest factor in expecting revenue to improve in June versus March?

MR. GREG MELAND:
Let me just make one comment on the linearity. I will let Dan give you the kind of more detail, but when I was talking (technical difficulty) business come in fairly consistently, that's the order rate that comes in the door, how we are capturing the business. How we get it out the door is dependent on us and customer availability, so there's a little distinction about how the quarter piled up and it was very back end loaded as it was for many companies.

MR. DANIEL KINSELLA:
The percentages were roughly at 25, 25, 50 for January, February, March.

THE CALLER:
Thanks.

MR. GREG MELAND:
I guess from a why do we think it's going to be a stronger, it's the −− forecast that we are seeing I think the linearity will be better, I think we will start out the quarter much stronger than we did last quarter and we won't have quite the hill to climb as we get to the end of the quarter.

MR. DANIEL KINSELLA:
Regarding the staffing levels, rough numbers we're down about 15 percent from our peak staffing of late last year. We continue to prune some staff but as Greg mentioned there has been a conscious decision made to keep the technical and sales infrastructure in place so that

we can enhance our growth rate coming out of this.

THE CALLER:
So what is your total headcount now?

MR. DANIEL KINSELLA:
Roughly 200.

THE CALLER:
And what sort of pattern do you anticipate if you land somewhere in the 24 to 28 million revenue range in Q2, what sort of expense pattern are you expecting to go with that now?

MR. GREG MELAND:
Are you talking about headcount?

THE CALLER:
Operating expenses.

MR. GREG MELAND:
Basically, we're going to try to hold everything at an existing run rate here of about −−.

THE CALLER:
In absolute dollars you're saying?

MR. GREG MELAND:
Yep.

THE OPERATOR:
Clint Morrison (phonetic) with Miller Johnson Styken and Kinnard (phonetic).

THE CALLER:
Greg or Dan, can you talk about the amount of business that came out of your existing customer base? You always pride yourself on customer retention and with the increased competition are you retaining customers at the same rate?

MR. GREG MELAND:
Thank God for our historical, this quarter was a big example and I think a little bit indicative of what is going on out there. Huge dependence on existing customer base, about 95 percent of the business came from existing customer base this time, so very little new customer activity during the quarter.

THE CALLER:
Are you finding you're actually losing any existing customers because of aggressive pricing or competition?

MR. GREG MELAND:
No. You know you lose a deal here and there but a deal does not −− we have very broad penetration in the customers and any particular product add we might have lost but we continue to retain our customers at our historic levels.

THE CALLER:
I think when Dan was going through the numbers the guidance suggested that you're looking for comparable kinds of gross margins in the upcoming quarter, although we're obviously looking for a revenue pickup. If we get towards the high−end, are we still thinking we have got comparable gross margins where the mix is lots of little stuff or to get to the high−end of your range do we start seeing some of the larger programs come through and get the margin kick also?

MR. GREG MELAND:
We have a number of large deals that are out there. Even during this quarter there were a number of large deals, a million and a half, $1 million. It's just we would like to see more of both, the smaller deals and the larger deals, but there are a number of deals that are out there that appear to be moving forward that could move us toward the upper end.

THE CALLER:
I guess I'm trying to find out if −− you gave a fairly wide revenue range, are you looking for the same mix in structure if you do the high−end of the revenue or the low−end of the revenue or is the high−end predicated on things changing and some of these bigger ones starting to fall −− bigger opportunities falling and consequently the income statement?

MR. DANIEL KINSELLA:
The margins that were used to come up with the loss range assume a similar gross profit level across the whole range and that is due to lack of visibility on just what that mix will be. Historically, if we really get it going and get up towards the higher end of the range you would expect the larger, more complex transactions to be involved in that which traditionally give us a higher margin. (technical difficulty) If you net−net it all down, it would say that if we get up towards the higher end and have a pickup in margin, there would be some upsides to the (indiscernible) loss guidance.

THE CALLER:
Final question, is there any way to quantify −− you keep talking about the strengthening pipeline −− sort of the backlog, the pipeline to quantify or at least to quantify how much it may have changed over the last quarter?

MR. GREG MELAND:
It basically maintained. We had our sales managers go in and really scrutinize and analyze the pipeline and take out a few things, but we are running at a rate that is probably two times, a little stronger than two times what we are forecasting and that doesn't even include what we brought into the quarter. So feel good about the start and the opportunity we have for the rest of the quarter with the pipeline that is over two times what we need for the entire quarter.

THE CALLER:
Thanks.

THE OPERATOR:
Peter Shumann (phonetic) of PAS Capital (phonetic).

THE CALLER:
I was wondering if you guys could speak to your growth initiatives and also any long−term

expansion plans to increase your presence on the West Coast via either internal growth or acquisition?

MR. GREG MELAND:
Sure. The West Coast is something we have spent some time and energy on over the last year or so. We're obviously very strong in the Midwest here. We have done acquisitions and built−up the Southeast. We have had a presence up in the Northeast that is reasonable, but the West Coast −− and also the Southwest areas that we have been investing in and building out over the last year we expect to start to reap some of the investment and turn that into business out there but it's definitely an area kind of on the −− internal growth rate. We're also looking at opportunity to make acquisitions to strengthen territories like we did back in 1998 with Direct Connect down in Atlanta. Definitely a focus for us and we will continue to push on all fronts.

THE CALLER:
Thank you.

THE OPERATOR:
(indiscernible) with Citigroup Asset Management.

THE CALLER:
Couple of questions. First, you talked about (indiscernible) revenues distinctly last quarter and I was wondering how that is tracking this quarter?

MR. GREG MELAND:
I don't have the numbers −− maybe I do. It actually fell off a little bit over the previous quarter, but −−.

THE CALLER:
What's the acceptance part of (inaudible) and then the interest for the product?

MR. GREG MELAND:
Actually the interest level is fairly high right now in NAS. I don't know if the pure numbers in our case really tell you about the trends (indiscernible) getting a particular order at a certain time, but if you go back and compare activity and interest level six months ago versus today, there is definitely a lot more interest and discussion in NAS than there was at that point.

THE CALLER:
Can you talk a little more about what drove the rebound from 5 percent to 9 percent in infrastructure?

MR. GREG MELAND:
I think it was really continued buildout of some of the infrastructures that we had put in place before, along with a couple of large deals that were kind of SAN business continuance protection. One of our largest wins this time around was in the healthcare and that was a SAN buildout. So basically continued activity and interest in SAN space.

THE CALLER:
You say that competition is still fierce and anyone in particular −− I think last quarter you

were saying it was really the onset of Sun competing with the HTS (phonetic) product and how that is coming along.

MR. GREG MELAND:
The competition is fierce. I don't see pricing is as fierce as it was at the end of last year. It's just that if you take the total industry in aggregate and you start to add up the revenues by companies, it's probably down 40 percent versus what it was a year ago and you have a lot of salespeople that are hungry looking after every single opportunity and that's what makes it more competitive than price issues right now. Price is still aggressive, but just the fact that you have everybody chasing anything they can on the street to try to drive revenues.

THE CALLER:
Thanks.

THE OPERATOR:
(CALLER INSTRUCTIONS) David Fondry (phonetic) of Heartland Advisers.

THE CALLER:
You said 95 percent of success came with existing customers, are your salespeople not aggressively approaching new customers? It's a little bit disturbing that new customers −− that you have not attracted more new customers.

MR. GREG MELAND:
If you go back every quarter up until now, we have always had a pretty good blend. Actually, the 80 percent started to decrease a little bit. Some of the new territories we opened up are producing. I just think it's −− when you have newer development territories and people are trying to open up new accounts and nobody is spending money that's pretty tough versus focusing back a little bit where you've got good reputations and you're capturing everything you can get out of your existing accounts. So I think it's more of a reflection of the environment out there than interest. I have had, just in the last two weeks, two large accounts in here that we have not done business with in the past that when we kind of explained how we do things and what we bring to the table, extremely interested. In fact, I've had three in the last two weeks with large companies explaining our kind of consulting ability and knowledge of the industry and allowing their people to free up to work on initiatives that would drive their companies forward versus trying to track storage. We have out of those three meetings three opportunities to go and do some whiteboarding and engagements with customers we've never had in the past. I really think it's more a function of tough times and people focusing where they think they can get it versus trying to earn those new customers.

THE CALLER:
Is there any way you track how your salespeople are making let's say "cold calls" or are calling on new customers versus going back to the comfortableness of existing customers?

MR. GREG MELAND:
That's one thing that the Siebel System gives us a lot more information about opportunities and what they're chasing, and also with the increase in field management we have they are working with everybody and coaching them and consequently trying to expand that business. We don't have a −− we don't track it per se. Steve Howe may spend more time on that. It's not something that I really spend a lot of time on from a top−level.

THE CALLER:
Can you give us a sense of what is happening early April. I guess you suggested that −− things are −− that you expected orders to be more linear in the quarter and maybe deliveries as well. Is it more of the same in early April or is there any more order activity?

MR. GREG MELAND:
We are expecting a very strong order week this week. As I mentioned I think we will start out the quarter capturing much better than we did at the beginning of last quarter. It could be in that 30 percent range or even higher of the range we provided out there for you.

THE CALLER:
Thank you.

THE OPERATOR:
A follow−up from Jim Poynter of Unterberg Toebin.

THE CALLER:
If you look at your business just in terms of customer type or by industry that the customer is in, are there any particular industries that are somewhat better than the rest and those that are really tough right now for you or is it similar behavior across industry spectrum?

MR. GREG MELAND:
I think there are industries that were more immune to the trouble that have money, but from the need it's pretty widespread. When I look at our top 15 accounts, we had pretty good distribution from −− as I went through healthcare, telecommunication, Internet provider, defense, manufacturing, professional services, consumer products, pretty even distribution.

THE CALLER:
Thanks.

THE OPERATOR:
At this time, we have no further questions.

MR. GREG MELAND:
If there are no more questions, thank you everybody for your time. We will talk to you again soon. (CONFERENCE CALL CONCLUDED)

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04/17/2002 02:00 pm	**MTMS**	**Made2Manage Systems, Inc. (MTMS) − Q1 2002**

THE OPERATOR:
Good morning, welcome to the Made2Manage Systems' First Quarter 2002 Earnings Conference Call. You are currently on a listen−only mode. There will be a question−and−answer session following the introductory comments by Made2Manage Systems management. This conference call may contain statements that are forward−looking within the meaning of Federal Security Laws, and are based on Made2Manage's current expectations and assumptions, which are subject to a number of risks and uncertainties that could cause actual results to differ materially from those anticipated. Factors that could cause actual results to differ from those anticipated are detailed in the company's Securities and Exchange Commission's filings. With us today from Made2Manage Systems are David Wortman, President and Chief Executive Officer, and Traci Dolan, Chief Financial Officer. Go ahead, Mr. Wortman.

MR. DAVID WORTMAN:
Thank you. Good morning, everyone. Thanks for joining us for our first quarter 2002 investor conference call. As always, we appreciate your interest in Made2Manage. Traci and I look forward to sharing our results with you and answering your questions. The first quarter was certainly challenging one for us and as it appears for the enterprise software industry as a whole. In our case, we were able to improve profitability dramatically from a loss of 44 cents in the first quarter of 2001 to 7 cents in this year's first quarter. We were able to accomplish that despite lower revenue. We believe the decline in revenue was a function of two factors. The first is the economy, which continues to be weak, causing prospective customers to delay licensing our products. Second was the set of changes we've made to the structure of our sales organization, which cause some temporary disruption in such changes always do, but once we

believe, will contribute positively to our future performance. I'll talk more about those later in the call. Let me turn things over to Traci for more in−depth look at our financial results and when she's done, I'll give you some further thoughts in the business and the outlook for the year. Traci, it's all yours.

MS. TRACI DOLAN:
Thanks, Dave. Good morning. Our revenues for the first quarter were 7.4 million compared to 8.6 million for the same quarter in 2001. Software license revenue was 2 million compared to 3.9 million in 2001. Services revenue was 5.3 million compared to 4.5 million in the prior year. The decline in software license revenue is largely the result of delayed spending by prospective customers due to the sluggish economy. Another factor in the software license decline, we believe, was caused by some strategic changes we made to the sales organization during the first quarter that resulted in some short−term disruptions in closing business. Dave will elaborate on that further in his presentation. Software licenses were down both in the bar and direct channels. The average direct contract was $112,000 in the quarter compared to 139,000 for the first quarter of 2001. The mix of new transaction was nearly 80 percent from the direct channel, which is higher than our typical mix of 50 to 55 percent direct. The higher services revenues are driven by both support and maintenance services, and education. Both revenue streams are subscription base and reflect to increase in installed base of customers from prior year of first quarter. The gross profit margin was 65 percent, which is up from 61 percent in the prior year first quarter exclusive of the prior year restructuring charge. The first quarter 2002 profit margin is consistent with full−year 2001 profit margin. Third party software sales accounted for 15 percent of the software licenses consistent with 15 percent in the prior year first quarter. We expect that this trend will continue. Operating expenses exclusive of the restructuring charge, decline 19 percent from first quarter of 2001 to $5.2 million or 70 percent of revenues compared to 6.5 million or 75 percent in 2001. All operating cost decline as a result of ongoing cost management and selling cost were further impacted by the revenue shortfall or system sales in the first quarter. Our head count is 227 at March 31, 2002 compared to 249 a year ago. Our comparative operating results for the first quarter exclusive of the prior year restructuring charge are an operating loss of $415,000 in 2002 compared to $1.2 million of operating loss in the first quarter of 2001. Net loss for the quarter was $334,000 or 7 cents per share compared to 1.1 million or 23 cents per share in 2001. The operating loss and net loss for the first quarter of 2001, including the restructuring charge, was $2.8 million and $2.1 million or 44 cents loss per share. Our results for first quarter 2002 reflects no tax benefits due to our assessment about the near−term recoverability of significant tax loss carried forward. Prior year results include a reduction for a tax benefit at a 20 percent rate. At March 31, 2002, we had $15 million of cash in investments. For December 31, 2001, cash and investments declined by $47,000. The cash and investment balance translates into more than $3 per share. The company continued to carry no bank debt. Accounts receivable net were $5.9 million at March 31, 2002 compared with 6.8 million at December 31, 2001, that represents a DSO of 71−days consistent with December 31, 2001. DSO at March 31, 2001 was 99 days. Deferred revenue was $9.7 million compared to $10.5 million at December 31, 2001 reflecting a low new, system sales for the quarter. Deferred revenue for March 31, 2001 was $11 million. Total shareholders' equity was $12.1 million or approximately $2.50 book value per share outstanding. Dave.

MR. DAVID WORTMAN:
Great. Thanks, Traci. As you can see our financial performance continues to improve even in a very difficult market environment. At the same time our new business pipeline is improving

points to an economic recovery, however, the full effect is yet to be realized. We are aggressively managing our cash and our cost. We are considering to roll out new and improved products and services that bring value to our customers hoping them to meet their business objectives, and we foresee growing demand in the future as mid−market manufacturers increasingly recognize the need for integrated business systems, dealt some streamline operations, reduced cost, integrate their supply chains and compete in tough global markets. In my opening comments I mentioned a set of changes in the structure of the sales organization we implemented in the first quarter. The changes were designed to bring more focus attention to important customer categories and to leverage the capabilities of our sales management team. There were three changes. First, with any sales region, we designated a team of sales reps to focus only on strategic account that we believe offer greater long−term (indiscernible) opportunities to us. Second, we establish a separate sales management team devoted to recruiting, developing and supporting our network of value−added resellers. Third, we move management responsibility for sales store installed base of accounts to our area sales managers getting more leverage from the relationships built there in initial sale and getting our installed account sales reps closer to their customers. While the implementations of these changes cause some temporary disruptions in our ability to close some business, we are confident that they will contribute to improve results in the future but it's more channel−focus approach. On the product front, we announced our new business analysis application built with Microsoft.NET and XML Web Services technology. M2M business analysis is an advance product that extends our business intelligence suite to provide online analytical processing information cubes that are hosted and refreshed by Made2Manage and are acceptable from anywhere in the world with Microsoft Office XP and a Web browser. The first three cubes to be released are Demand Sales, Purchase Review and Profit/Loss Review; additional launch will be announced. Our customers are please with our Cyber (phonetic) hosted model. They don't have to handle any of the IT requirement to post the OLAP information cubes that is use the internet to link to the application and the application to find better data source automatically. Our new business analysis application extends our use of the Microsoft.NET Framework and XML Web Services, which we've already successfully applied to our M2M VIP e−commerce and electronics store front applications. Also on the product front, our new Supply Chain Management application, M2M synchronizer, is now in live operation at Abba Systems in Ontario. Synchronizer is a Theory of Constraints base production scheduler that features powerful optimization technology to help manufacturers dramatically increase factory throughput. The new application is an integrated component of the Made2Manage enterprise business system. Thus implementing Theory of Constraints practices in installing M2M Synchronizer in 2001, Abba Systems have seen an increase in throughput and a capacity increase of 80 percent while reducing both its inventory and its lead times. They are able to accommodate quick turn−around times for new orders without delaying (phonetic) orders that are already in production. With M2M Synchronizer, we're delivering Tier I (phonetic) Supply Chain Management functionality to mid−market manufacturers enabling companies like Abba Systems to truly optimize supply chain processes and gain an competitive advantage. Our relationship with Microsoft continues to get stronger. We are incorporating .NET technology across the breath of our enterprise solution. We've been able to use .NET to link manufacturers to their supply chain to change the way they manage the shop floor and to provide them with better access to business intelligence. During the quarter, we were honored to be recognized by Microsoft for our innovative use of the .NET platform. We share this recognition with two other companies that are working with Microsoft to showcase our new .NET applications to developers. As part of that collaboration, we share this stage with Microsoft CEO, Steve Baumer (phonetic) at the

Microsoft visual studio .NET launch in Chicago. Microsoft Chairman, Bill Gates −− Bill Gates also address the meeting on the virtual mode from San Francisco. During the event, we had the opportunity to showcase our applications with more than 4,000 developers. Our financial outlook for 2002 remains unchanged from our January 24th guidance. We continue to anticipate that earnings will range from 25 cents to 35 cents per share for the year, a dramatic improvement from the 98−cent per share loss in 2001. We also anticipate that earnings will improve on a quarter−over−quarter basis from the prior year. We further anticipate the 2002 revenues will exit 2001 revenues in the range of 8 to 12 percent based on continued growth in the number of mid−market manufacturing sites reserve and increase penetration of our installed base with additional applications. Finally, we anticipate positive cash flow in the range of $3 to $4 million. Our guidance was base on improving performance as the year progresses and considers both our normal business seasonality and a stronger economic environment in the second half of the year. With that, Traci and I are ready to take your questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) Catherine Moore (phonetic).

THE CALLER:
I'm Catherine Moore under Berthoven (phonetic). I wanted to ask about the Supply Chain Industry. Does that feel as to becoming easier for an ERP and integrated ERP vendor to sell supply chain modules? Right now you think people are looking for low cost and modular supply chain in the big application and then if you can talk to us a little bit more about the numbers of supply chain systems that you have in any ERP's from now?

MR. DAVID WORTMAN:
Sure. I felt for quite sometime that the most effective way to deploy supply chain applications, whereas an integrated part of a more complete suite that included ERP, the data that's necessary to drive the supply chain applications including the current status of the shop floor and the current order book, and expected demands typically reside in the ERP database. So, our strategy has been to deploy these applications in a fully integrated fashion rather than operating our supply chain applications independently from the ERP application suite that we've always offered. So, integration in my view is the key −− I think there is a great deal of evidence throughout the market both in the upper Tier's of the marketplace as well as in the mid−market to suggest that integration is one of the biggest challenges that any company faces that move to bring Supply Chain Management application in house. And so by taking that burden off of them, by taking the responsibility for the integration ourselves, we believe we put ourselves in a great position. With that said, it's very important that the back office operations be working well in order for the supply chain applications to be effective. Our supply chain applications are relatively new synchronizer, which is really the corner stone of the application suite introduced in the fall of last year. And today we have less than 5 percent of our customer base having license it, and those that have license that in early stages of bring it up live. But as I've said earlier and talking about the Abba Systems situation, the initial reports are very favorable about the benefits that they get.

THE CALLER:
Okay, great. Can you just give us any commentary you might have on discounting in the general −− in the price software market? Do you feel this March was a big discounting quarter and just that following to June or was it just total reluctance to buy?

MS. TRACI DOLAN:
Our discounting, Cathy, we didn't see much of a difference from last year. In the same quarter, it was pretty consistent. We felt this more of reluctance to buy.

THE CALLER:
Okay, great. Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) Mr. Wortman, I am showing no further questions.

MR. DAVID WORTMAN:
Alright. Well, thank you and thanks to everyone for taking your time to join us this morning. We are dedicated to building a leadership position in the enterprise business system market for mid−market manufactures. We believe in our strategy, in our products, in our market and our people. We remained committed to improving our financial performance while increasing our customer base, expanding our market share and driving revenue growth. We're excited about our future and believe that our stockholders will be rewarded for the confidence that's shown in us. We'll talk with all of you again in July after the close of our second quarter. Thanks again for coming.

THE OPERATOR:
Ladies and gentlemen, a rebroadcast of this call will be available approximately one hour from now. To access this rebroadcast, you may dial 1−800−428−6051, for the pass code ID of 238−050. This rebroadcast will be available until April 24, 2002. That concludes our conference for today. Thank you all for participating and have a nice day. All parties may now disconnect. (CONFERENCE CALL CONCLUDED)

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04/17/2002 04:30 pm	**CYBS**	**CyberSource Corporation (CYBS) − CYBS Q1 2002 Earnings Conference Call**

THE OPERATOR:
Good afternoon. My name is Yumiggi (phonetic) and I will be your conference facilitator. At this time, I would like to welcome everyone to the CyberSource First Quarter 2002 Financial Result Conference Call. All lines have been place on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer period. If you would like to ask a question during that time (CALLER INSTRUCTIONS), thank you. I will now turn the call over to Steve Pellizzer.

MR. STEVEN PELLIZZER:
Welcome and thank you for joining us today. I'm Steve Pellizzer, Vice−President of Finance for CyberSource and this is our conference call to discuss our First Quarter 2002 Financial Result. By now, you should have received the press release via fax or e−mail. It is also available at CyberSource.com. Also, participating in the call today is Bill McKiernan, our Chairman and CEO. This prepared remarks will run for approximately 15 minutes then we will open the call up for questions and answers. Before we get started, as a reminder during the course of this teleconference we will make certain forward−looking statements regarding our business and results of operations. Such forward−looking statement include the timing and number of customers that will be generated to the small business offering channel program, the transaction processing capacity of our system, the number of transactions we expect to process, the potential for increase sale of enterprise software and professional services when the economy improved, our status as a leader in the industry and whether we can maintain that position, our ability to capture new market with risk manager, the opportunity then the point of sale market, our ability to continue development effort to address the market need of our customers, any financial forecast including but not limited to

expected revenues, margins, expenses, cash balance, cost structure, pipeline, whether we will become a cash flow positive on an EBITDA basis by the end of the year and optimism about opportunities market in the economy. We wish to caution you that such statements are just beliefs or prediction and then actual results might differ materially from those projected in the forward−looking statement. These statements are also subject to risks and uncertainties including but not limited to the following: our limited operating history; general economic condition; unforeseen technical difficulties relating to the internet; forecast of transaction volume; potential system failures; any intense competition in our industry. Further, CyberSource is half−financial; business, operations and stock performance is not necessarily indicative of CyberSource its future performance. Listeners are referred to the document filed by CyberSource with the SEC specifically Form 10−K for the year ended December 31, 2001, which include this and certain other important risk factors. And with that, I'm please to introduce Bill McKiernan.

MR. WILLIAM MCKIERNAN:
Thank you, Steve. Good afternoon everyone and thank you all for joining us. Overall, we are pleased with our results for the quarter inspite of the challenging economic environment. Our revenue for the first quarter was 6.8 million slightly above our guidance of 6.7 million. Our sales force is been working very hard to close deals and we ended the quarter with a record pipeline led by decisions are still very slow in coming. Our margins improved from 49 percent last quarter and 44 percent for all of 2001 to 52 percent in Q1. Our approved margin to let us to reduce our loss per share to 12 cents which is 3 cents better than the guidance we gave at the beginning of last quarter. Equally important, even with the dramatic reductions in head count from last year. We are able to maintain our customer satisfaction levels our uptime performance and introduce a number of enhancements and new offerings during the course of the quarter. CyberSource transaction volume continues to be very strong as we process 49 million transaction this quarter. This represents strong volume growth excluding transaction process by PayPal last year. We process 2.5 million more transactions in Q1 2002 as compared to Q4 excluding PayPal which is impressive giving at Q4 volumes always reflect the holidays sales spike. Inspite, of the departure PayPal previously one of our highest transaction volumes customers, we still achieved $5.1 million in transaction services and support revenue for the quarter. This is largely due to the transaction volume growth for existing and new customers. We recently introduced the small business offering to a select of group of channel partners primarily banks. To bring the enterprise quality, reliability and support we have traditionally offer to large customers to a new segment of the market. I'm very pleased to report that initial reaction to this offering has been very positive. We are hearing from this channel partners that they eager to work with CyberSource. If they are in many cases dissatisfied with their current offerings. These partners are signing up 100 of merchants per month individually and thousands in the aggregate. I believed these channel relationships will bring us significant numbers of new customers by the end of the year. Equally important, because of the capacity we have, which we currently estimate at about 8 billion transactions per year. We should have plenty of headroom to add incremental volume without significant additional cost. Software and professional services performed according to our guidance in the difficult environment. With revenues of just over $1,700,000 respectively. Software and professional services represent important offerings for CyberSource. Not only from a revenue standpoint but also from a customer standpoint. Customers like the idea that they moved seamlessly between an outsource solution or an in−source solution from a single vendor. Furthermore, our experience with the payment software platform allows us to more efficiently developed software based risk solutions like our industry in leading risk manager

to that five offering. These businesses are also very well positioned when the economy eventually turns and enterprise software and PS begin to get more attraction. In the mean time, we are contributing strong margin to the company and provide good differentiation for CyberSource. Inspite, of this very challenging economic climate we are pleased to report we exceeded our EPS goal for the quarter. Our loss per share of 12 cents for the quarter was favorable by 3 cents the analysts consensus estimate of a 15 cents loss. This result is a dramatic improvement of a loss per share in Q1 of last year 30 cents. Contributing to this result is our improved gross margin. For the 13th consecutive quarter our gross margin improved. The overall gross margin for the first quarter was 52 percent well above our prior guidance of 49 percent and significantly better than the 36 percent we reported for Q1 of last year. We also aggressively managed our expenses and be consensus expectations for total operating expenses, net loss and loss per share. Our cash burn rate for the first quarter was 4.4 million and includes 2.3 million associated with severance cost from Q4 and $39,000 used to buyback 44,000 shares under our stock repurchase program. Today we spent 3.1 million repurchasing our stock with an average price of $1.06 per share. We expect to end the year with approximately 49 million in cash excluding any further share repurchases. Overall, on the operational side of the business I am very pleased with the progress we have as a company over the course of the past year and particularly in the first quarter of this year. Our product development team is been developing new products and product enhancements with excellent quality. Our operations group has done a great job achieving high−levels of system availability, security and reliability. And our customer support team consistently delivers high quality, enterprise levels support to our customers with very high customer satisfaction. Among our product development achievement this quarter is the introduction of an enhance web base reporting system for our transaction customer. This new system allows our customers to easily access transaction data, identify critical business trends and reconcile their financial statements for simplified business analysis. And include the graphical format to really straight trend like amounts, process by currency, risks profiles and other prog related items. Also, worth noting is the differentiate from our payment service is our ability to batch process and track settlements to ensure that each merchants payments settle on time. Our customers tell us our systems are far superior to the systems they've experience from our competitors. We further strengthen the security of our payment processing systems, which used the industry most advanced inscription standard to provide our customers with highly secure and efficient electronic payment processing. Unlike security solutions used by some of our major competitors such as passcode authentication. CyberSource is the only payment gateway provider to enforce a highly secured PKI based security model for all of its transaction. Ironically, one of our competitors VeriSign a PKI vendor doesn't even used PKI technology to authenticate the best majority of the payment customers or transaction. They still relying at user name and password system which inherently less secure. With our recent security enhancements not only can our customers be assured they're transaction are secure we've also delivered a dramatic increase in cryptographic performance. They're by reducing average transaction times by nearly 50 percent and raising our payment processing capacity by more than 40 percent. In addition to our sales attention to security we consistently maintained our 99.9 plus percent system uptime. We believed our improving track record with category leading merchants, proving operations and round the clock monitoring help us maintained our position as the leading provider electronic payment and risk solutions. As previously mentioned, we also launched in Q1 a small business offering. They combine basic payment authorization and simple fraud detection into a single−service for small businesses processing less than 1,000 (indiscernible) per month. We feel this offering will be key to expanding the number of channel partners in the future. On the risk management fund, we introduce the new version of our risk manager software. We have evolved to risk manager into the industries first extensible decision management platform for centralized control and simplified management of transaction risk. This platform provides a powerful rule builder as well as the ability to add or change in real−time risk management processes and custom or third party plug−ins. Because of the flexibility in customization offered by this new platform is key to our success in capturing new markets such as gaming were aged and location authentication are critical to do in business. We've already realized some success with a major gaming provider and feel well positioned to capture more business with this new platform. With that, our technologies up with world class customer support. We work very hard to make sure our customers are satisfied with our offerings and we continue to earn high−marks for customer satisfaction. I believed this is yet another key differentiated for CyberSource. While sale cycle is still long during the course of the first quarter. We added 210 new customers to book of which came to CyberSource through our channel program. Some key new customers include the University of California System, HNR Block, Holland−America Lines, JRElectronics, Overstat.com and TierraLycos, US Hispanic Portal Tierra.com. These enterprise customers in multi−channel businesses demonstrate the appeal of CyberSource to large established enterprise accounts. CyberSource wins customers from a number of reasons including our reputation for security and reliability, exceptional customer support and our proving track record with enterprise class accounts. Equally important, our solutions support transactions from multiple channels including websites call centers and point of sales systems. And the many integration we've built to leading commerce platforms. We still believed that going−forward the POS opportunity is an important one for us. We will continue our development efforts to address the market need of our transaction, software and risk management customers. We will also continued to developed solutions that seamlessly integrated with virtually all the significant commerce platforms from IBM, Microsoft, BEA etc. As well as (indiscernible) and sharing systems from Oracle, ASP and (indiscernible). And now, for a review of the first quarter financial I'll turn the call over to Steve Pellizzer our VP of Finance.

MR. STEVEN PELLIZZER:
Thanks, Bill. We begin 2002 with the strong performance as we exceeded the revenue guidance that we provided for the quarter and controlled our spending. As a result, the net loss for the first quarter was $4 million or 12 cents per share as compared to our guidance for the quarter of a net loss of 4.8 million or 15 cents per share. As Bill mentioned our first quarter revenues were 6.8 million. Transaction and support revenue in the first quarter was consistent with our guidance at 5.1 million or 200,000 less in the 5.3 million that we recorded in the first quarter of 2001. The declined is primarily due to the loss of PayPal in the fourth quarter of 2001. Professional service revenue was also consistent with our guidance of just over 700,000. Enterprise software revenue was 1,400,000 higher than our guidance. Again, our gross margin continued to improved. Gross profit was 3.6 million or 52 percent in the first quarter. This compares to a gross profit of 3.8 million or 49 percent in the fourth quarter of 2001. Cost of sales for transaction processing and departure services include infrastructures and customer support cost as well as depreciation on our data center equipment. Cost of sales for professional services are comprised of personnel cost and expensive as well as related over head. Cost of sales for enterprise software includes customer support personnel cost as well as fulfillment cost. Again, we continued to a good job controlling our spending. Our operating expenses for the first quarter was $7.8 million as compared to $10.2 million in operating expenses last quarter and the guidance that we provided for the quarter of $8.3 million. From a financial perspective, the company is very healthy. As of March 31st, our

cash and short−term investment positioned was approximately 54.7 million. In addition, our net account receivable decreases by 300,000 as compared to the fourth quarter of 2001. Now, I will give you some more detailed guidance for the second quarter and the year 2002. In write of SEC fair disclosure or FD this forecast which is made in good faith and was based on all the market information we have available today will be the only numbers of the company will comment on going−forward or until updated by the company. We also assume no duty to update these numbers at anytime during the quarter. Looking at the second quarter, we expect revenue to be approximately 6.9 million. Broken down we expect transaction and support revenues to be 5 million. Professional services revenues to be 900,000 and enterprise software revenue for financial reporting purposes to be $1 million. We currently estimate transaction volume in the second quarter to be between 44 and 46 million transactions. We expect the blended gross margin for the second quarter to remain at 52 percent. We expect total operating expenses for the second quarter to remain at approximately 7.8 million. Sales and marketing expenses are expected to be 50 percent of total expenses for the second quarter. Product development expenses are expected to be 28 percent to total expenses for the second quarter and general and administrative expenses are expected to make up the remainder at 22 percent. We currently expect the net loss for the second quarter to be approximately $4 million and the loss per share to be 12 cents per share on a weighted share count of 32.5 million. For the full−year 2002, we continue to expect total revenues to be approximately 31 million. Broken down we expect the transaction and support revenue to be 22.3 million. Professional service revenue to be 3.9 million and enterprise stock per revenue recognize financial reporting purposes to be 4.8 million. We continue to expect the blended gross margin for 2002 to grow throughout the year and believed we can achieved gross margin of 58 percent for the full−year. We expect total operating expenses for 2002 to be approximately 29.8 million given the cost savings that we achieved in the first quarter. Sales and marketing expenses are expected to be 49 percent of total expenses for 2002. Product development expenses are expected to be 29 percent total expenses and a general and administrative expense is 22 percent. We currently expect the net loss for 2002 to be approximately $11 million and we expect the loss per share to be approximately 34 cents on the weighted average share count of approximately 32.5 million. For the remainder of 2002, we are planning on capital expenditure of approximately $500,000. Cash consumption for 2002 was still forecasted to is approximately $10 million excluding any cash consumed than the 2002 share repurchase program. Importantly, we continue to believed that we will be EBITDA positive in the fourth quarter of 2002. Now, I'll turn the call back over to Bill to wrap it up.

MR. WILLIAM MCKIERNAN:
So, all the −− overall economic environment continues to be challenging we are finding that customers and partners are searching for high quality, well−supported world solutions which is with CyberSource is all about. Our sales pipeline is never been better but we still find the customers are slow to make decisions. However, as you can tell by the financial guidance that Steve provided for this quarter we are on track to maintain our efficient cost structure and revenue guidance for the remainder of the year. We have accomplished the great deal this quarter to bolster the reliability, security and functionality of our solutions and I remained very optimistic about the future. Did you see online sales are still forecasted to double every couple of years? In the category of card not present transactions, Internet sales are gaining shares from catalog sales. Online retail sales are growing approximately 4 times faster than offline retail sales. I'm optimistic about the opportunities for our new small business offering, our risk manager platform and the POS opportunity for our payment offerings. With our cash balance in solid, technical and operational infrastructure we are well−positioned to assessed

acquisition possibilities that will compliment our business and provide more offerings to cross sale and up sale to our installed base and new customers. Additionally, we have committed resources to investigating the role CyberSource can play in the web services paradigm. Which is in natural fit for CyberSource simply it that is exactly what we've been doing for the last 6 years and we have the infrastructure and expertise to manage the business rules and logistics of such a model. There is no doubt CyberSource is still the best choice for payment and fraud solutions. We're the only company that offers world class solutions with both and an in−house software and outsource transaction offering. Combined with world class risk management offerings plus we have highly skilled PS resources to implement the solution. We're very excited about extending these offerings to the small business community. Now, operator. I'll be happy to open up the call for questions.

THE OPERATOR:
At this time, I would like to remind everyone in order to ask a question (CALLER INSTRUCTIONS). Franco Turnelli (phonetic) of William Blair.

THE CALLER:
Bill, Steve good afternoon. How are you?

COMPANY REPRESENTATIVE:
Hi, Franco.

THE CALLER:
Couple of −− I think very quick questions for you. The increase in the number of transactions was very much greater than the increase in revenue both on an absolute basis and the relative to expectations. I'm assuming that this −− I mean, can you tell us what's going on in terms of the mix there in terms of the average transaction size. Just going to give us some color on that.

MR. STEVEN PELLIZZER:
Yes. Because of the increase volume, we have customers who were able to take advantage of volume placing model. And so there average transaction price was low for those incremental transaction and that play off probably the most significant part of it.

THE CALLER:
Okay. And then you mentioned what −− very much better than expected although the revenue was basically in−line apart from poor modeling on that part. Can you give us any thing side into why that might have been?

MR. STEVEN PELLIZZER:
Yes. It's impart related to some discretionary spending cost in the operation area. But also some favorable depreciation expense as well. We have forecasted quietly higher depreciation expense that we actually recorded.

THE CALLER:
Okay. And those things will apply in the second quarter as well or is this something different going on the second quarter. But −− maybe you'll be able to hold on to the margin.

MR. STEVEN PELLIZZER:
No, that's apply as well which is why we've given guidance of 52 percent terms of our gross margin.

THE CALLER:
Okay, one final question for you. And congratulation from the (indiscernible) and some of the (indiscernible) transactions I mean that one in particular. Is (indiscernible) introduced some of additional seasonality that you want us to be aware of this as we go in forward?

MR. STEVEN PELLIZZER:
I think we've included that in the models.

THE CALLER:
Okay, thanks guys. Great quarter.

MR. STEVEN PELLIZZER:
Thanks, Michael. But you're right on the age of (indiscernible). They do quite a bit of their transactions right up until April 15.

THE CALLER:
Thanks though.

THE OPERATOR:
Peter Schlider (phonetic) of Peninsula Capital.

THE CALLER:
Hi, Bill and Steve. Great quarter. I'd like to see the kind of progress you guys are making.

MR. STEVEN PELLIZZER:
Thanks, Steve.

THE CALLER:
First of all, that HRblock is that in this quarter in terms of transactions that might have been...

MR. STEVEN PELLIZZER:
Yes it is. They find up with us in 2001 and become significantly running transaction in kind of a late January or the February timeframe.

THE CALLER:
Of this year?

MR. STEVEN PELLIZZER:
Of this year.

THE CALLER:
And does that a significant volume or is that just an incremental piece of business?

MR. STEVEN PELLIZZER:
No, it is a significant volume for us.

THE CALLER:
Okay, great. First on the −− I can't blank out or I didn't hear on the cash burn. You burn 4.4 million but you'd said that 2. Something of that was the I guess it playing with the sovereigns and the shutdown cost of down fires in the company.

MR. STEVEN PELLIZZER:
That's correct.

THE CALLER:
Where was that number?

MR. STEVEN PELLIZZER:
The 2.3 million?

THE CALLER:
2.3 million, okay. And that's included in the 4.4 million?

MR. STEVEN PELLIZZER:
Yes.

THE CALLER:
Alright. So, the cash burn that we would expect in this quarter would be at around 2 to 2.5 million, is that reasonable?

MR. STEVEN PELLIZZER:
I think it might be a little higher than that.

THE CALLER:
Okay, alright. Then in your guidance, if I just go through the numbers in your guidance. I only get about a $3.3 million loss on an operating basis. Am I missing something there?

MR. STEVEN PELLIZZER:
For our Q1?

THE CALLER:
For Q2.

MR. STEVEN PELLIZZER:
It maybe in a −− I think you what you might be missing is interest. We can touch base...

THE CALLER:
No, we could do that off−line. Next question, the new platform the you came out with Bill how was that going to impact the revenue line as you go forward? Is that or even the cost side? Is there either a side of assets that's going to be impacted by this new E −− I forget the name of it −− ECRM or something like that.

MR. WILLIAM MCKIERNAN:
The risk manager platform?

THE CALLER:
Exactly.

MR. WILLIAM MCKIERNAN:
Yes, now that the revenue on cost implications is that our built in to the model and into the guidance that Steve share. We think that while its position today as surely a solution designed to mitigate risk for customers particularly in the front area that that platform is extensible to other areas as well. For example on the gaming space. Where not only to gaming companies have to manage the front risk associated with that business? But equally important is a whole set of compliance issues that they have to make sure that they pay attention to. And the compliance issues relate to for example in the US outside of Nevada, it is illegal to gamble on−line. So, the big regulated gaming companies, those companies that have regulated casinos in Nevada, New Jersey and places like that are very, very (indiscernible) those regulations. And I don't want to do anything to jeopardize their gaming licenses. So, they are very, very concern as they comply with those touch of regulations. And this risk manager platform is designed to be that positioning engine to allow them to analyze things like we're the customers dialing in from. Are they in fact of aged to gamble for that jurisdiction, etc.?

THE CALLER:
That's a lot of intelligence. I'm also curious Steve about the actual depreciation in the quarter. What was that? Is that about 600,000 bucks?

MR. STEVEN PELLIZZER:
That is about right, yes.

THE CALLER:
And that's mainly in the transaction and support line?

MR. STEVEN PELLIZZER:
Primarily in the operations area but also down below obviously in the operating expenses as well.

THE CALLER:
Okay. And then, if you look at your transaction gross margin, it doubled year over year. I'm kind of curious what your forecast are for gross margin in the transaction area both for the second quarter and then for the full−year. I know that's a PayPal driven for the most part. But, there are probably also some cost savings that have happened there too. I'm guessing.

MR. STEVEN PELLIZZER:
Yes. Grant for Q2 we're looking at about 48 percent in a way of a margin and then for the year about 52 percent. And again, this is impart part of the benefit we're getting is we depreciate our operating equipment over a three year life and so some of the equipment that we have purchased in years back are falling off.

THE CALLER:
Okay. Well, great. Congratulations on the great quarter and I'll follow−up with you.

COMPANY REPRESENTATIVE:
Great, than you.

THE OPERATOR:
At this time, I would like to remind everyone in order to ask a question (CALLER INSTRUCTIONS). Nick Farwell (phonetic) of Arbour Group.

THE CALLER:
Good afternoon, Bill.

MR. WILLIAM MCKIERNAN:
Hi, Nick.

THE CALLER:
May I just get a quick clarification on a couple of points you've already talked about? One of them is I think Steve mentioned that your cash burn might be slightly higher than the roughly $2 million. That is the adjusted of the adjusted cash burn here on the first quarter. If I take out the 2−3 in severance and then roughly 100,000 per share of purchase.

MR. STEVEN PELLIZZER:
Correct.

THE CALLER:
What would cause that incremental cash burn since you're rob your guidance as roughly somewhere to the first quarter number that just ended?

MR. STEVEN PELLIZZER:
In (indiscernible) we've got still some severance payments that are going to carry out into Q2. That's probably about half a million. And then, it's impart just due to the revenue obviously that we generate as well.

THE CALLER:
So, there maybe some small timing issues within working the capital level little factors of that nature?

MR. STEVEN PELLIZZER:
Correct.

THE CALLER:
In your guidance for the year that you provided in the fourth quarter you had transaction volume roughly 23 million or that was the guidance at that time. Your guidance is a $1 million less now. Is there anything you can provide us in terms of clarification for (indiscernible) that factor as modest as that may sound?

MR. STEVEN PELLIZZER:
Well in parts, we didn't see as many new customers sign−up in the first quarter, which is the primary reason for kind of a pull back. We are a little bit more conservative in going out and planning our new customer additions throughout the rest of the year.

THE CALLER:
So, is that primarily based on new −− the start of a new customer as opposed to current customers use it rates?

MR. STEVEN PELLIZZER:
Yes, it would be the new customers.

THE CALLER:
There is a line item. I have totally drawn on the (indiscernible) where you have lost on investments on the joint venture. Could you remind me what that relates to?

MR. STEVEN PELLIZZER:
Yes, that's relate to our investment and our Japanese joint venture just states back to early 2000 I believe that we kicked that off.

MR. WILLIAM MCKIERNAN:
We are the majority investor in CyberSource KK based in Tokyo and the other investors in that joint venture are Marbetti and Trans Cosmos, Inc. They split 49 percent we owned 51 percent.

THE CALLER:
What is the outlook for that business, Bill? Could you give us some sense of what that may generate you to positive cash flow or positive financial release from a financial accounting basis a positive contribution?

MR. WILLIAM MCKIERNAN:
Yes, Nick. I wouldn't expect them to generate much this year. The economy over there is very tough at the moment. They don't expect things to turn around anytime this year. Our losses from the JB would be nominal this year. It's a pretty small investment overall and they have about probably 14 to 15 people there in the office. So, I think you'll see probably second half of '03 when that will start to put some meaningful results.

THE CALLER:
Okay. So, perhaps this year in aggregate we might loss less than half a million bucks just taking first quarter and multiplying by four.

MR. STEVEN PELLIZZER:
Yes. What you see on our balance sheet is the actual investment balance. So, we basically take our percentage share of the loss and find that to the two investments.

THE CALLER:
Right. So, I assume it's not the equity method. So, the way you run out that equity it disappears. This you continue to reflect the losses as long as there are losses incurred. Is that correct, Steve?

MR. STEVEN PELLIZZER:
No, that's not correct. Once we actually apply our share of the losses again the investment balance.

THE CALLER:
Then it disappears?

MR. STEVEN PELLIZZER:
Then it disappears.

THE CALLER:
Then how much of your investment balance do you have left?

MR. STEVEN PELLIZZER:
There is only about $72,000 left on the books as of March 31st.

THE CALLER:
So, does that mean that (indiscernible) you'll not going to see this line item for the balance of the year?

MR. STEVEN PELLIZZER:
Yes, it actually probably at the end of this quarter it will probably be gone. Q2.

THE CALLER:
Are there any other aspects of the business where you believe having now had the initial first quarter to evaluate business? Where you see that the credit occur perhaps incrementally more leverage either way than what you previously anticipated when you provided us guidance at the end of the fourth quarter?

MR. WILLIAM MCKIERNAN:
The business is inherently leverageable, Nick. And what I mean by that is if you look at that the three core revenue string transactions software and professional services each of those is highly leverageable particularly the transaction software. And on the transaction side the cost was on the processing in incremental transaction which really nominal and that's why our margins are starting to expand across the board. Some are really were software and the same thing the software build and incremental cost is very small. Even on the TF side, which historically people will think about it as very leverageable business. We're continually developing IP that we look to reuse remarket to our customers so that there's leverage element there as well.

THE CALLER:
I guess what I was −− I understand that (indiscernible) wondering if at this particular point in time, whether you felt there was any incremental opportunity for example the enterprise software business perhaps achieved a volume level higher than what you're currently suggesting might. I've realized this as the best guest projection of 5 million. Given the leverage in that business with 90 percent gross margin obviously incremental volume will have a big impact and be able to achieve break−even by the fourth quarter. Or of course, some time before or after that.

MR. WILLIAM MCKIERNAN:
Well as I mentioned in my comments when we review our sales pipeline at the end of the last quarter, it has never been stronger across the board. Software, PS, and transactions. The challenge continues to be to move those deals out of the pipeline column and into the book column. And things are loosing up a little bit out there. I'm optimistic but we're not in the position at this point to build that into any guidance or any forecast.

THE CALLER:
So the guidance you're providing us is still as you've just mentioned now still suggesting EBITDA break−even or being slightly positive in the 4th quarter of '02 not including perhaps achieving volume higher than the 31 million.

MR. WILLIAM MCKIERNAN:
Well, that's correct. That's really correct.

THE CALLER:
Thank you, Bill, Steve.

MR. WILLIAM MCKIERNAN:
Thanks, Nick.

THE OPERATOR:
Peter Schlider (phonetic) of Peninsula Capital.

THE CALLER:
Well at this time, this is putting you on the spot so I give you that on the heads up. I'm looking at the 34 cents loss for the year. And you're kind of saying that you're on a flat loss sequentially. And then, that would imply a 7 cents loss in the third quarter and break−even for the fourth. That's a pretty big delta in the September quarter. Is that a −− that's normally a kind of a seasonal marginal quarter, isn't it?

MR. WILLIAM MCKIERNAN:
Not for us.

THE CALLER:
Normally it takes off?

MR. WILLIAM MCKIERNAN:
We usually do pretty well in Q3.

THE CALLER:
Okay. And on the cash burn you are speaking with the 49 million as the ending year cash, which would imply that we burn another 3 million roughly next quarter 2 million and 1.5 or something like that.

MR. STEVEN PELLIZZER:
Yes, that's close.

THE CALLER:
Okay, great. Thanks again.

THE OPERATOR:
At this time, there are no further questions.

MR. WILLIAM MCKIERNAN:
Well, thanks very much for joining us today and we look forward to be with you review again

in 3−months.

THE OPERATOR:
Thank you for joining in today's conference call. You may now disconnect. CONFERENCE CALL CONCLUDED)

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04/17/2002 02:00 pm	**BARI**	**Bancorp Rhode Island Inc (BARI) − BARI Q1 2002 Earnings Conference Call**

THE OPERATOR:
Good morning ladies and gentlemen. Thank you for standing by. Welcome to the Bancorp Rhode Island Inc. 1st Quarter Earnings Conference Call. At this time, all participants are in a listen−only mode. Following the presentation, we will conduct the question−and−answer session. Instructions will be provided at the time (indiscernible) the question. If anyone has a difficulties during the conference, please press star "0" for operator assistance. I would like to advice everyone this conference call is being recorded. I will now turn the conference over to Meryll Sherman, President and Chief Executive Officer. Please go ahead.

MS. MERYLL SHERMAN:
Good morning and thank you. I am Meryll Sherman, President and CEO of Bancorp Rhode Island Inc. I would like to welcome you to our 1st Quarter Analyst Conference Call. We are going to follow some similar format to our previous calls, our CFO and Treasurer, Al Lithimer (phonetic) is here with me, briefly take his view on our 1st quarter results. Then both Al and I will be available to answer any questions you may have. Someone has asked me if how many people are participating. We have been thinking back with that, but at this point, who are listening on in the call. During this conference call, we may make forward−looking statements within the meaning of the Securities and Exchange Act of 1934. These statements are based on our press release and are necessarily based on certain assumptions but they are subject to risk and uncertainty. Actual results may differ materially from those discussed here. More information on these risk factors can be found in the company's filing with the Securities and Exchange Commission. With that, I would turn the call over to Al.

MR. AL LITHIMER:
Thank you very much Meryll. Good morning to everyone on the call. I would like to start off and say that Bancorp Rhode Island was happy to report 1st quarter earnings of $1.7 million. That is up 9.3 percent over the 1st quarter of 2001 and 6.1 percent over the 4th quarter of 2001. These earnings represented 43 cents on the diluted earnings per share basis and that is up 7.5 percent from the 40 cents reported in the 1st quarter of 2001 and up 5 percent over the 41 cents reported in the 4th quarter of 2000. Cash basis earnings per share were 48 cents up from 45 1st of last year and we had stated that the end of last year Bancorp Rhode Island will continue to present our earnings of both in cash and cash basis. While earnings for the 1st quarter were at the higher end of the guidance range. One must bear in mind that a number of the costs of our expansion initiative have not yet been incurred. Turning our attention to the balance sheet, the positive growth was strong for the 1st quarter reaching $693 million in total deposit. That is up $22 million since the end of the year. Checking and savings deposits were up nearly $32 million during the quarter and that represents an approximate 7.5 percent increase. Savings and checking deposits now represent nearly two−third of total deposits. During the quarter, SDs declined $9.6 million as lower interest rate continues for the demand (indiscernible). That growth in deposit, coupled with the growth in federal home loan bank borrowing is what funded our asset growth. Asset growth jumped $68 million since year−end reaching $930 million for the end of the 1st quarter. On the asset side of the balance sheet, this growth was primarily concentrated in mortgage box securities, which were up $35 million, and investment securities, which were up $14 million. The loan portfolios experienced high prepayments in the residential portfolio during the first 2 months of the quarter and some moderation of those prepayments during the 3rd−month but overall residential mortgages declined by nearly $15 million. A commercial portfolio continued to grow with total outstanding reaching $242 million at the end of the quarter, which is up approximately $3 million at the end of this term. Our net interest margin was 3.63 percent for the quarter that is down from the 1st quarter of last year, where it was 3.99 percent but represented really a stabilization from the 4th quarter of 2001, where we reported our net interest margin of 3.66. Despite decline of 3 basis point that primarily attributable both in mortgage box securities and investment securities that was entered in the 1st quarter of 2002. But if quality remains strong our performing loans are down to only 10 basis point of total loan (indiscernible) to 12 basis point at the end of the year. And our allowance for loan losses, total loan was at 1.49 percent up from 1.40 at the end of the year. These numbers are exceptionally low and again we must caution everyone that as the portfolio matures and as changes in the local and national economy take place as these number end as they go up. Non−interest incomes are continued to expand. Non−interest income is an area that we have been concentrating on now for many years has reached to total of $1.5 −− reached almost a total of $1.6 million for the quarter, up from $1.1 million 1st quarter of last year and represents 69 basis point of average asset for the 1st quarter of 2002. As I had said, this an area we have been concentrating on for a long period of time. And to give you a sense of the progress that we have made, if we go back to 1997, total non−interest income that year was only 38 basis point of average asset for that year. The growth during the 1st quarter was centered in really three areas. Both in non−deposit investment program, commissions were up $176,000. They entered into purchase of some bank loan life insurance during the quarter which (indiscernible) $95,000 of non−interest income. And service charges on deposit products were up $89,000 during the quarter. Most of this growth resulting from the both and outstanding account numbers as balances. And that really summarizes the comment that I would like to make for the 1st quarter. I am happy to open the conference call to question at this point. Both Meryll and I look forward to your questions.

THE CALLER:
Thank you. One moment please. Ladies and gentlemen we will now conduct the question−and−answer session. (CALLER INSTRUCTIONS). Your first question comes from Brent Robertson from Midwife Research. Please proceed with your question. Question −− actually I have got several only now (indiscernible) which you answer it once. First, I saw Al's comment this morning in American Banker on (indiscernible) about being too early to tell on their retail. Is there any other color you can give regarding what you might see in terms of and obviously catering to a little different (indiscernible) and you are but any other color you can give on what you might expect for now?

MS. MERYLL SHERMAN:
I am glad you saw that comment. I was sitting here smiling I have not seen the comment can you −− so I cannot −− I did not even hear the question quite well.

MR. AL LITHIMER:
Well and I am now jumping here. This is Al. The question or the comment that I was quoted in the American Banker this morning was with (indiscernible) change of focus that we think that −− that was going to make an immediate impact upon our business. And my comment basically, it said that, traditionally (indiscernible) and ourselves have focused on different market segments and that I thought at this point in time was too early to tell what specifically the impact of (indiscernible) most recent announcement we are going to have on our business. Meryll, if you would like to extend upon that at all.

MS. MERYLL SHERMAN:
Al is right (indiscernible) on that extend on it. So −− you know we really (inaudible).

THE CALLER:
If I may ask as I go (indiscernible) in to spending a lot money on retail, which is sound like they may do as just that. Do you change anything you are doing specifically to kind of act there more aggressive nature in the market?

MS. MERYLL SHERMAN:
Al said it would be premature. I do not want −− let me suggest that it is like turning a large battleship around. And one of the things that we do in specializing is delivering hands−on service and you know kind of have nice one place associated with that which is good for business. And I think we have got reputation by word of mouth and originally build gap between our advertising and what we say we are and with what we do everyday in terms of service. So, I think if we −− which −− you know it had a very extended history not being the most user−friendly, customer−friendly organization and that part of where are they going and I have not −− you know I read some of the comments as well but it comment seems to (indiscernible) direction. And I think it is going to take more time to speculate that so for immediate future probably not a lot of impact but you know we will wait and see. It really too early to tell but we are going to keep doing what we are doing.

THE CALLER:
Okay, obviously it is fairly. Question on long growth, you are previously giving guidance I believe to 12 percent at least on loans and you are seeing nice as your commercial growing somewhat and you are obviously hired more personnel to continue that endeavor. Can you give any new guidance on long growth for the year −− have you seen change any in the past

quarter?

MS. MERYLL SHERMAN:
Sure, kind of funny when you look at the numbers during this year, a loan of $3 million increase quarter−of−quarter you look as it slow down. We actually book the tremendous amount in business and the pipeline is very strong. We had 2 large of credits, one of which is a revolver and (indiscernible) still accustomed to pay the balance down and then we had a participation in loan that had been with us since we opened and it was (indiscernible) previously on that credit (indiscernible) one of the original deals is part of the (indiscernible). So, we are comfortable with the activity and pretty pleased about it and hopefully we will be able to start closing in more significant rate of entries. We do look for a double−digit growth here and time will tell whether we can accomplish that. (inaudible).

THE CALLER:
Okay and then lastly, you added quite a bit to the (indiscernible) this quarter and first it was reserve in (indiscernible) and obviously you are going your commercial portfolio. Can you give us any thoughts on the reserve in relation to launch going forward? And what is your money to −− and obviously had no commercially charge off this quarter but if you did that some way in a year, would you keep the provision somewhat in the 1st quarter or would you (indiscernible)?

MS. MERYLL SHERMAN:
You are threading into an area that we have not been question than before so I come a little (indiscernible) responding and I think I had to shape it. We basically set a budget at the beginning of the year and we try not to bury too much from it. We did run pretty strong this quarter in terms of lack of charge−off and the coverage ratio is really healthy at this point but this is the position we like to be in. And I think that we are just going to have to adopt a wait and see attitude, you know in some point, you do not have to be provisioning but we refer not to have (indiscernible) one way or the other in terms of (indiscernible) provision.

MR. AL LITHIMER:
That means but naturally we do take into consideration the level of non−performers at that moment in time in addition to historical level since the −− do overtime make modification to what we are provisioning based upon the current set of fact that are presented. But it is −− again at this particular point here not knowing what exactly is going to happen with the economy is little difficult to predict accurately where those provision numbers will −− but they will reflect actual experience that takes places during the year.

THE CALLER:
Okay, great. Good quarter.

THE OPERATOR:
Gerry Shock of KBW.

THE CALLER:
Most of my questions were answered. By the question in terms of the deposit growth that you had, were you saying that there is an actual increase in the number of accounts? Or you seeing more in average balances are going up as before −− I guess putting money in the bank as suppose to investing at all sort at this point?

MS. MERYLL SHERMAN:
Can I answer that by saying both −− you know we are experiencing positive (indiscernible) but we do have a (indiscernible) number of new customer and I can also tell you that we are pretty active right now in terms of running at couple of marketing campaign part of our strategy and someone have been to launch our visibility that we are back on (indiscernible) that billboards were running process. We are running small business stuff along promotion now and I suspected the part of the promotion would be in (indiscernible). So, we had some nice number of account closed in checking and account side and was in put to (inaudible).

THE CALLER:
Okay. Great. Thank you.

THE OPERATOR:
Flay Louis of (indiscernible) Research and Management.

THE CALLER:
Just a couple of, you know some (indiscernible) small things, interest income was down this quarter versus the previous quarter, just wondering what contribute to that? Although interest expenses down more and then you mentioned expansion plan have not been fully expensed yet, what kinds of schedule for expensing those expansion plan, and what expenses are we talking about here?

MR. AL LITHIMER:
On the decrease and total interest income quarter over quarter that is a result of general interest rate environment that we are all in. And as you also pointed out that total interest expense did also go down quarter over quarter so that our net interest income for the 4th quarter was very similar to what we experienced here in the 1st quarter. We were at $7,600,000 for the 4th quarter we are at $7,617,000 for the 1st quarter of this year. What you are seeing there is the ramification of market interest rates coming down, manifesting it (indiscernible) both the interest income and interest expense side.

THE CALLER:
Which you were able to get your EBITDA, your costs are coming down faster than your income?

MR. AL LITHIMER:
It is basically the total came down a similar amount because net interest income remains relatively unchanged quarter over quarter.

THE CALLER:
And what if indeed we have seen the bottom in interest rates, so what is that mean for those lines going forward?

MS. MERYLL SHERMAN:
We expect that we are moderately interest rate sensitive and would anticipate (indiscernible).

THE CALLER:
I am sorry, one more time Meryll.

MS. MERYLL SHERMAN:
We are moderately interest rate sensitive and we anticipate we would benefit from a moderately (inaudible).

THE CALLER:
Okay thanks.

MS. MERYLL SHERMAN:
The expenses and expansion, you take a look at the 3 elements of the expansion plan one involved (indiscernible) and second involved hiring a new wonders and the third involved campus made program with the (indiscernible) we broke ground for the western (indiscernible) (indiscernible) plans. We have identified this site or instinct it was on the permitting it maybe a little longer than we like any off the ground although we still trying an impressive schedule (indiscernible) by the end of the year. But those are kind of expenses you look at the second half of the year same thing with the (indiscernible) site. It is really that we have 2 or 3 sites will see how (indiscernible) (indiscernible) on my mind. We are still looking for a lender for (indiscernible). Some of the expenses that way have been occurred and some of this (indiscernible) that way. And then the final element is (indiscernible) continue with our campus made program and some marketing material (indiscernible) will see some of those class build over the course of the year.

THE CALLER:
Okay, presumable a fair amount of the branching expenses will be capitalized is that correct?

MS. MERYLL SHERMAN:
It is less sequential on what you capitalize and the reality is when you open a branch you have basically very modest zero in deposit and you are running full (indiscernible). And you make sure you have nice full staffing and once people come in you may have seen all those smiling faces. So that is the (indiscernible) negative in (indiscernible) probably.

THE CALLER:
Okay. Thank you very much.

THE OPERATOR:
Bill McCrystal (phonetic) from (indiscernible).

THE CALLER:
Sort of question from expense side just from a run rate. Given the 1st quarter as a base would it be some sort of an orderly progression for the rest of the year. Or do you see it sort of spiking as some of these new expansion plans take hold?

MR. AL LITHIMER:
I mean I think Bill there is a combination of a little bit of both in there while all of the expansion plans are not to is that (indiscernible) one particular month during the year. You would not have a spike as a result of that. But when a branch comes on line or the lenders had brought on board you do have an increase as a result of that. Overall I think that it will be more of a progression as the year goes by just simply because again they are not all scheduled to open on the same day.

THE CALLER:
Okay one other point, could you give a little detail on the security side on the mortgage (indiscernible) adjustments from the assets−liabilities standpoint, what kind of average duration or whatever you looking at?

MR. AL LITHIMER:
Sure I would be happy. On the asset side of the balance sheet, we invested in hyper norm both 31 and 51 hyper norms. Primarily 51 ready in (indiscernible) issues. And on the liability side, we funded those with a serious of better home loan bank advances, combination of both ranging from 1−5 years and also use a 5−year amortizer. So the longest rate lock on the asset side is for 5 years and the longest rate lock on the liability side is also for 5 years. The duration of the liabilities is actually slightly longer and the duration of the assets, it was one of our conscious decisions in structuring the transaction vis−a−vis the overall sensitivity of our balance sheet.

THE CALLER:
Could you talk a little bit about the market from economic standpoint whether you seen some increase or anticipate some increase usage or generally what you see going on?

MS. MERYLL SHERMAN:
And that is characterized deployment is moderate. If you look at last year you will have kind of our customers did not have good years they had before but they still (indiscernible) functioning and largely profitable as to have some people is saying this thing bit of an uptake that some of the sale this year running ahead. Real estate remains relatively strong that has ever really often in a significant way, although supposed the Boston market is softening which (indiscernible) (indiscernible) but things just okay and slightly probably better than okay. I think we are excited about it but I do not see any really bit (indiscernible).

THE CALLER:
Okay, thank you very much.

THE OPERATOR:
(CALLER INSTRUCTIONS). (technical difficulty). There are no further questions at this time, please continue.

MS. MERYLL SHERMAN:
Okay, thank you all for listening in and we are looking forward to chatting again at the end of the next quarter, good morning.

THE OPERATOR:
Ladies and gentlemen this concludes your conference call for today. We thank you for participating and please disconnect your lines. (CONFERENCE CALL CONCLUDED).

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04/17/2002 06:30 pm **BOBJ** **Business Objects SA (BOBJ) − BOBJ Q1 2002 Earnings Conference Call**

BUSINESS OBJECTS S.A. (BOBJ)

THE OPERATOR:
Good afternoon. My name is Danielle and I will be your conference facilitator. At this time I would like to everyone to the BUSINESS Objects (BOBJ) first−quarter earnings call. All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question−and−answer period. (OPERATOR GIVES CALLER INSTRUCTIONS.) Mr. Markley (phonetic), you may begin your conference.

COMPANY REPRESENTATIVE:
Welcome to our conference call for the first−quarter 2002 earnings announcement. This call may not be reproduced in whole or in part without the written permission of the Company. On the call today are Business Objects' Chief Executive officer Bernard Laiutaud and our Chief Financial Officer, Thomas Weatherford. Before we begin, I remind you that during the course of today's call our executives will make projections and other forward−looking statements, in particular, statements regarding the business outlook, future financial and operating results, new markets, partners products, services, features and content. We wish to caution you that such statements are just predictions based on management's current expectations or beliefs and that actual events or results may differ materially. We refer you to documents the Company files with the Securities and Exchange Commission, including the 10k for the year ended December 31, 2001. These documents identify important risk factors that could cause actual results to differ materially from those contained in our forward−looking statements. I caution you that the Company assumes no duty to confirm, update or revise the financial forecast for the quarter or year or any other forward−looking information contained in this call as a result of new developments or otherwise. Finally, when

we move to the question−and−answer session, we ask that you limit yourself to one question and a follow−up question. Thank you. I will turn the call over to Thomas Weatherford.

MR. THOMAS WEATHERFORD:
Welcome, everyone, to our call for Q1. All amounts mentioned in this call will be in U.S. dollars. Total revenue for the first−quarter was a record 107.5 million, as compared to 98.3 million for the same quarter last year. This was a nine percent increase. I like to also remind people the last quarter, 2001, increased 35 percent. License revenues increased four percent to 63.2 million while service revenues were 44.3 million, an 18 percent increase over the prior year. The euro weakened after strengthening all throughout 2001. As a result, the overall revenue increase would have been 13 percent on a constant euro basis. The growth rate by region was: Americans, 48 percent; Europe and local currency, negative six percent; Japan and local currency, −18 percent; the rest of the world, positive six percent. License revenues were 59 percent of total revenue and we added 558 new customers. Total gross margin for the quarter was 84 percent and level with the first−quarter of the prior year. License margins were 99 percent while service margins were a strong 62 percent. Operating expenses for the quarter were 69 percent of revenue as compared to 69 percent in the prior year's quarters. The operating profit was 15 percent of revenue and level with the previous year's margins. Other income was $2 million, compared to 2.8 million in the prior year, due primarily to lower interest rates. Net income for the quarter was 11 million. This was a five percent increase over the first−quarter of 2001. Ending cash, including short−term investments and restricted cash for the quarter was 270.7 million, an increase of 21 million in the quarter. DSO or days outstanding were 68 days this quarter. The significant point of this quarter's performance are as follows: we were able to achieve continued positive revenue growth in the face of a continuing tight IT spending environment. We continued to gain new customers as as 58 percent of all license orders were from either from new customers or new applications. The revenue split by division in U.S. dollars was Americans, 47 percent; Europe, 46 percent; Japan, four percent and the rest of the world, three percent. Revenue from indirect channels was 49 percent of license revenue. There were four deals over $1 million this quarter. We endedthe quarter with 356 quota carrying salespeople. In total, we have 2,231 worldwide employees. The DSOs were 68 days. Receivables over 90 days, 120 days for Italy and Spain continued to be less than 10 percent of total receivables. This result was below our model of 70 to 75 days. In fact, overall the aging improved in a very difficult environment. Our Extranet business segment achieved over 23.5 million of license and services revenue and grew at 39 percent. Our Analytical Applications segment acheived 3.5 million of license revenues and grew at 165, percent. Our balance sheet position indeed remained strong with over $270 million of cash. Our cash increased by 21 million, due primarily to net cash from operations and lower capital expenditures. Deferred revenue at 69.6 million increased 17 percent sequentially over the fourth quarter. Before I give the guidance for the coming quarter and total next year 2002, this year, I would like to read this statement. The following information concerning our forecasts for both the current quarter and this year represents our outlook only as of the date hereof and we undertake no obligation to update or revise any financial forecast (indiscernible) forward−looking statements as a result of new developments or otherwise. Now, for our guidance we will also be in U.S. dollars. The second−quarter 2002, this current quarter, we expect a revenue of between 108 to $110 million and operating profit around 15 percent of revenue and an earnings per share between 16 and 17 cents. Fully diluted shares outstanding are expected to average 65.5 million for quarter. For the total year 2002, we expect revenue to be between 455 to 465 million with an operating profit of 16 percent of revenue. Diluted earnings per share and per ADS is projected to be between 74 and

77 cents. Outstanding, fully diluted shares are expected to average 66 million for the year. We have lowered the top end of our revenue and profit guidance. The decrease is only two percent. Although we feel confident about our position in the marketplace, we cannot ignore all the pre−announcements and the obvious signs of economic weakness in Europe and Japan, two of our marketplaces. In further analyzing the quarter, we achieved our 19th consecutive quarter meeting our guidance. I believe that this reinforces our commitment to our shareholders. All the fundamentals are in place, revenue growth, expense control, strong gross and operating margins, DSO's favorable to the industry standard, positive cash flow and a strengthening balance sheet. Indeed, this is an exception in these times. Our new markets of Extranet and Analytical Applications are meeting our expectations. We have continued progress in the key America's market, growing 48 percent this quarter. The European and Japanese markets are weak. We have been saying for some time that the worldwide IT spending recovery would be slow. Unfortunately, we appear to have been right, so we are prudent in our outlook. Although IT spending is tight, we continue to strengthen our position in the business intelligence analytical space. Bernard?

MR. BERNARD LAIUTAUD:
Q1 was a solid quarter for Business Objects, despite the continued difficult economic environment we've been facing and a weak European currency. During the quarter, we have continued to reinforce our leadership in the BI space, increasing our marketshare against all our traditional competitors. We have shown outstanding revenue growth in our U.S. operations, signing key transactions with premier customers and finally, we are showing very good momentum in our new high−growth activities, Extranet and Analytical Applications. Let's start with our momentum in the various geographies. For North America, as Tom mentioned, had an outstanding quarter. It grew (indiscernible) revenue 48 percent compared to the same period last year. This is in comparison with the previous growth rate of 17 percent in Q4, versus Q4 2000. For the license performance, it was particularly impressive with a 57 percent growth rate. As a result, North America represents now 47 percent of the Company's total revenue. We were also able to show sequential license growth in the U.S. from Q4 to Q1, which is highly unusual. These results, I believe, are the consequence of strong sales management and key customer wins but also of the speed at which we're moving to our new approach to the market, i.e. solution selling and move to high−growth areas like applications. We continue to offer strong, differentiated value over (indiscernible) competition. We had several key customer wins over $1 million in Q1, including Seven−Eleven and the U.S. Department of Labor. The Seven−Eleven was a more than $1.5 million transaction. The store chain will use Business Objects to perform profitability and merchandising analysis. In addition, they will implement the supply chain extranet. This was a model transaction for us this quarter, as it was one, a large deal but also a mix of applications and extranet. The Occupational Safety and Health Administration Office from the U.S. Department of Labor has selected Business Objects and will use it for compliance reporting and workplace safety analysis. That was also a very large transaction for us in the first quarter. We're extremely encouraged by the business momentum in this geography. Our 57 percent license growth rate indicates that we're continuing to grow significant marketshare over all our direct competitors at a very fast rate. On the other side, Europe experienced broad−based economic slowdown and as a consequence, our European operations showed a negative growth of six percent of local currency. Regarding economic conditions, as we indicated in the past quarter, we feel that Europe is lagging compared to the U.S. and we anticipate that situation to remain the same for at least the upcoming quarter. Because of that, Europe is also slower at transforming to our new sales model as compared to the U.S., which is much more homogenous

organization. As we continue to allow these changes, though, I believe we will start seeing positive momentum in Europe. On a global basis this quarter, we saw about the same amount of (indiscernible) transactions than in Q4 last year −− four deals over $1 million and eighteen deals over (indiscernible) compared to three and 13 in the first quarter last year. The proportion of revenue coming from transactions over 200,000 increased from last year from 35 percent now to 47 percent. The average deals size, although still small at about $35,000, increased by 23 percent compared to last year and that is the direction we want it to go. We added 558 new customers to our install base and we now have more than 15,500 customers worldwide. Let's now talk about Extranet. This quarter, we've once again increased our progression in the Extranet business. The revenue for the quarter was 23.3 million, i.e. a 39 percent increase over the same quarter last year. We saw 115 Extranet transactions and added more than 30 new customers, bringing the total number of Extranet customers to more than 780. Major transactions were America Online, ADP and Express Scripts (phonetic). America Online will use Business Objects to extend an Extranet to its advertisers, giving them the ability to analyze the effectiveness of advertising campaigns and promotions. Another example is ADP. The world leader in payroll services is building a pan−European Extranet to provide their clients HR department information and reports on payroll processed each month. Finally, Express Scripts (phonetic), which is one of the nation's largest pharmacy benefits management companies, is building an Extranet to provide pharmacy benefits information to 2000 external users, including third party administrators, managed care executives and professionals in the health−care industry. Our leadership and expertise in Extranet continues to be the clear differentiator for Business Objects and enables us to offer much more complete and much higher valued solution than our competitors. Let's now talk about Analytical Applications. Analytical Applications division made great progress during Q1 as well. The application division closed a total 31 transactions. This represented $3.5 million of pure analytical applications license, representing 165 percent growth compared to same quarter last year. Twenty−two of these 31 transactions were for the new analytical solutions and represented more than 80 percent of the revenue. In Q1, we added many customers to our growing list of applications references, including Seven−Eleven, the New York Times, (indiscernible) in the UK, MasterCard, Walmart.com, Mercury Interactive, (indiscernible) in the UK, (indiscernible) National, (indiscernible) and ABN AMRO (phonetic). As I mentioned last quarter, the $3.5 million represents the software revenue generated by the product of the Analytical Application division. If we include the drag BI (phonetic) license and services associated with these numbers, we would arrive at a contribution of around $9 million for the quarter. Last quarter we gave out a license revenue for the year and stated our goal to double that revenue in 2002. With 165 percent growth for the first quarter, we are well underway for reaching our goal of 16 million for the year. I'm very pleased with the momentum that we've been getting in that space. The general sales force is very enthusiastic about the application foundation solution and our new dedicated application sales force has (indiscernible) to be productive and help close a number of transactions. Our model, which is based on providing our customers with an open solution that allows them to purchase prepackaged, analytical application modules or to build their own, is working very well. As an example, Seven−Eleven, which I mentioned earlier, was a landmark application win for us last quarter. It purchased our prepackaged product analytical application module and will perform product category analysis per store with our solution. On the other hand, ABN AMRO in Holland decided to use our Analytic Application framework to customize its own HR analytic application. They will use application foundation on top of PeopleSoft HR solutions. Okay, let's now talk about channels and alliances. Our indirect channels and our key partnerships continue to generate a very strong performance. Revenue contribution from partners represented 49 percent of total sales in the first quarter, which is in line with our 50−50 percent goal. We are continuing our penetration of this system integration community. This quarter we had good traction withy EDS, which partnered with us at Seven−Eleven and Express Scripts (phonetic) and we continue to do excellent business with IBM. On the enterprise application front, (indiscernible) has recently certified our solution on (indiscernible) seven and we have announced our integration with PeopleSoft EPM. We also announced today that we're enhancing our strategic alliance with BEA. This includes joint development efforts to develop portlets for BEA's Enterprise Portal, a support for BEA Weblogic Platform for our Analytical Application foundation and our software development kits as well as a number of joint marketing activities. This quarter we also started to see Analytic Application deals in the channel area. One example was Market First, which specializes in marketing automation solutions for the Enterprise and purchase (indiscernible) solution. Overall, from competitive standpoint, we're seeing our position strengthening. Business Objects continues to expand its marketshare, as demonstrated by the growth of our license revenue. For the past past three quarters we have grown our license revenues vs. the same quarter of the prior year. Our direct competitors have all had negative growth for each of these past three quarters. Our most direct competitor continues to be Cognos. We believe we continue to win in most circumstances as was the case in Q1 at Seven−Eleven, Express Scripts (phonetic), the Navy, the (indiscernible), the (indiscernible), the Australian and New Zealand Banking Group, Transport Canada in Ottawa, Market First, Elite Information Systems and many others. Let's talk now a little bit about all the highlights for the quarter. During the quarter, we have continued a number of transformations that are important for the future of Business Objects. First, the move towards applications: we've been dedicated significant efforts in introducing these new applications and product to our sales force. We believe that the leading vendor of business intelligence will have a complete solution, including BI tools, BI platforms and Analytic Applications. These are brand new products that our sales force is now progressively embracing. Second is solution selling. Parallel to the push towards applications, we've been moving the sales force to a new sales methodology which allows us to sell higher valued solutions at higher levels in our customer base. We have already invested significant efforts in retraining our sales organization and have started to get good results. We will continue these trading efforts during Q2 and we should be done at the end of the quarter. Finally, customer advocacy: a couple of quarters ago we had embarked on a customer advocacy program, enhancing our technical support functions, building customer (indiscernible) internet applications such as the e−store and a customer Extranet. As a January 2002, every single employee at Business Objects is compensated on customer satisfaction through a customer loyalty index which is (indiscernible) quarterly. We've already seen significant progress in the index since we started. To summarize, I believe we continue to strengthen our leadership position in the BI and analytical market. We reached the status of number one in business intelligence. According to training 12 months of software sales, we're about 12 percent bigger than the No. 2 player and because of our positive growth rate, the gap has been increasing, especially vis−a−vis the smaller vendors. Thanks to strong sales execution and continued market demand for Analytics, we're one of just a small handful of software companies that has continued to grow throughout this period of economic weakness. Most software companies are showing reduction of their business, especially the software license area. This performance speaks to several competitive advantages I believe we will continue to build upon in the foreseeable future. We have a very strong customer base. Today, more than 15,500 customers around the world rely on our products to run their business. Upselling these large install bases creates a path to growth in a weak IT spending environment. We have an extremely strong network of partners. Half of our business comes from this network. They provide an extended coverage of the marketplace and help us have an even greater marketshare position. We have taken a strong position in new high−growth markets like Extranet and Application. In particular, Analytic Applications are at the beginning of their product cycle and represent a key long−term growth opportunity for us. Finally, based on the success that we're having in the U.S., we're confident that our transition to our new sales approach is proving successful. Business (indiscernible) solution, in general, and Business Objects (indiscernible) in particular continue to be well positioned to selling weak IT spending environment as they provide rapid ROI with a low upfront investment. Business intelligence, as I mentioned several times, is a strategic market in itself. It is not a marginal complement of ERP, CRM or (indiscernible)CM. Customers need more than operational reporting to reach agility, efficiency and (indiscernible) intelligence in the business processes and need to have an enterprisewide business processwide business intelligence strategy. In conclusion, we're confident about our future. Considering the very weak and very difficult IT environment, we feel it's our duty to be cautious in our guidance but we are building solid momentum. As always, we remain focused on execution, which is a key to our success. With that, I would like to turn it over to the operator, who will poll you for your questions.

THE OPERATOR:
Thank you, sir. (OPERATOR GIVES CALLER INSTRUCTIONS.) Your first question comes from Scott Phillips of Merrill Lynch.

THE CALLER:
Congratulations on the quarter. With regard to the Analytical Application business, you showed strong traction and you have noted that it was really the sales of the new modules that you saw the stronger sales take in. I wonder if you could provide some more color around that? What modules in particular maybe tied back into Seven−Eleven and some of the other customers that you cited?

MR. BERNARD LAIUTAUD:
It was actually across the board in terms of the modules. We saw −− what I explained is that we saw that we were selling these modules. We also −− the fact that we have this build and buy strategy where we can say to a customer, "You can either buy our existing modules or we can build your own" is proving very efficient. But in terms of the modules that we've been selling, we've been selling all modules this quarter. Proportionally, we have sold more of the customer intelligence modules because they are a little more mature than the other ones. The supply chain modules are very new, but the product analytic module, which is also fairly new, is the one that was purchased by Seven−Eleven.

THE CALLER:
And my follow up question would be, was that a competitive situation or was that a deal that you are unopposed?

MR. BERNARD LAIUTAUD:
At Seven−Eleven?

THE CALLER:
Maybe, just some color around the competitive situations with regard to the Analytical apps themselves. Are you seeing any of the other vendors that are claiming to have the technology

in these fields?

MR. BERNARD LAIUTAUD:
Yes, I think we're seeing −− you know, the traditional competitors in these deals. The fact that we have −− we would going to these deals and at the beginning of the sales cycle, we would have everybody. So Cognos would be in their. Potentially, competitors like Informatica but it would be pretty rate, I would say. In general, it would be the traditional BI vendors. As we progress (indiscernible) see the breadth and the depth of our Analytical application and then we would, in the end, be the only one in the competition.

THE CALLER:
Was it modules? I Mean, what was it in that (indiscernible) explained the competitive landscape being sort of the name cast of characters. What was it about your module that allowed you to win in that situation?

MR. BERNARD LAIUTAUD:
If we take the case of Seven−Eleven, I think what we saw there is, because we are strong in the customer intelligence and the product intelligence, we were able to win, whereas Cognos would be more geared towards financial applications, whereas they are much less −− they have a much less solution in the customer analytic and the product analytics. ind we have a broader solution in customers and supply chain and product is a strong factor.

MR. THOMAS WEATHERFORD:
I think the fact that our offering is broad−based beyond applications −− because the Seven−Eleven deal also included a large portion of Extranet in there is well. Having the Internet, the Extranet and the analytical applications presents one vendor to the customer.

THE CALLER:
Great, thank you.

THE OPERATOR:
Your next question comes from Jim Moore of Deutsche Bank.

THE CALLER:
I wanted to ask you about the reduced guidance. How much of this is from data points that you are actually picking up in your own company that Europe is weakening? Or is this just sort of external influence on you, given the macro statistics coming out of Europe? And also, what's going on with other software companies around you?

MR. THOMAS WEATHERFORD:
I think it's a combination of both. We saw in Europe this last quarter broad−based weakness, when the (indiscernible) had been limited to one or two countries −− it was more broad−based. So, you take what we encountered plus what other companies are saying and that led us to taking the top down slightly. We only took it down two percent.

THE CALLER:
You've only seen it in Europe. You really haven't seen anything in your own business in the States yet that would indicate things are starting to slide a little bit?

MR. THOMAS WEATHERFORD:
I don't think anything is sliding. I think it is slowly recovering but I think the keyword there is slowly recovering.

MR. BERNARD LAIUTAUD:
I think in the U.S., in general, we were very pleased. The growth rate is very fantastic in Q1. If you look at the growth rate of the U.S., it had gotten reduced, progressively, last year. You know, we started at around 50 or so percent in Q1 of '01 and then it went down down progressively throughout the year. We ended Q4 at 17 percent growth in the U.S. and Q1 we bounced back at 48 percent, so it was actually a very strong growth. This is very positive.

THE CALLER:
Some of the deferred revenue being up quite a bit sequentially, what are the components of deferred? What actually drove that?

MR. THOMAS WEATHERFORD:
It is primarily maintenance and I think it's just that our customers are renewing their maintenance at an increasing rate. I think this shows that they are actually deploying the software and using it.

THE CALLER:
Is there some seasonality to that?

MR. THOMAS WEATHERFORD:
There is some seasonality because we tend to at the end of the year try to get customers because they renew on an annual basis. And if we have two or three divisions that may have purchased through the year, we try to get them on one maintenance plan at the beginning of the year. So we tend to see the seasonality increase happen at the beginning of the year -- end of the year and the beginning of the year.

THE CALLER:
Thanks a lot.

THE OPERATOR:
Your next question comes from John Segrich of Goldman Sachs.

THE CALLER:
Two questions here: could you just talk a little bit about what you saw in terms of closure rates and maybe give us a sense of what's going on in the pipeline, especially around those larger Enterprise type deals? Secondly, if you could just spend a little bit of time of the Extranet business. Obviously, you have turned in great growth but it has dramatically slowed down from last year. And help us understand why that's the case. Is it that we've got the easy customers now, things take a little longer in terms of sales cycle or is there something else going on?

MR. BERNARD LAIUTAUD:
Well, in terms of (indiscernible), I think what we've seen is an improved rate is reflected in the results. I think we had a good pipeline in both main geographies, U.S. and Europe, at the beginning of the quarter. The closure was tougher in Europe, so the closure rates were much

tougher in Europe than in the U.S.. The pipeline is actually strong; it's very solid but we felt that, you know, in the last few weeks of the quarter, the closure rate was weaker than we thought it would be in Europe, specifically, not in other geographies. We believe that as the economy starts being a little better over there, I think the closure rate will improve.

THE CALLER:
In Europe, did the closure rate pickup sequentially from the fourth−quarter?

MR. BERNARD LAIUTAUD:
I'm sorry. No, I mean, not in Europe, I would say. I don't think −− in Europe, we have not seen a progress from Q4 to Q1. In Q1, there was probably a little tougher in closure rates in Europe than in Q4. (Indiscernible due to multiple speakers) because in Q4, you always have −− there is significant incentive for both salespeople and from the customer standpoint to do the deal. In Q1 it's less −− we have less of that pressure.

MR. THOMAS WEATHERFORD:
John, your second part of the question was Extranet and the growth rate over previous years. Breaking it out by region, one is our guidance for the year was in excess of 30 percent and so we are ahead of that. That's the good news. We knew it would slow down to some degree. When you look at it by region, it was really an economic slowdown issue because Europe was actually down slightly from Q1 of last year and the U.S. grew over 200 percent in terms of their Extranet. So, the economy that's growing strong grew very well and the reason why we didn't show a larger growth was because of Europe.

MR. BERNARD LAIUTAUD:
I think what we have also is we have a tough compare, I believe , in Q1 because last year was pretty strong. We had an extremely strong growth rate in Extranet in Q1. It was sequentially bigger than Q4 '00, so −− (technical difficulty) −− in there.

THE CALLER:
Great.

THE OPERATOR:
Your next question comes from Donovan Gow of SG Cowen.

THE CALLER:
On the Extranet side, can you talk a little more about the trend you are seeing in terms of deal size? It looks to me (indiscernible) quick math that deal size has gone up there in other metrics like number of users, if you're seeing more traction on the suppliers side of Extranet vs. the customer side? Secondly, could you give us a little more color around the sales (indiscernible)? You made a comment about it being a little more difficult to adjust in Europe and just what you're doing around analytical applications and extranet as for as the sales (indiscernible) is concerned?

MR. THOMAS WEATHERFORD:
I'll take the first part. In terms of deal size, you're right. We saw the deal size, average deal size, in extranet go up substantially. The number of customers over $250,000 grew substantially. So, we are seeing larger deal sizes on extranet overall. That was both in Europe and the US. We just saw less activity in Europe because of the economic slowdown than in

the U.S..

MR. BERNARD LAIUTAUD:
Yes, with regard to the pickup of the new model in Europe, There's two major things that we are doing. One is, obviously, pushing the new product to the new high growth areas and Extranet now is pretty much mainstream in the organization, so that's not brand−new. Definitely Analytic Applications is still new to the general sales force. The second piece is solution selling, which is the overall −− the new way of approaching a customer. I would say, generally, when you have these kind of transformations, it's easier to implement them in a homogenous geography, which is the case for the U.S.. So, the rate transformation −− the speed of change is a little faster in the U.S. because it's one country. Europe −− no matter what is (indiscernible) aggregation of nine (indiscernible) very different countries with different languages and different ways of doing business. So, the speed of change is a little slower there, so it's actually expected that we would take more than just one quarter to move towards that. So, we are continuing to invest (indiscernible) there will be more training. We also are are doing more pan−European training and marketing which we were not doing before and that's going to help bring in these transformations at a faster rate.

THE CALLER:
Okay, thank you.

MR. BERNARD LAIUTAUD:
What we see is that they're are certain countries that are think are peaking up a little faster than others in these new areas. Like the UK, for instance, is now fully embarked on these new high growth areas and that translates to better performance.

THE OPERATOR:
Your next question comes from Mark Murphy of First Albany.

THE CALLER:
Tom, did I hear you correctly that the quarter carrying sales headcount what 356 or did you say 386?

MR. THOMAS WEATHERFORD:
356, Mark.

THE CALLER:
Is that down from 384 at the end of Q4?

MR. THOMAS WEATHERFORD:
Right. That is down from 384. There is no one area but basically, it was going and looking at the lower performing salespeople in the different areas and basically losing that headcount. We actually moved that headcount into new product development.

THE CALLER:
Okay. Now, relative to that number, Tom, what does that imply about the Company's targets for quotas and what kind of a percentage increase do you expect to see this year?

MR. THOMAS WEATHERFORD:
One is quotas per salesmen have gone up, year−over−year. Last year we added a lot of headcount and if you did the theoretical calculation, most of that population is now fully mature; they've been here a year. That means they are fully capable of hitting their quota. So, we have more than enough sales capacity to go beyond our guidance and our plans are to look at not so much increasing the quantity but increasing the quality of our sales force to handle the more strategic accounts. That will be evolving over time.

THE CALLER:
One other question, with −− going back to the deferred revenue, it does look like a much larger increase that you would usually see in terms of seasonality. Is there any change in terms of your visibility, overall visibility entering Q2 with the deferred revenue being up line that and then fine−tuning of guidance?

MR. THOMAS WEATHERFORD:
Yes. I mean, to some degree I would say that's true, even though I think that our fine−tuning guidance really was spread over the remaining three quarters, including Q2. The deferred income revenue that gives us visibility because that's primarily maintenance but I would say that visibility did not change that much.

THE CALLER:
Okay, thanks very much.

THE OPERATOR:
Your next question comes from Bernd Volkel of CSFB.

THE CALLER:
Is it right that all your products are running on top of Windows NT and if that's an important question, (indiscernible) want to do more Enterprise−wide rollout? The reason I'm asking is because Cognos seems to be making a bigger point that their product is also running on UNIX.

MR. BERNARD LAIUTAUD:
No, it's completely untrue. Our products run on NT and on UNIX. We run on Sun Solar (indiscernible), HB and IBM. We would not have the partnerships that we have with IBM if we didn't run on IBM, so no, we have been doing business on UNIX for probably about seven years. I don't know what they are talking about.

THE CALLER:
Thank you.

MR. BERNARD LAIUTAUD:
You must confuse us with someone else.

THE OPERATOR:
Your next question comes from Joseph Jarley of Morgan Stanley.

THE CALLER:
Tom, you talked about how you've spread the modification of the guidance over the next

three quarters. When you look out past the June quarter into the historically seasonally weak September period and then into December, taking a quick stab at this, it looks like you're still facing at a minimum to meaningful growth objectives on a year to year basis, on the license side. And also, some sequential jumps into the fourth quarter, if I've got it right −− that are pretty high. What gives you the confidence from here that you may not have to do this again? In other words, have you taken numbers down enough here or are you trying −− is there some optimism still being baked into the rest of the year?

MR. THOMAS WEATHERFORD:
Good question. I don't think we could ever guarantee our guidance. I think we've modeled it quarter on quarter and what we expect to see this year is a normal seasonality to some degree. In other words, what's always happened in Q3, you'll probably see that reflected this year and we always have a bump in Q4. We had a pretty strong bump in Q4 this last year, 31 percent sequential growth. So we're just really modeling what we've experienced in the past. There's no pessimism in these numbers; there is no optimism in these numbers. What we hope to do is in case we're all wrong and the economy recovers dramatically on the IT spending, we can take advantage of any type of upturn rather than hoping for the upturn just to meet our numbers.

THE CALLER:
Final question, in the final days of the quarter, where maybe business didn't come through −− we're hearing a lot of that out there. We talked about this in the past (indiscernible) was there anything that the Easter holiday and the Jewish and Christian holidays falling at the end of the first−quarter −− does that contribute to any of the softness you saw? Is business not able to get done from, say, Wednesday through Sunday in the final days of the quarter?

MR. THOMAS WEATHERFORD:
I would say there was some minor impact with the financial deals, you know, deals in the financial districts.

THE CALLER:
Great, thanks. Our next question comes from David Beck of RBC Capital Markets. Good evening, gentlemen, good quarter. I just want to look at the analytical applications business a little more. You find −− can you generalize or perhaps divide that the business is such that Analytical Applications are −− do Analytical Applications, you believe, will be leading business intelligence sales or are they effectively selling into some of the install based? Is there a way to provide a bit of a mix and a model you found to be successful in telling those?

MR. BERNARD LAIUTAUD:
I think we are going to have different kinds of situations, depending on the need of a customer. So, if they −− you know, we're going to be able to sell (indiscernible) the application foundation product into the install base, I think fairly easily, because it is a product that brings added value, much more functionality and people understand it quite well. I would say our customers see the immediate added value. When we sell the modules with it, then it means that it's really a different kind of sale when we approach the business executive. And in that case, we tend to generate something brand−new in a brand−new part of the organization. And sometimes it's going to, first of all, enable us to get into parts of a Company or new customers that we would have absolutely no way of penetrating without that. So, in that case, we will drive business intelligence (indiscernible) platform with it. As I

mentioned, probably about 2.5 times what we see in the application software but I think will see a mix because they are also in large, Enterprise transactions. What I think customers are looking for is a vendor that can provide them with the complete solution set. They say, "Well, for this particular kind of need, I need to have a broad BI platform infrastructure. For this other need, for this department then I can use the application foundation. For these particular other departments we are going to use your prepackaged analytical module. So, unless I give your a very clear answer, basically, at this point, when it's so early in the market development, I think we are going to see a little bit of everything.

THE CALLER:
Is there a (indiscernible) license number that you can break out that is sort of a side of the Extranet and Analytical Applications business? Is that something you are really not giving that kind of detail out?

MR. BERNARD LAIUTAUD:
We don't give out that detail.

THE CALLER:
Just in the Groups? Then just one final −− would it be fair to say then, just based upon all these characterizations on guidance in in Europe, (indiscernible) the U.S. is proceeding and is expected −−to, well, the U.S. has proceeded how you expected in previous guidance, so it's effectively going according to plan and there's no real changes on this guidance or your perspective on the U.S. market −− U.S. IT buying market? Is that reasonable to say that?

MR. THOMAS WEATHERFORD:
I'd say yes. Overall, that's true. If I can be perfectly honest, I'd say probably the U.S. was a little bit stronger and and Europe was a little bit weaker but it wasn't significant. It was in line with what we expected.

THE OPERATOR:
Our next question comes from Ivas Leven (phonetic) from Leven (phonetic).

THE CALLER:
Congratulations on another great quarter. I had a question regarding a deal or at least a client, GE Medical. Cognos has been talking quite a bit about how they replaced you on this deal. Can you talk a little bit about what happened and if you have other contract with them, with GE Medical and sort of shed some light on that?

MR. THOMAS WEATHERFORD:
Well, I can answer that one. First of all, we have −− you know, we compete against Cognos in many deals, so as I mentioned, it's almost a direct competitor. So, I would say sometimes they're going to win some deals. As I mentioned in my prepared remarks, we believe that we win many more times than they way; that is proven by a number of the competitive situations that I mentioned. I mentioned about eight or ten that we won against them. There are some situations where we were competing, some situations where we kicked them out of existing accounts. What I would say −− in this particular instance, there are −− I mean there are several parameters in a transaction; there's also past relationships of people, and who is running the deal at the customer; it happens that the customer had a new CIO who had a very strong past relationship with Cognos, and that basically was the main reason. Steve, this is

Tom Weatherford. It's easy to kind of pick one customer and say, "We won that deal against whomever," but let me give you some more facts. We had four GE customers this last quarter −− GE Client Business Services, GE Corporate RGE Corporate Canada, and GE Power Systems. All four of those, we competed against Cognos and won. So we think it was 4−to−1 in terms of GE this last quarter.

THE CALLER:
Okay, great.

THE OPERATOR:
Your next question comes from Stephen Fraenkel of Oddo.

THE CALLER:
Yes, hello Tom and Bernard, congratulations for the quarter. I had two quick questions. First about Europe −− the growth rate, the difference sort of growth rate between Europe and U.S. is very important; I was just wondering if there was −− besides the economic situation, and the IT spending environment, any execution problem in certain countries of Europe. I remember you had high hopes six months ago, something like that, for Germany for instance −− could you give us some more light on how −− of whether there is any country where you are disappointed by the execution of the (indiscernible)?

MR. THOMAS WEATHERFORD:
I would say the U.S. performance, it's because they're basically hitting on all cylinders, and the economy that is still recovering. So 48 percent is just an excellent growth rate; even in a strong economy, that is an excellent growth rate. In terms of Europe, as I would say, it varies country to country. I would say that we still −− in certain countries like Germany −− need to do better, and other countries we're doing very well. So it varies country to country. I would say, probably the overall economic slowdown seems to extend that to all countries across the board in Europe, and that's the first time we've seen that.

THE CALLER:
Okay, and second short question, it appears to me that at best the Intranet growth rate was flat for Q1 −− do you think that your marketing campaigns around the standardization of business (indiscernible) is getting traction in such a difficult economic environment?

MR. BERNARD LAIUTAUD:
That's a good question. I mean, (indiscernible) sure that in tough environment that deals that tend to be questioned the most are the largest ones, or they tend to be pushed in the future, so the enterprise deal −− when we talk about standardization −− that's where you see the largest transactions, and I believe the message continues to be very effective and it's moving its way up. It continues to be one of the major reasons why we win deals but they don't necessarily implement it won't go. So what we see is that we have some companies whose say yes, we need to have one Enterprise solution but I am −− because of tough IT spending, I'm not going to buy the Enterprise license in one shot because I know that I'm not going to deployed that quickly. So, they believe in the concept. The implementation is more incremental than upfront.

THE CALLER:
Thank you very much.

THE OPERATOR:
Your next question comes from Frank Sparacino of First Analysis.

THE CALLER:
I'm trying to get a sense of how important the applications business is, going forward. Correct me if I'm wrong, in prior conversations you guys of stated that applications would not be more than 25 percent of revenues in future years. Also, from an RDperspective, if you look at what the total number of people that you have, how is that divided between the core Business Object 2000 product and the Applications? What other resource is being dedicated to that?

MR. THOMAS WEATHERFORD:
We ended up with 530 in total RDand about 12 percent of those, 60, are in Apps RDat this point. That's on headcount side.

MR. BERNARD LAIUTAUD:
On the revenue side, it is progressing fast, as we mentioned. It is −− we are at the beginning of the cycle, so last quarter I had compared it a little bit to the Extranet growth in the early days, where (indiscernible) growth is (indiscernible) just a few percent of the Company and it has moved to be around 20 or so percent. I think we are seeing something similar in the application, where it's today pretty small, in terms of its contribution but it's growing at a very fast rate and it's going to take a year or two years to become a significant portion of our revenue. As I mentioned also, I think , several times, we don't believe it's going to take over the main platform for quite a while. We believe that the leading company in that space will have a balance of revenue between the platform and then the application (indiscernible) −− the tools platform and application will be balanced but we will need to −− the leading company will need to have both; they can't just have the application.

MR. THOMAS WEATHERFORD:
If you look at the 25 percent and what we wanted to do was not totally position the Company on the new product because our base product is still very strong and we don't have to move away from that. But if you assume we are 500 million or $1 billion company, 25 percent of our revenue would be a 125 to $250 million business. There's a lot of software companies out that would dream to have that type of business. So, we think it's having the whole range of products that is the strength compared to narrowly focused companies that may only offer one or two of the products.

THE CALLER:
Okay. Then, if you could help me understand −− if there's 3.5 million license in the Application side of the business and I think, Bernard, last quarter you talked about that would translate into 1.2 or 1.3 times revenue for tools. If that was the case this quarter, if I take 3.5, I do that factor, I come up 4.5 and sort of drag through from the tools, that's eight million and you said you had nine million total, so that's only one million of services. I am wondering why the mix on that business would be drastically different than the core business?

MR. BERNARD LAIUTAUD:
Actually, what I've done is, in order to derive the 9 million, I've done the exact same percentage as last time. So last time, say, I took eight million and I added 1.5 times that number and (indiscernible) the contribution is about 20 million. So, that's based on what we see in a typical environment, so the combination of license and service is about one, 1.5 times

the initial number. So I have taken the exact same percentage; from eight I got to 20 and from 3.5 I got to nine. It's not −− that's my assumption of the contribution. If we do an analysis, deal by deal, which is a little hard to do because we have to make sure that we (indiscernible) thing (indiscernible), it would actually −− our analysis currently translates to more than nine million but I decided to be conservative in my appreciation.

THE CALLER:
Okay, thanks guys.

THE OPERATOR:
Your next question comes from Brent Williams of McDonald Investments.

THE CALLER:
Could you go over the local currencies vs. U.S. dollar growth rates? I've a new keyboard here, so I scrambled it all when I was going over it.

MR. THOMAS WEATHERFORD:
U.S. is forty−eight percent in dollars U.S.. Europe was six percent local currency. Japan was negative, a −18 percent local currency. The rest of the world, which is really billed in U.S. dollars, except for Australia but it's fairly close with six percent growth positive.

MR. BERNARD LAIUTAUD:
(inaudible),.

MR. THOMAS WEATHERFORD:
What was the question in U.S. dollars? (indiscernible due to multiple speakers).

THE CALLER:
What was the (indiscernible)?

MR. THOMAS WEATHERFORD, JR.:
To be honest with you, I don't...

THE CALLER:
Okay. I just wanted to make sure I got all the −− (indiscernible due to multiple speakers).

MR. THOMAS WEATHERFORD:
It would be −− Europe, it would be 11 percent in U.S. dollars and on Japan it would be 28 percent negative growth in both cases on U.S. dollars.

THE CALLER:
One of the things that has happened over the last couple of −− last quarter or two is that there's been kind of a soap opera in the market for ETL tools. And there were a series of announcements that perhaps (indiscernible) some realignment and some defaco (phonetic) partnerships, particularly Thinking of Informatica here. Have been any changes in terms of customer interest in the ETL market as a whole? Has there been any changes in terms of the tectonic shifts there having any traction? Do you think that that's maybe affecting some vendors' momentum in terms of trying to (indiscernible) other vendors that are focused ETL, trying to be an integrated vendor the way you described this ultimate company is going to be?

MR. BERNARD LAIUTAUD:
I think what we are seeing is in the Application part of our business, I think customers want to see how the application connects and therefore, it's important to have strong alliances in that business. So, that's why we have developed −− you know, we have extended our partnership strategy quite a while ago already because before we were working quite a lot with Informatica and today we're working with them but also much more ways with others, like Essential or other companies like (indiscernible) or smaller companies. So we have today been very successful at this and we bring in the partners depending on the particularity of the customer. I think that need to good alignment with partners on the data integration space is important in the number of these deals.

THE CALLER:
I guess what I was asking probably is, has that strategy shift −− which I guess must have been six or eight months ago −− has that started to gain traction? Because, obviously, announcing that you are looking at expanding out the partner range of partnerships and then seeing it gain traction in the customers' mind −− obviously, there is going to be a timeline ther. I guess I was −− from where you sit, has that strategy shift started to −−?

MR. BERNARD LAIUTAUD:
I think what we are seeing −− again, we are seeing an interest in the customers of having us really recommend a partner. We tend to (indiscernible) who should we use for the data integration, so having a strong partner there helps. Now, if you have −− in the case of Informatica, they offer their own solution but the are core competency is in data integration. It's not much in the (indiscernible) and I think the foreign piece is the piece in the (indiscernible) application, is the piece that drives the sale and drives the choice of the data integration piece, not the other way around.

THE CALLER:
Okay, then lastly, in terms of propelling the growth of the Analytical Applications business, it looked like the Analytical Applications business two, 2.5 years ago −− it looked like the sort of thing that customers would just get it pretty quickly that hey, you know, I really need to do this because just using core business intelligence tools that don't have application−specific functions, that that's doing a lot for me. And it took a lot longer than maybe a lot of people would've thought. Do you see any changes out there, particularly in the customer focused side? Are customers experiencing more pain in their CRM applications in terms of maybe expectation versus reality, (indiscernible) a little further down the path that's causing them to reach for you guys maybe a little faster and more readily than in the past? Or is it just simply that your sales force is out there and is able to push the product out into the market, now that they are more trained and that they have had a comfort with it?

MR. BERNARD LAIUTAUD:
No, I think you are right. There is definitely an awareness now that the operational applications in CRM and also in other areas, do not provide a good analytic platform. So, they have implemented all these systems. They realize that (indiscernible) they are reaching a certain maturation of their deployment and they realize that they still haven't resolved the core issue, which is how do we leverage all the information that we collect through these business processes. They realize also that the business of Analytix is very different than the business partners automation. You have to reach across multiple business processes. You have to be able to run on top of multiple applications and that is something that we provide. So, I think

that that awareness pushes more companies towards us than in the past, absolutely.

THE CALLER:
Would you say that that awareness is moving sort of out of the theoretical realm into the more pain and urgency realm?

COMPANY REPRESENTATIVE:
Yes, I believe so.

THE CALLER:
Your next question comes from Robert Smithson of Arete. I just want to understand how important maintenance is to you revenue base, where that sits and what your growth rates would have looked like without a maintenance (indiscernible) year−over−year?

MR. THOMAS WEATHERFORD:
Maintenance is probably our fastest−growing segment today. It's about −− if you look at total revenues split for 2002 Q1, 59 percent were license and 49 percent were services. Out of 41 percent, about half of that is maintenance. So, it's very important to us for two reasons: one is, the revenue stream that gives us visibility −− it's a growing revenue stream but it's also a very clear indication of that our customers are using the product and it's also a way of keeping in touch with our customers as well to go back to them and sell them additional products as well.

THE CALLER:
Again, can give us an indication of what the growth rate was in maintenance?

COMPANY REPRESENTATIVE:
The overall growth rate was 18 percent. I think maintenance was higher than that and the other areas were lower.

THE CALLER:
Great, thank you very much.

THE OPERATOR:
Your next question comes from Graham Tenaca (phonetic) of Tenaca (phonetic) Capital Management.

THE CALLER:
I'm just wondering, Bernard or Tom, if the European downturn or slowdown is lagging the U.S. business more because of the economic cycle in Europe in BI software or because of some of the internal things with a new business model?

MR. BERNARD LAIUTAUD:
It's mostly the economy, Graham. Our own transformation is a secondary factor.

THE CALLER:
I had two questions −− I was just wondering if, in terms of the U.S. IT capital spending cycle, how you see the industry in terms of demand and snapback for business intelligence software and Extranets and analytical apps, those three subcategories or categories, versus the overall IT capital spending cycle, which appears to be slow in taking off? Thank you.

MR. BERNARD LAIUTAUD:
Well, I think it's obviously hard to predict fully but I think (indiscernible) in general is very favorable compared to other categories, again, because it's easier to understand. It's a smaller upfront investment; you can get quick returns on it, which I think is absolutely critical when you're a CIO. You want to make investments that will have immediate returns. That's probably the key. As we discussed earlier, because now there are a number of applications that are reaching some point of maturity, it's a fairly natural extension. A number of customers would wait until they are done with the implementation of an application before they would move towards business intelligence but it gives this particular market in general more resilience to IT spending slowdown.

UNKNOWN SPEAKER:
So, it cushions you on the downside. I guess part of −−− this was supposed to be one question −− the focus was on the snapback. In other words, as IT capital spending does come back in terms of corporate spending the U.S., would you expect this space to be coming back with it earlier or perhaps later?

MR. BERNARD LAIUTAUD:
No, there is −− I think we would get a good (indiscernible) because I think there is definitely much more visibility on this particular space. Lots and lots of companies, depending on whether they are software vendors or systems integrators, partners are talking about business Analytix as being a very important requirement. I don't think this particular market has been more visible than (indiscernible) in the past. So, if we have (indiscernible) economic fundamentals to help, I think that will be positive.

THE OPERATOR:
Your next question comes from Ian Morton of J.P. Morgan.

THE CALLER:
It's Matt Davies (phonetic) for Ian Morton. A quick question −− as you transition more of the Company's resources toward solution selling, have you changed in any way how you are managing the indirect channel?

MR. BERNARD LAIUTAUD:
No, not really. We've always had the strategy vis−a−vis the channel, to have a clear separation, which is for most of our channels −− we focus our own direct sales force on named accounts and everything else which is not part of the named account list goes to the channels. That provides a clear separation and it helps us concentrate on big accounts, which lends themselves well to the solution selling approach. Solution selling is not particularly well adapted to small accounts, small deals, which is more what we reserve for our Channel partners. So, we don't have to do a big transformation of the Channel strategy. However, I would say the one think it would do is as we move towards solutions, it helps actually bringing more business and more partnerships with systems integrators.

THE CALLER:
Then, on the solution selling front, in terms of deals sizes and larger deals sizes, of your four deals over $1 million, were there any over $2 million? When you look at your pipeline, are there any over $2 million? Thanks for a much.

MR. BERNARD LAIUTAUD:
In the four deals, there were none that were multi−million dollar transactions but the −− there are definitely some in the pipeline.

THE OPERATOR:
Your next question comes from Sameer Hirji of Bank of America.

THE CALLER:
A quick question on −− one of the things you mentioned in the past was the hiring of account executives with industry experience to target the mostly high−end or the Analytix sales. I just wanted to know how that was progressing? What proportion of that program is complete? Secondly, if you could just mention in terms of competition within the Analytical Applications space from the ERP vendors?

MR. BERNARD LAIUTAUD:
In terms of hiring a sales force with a higher, bigger industry experience, we are moving quite well in this area, especially in the U.S. where we hired a lot of new people. In particular, as I mentioned last time, we have built a small team which is focused on selling just the application to certain verticals. We have built that team so that team is now complete and it is a small team for now and we have hired people with application experience, people coming from Seybold or other similar types of companies, so that has progressed well.

MR. THOMAS WEATHERFORD:
In terms of competition, if I take two or three of our large application deals this last quarter, it was either not our direct competitors, our traditional direct competitors (indiscernible) Cognos; it was one or the other career. Then maybe microstrategy in there as well.

THE CALLER:
Okay. I'm sorry, one more thing. Did you say that the average deal size for analytic application tends to be on average lower (indiscernible) ROI is hence faster? Because from the base (indiscernible) it seems as if the average deals size for the Enterprise deals would seem to be a smaller part. Could you just explain that, please?

MR. BERNARD LAIUTAUD:
What I meant is that the investment that a company has to make in our software (indiscernible) the deal size for it is lower than what it would be for a large Enterprise application solution, which means that if a company contemplates buying SAP or buying Business Objects, these are very different types of investments. One is going to be in the hundreds of thousands of dollars, (indiscernible) Business Objects and ATP (phonetic) is going to be tens, if not hundred million dollar investment. That (indiscernible) I was comparing the analytical upfront investment for Business Objects versus another vendor, like an Enterprise vender, (indiscernible) versus our own average deals size in other parts of our own business. (indiscernible due to multiple speakers).

THE CALLER:
Thanks very much for that.

THE OPERATOR:
Our final question for this evening comes from Mary Johnson (phonetic) of Goldman Sachs.

THE CALLER:
Congratulations on the quarter. I had two questions, one is with regard to your search for a new head for your Applications division. I was wondering if you could maybe update us on the progress on that −− when we can expect to have someone in place −− any color around that? Secondly, I just wanted to follow up on the question on the indirect (indiscernible) channel as a proportion of sales. Was that in line with expectations for the quarter? Did they deliver what you expected? Did you think it was going to go down sequentially as a portion of revenue this quarter? Can you give us color on that?

MR. BERNARD LAIUTAUD:
Vis−a−vis a new leader for our Analytical Applications −− we've not yet decided to do a straight replacement, so we're looking at the best way to organize that particular area. This is in progress right now. On the other piece, which is the percent of indirect −− yes, we have always said that the model was around 50−50 and that we felt that −− because we've had a little more than 50 percent in indirect in the past, so we always said we thought that it was a little higher than our model. So at 49 percent, between 49 and 50, 51, we think we're right there. We're very pleased that.

THE CALLER:
I would (indiscernible) in line with what your model is. I was wondering if you felt that the channel −− there was more weakness is in the channels than, say, in previous quarters, whether (indiscernible due to multiple speakers)?

MR. THOMAS WEATHERFORD:
I think it was more geographically based. For example, as we said, the weakness we saw this quarter, economically, was in Europe and Japan. Japan is primarily an indirect model, so that meant they went down as a percent of our total revenues. Europe also went down as a percent of our total revenue. They've traditionally had a higher indirect portion that the US.

THE CALLER:
Great, thanks very much.

THE OPERATOR:
There are no further questions at this time.

MR. BERNARD LIAUTAUD:
I'd like to thank everyone for joining us today. Again, we were pleased with our performance and our progress across all these different fronts. To summarize, we (indiscernible) strengthen our leadership in BI, particularly within the U.S., which is our number one market. We believe our marketing strategy (indiscernible) core development continues to differentiate us from competition in ways that are positive for us and our customers. We will continue to make the investment in the people, products and infrastructure that will keep us ahead. Thanks for your interest and support and we look forward to talking to you again in July. Thank you.

THE OPERATOR:
Thank you for participating in today's teleconference. You may now disconnect.
(CONFERENCE CALL CONCLUDED)

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04/17/2002 01:00 pm	**PRSW**	**Persistence Software (PRSW) − Mid−Quarter Update**

THE OPERATOR:
For opening remarks and introductions, I would like turn the conference over to Mr. Joe Dorame, with RCG Capital Markets Group. Please go ahead, sir.

MR. JOE DORAME:
Thank you to everyone for taking time out of your busy schedules today to review Persistence Software's preliminary first−quarter financial results. With us today representing the Company are Mr. Christopher Keene, Chief Executive Officer, and Ms. Christine Russell, Chief Financial Officer. Before we begin, let me submit for the record the following disclaimer. This conference call is made available by the way of webcast technology on the Internet and direct dial via conference call service to all interested parties. Certain statements made during this conference call may contain forward−looking statements which are made pursuant to the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995 as well as Regulation FD. These foward−looking statements may involve risks and uncertainties that could cause actual results to differ materially from the forward−looking statements. Potential risks and uncertainties include, but are not limited to, Persistence Software's limited operating history, potential fluctuations in operating results, the potential need to raise cash in the future, uncertainties related to long sales cycle, the reliance on a relatively small number of customers, dependence on the Java programming language and the enterprise Java becoming widely accepted standards, failure to manage resources or attract and retain the services of key employees, the need to develop −− to deliver products that are free of defects and errors and meet rapidly changing technology standards and customer requirements, the need to build a strong direct sales team and develop third party sales channels, dependence on enterprisewide system deployments and the need to address

competition from companies with substantially greater resources. Further information regarding these and other risks and uncertainties are detailed in the Company's Securities and Exchange Commission filings. With that having been said, I would like to turn the call over to Mr. Chris Keene, Chief Executive Officer of Persistence Software.

MR. CHRISTOPHER KEENE:
Thank you, Joe. At the beginning of 2002, we laid out our strategy to bet on our new EdgeXtend product to drive revenue growth for the year. This strategy has three areas of focus. First, we have positioned Persistence Software as a solution for data access bottlenecks enabling companies to get real−time visibility into the state of their business. We call this a windshield for business visibility. Second, we have bet on our new EdgeXtend product as a driver for revenue growth in 2002. EdgeXtend enables companies to achieve the benefits of our distributed caching technology while using market leading application platforms such as IBM's WebSphere and BEA's WebLogic. Finally, we believe that our EdgeXtend product has powerful benefits for partners because it encourages companies to deploy application much more broadly through the network. Our 2002 strategy is to use EdgeXtend to deliver −− to develop mutually profitable partnerships with IBM and BEA. From a strategic perspective, Q1 was a very positive quarter for Persistence Software. Despite the weak overall market for technology, Persistence took in well over 5 million in book purchase orders. We not only saw continued demands for our PowerTier products but also surprising strong demand for our new EdgeXtend product which shipped in late March. The EdgeXtend products which was commercially released in March is a follow−on to our PowerTier products family. Because the core technology for both products is identical, we assumed that our long−established revenue recognition policies for PowerTier would apply equally to the EdgeXtend product. After the close of the quarter, we were advised by our accounting firm that we would have to treat all revenue for our initial EdgeXtend deals very conservatively. Rather than recognizing revenue on invoicing, as is typical, we are recognizing revenue on this first few EdgeXtend deals after the collection of revenue or after the collection of cash. Consequently, a substantial percentage of the accepted purchase orders for the first quarter will not be recognized until subsequent quarters. This affected not just EdgeXtend purchases, but also purchase orders which included both the EdgeXtend and PowerTier licenses. We do not expect this cash basis approach to revenue recognition to apply beyond Q1. Because we close multiple EdgeXtend deals in Q1, we have been assured by our auditors that we will be able to apply our traditional revenue recognition policies to EdgeXtend orders we receive in Q2 and beyond. Right now Persistence has the strongest product offering we have ever brought to market. Our EdgeXtend product is able to address over 70 percent of those application server platform customers who have chosen either BEA or IBM. We have the strongest management team in place the Company has ever seen and we have a rapidly growing funnel of sales opportunities that makes us feel very confident we will be able to grow revenue in 2002. With that, I would like to turn the call over to Christine Russell.

MS. CHRISTINE RUSSELL:
Thank you, Chris. While we are, of course, disappointed with the financial results, it appears we will be reporting in a few weeks given the deferral of a substantial amount of revenue which will be recognized over the next four quarters. We are very happy with some of the preliminary operational and balance sheet results we can discuss with you. As we reported in our press release, we expect to post revenues for the first quarter in a range of 2.1 to 2.3 million. This will yield bottom−line loss of 15 to 16 cents per share. Our operating costs remain under control setting the stage for future profitability as we recover the millions of

dollars of deferred revenue over future quarters. Our balance sheet continues strong with 7.2 million of cash at the end of the first quarter. This represents a cash use of only $200,000 in the first quarter. Collections are on target and expense growth has substantially leveled out bringing cash use way down. DSOs of 55 days are at the most efficient level in the recent history of Persistence. Deferred revenues increased to 4.6 million and include a portion of the licensed revenue for product that we delivered in the first quarter but for which we were unable to recognize revenue. As Chris Keene mentioned, the decision to defer this revenue was made in cooperation and consultation with our independent accounting firm. In this climate of nervousness surrounding many firm's accounting practices, we are committed to continuing to deliver financial results that follow conservative GAAP and financial reporting practice guidance. We're thrilled with this large new piece of business and we believe it speaks highly of our technology and reinforces our value proposition. We can and have provided significant savings to clients by providing software−based cash and solutions rather than expensive hardware−based solutions. We believe this contract is the first of much good news to come. We expect to report the final first−quarter numbers in detail in a couple of weeks. Now looking forward, while we continue to have limited revenue visibility like many of our software colleagues, we can now factor in some of deferred licensed revenues in our forecast. Revenue for the second quarter are targeted to be in the range of 6 million. Revenue in this range will drive a profitable bottom−line result. And finally, please be aware that the previous forward−looking statements are estimates based on management's expectations, goals and objectives on April 16, 2002. As the statements are forward−looking, actual results may differ materially as discussed more fully in today's press release. That concludes our remarks and we would be happy to take questions at this time.

THE OPERATOR:
(CALLER INSTRUCTIONS) Our first question will come from Peter Sheidler (phonetic) with Peninsula Capital.

THE CALLER:
First of all, you know, the first quarter results are disappointing. It sounds like the bookings were just great. So congratulations on a great bookings quarter. I am curious, in terms of −− first of all, the customers and large −− it sounds like a fairly large company, how long was the QA cycle for them to make a decision of piloting period for them to make a decision on EdgeXtend?

MR. CHRISTOPHER KEENE:
This is a company we have been working with for over a year and a half. They are actually in deployment now, but significant media related project and that project has been built on PowerTier and will be in their initial deployment probably close to the end of this year will be mostly PowerTier. Over the last quarter, they began examining the EdgeXtend product and looking at additional project opportunities where they believe EdgeXtend may be valuable. And this really fits −− I think it's a very strong validation of our strategy. We believe that our best opportunity initially for EdgeXtend is to go to initial customers who have chosen our PowerTier product and who would like to continue to receive the benefits of our data management of our caching but have also made corporate decisions for other application servers from IBM and BEA. And this media company is no exception. They have chosen PowerTier for one very large and very strategic project. They believe in the value and benefits of our caching, but they also have standardized in their company on −− for different projects on products from IBM and BEA. So this really for them represented the best of both worlds.

They get to continue to receive the value of our caching of our efficient data management for the very performance−intensive projects that they are deploying, but they also get to leverage the standards decisions that they have made for IBM and BEA products. So I think the short answer then to that question is they evaluated the product as part of a beta program. We actually had some consultants there to show them how to use the product and based on that, they made a decision to go forward with not just PowerTier product for their initial rollout, but also the EdgeXtend product for some other future projects.

THE CALLER:
And they made a fairly substantial decision on the EdgeXtend product correct?

MR. CHRISTOPHER KEENE:
The decision for each product was a seven figure decision.

THE CALLER:
Right. Then, as you look forward, the EdgeXtend product will be sold, as you said, initially to the base at least targeted initially at the base given their existing implementations of PowerTier. I'm wondering if you think there is a reasonable likelihood that you will be able to go outside of the PowerTier base and when do you think that is a possibility?

MR. CHRISTOPHER KEENE:
That is a great question. First of all, we were blown away at the rapidity of adoption in our EdgeXtend product. We took it into beta at the beginning of the year. We did a first customers shift mid to late March. And we had two purchase orders that we accepted for the EdgeXtend product in this quarter. We also had what I would call a purchase commitment. In other words, a customer came to us after their evaluation and said we have selected your product on a technical basis and we intend to contract with you next quarter. Now the two purchases that we got were both existing customers. The purchase commitment which we are now −− and we are now negotiating a contract with this customer that represented a net new customer. So my expectation is that, again, we were surprised to see people who we had not had pre−existing business relationships with adopt this product so quickly. So what I would expect to see moving forward is that we will probably run at about a 50−50 rate between existing Persistence customers who now are choosing this EdgeXtend product either to migrate an existing PowerTier project or for a new project opportunity and net new customers, some of whom now are coming through IBM and BEA referrals, who will adopt this technology because it fits a particular business need they have for real−time computing or very efficient data access.

THE CALLER:
Congratulations on a great bookings quarter.

THE OPERATOR:
(CALLER INSTRUCTIONS) Richard Burnley with Longport (phonetic) Partners.

THE CALLER:
Good afternoon. Two questions if I may. Why was the EdgeXtend sale deferred while the PowerTier million dollars was recognized?

MS. CHRISTINE RUSSELL:
The PowerTier revenue was not recognized. The PowerTier portion of the sale was not recognized. That was one of the reasons why we did not meet the expectations in the first quarter. So actually both -- all of the licensed revenue, both portions PowerTier and EdgeXtend have been deferred over the next four quarters.

THE CALLER:
I misspoke. Sorry. As I understood the release, the PowerTier will get recognized in April and the EdgeXtend will get deferred further. If that is correct, why did that happen?

MS. CHRISTINE RUSSELL:
Since the accounting and revenue recognition is basically being done on something not exactly, but more similar to cash basis accounting, the payment for EdgeXtend is further out than the PowerTier payment. The PowerTier payment is due on April 30th.

THE CALLER:
Is that because the EdgeXtend will not get shipped until later?

MS. CHRISTINE RUSSELL:
We grant commercial rights to the EdgeXtend product in June. But, yes, your statement is correct.

THE CALLER:
Is the simple math of the 2.7 million shortfall from your previous guidance -- I am not very familiar with your company, but the guidance in January suggests that 2.7 shortfall that you would make up one million of that loosely speaking in the second quarter and then another million 7 in the second half?

MS. CHRISTINE RUSSELL:
The customer does not tell you exactly what the dollar amounts are involved, but the number is probably -- is actually higher than the number that you mentioned or thereabouts. You are not too far off.

THE CALLER:
Thank you.

THE OPERATOR:
From Torn (phonetic) Water Company we will hear from Guy Clemente (phonetic).

THE CALLER:
Can you make any comments on how you are doing with the customers you have on beta test and your closing results, some idea of the sale cycle. And I also got into the call a little bit late. You might have covered this already. To what extent are you gaining visibility in your business going forward? It seems like most software companies still don't have visibility and the current environment software is being deferred. How is looking with you guys?

MR. CHRISTOPHER KEENE:
So that was a multipart question. I will try to take it one at a time. The beta program has been, I would say, very successful. And our objective at the beginning of the year in Q1 was simply

to have three to five successful betas by which that meant they installed, they use the software, they gave us a valid good feedback. To have three of our beta testers actually either purchase or make a purchase commitment to us represented a pretty resounding success for the beta program. So what I would say is our early observations are that this product seems to meet very well customer requirements and expectations for bringing very efficient data management to the IBM and BEA platforms. That is point number one. Point number two, I think it is fair to say that coming into the first quarter we saw as a number of other software companies have reported a pretty weak demand environment, not a whole lot of activity, not a whole lot of net new opportunities in that first quarter. That seems to have turned around for us and one of the reasons that we are sounding a little bit more optimistic here is we are seeing net new opportunities and these are six−figure and seven−figure opportunities come into our pipeline. That is a combination of existing customers as well as surprisingly some new customer opportunities where there just seems to be a real pain point in the market right now for some customers who are looking to take an application that they may have developed with BEA WebLogic or IBM WebSphere and now deploy it much more broadly and as they go into that broad deployment, they are finding that either they are not able to maintain the response time that they think they need to have or the investment, the capital cost to do that broader deployment are prohibitive. And what is interesting is is we have a very compelling cost justification story here that is playing very well with the market and we have done −− we have put together an ROI model for our customers and prospects and the rule of thumb is for every thousand users that you expect to have on your system, we can save you about $1 million in your deployment. For every data site −− for every location that you plan to run or operate your application, we can save you about $1 million. And for every hundred data access classes or tables that you're going to access through this project we can save you about $1 million. Using that math, for example, we have had existing customers validate with us savings of $50 million using our unique and very efficient data management architecture. And that savings comes from not having to purchase as much hardware, not having to purchase as much software, being much more efficient in managing data. And, consequently, being able to scale your application with much lower database costs in particular. So net net we are seeing improved visibility, we are seeing acceptance from our beta customers and we're starting to see the sales funnel turn up a bit all based on the notion we have a value proposition which seems to be right for the time which is companies are looking for very solid payback as they deploy these Web services and Web−based applications.

THE CALLER:
Quarterly IT departments are looking to be more efficient in their spending of dollars these days. Chris Russell, the second quarter expecting to be cash flow positive?

MS. CHRISTINE RUSSELL:
For the second quarter, we are looking for cash to stay within about 5 to 10 percent of where it is right now. I would not necessarily forecast for cash to be positive. What you need to do is you need to have more than one−quarter of profitability for that to happen because what you do with a lot of your sales coming at the end of the quarter is you store your cash up in accounts receivable until the following quarter.

THE CALLER:
Are you expecting that to turn for you at any point this year?

MS. CHRISTINE RUSSELL:
Once we have consecutive quarters of profitability.

THE CALLER:
At this point, do you have any buy side analysts sniffing around looking maybe to follow your stock?

MS. CHRISTINE RUSSELL:
Yes.

THE CALLER:
Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) There appears to be no further questions. Mr. Keene, I'll turn the conference back over to you for any closing remarks.

MR. CHRISTOPHER KEENE:
So I think the net for our remark here are we have laid out a very specific strategy to commercialize and grow revenue based on our new EdgeXtend product. In a fairly short period of time, we've seen a number of encouraging signals that EdgeXtend will be well accepted in the marketplace not only by existing Persistence customers but also by net new customers who have this pain point of needing more efficient data access. We look for Q2 to be a stronger quarter and we look for increasing visibility as we move through the year and start to see increasing sales funnel with our EdgeXtend product. This concludes the Q1 earnings call. Thank you for calling in.

THE OPERATOR:
That does conclude our teleconference for today. Thank you very much for your participation. (CONFERENCE CALL CONCLUDED)

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04/17/2002 11:00 am	NWPX	Northwest Pipe Company (NWPX) − NWPX Q1 2002 Earnings Conference Call

COMPANY REPRESENTATIVE:
−− market here for water transmission. However, the delays that we have already experienced will continue to effect us adversely in the second quarter due to the leadtimes in our industry. At this time we expect both our bookings and capacity utilization rates to improve in the second half of the year. If bidding does increase as expected we should see sales volume and gross margin percentages improve as well. In the Tubular Products Group our sales were down 20.3 percent to $21 million from $26.3 million recorded a year ago. The decrease resulted from the soft market conditions we have seen over the past several quarters. However, the difficult market conditions that began to effect this segment in the second half of 2000 seem to bottom out in the fourth quarter of 2001. We are seeing improvements in the marketplace for our products. Increased demand is not uniform across our productlines, as you would expect, but we did see at least small increases across the board in the first quarter compared to the fourth quarter of 2001. Overall, sales in the first quarter of 2002 were approximately 10 percent higher than in the preceding quarter. We expect continued improvement in the second quarter of this year. Gross profit during the quarter was $1.4 million. This is well off the $2.7 million recorded last year, but we are again showing improvement from the fourth quarter of 2001. The gross profit in the fourth quarter of 2001 was $467,000. In the first quarter of this year we added almost $2 million in revenues and almost $1 million in gross profit. In the second quarter we expect to see further growth in gross margin as volume continues to increase and price increases, which have already been put into place, start to have an impact on our results. Steel costs are the major component of our overall costs in the Tubular Products Group, and steal −− the cost of steel is a major issue for this group and a major source of uncertainty. The 2001 trade case remedies, which were put in place earlier this year, have begun to impact our operations. President Bush established

a 30 percent tariff on steel coil with certain exemptions and established a 15 percent tariff on pipe and tube, again with certain exemptions. Our biggest concern with this action was a possibility that a teriff would be placed on steel coil but none on pipe. This would have put us in a difficult position with certain of our productlines that are subject to import pressure. Instead, we got a resolution that recognizes steel coil and steel pipe need to have similar treatment. And on the surface this is a much better result for us. The steel industry in the United States has moved very rapidly to increase pricing both in anticipation of teriffs and continuing after the announcement. In some cases we have seen 50 percent increases in steel coil costs in the past few months. As of today, further price increases are still expected in the third quarter of this year. To date we have managed to increase our selling prices enough to avoid any significant deterioration in the spread between selling prices and the cost of steel. However, it is unclear if our customers will continue to accept price increases as rapidly and continuously as they are proposed by the steel industry. We are starting to see some imported steel come back into the market, and there is certainly speculation that the combination of a greater import presence, plus the expected re−entry of LTV into the market, may have a leveling impact on future increases. At this time, however, it is very difficult to offer a conclusive opinion about steel costs. Clearly our ability to manage the spread of selling prices over steel costs will be a significant factor in our margins in the next few quarters. Ultimately we expect the uncertain steel market to return to more normal patterns. When this happens, we believe the full impact of the operational improvements we have made in the Tubular Products Group will keep us very competitive across our productlines and will help return margins to historical levels. Selling, general and administrative costs for in the company as a whole increased slightly to $5.7 million for the first quarter of 2001 compared to $5.6 million in the first quarter −− excuse me, $5.7 million in the first quarter of 2002 compared to $5.6 million in the first quarter of 2001. SGAcosts were down $660,000, however, from the fourth quarter of 2001 as we work to control these expenses. We expect SGAcost to remain at less than $6 million per quarter for the rest of the year. Interest expense was $1.4 million for the quarter, down from $2.5 million for the same period last year. This is a result of the completion of the operating leases in the second quarter of 2001, lower interest rates and lower borrowings. Interest was down slightly from the fourth quarter of 2001 as well. Based on expected borrowings and assuming flat interest rates, we expect interest expense to continue in this range for the rest of the year. After adjusting for taxes, net income was $1.8 million for the first quarter compared to $2.3 million for the first quarter of 2001, and this equated to 27 cents per share based on 6,711,000 shares outstanding, compared to 6,616,000 shares outstanding last year and an earnings of 34 cents per share. Looking at the balance sheet, working capital is approximately $110 million at March 31st, 2002 with a current ratio of 3.3. A year ago those numbers were $77 million for working capital and a current ratio of about 1.8. Debt as a percent of total capitalization is down to 37.7 percent compared to 55.2 percent at March 31st, 2001. Our total assets are approximately $265 million and equity has increased from $110.1 million a year ago to $120.2 million as of March 31st, 2002. As we look ahead, we see opportunities for improvements in both our groups. Demand in the Tubular Products Group is increasing. Demand for these products trend along with the general economy and certain subsets of the general economy. While all indicators are not positive, we are optimistic that a recovery is underway and that it's starting to have impact for our products. We expect this to continue in the second and third quarters. As mentioned earlier, the cost of steel coil is a serious issue for this group. So far price increases to offset the increasing cost of steel have met with market acceptance. We have increased selling prices for all of our product lines, in some cases two or three times in the past few months. We are working to minimize the impact of the rising cost of steel, and also to pass on these costs wherever possible with an objective of maintaining our spread. The Water Transmission Group has suffered from a slowdown in bidding activity over the past several months. This is clear from our backlog which is at its lowest point in the past two years. This will have an impact on our results in the second quarter. We expect to see slightly lower revenues and margins in this quarter. Obviously we are continuing to work to fill available capacity during the quarter, but with today's extended leadtimes this appears increasingly unlikely. We do expect bidding activity to improve and our backlog to build during the second quarter. This should lead to better results in the second half of the year. In the long−term we continue to expect strong markets in water infrastructure as new systems are built to address population growth, as well as to replace aging and possibly failing pipelines. We are taking steps internally to address the markets we see in the near future. We are focusing on improving our operations and also updating equipment in four key facilities in order to enhance our competitiveness. In conclusion, we were pleased to see an upturn in Tubular Products during this quarter. We have worked hard to improve our operations in this group, and we are looking forward to demonstrating this improvement if the market continues to recover. At the same time, the Water Transmission results are somewhat disappointing. This business is often subject to uneven bidding activity and unfortunately this is impacting us right now. We are convinced this is a short−term issue, however, and are looking forward to increasing activity which will lead to better results. At this time I will be happy to answer any questions. Michel.

THE OPERATOR:
(CALLER INSTRUCTIONS) Our first question comes from David Flandry (phonetic). Your line is open.

THE CALLER:
Good morning, Brian. Can you −− on the tubular product side revenues were up about a million dollars over the fourth quarter, but can you give us some idea about volumes? If you've put through all these price increases, some of that increase in revenue is clearly the result of volume as opposed to −− a result price as opposed to volume.

MR. BRIAN DUNHAM:
David, most of the −− almost all of the increase in the first quarter is volume related. Most of the price increases went into place −− announce in the first quarter took effect towards the very end of the quarter. And we have further ones taking effect in the beginning of the second quarter. So virtually all of that increase is volume.

THE CALLER:
Okay. And when you talk about spreads, are you talking about widening margins? For example, if I have a piece of product that I sold for $100 and I take it to $120, and I sustain my gross margin percentage, I should get more absolute gross margin dollars. Is that the kind of effect you would expect in tubular products as we go forward?

MR. BRIAN DUNHAM:
When we talk about the spread we're really talking about two components to it, the selling price obviously and the cost of steel. We take out of that our processing cost which we believe we can hold pretty consistently. And what we are hoping to do is maintain the spread over the cost of steel. So if steel goes up $20 your selling price goes up $20. If your conversion costs or your processing costs stay the same, you're going to end up with the same dollars but a different percentage in margin. If you're able to increase your spread higher than

the cost of steel, you'll end up with growing dollars in margin but you may not end up with a growing percentage because obviously you based the percentage on that increased steel price.

THE CALLER:
Right, okay. So you're saying you want to hold your spreads or you're hoping to hold your spreads constant, which really is not going to give you more gross margin dollars?

MR. BRIAN DUNHAM:
Certainly we would like to see margins improve, but the first objective is to not lose anything as you see the steel market go through this gyration that it's going through right now.

THE CALLER:
And in the tubular markets as we move into Q2 and Q3, I mean they are typically seasonally stronger periods, are they not?

MR. BRIAN DUNHAM:
Yes, we typically are a little stronger in Q2 and Q3. Q1 is probably the third−best quarter and Q4 is the generally the fourth.

THE CALLER:
Okay. And I'm sorry, Brian, I missed the early −− I had a wrong conference number, and I missed your early comments. But can you just talk a little bit more or can you give us a little more flavor on why you're confident that bidding in the second quarter should be stronger? Are there more opportunities that you're tracking, what gives you confidence that Q2 bidding activity will increase?

MR. BRIAN DUNHAM:
Well, as you know, we track the agencies activities very, very closely. And in the delays that we saw in this quarter, if you go back, we talked about those in our last quarterly release as well. We expected to see this. We did. But we also expect to see those jobs start to break loose in the second quarter. We've already seen that activity start to pick up here in the first 15 days or so in this quarter, and at this point we don't see anything to suggest that we're not going to see that stronger bidding activity in the second quarter and continuing on through the rest of the year.

THE CALLER:
And Lastly, can you kind of give us some idea what the competitive environment is? Is your primary competitor still staying reasonably rational on their bidding activity?

MR. BRIAN DUNHAM:
As always, when bidding activity is lighter the competitive environment gets a little bit tougher. Everybody has the same issues that we do with a relatively high fixed cost in these manufacturing facilities and especially with longer leadtimes not as many opportunities to fill those spots. So it tends to get more competitive when bidding is light, and I think we have seen that. And so the margin that's in our backlog is not as good as what we'd like it to be. But we also think the margin will improve as bidding improves, and we have every reason to expect that will happen.

THE CALLER:
Great, thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) At this time I have no questions. Thank you.

MR. BRIAN DUNHAM:
I guess if there are no further questions we'll conclude the call. Thank you very much for your participation, and we will announce the second quarter earnings release in a couple of months. Thank you very much, bye.

THE OPERATOR:
Thank you and have a nice day. All parties may disconnect. (CONFERENCE CALL CONCLUDED) \plain \fs24 \ATXts750\sl495 \ATXnt874

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04/17/2002 02:00 pm	**KIND**	**Kindred Healthcare Inc (KIND) − KIND Q1 2002 Earnings Conference Call**

THE OPERATOR:
Welcome to the Kindred Healthcare Inc. conference call. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Mr. Eddie Jones. Please go ahead, sir.

MS. MARIA SCEPPAGUERCIO:
Good morning. Welcome to Kindred Healthcare's first−quarter 2002 conference call. My name is Eddie Jones with Corporate Communications. Before the company's presentation, I would like to read a cautionary statement prepared by the Company. This conference call includes forward−looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended and Section 21E of the Securities Exchange Act of 1934 as amended. All statements regarding the company's expected future financial position, results of operations, cash flows, financing plans, business strategy, budget, capital expenditures, competitive positions, (indiscernible) opportunities, plans and objectives of management and statements containing the words such as anticipate, approximate, believes, plan, estimate, expect, projected, could, should, will, intend, may and other similar expressions are forward−looking. Such forward−looking statements are inherently uncertain and stockholders and other potential investors must recognize that actual results may differ materially from the Company's expectations as a result of a variety of factors including without limitation those discussed below. Such forward−looking statements are based on management's current expectations and include known and unknown risks, uncertainties and other factors, many of which the Company is unable to predict or control that may cause the Company's actual results or performance to differ materially from any future results or performance expressed or implied by such forward−looking statements. These statements involve risks, uncertainties

and other factors detailed from time to time in the Company's filings with the Securities and Exchange Commission. Factors that may affect the plans or results of the Company include without limitation the ability of the Company to operate pursuant to the terms of its debt obligations and after lease agreements and with Ventas, Inc., the Company's ability to meet its rental and debt service obligations, adverse developments with respect to the Company's liquidity or results of operations. The ability of the Company to attract and retain key executives and other health−care personnel, increased operating costs due to shortages and qualified nurses, and other health−care professionals, the effects of health−care reform and government regulations, interpretation of regulations and changes in the nature and enforcement and regulations governing the health−care industry, changes in the reimbursement rates or methods of payments from third party payers including the Medicare and Medicaid programs and the newly proposed prospective payment system for long−term acute care hospitals, national and regional economic conditions including their effect on the availability and cost of labor, materials and other services, the Company's ability to control costs including labor costs in response to the prospective payment systems, implementation of the Company's corporate integrity agreement and other regulatory actions, the ability of the Company to comply with the terms of its corporate integrity agreement, the effective or restatement of the company's previously issued consolidated financial statements, the Company's ability to integrate operation for the acquired facilities and the increased in cost of defending and insuring against alleged patient care liability claims. Many of these factors are beyond the control of the Company and its management. The Company cautions investors that any forward−looking statements made by the Company are not guarantees of future performance. The Company disclaims any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward−looking statements to reflect future events or developments. It is now my pleasure to introduce the speakers for today's call. Eddie Kuntz, Chairman and Chief Executive Officer of Kindred, and Rich Lechleiter, Chief Financial Officer and Treasurer of the Company. Mr. Kuntz will begin the call.

MR. EDWARD KUNTZ:
Good morning, everyone, and welcome to the Kindred Healthcare conference call. After the close of yesterday's market, we released operating results for our first quarter ending March 31. On an overall basis, operating results for the quarter were clearly in line with expectations with both of our operating provisions reporting improved results over last year. As you can see, consolidated revenues increased 8 percent to 811 million in the quarter compared to 752 million in the first quarter of last year. Operating income or what we call EBITDAR rose approximately 11 percent to 115 million from 104 million a year ago. First quarter net income totaled $18 million this year or 90 cents per diluted share. A couple of other comments. On the finance side of the business, we continue to improve our liquidity during the first three months of this year. Positive net cash flows for the quarter totaled $20 million as you can see from the disclosures we made. At the end of the quarter, our cash and cash equivalents totaled 211 million and that is about the same amount as our total funded long−term debt. As Rich Lechleiter will detail later in the call, we're doing a good job of collecting the receivables, managing the working capital of the Company and controlling routine capital spending. Last week we announced significant amendments to the revolving credit facility and our senior secured notes that will provide what we believe to be increased financial flexibility for the Company. The changes allow the Company once again to make acquisitions or investments in existing properties up to 130 million compared to the 30 million limitation that we had in place before entering into those credit agreement amendments. Within the 130 million, we

can borrow 45 million under the revolving credit facility to finance any future acquisitions or investments. Finally, the aggregate credit under the revolver which had been reduced in connection with the public offering which we did last November was restored to its original $120 million level. Again, all of which we announced previously. On the acquisition front in the quarter, we completed the Specialty Healthcare Services transaction for 45 million right at the end of the quarter, actually on April 1st. This acquisition will add 6 hospitals, 3 of which are freestanding hospitals and it will also complement our existing operations in Southern -- in California. The remaining facilities are in Cleveland, Philadelphia and Charleston, South Carolina and they are hospitals within hospitals. We also acquired specialty interest in a new hospital within a hospital in Dallas that we expect should open in 2003. Last year or in 2001, specialties revenues were approximately $76 million and as we have indicated, we believe the transaction will be slightly accretive to our earnings in 2002. As we previously announced, again, the entire purchase price was financed through existing cash and did not require us to use any additional financial resources associated with the credit agreements. I also note in the quarter, again, as we previously announced, we began operations of two pulmonary units in New Jersey as well as announcing a planned opening of a hospital within a hospital in the Wilksbare (phonetic) Scranton, Pennsylvania and a stand-alone hospital, a freestanding hospital in Scottsdale, Arizona that should either in the second or third quarter of this year. Our first quarter results also include a new freestanding hospital that we opened in Las Vegas in December 2001 just at the end the year. At this time, I'm going to turn the call over to Richard Lechleiter to discuss more detail concerning our financial results for the quarter and I will come back with some additional closing comments.

MR. RICHARD LECHLEITER:
Good morning, everyone. As Eddie mentioned, our consolidated results for the first quarter reflected continued improvements in both of our operating divisions. On a consolidated basis, our EBITDAR margins improved to 14.2 percent compared to 13.8 percent last year. Consolidated EBITDA totaled $50 million in the first quarter of this year. Pretax income for this year's first quarter was $31 million and the effective tax rate for the Company was 41.5 percent, down from 43.5 percent that we accrued in 2001 after our emergence from bankruptcy. Net income of 18 million or 95 cents per diluted share was clearly in line with our expectations. I want to spend some time reviewing the operating results of the two divisions. First, the health services division. Nursing center revenues grew 8 percent in the first quarter to 462 million compared to 429 million in the first quarter of 2001. Total patient census was relatively unchanged from last year while our patient mix improved a significantly. Medicare averaged daily census for the quarter totaled 4,885, up 7 percent from a year ago. On a per patient day basis overall revenues in the first quarter this year grew 7 percent to $163 from $153 last year. Medicare revenues per patient day in the first-quarter rose 10 percent to $358 compared to $325 for last year's first quarter. Most of the increase was attributable to the BIPA reimbursement changes that became effective on April first of last year and improvement in Medicare Part B utilization. Medicaid rates held up well in the first quarter rising 4.4 percent to $114 from $109 per patient day last year. We would caution, however, for the balance of the year we're still expecting certain softness in these rates as some key states in which we do business respond to budget pressures associated with a somewhat weak economy. We reported first quarter nursing center EBITDA of 81 million, an increase of 14 percent over last year's 71 million. The EBITDAR margin expanded to 17.5 percent this year compared to 16.4 percent in the first quarter of 2001. Overall operating expenses in the nursing centers increased 6 percent in the first quarter compared to a year ago. Our hospitals reported a good first quarter. Revenues grew 9 percent to 296 million in the

quarter this year compared to 272 million a year ago. Overall patient census rose almost 6 percent. On a same−store, basis volumes were up 4 percent. Patient mix for the quarter improved as well. (indiscernible) census improved to 20.3 percent of total patient days from 19.2 percent last year while Medicaid patient days declined to 11.7 percent of total days compared to 12.8 percent last year. Medicare mix was unchanged from the year ago. On a per patient day basis revenues rose 3 percent. Hospital EBITDAR for the first quarter totaled $59 million, up 9 percent from last year's 55 million. EBITDAR for this year's first quarter includes 1.5 million of insurance proceeds from last year's flood damage at our Houston hospital. We are continuing to make progress in our pharmacy business as well. Revenues increased 11 percent to 61 million in the first quarter of 2002 compared to 55 million in the same period last year. Substantially, all the increase was attributable to growth in our customer base. At March 31, 2002, we serviced approximately 57,500 licensed nursing home beds compared to 51,600 beds a year ago. EBITDAR totaled 5.7 million this year versus 6.2 million last year. Corporate overhead for the first quarter of 2002 totaled 33 million compared to 29 million last year. This year's overhead included severance pay of approximately 1.5 million and amortization of the restricted stock issued at the time of our emergence from bankruptcy. Depreciation and amortization totaled 17 million in the first quarter. In connection with our adoption of SFAS No. 142 we have stopped the amortization of goodwill effective January 1, 2002 resulting in a net income benefit of approximately 1.4 million or 7 cents per diluted share for the quarter. The transition test required by the new pronouncement did not require any write−off of the $108 million of goodwill on the balance sheet at year−end. Interest expense, substantially all of which relates to the Company's outstanding senior secured notes aggregated $4 million in the first quarter of 2002. This debt currently bears interest at six−month LIBOR plus 4.5 percent. Investment income related to excess cash in are captive insurance subsidiary investments totaled almost $2 million in the first quarter this year. I want to take a few moments to review the balance sheet at March 31st. As Eddie mentioned earlier, we are continuing to improve our liquidity. Cash and cash equivalents totaled $211 million, up from 191 million at December 31. Accounts receivable which typically increased in the first part of the year actually declined to a 414 million from 419 million at the end of 2001 as a result of improved hospital Medicare collections. Net accounts receivable days at March 31, 2002 improved to 45.9 from 48.8 at December 31st and 48.3 at April 1, 2001, the effective date of our fresh start accounting. We are also building our operating cash as we return to a more normal vendor payment cycle resulting in an increase of accounts payable to 113 million from 100 million at December 31. Funded long−term debt stood at 212 million and did not change from December. Cash flows from operations in the first quarter of 2002 totaled $33 million compared to $36 million last year. Because the Company was still in bankruptcy in the first quarter of 2001, these amounts are not necessarily comparable. However, we are pleased that our net investment in working capital so far this year was only $7 million. Capital spending was 10 million compared to $22 million a year ago. On an annual basis, we expect our routine capital spending this year to approximate $75 million. On an overall basis, our net positive cash flow for the first quarter of 2002 totaled $20 million. That concludes my remarks on the quarter's performance. Eddie.

MR. EDWARD KUNTZ:
I just want to make a few comments before we turn it to questions. First, we are pleased with the result in the quarter in both of our divisions. We have obviously managed to improve the balance sheet, but more importantly, we see ourselves making progress in our internal processes that we use to improve the quality of services. Clearly, while we continue to have quality regulatory issues at very specific facilities in a portfolio of this size is not unusual, our

internal monitoring process is that we have (indiscernible) continually improve our culture across the Company. As I said many times over in all of my presentations, financial success in building a company is on a building by building basis and we will always follow our commitment to providing quality of care to our patients and our residents. With respect to the balance of the year, we can affirm our previous guidance that was issued with our year−end 2001 results. In particular we continue to expect overall revenues in 2002 to approximate 3.2 billion and operating income should range between 460 million and 470 million while net income should approximate between 63 and 68 million. These estimates include the impact of specialty health−care acquisitions completed on April 1st. A few words on the legislative front. We continue to monitor discussions in Washington and participate in lobbying efforts concerning the Medicare reimbursement changes both on our hospital side of the business and our nursing home side of the business. As you are probably all aware, they're significant issues involved here and let me touch upon a couple of them as they affect the Company. First, with respect to the change in hospital reimbursement to a new perspective payment system from the current cost base system, as you know, CMS formerly HCFA issued proposed regulations for a perspective payment system covering long−term care hospital providers on March 22nd. Since that time we have expended a significant amount of resources in an attempt to apply almost 400 page to proposed rules to our specific hospital visits. There is still a lot of work to be done. It is a very complex rule but appears at this point that the proposed rules are basically budget neutral for the industry. We also performed an analysis of the impact of these rules on the specialty facilities before we completed that acquisition to sort of validate our $45 million investment. (indiscernible) period is now underway before the issuance of the final rules and as you would expect, we have a number of questions and comments and are discussing these with the government directly. The proposed effective date for the new system is October 1, 2002, but because of the way our cost reporting years work in our hospital business, this system is not expected to be effective for us until September 1, 2003 or an 11 month hiatus for (indiscernible). Obviously, we will have more to say when the new rules become final and we're then able to comment on them more specifically. Next reimbursement issue is in the nursing home business as we've already disclosed in our 2001 10−K some of the additional reimbursement legislated by Congress during the past few years is scheduled to expire this September. In particular, under the BBRA, the 4 percent across the board increase and the nursing increases in Medicare component under the BIPA legislation commonly known as in total to Medicare (indiscernible) are scheduled for expiration. As you know, both of these measures were enacted by Congress to essentially fix Medicare reimbursement cuts promulgated under the original PPS legislation of '97. In short, we believe it's important the federal government continue these expenditures or these improvements to the rates. The inessential argument in favor of Kindred and I might add (indiscernible) industry are one, the add on both under BBA, BIPA and BBRA literally get us back to the original intended cuts of the '97 BBA Act. Two, it's an election year and politics (technical difficulty) not a congressman and the administration wants to be perceived as cutting rates to seniors. Three, I really believe this is generally a better understanding that quality matters and it costs more to provide quality under the Medicare programs. Lastly, I think there is some recognition and I cautiously use the word some but the rates must be stable to attract capital to the industry. While it's uncertain as to the future outcome of the Medicare (indiscernible) debate when both economies (indiscernible) sensitive for the regulatory and financial concerns of the industry and we remain cautiously optimistic. As a practical matter, I do not expect to see any discernible clarity on the (indiscernible) issues until the federal budget negotiations are completed in the fall. All in all, a good quarter for the Company I am pleased with the strength of the management team with the addition (technical difficulty) President of the Company and the promotion of Rich Lechleiter to CFO. We clearly continue to improve the base of our operations in the quarter and we've begun to regain some modest growth momentum while continuing to improve the cash position and the balance sheet. That concludes our remarks for the quarter. Operator, we are now ready for questions please.

THE OPERATOR:
(CALLER INSTRUCTIONS) We will take our first question from Adam Feinstein (phonetic) with Lehman Brothers.

THE CALLER:
It's actually Kevin Fishback (phonetic) filling in for Adam. In your press release you quantified the benefit that you received from BBRA in Q1 as 14 million I believe. However, the way I understand it is that part of that increase, the 4 percent increase is going to go away in October. Do you have any sort of breakout of that 14 million between the 4 percent that's going to go away and the 20 percent that is supposed to say until (indiscernible) the (indiscernible) system?

MR. RICHARD LECHLEITER:
I have got some break down --

MR. EDWARD KUNTZ:
Before we get to the breakdown, you said something that I don't mean to (indiscernible) with your words, you said the 4 percent is going to go away. Let's just clarify that and say if nothing happens, the 4 percent goes away.

MR. RICHARD LECHLEITER:
The component breakdown on that, Kevin, of the 14 million, 5 of it relates to the across the board increase of 4 percent and the remaining 9 million relates to be 20 percent increase in (indiscernible).

THE CALLER:
Great. Also it looks like you reduced your nursing home count by 9 facilities in the second quarter and another 11 in this quarter. Are there more facilities that you are looking to divest or have you completed all your cutting of facilities?

MR. EDWARD KUNTZ:
Kevin, almost all of that relates to the management contracts. If you recall in the midst of the bankruptcy we undertook a whole series of sort of interim management contracts largely emanating from some of the issues that Omega (indiscernible) Healthcare (indiscernible) had. We took on a number of those contracts literally on an interim basis. We are in the process of pretty much giving them back to Omega. That's where they are. They're not leased or owned properties and they really have no significant impact on the financial results of the Company.

THE CALLER:
One last question before I monopolize the whole call. It looks like you had a really strong quarter at least our estimate, but it looks you are confirming guidance. Are you being conservative for the rest of year or are there any moving parts in there that we should know about?

MR. EDWARD KUNTZ:
I think we're always going to be conservative. There are always lots of moving parts in a business like this. We face issues as we said in our remarks going forward particularly with respect to rates and the like that are very much unknown particularly on the Medicaid side let alone the guidance that we have given on the Medicare side that obviously assumes the continuation of those Medicare rates and decline in rates based on the cliffs (phonetic). But you have a far from that, you have issues as to what's going to happen in the remainder of the year on the Medicaid side on the nursing homes that can influence these numbers tremendously. So, overall, for what we've seen in the first quarter we're pretty confident of our numbers and we've simply gone forward and sort of reissued the guidance in the general direction.

THE CALLER:
Thanks.

THE OPERATOR:
Matthew Ripberger (phonetic) with J.P. Morgan.

THE CALLER:
Congratulations on the quarter. I have three questions for you this morning. First of all, your occupancy levels at your hospitals increased very strongly year over year and sequentially to 67 percent. I wanted to see if you could provide some color as to what some of the drivers were that increased the overall occupancy level and what (indiscernible) that for '02 we should model a higher level of occupancy for the year versus '01?

MR. EDWARD KUNTZ:
Good question. First of all, the first quarter of the year, I think if you look historically at the Company, Matt, typically is the strongest occupancy quarter for the hospital Company. That is a reflection usually related to the winter season, the impact of respiratory infections and the like that directly impact our census. First of all, first quarter is usually the strongest. On the other hand, or complementary to that I would tell you that we're pleased with the occupancy improvements in the hospital. We are generally seeing it not in every hospital, but generally across the board. And if you look back over the last two or three−year operating history of the company, you will see a similar trend going on. It does not really represent a breakout of the trends, it represents let's just say a continuation of the continuation of the positive improvement in occupancy.

THE CALLER:
Can you comment whether the occupancy level for the acquired facility was roughly the same?

MR. EDWARD KUNTZ:
The occupancy level for the acquired facilities I think is slightly higher because in our situation particularly on the hospital side as we said before, we measure it off of our original licensed beds and in many cases, we are operating long−term care acute hospitals in settings where it is not possible to utilize all the licensed beds because of the equipment and the like that we have. And the ones we are acquiring particularly acquire a hospital within a hospital but generally all the licensed beds are available to you so typically they will run a higher percentage of occupancy.

THE CALLER:
Second question, just related to acquisition spending for the year, I wanted to see if you could provide any color about what you anticipate spending and then specifically if you are targeting more the nursing home side of the business or the LTAC (phonetic) side the business for acquisitions.

MR. EDWARD KUNTZ:
First of all, I cannot be specific about specific acquisitions. I will just leave it at that. Two, with respect to whether we are targeting the hospital side or the nursing home side, since we have emerged from bankruptcy all of the announcements that we have made have basic been on the hospital side. We really have not done anything on the nursing home side. Our strategy on the nursing home side has been to cautiously look. Our strategy has been in a couple of instances last year we bought in the leases. These were non−Ventas leases. We purchased a couple of nursing homes that we had leased that we though represented a good investment and we continue to look on the nursing home side. I will tell you we're looking on both sides and it is not a question of trying to balance one after the other. It's a little bit of sort of what is available in the marketplace at that given time. Obviously, the world of acquisitions on the nursing home side is a bigger world. The world of acquisitions on the LTAC side in particularly frankly is not a very big world. There is only 300 some long−term acute care hospitals in the whole United States.

THE CALLER:
Last question is just −− related to the Medicaid softening you mentioned later in the year, I wanted to see if you could help quantify what that could mean in terms of your average per diem rate and if you could highlight maybe a few states in specific where you are anticipating some type of rate cut.

MR. EDWARD KUNTZ:
I cannot tell you specifically what that means in terms of the Medicaid rates. I can tell you that we do expect as the year unfolds that the rate of the increase in the Medicaid nursing home side, the rate of increase will come down a little bit. Frankly, in the first quarter as Rich Lechleiter mentioned, we were pleasantly surprised that it did not come down very much. In fact, it maintained fairly well. On the other hand, most of the big states that we operated haven't been spoken for in 2002 yet so it's hard to predict. Obviously, it's a factor of which states are in trouble fiscally. I saw a report this morning from the National Council of State Legislators that indicated the total impact in this year was something like I think a $40 billion deficit at the state level. I'm not sure of those exact (indiscernible) I saw it on the wire this morning. For us, the key is not only which states are in trouble, but obviously where we have a large number of nursing facilities. Most states would include Massachusetts, Florida, California, Tennessee, North Carolina and the like −− and Ohio and Indiana. And those are the ones we really watch. I really don't have the specific −− I don't really have specific information, however, with respect to any of those states.

THE CALLER:
Thanks very much.

THE OPERATOR:
We will go next Jerry Doctorow (phonetic) with Legg Mason.

THE CALLER:
I was wanting to see if I could get a little more color on I guess the margins, particularly I guess on the hospital side. There is a couple of things going on, obviously, which have been touched on, the acquisitions and that sort of thing. You talked a little bit about where occupancies might go, can you give us a sense of what the seasonality of margins and whether margins again also change on that acquisition as we go forward in the year.

MR. RICHARD LECHLEITER:
I really cannot give any specific guidance. I think if you look −− let's talk about the hospitals for a moment. If you look at the hospital business, clearly, the first and second quarters are seasonally stronger than the third, the third being the weakest over the year and then there is a balance in the November and December period in terms of overall patient volume and the like. So I think if you look at our historical results, it's pretty easy to trend. I think on the nursing center side, clearly the margin comparison is very strong in the first quarter this year because this is the last quarter, if you will, where the BIPA monies are in this year's numbers and not in last year's. Obviously, next quarter there will be a lifetime comparison if you well. In terms of −− the key for us again is to control basically the rate of growth in labor cost less than or at least in−line with expected increases in reimbursement, that is really what we have to focus on the rest of the year.

THE CALLER:
In terms of just the seasonality, the specialty acquisition you don't think it's going to make that much difference in terms of historic pattern on the margins?

MR. RICHARD LECHLEITER:
I don't think so. I really don't think so. I don't think it's going to have a material impact. It should be slightly accretive this year, but I don't think it is going to have any material impact on any of the hospital margins.

THE CALLER:
Also, just on the acquisition, can you give us a sense of what depreciation sort of schedule of whatever you are using on that, it is a $45 million acquisition. I assume since your hospitals there may be a lot of (indiscernible) equipment so if you could give us a sense of how that depreciation comes on the balance sheet −− really on the income statement?

MR. RICHARD LECHLEITER:
While we have not completed the purchase price allocation as you alluded to and you are correct, a good portion of the purchase price will be considered goodwill and will not be amortized.

THE CALLER:
Okay. Any rough guess if we are trying to at this point is it 50 percent or something.

MR. RICHARD LECHLEITER:
Again, Jerry, I have not completed that work and I cannot begin to guess on that.

THE CALLER:
Eddie, one more broad, question, I was curious if you have a sense of what sort of an optimum size would be for sort of a nursing home company since acquisitions might be out

there, kind of where you are in terms of number of facilities and where you might want to be or what from the general strategic standpoint you would want to do from a geographic concentration standpoint or something.

MR. EDWARD KUNTZ:
First of all, I think that given the structure we have in place, the infrastructure we have in place in the company today both in terms of the operating division of our nursing home business and in terms of the structure of the corporate office vis−a−vis the information services department, I am pretty comfortable that we're capable of doing more. And by doing more, I'm not just saying one to ten nursing homes, I'm saying a chunk of nursing homes without defining it on the upside. It's pretty clear to me that even though we went through the depths of bankruptcy, for example, when we took in those managed facilities from Omega and I think they were almost 30, 34 facilities at that time and we did some systems work there. We brought them in without much of an infrastructure hitch which gives me some confidence that on the nursing home side, we can accommodate more given our systems. Now systems are one thing, operating field personnel are another thing and, for example, on the nursing home side, we're operating today in four regions in the country. My best guess is that if we were to expand that business and I caution the word hit, if we were to expand that business by any meaningful number of nursing centers, we would have to expand, for example, our regional structure and could not continue to operate with four regions, but would have to go to at least another region in the company. We are sort of at the maximum number of facilities per region basically. On the other hand, on the infrastructure side, computers, access information, patient records, financial records, that is a fairly scalable operation, Jerry.

THE CALLER:
So you think a 500 facility chain is not −− is perfectly doable as opposed to −−

MR. EDWARD KUNTZ:
Are you addressing the total or are you dressing the size of an acquisition?

THE CALLER:
I guess I thought at some point actually we had a conversation where there was sort of optimum size, there was 250 to 350 or something like rather than say 500. Obviously, Beverly got very big and ended up just getting a lot smaller. And I was just −− I'm not so much trying to pin you down on acquisition, although you may feel that way, but just in general, I'm trying to get a sense of sort of how the industry shakes out from a size standpoint if there's kind of a right size.

MR. EDWARD KUNTZ:
I'm not sure there is a right size to be honest with you. I'm not sure there's a right size or a perfect size. I think it depends upon the quality of your management, your infrastructure. Obviously, the services in each case and the like.

THE CALLER:
In terms of geographic concentration do you really want to build up in particular states is that sort of a −−

MR. EDWARD KUNTZ:
That's always going to be a goal because it's a more efficient way of operating. On the other hand, you're always going to look at the quality of the facility that you're going to look at. If somebody, for example, offered a facility in North Dakota today, we wouldn't even look. It doesn't make any sense. On the other hand, if you are already generally close to it or near it within a state, it would make sense to look at it on a facility wide facility basis. On a larger scale in terms of a larger group of facilities, I think it's going to depend upon where they are located and sort of how that maps intersect between the two companies.

THE CALLER:
Liability costs I was just curious whether they are stable going forward or whether we can, upwards or downwards, just get a sense of that. Thanks.

MR. RICHARD LECHLEITER:
On the malpractice costs in total company on the self−insured malpractice first quarter costs somewhere around 15 million compared to last year's numbers of about 12. So that continues to be an issue for the company.

THE CALLER:
And any initial claims −− any trendline at this point, up, down.

MR. EDWARD KUNTZ:
I just gave you the trend line in the sense that the accruals are up this year as we continue to look quarter by quarter at our malpractice reserves and get (indiscernible) actuaries and it continues to be a moving target. We address it every single quarter and we frankly accrue what the independent actuaries tell us to accrue for our liability lines.

THE CALLER:
Thanks.

THE OPERATOR:
Our next question from Deborah Lawson (phonetic) with Salomon Smith Barney.

THE CALLER:
I was just wondering if you could comment on the Medicaid situation. When do you think timing−wise you will have more clarity on just exactly what your rates might be for looking out second half of '02 or '03. Are there any big dates looming in terms of state decisions and that sort of thing and also can you comment on whether or not the Medicaid reimbursement in the states would have any separate impact on the pharmacy business? Thanks a lot.

MR. EDWARD KUNTZ:
With respect to Medicaid rates, it is state by state. I don't know off the top of my head, frankly, the actual month in which each state makes the decision. I do know, for example, that the California decision is usually August. I just happen to know that. But I don't know the state by state lineup. I would also tell you that in some cases the states are on biennial budgets. So in some instances, it's not a 2002 issue, it's more of a 2003 issue depending upon their budget cycle. So these things happen to come in and come out on a fairly routine basis. With respect to the pharmacy question, I think you can generalize the comment to say that we've got to be cautious about the pharmacy rates also if I understood your question, Debbie,

in a sense that as they look −− as the states look at potential savings and begin to either shave the reimbursement costs of the drugs or begin to shade the reimbursement for the for example the prescription fee that we get for filling a prescription −−

THE CALLER:
It's like a dispensing fee.

MR. EDWARD KUNTZ:
Exactly right, like a dispensing fee, it could impact us. Now I would tell you so far this year and we review this each month with the pharmacy guy −− so far this year we have not seen much if any of an impact. On the other hand, we have seen a slight increase overall in our cost of goods sold which is a little bit of a reflection perhaps of some tightening of the AWP in the states and the like.

THE CALLER:
Thanks a lot.

THE OPERATOR:
(CALLER INSTRUCTIONS) We will go next to Alex Converse (phonetic) with Credit Suisse First Boston.

THE CALLER:
A couple of follow−ups. First on the LTAC business, can you give us a little more detail on the private pay sector of that business. It appears volumes were quite stronger during the quarter but revenues per day were down a little bit year over year, I just want to know if there's anything unusual or unique going on in that sector of the business.

MR. RICHARD LECHLEITER:
I think if you look at sequentially at the rates in the hospital business on the private side what you've seen in the third and fourth quarter last year and again in the first quarter this year as some softening in those overall rates as the volumes increase and basically on an incremental basis, the additional volumes that is coming in is generally shorter stay and the acuity is generally not as high which is having some impact on the overall weight. I think that the 1600 and 1700 range is certainly in line with our expectations going forward. So clearly as we grow the volume, there is some softening in the rate.

THE CALLER:
Secondly, in terms of labor costs you touched briefly on margins. I was wondering if you could give us a little detail sort of up−to−the−minute or most recent trends you're seeing in terms of wage rates your ability to control temporary staff utilization and that type of thing.

MR. RICHARD LECHLEITER:
Let's talk about the nursing centers first. Really in terms of rate pressure versus hours utilization, basically kind of summarize the nursing center results. The hours we are expending per patient day are relatively flat compared to last year. The rates are generally up 4 or 5 percent in terms of wage pressure. The staffing costs, temporary staffing costs in this business is really not that material. Don has done a great job over the last two years at really reducing that number down to a very small number. On the hospital side of the business, a little different story. On the hours per patient day, we are running relatively flat compared to a

year ago. So it is kind of a similar story to the nursing centers. However, on the rate side, you are generally seeing rate pressure in the 5 to 6 percent range. And part of that pressure is a little higher rate of increase and the nursing part of that reason is because we have seen some pretty substantial growth in agency costs in the hospitals particularly with respect to registered nurses. So that is certainly an issue that Paul, Eddie and I are working on.

THE CALLER:
How much opportunity is there to reverse that or is this just kind of unavoidable giving the nursing storage, etc.?

MR. RICHARD LECHLEITER:
I think if you look at some of our bigger markets, Chicago and the like, then South Florida and so on, generally the issues on a local basis that we are dealing with are attracting qualified folks, particularly on night shift and weekends. Weekend in particular is a big issue for us. There are ways to address that in terms of pay differential and benefits and so on that we're looking at, but we don't think it is a problem that can't be solved to some extent.

THE CALLER:
My final question is you have been extending your terms a little bit with your vendors and your accrued liabilities has been reflecting that. At what point do you feel you are going to get this sort of a normalized level with Accounts Payable, is there sort of an important time where you are set to get there or a ratio of payables to cost if you are going to remain flat going forward?

MR. RICHARD LECHLEITER:
In particular, I'm not sure I can answer the question. We will continue to try to refine some of our vendor terms going forward and you may see some additional movement there. But I don't know if it would be terribly material. Really what we're focused on in terms of managing the balance sheet is really the net investment in working capital and it is certainly on an annual basis. And clearly in the first quarter so far the net investment working capital is very, very low. That's really the overall goal.

THE CALLER:
Thanks very much.

THE OPERATOR:
Andrew Bok (phonetic) with Goldman Sachs.

THE CALLER:
It's Brad (indiscernible) on behalf of Andrew Bok. Can you provide any more details on the financial profile of Specialty Healthcare Services. In particular, are the EBITDA margins on that business similar to your LTAC business? And then secondly, what are some potential opportunities to improve returns on that asset?

MR. EDWARD KUNTZ:
I'm not going to be real specific on Specialty. We have announced already what the revenue run rate was last year. We announced already what the purchase price was. I would tell you through on a fully integrated basis, I would expect that the margins on those beds, 400 some beds should be −− on a fully integrated basis should be no different than what we're

experiencing in the rest of the business. There is nothing unusual in that transaction nor is there anything unusual in those facilities compared to the other 50 some LTAC that we operate. So on a fully integrated basis, those margins should not be materially different than what the rest of our business is. That's about the only color I can give you on that.

THE CALLER:
Thank you very much.

THE OPERATOR:
Pat Redner (phonetic) with Deerfield Management.

THE CALLER:
I have a few little nitty questions. So on the LTAC margins, can we assume the 50 basis point decline in the LTAC EBIT operating income margin is due to the waging −− wage pressures?

MR. RICHARD LECHLEITER:
The answer generally is yes. We are actually seeing some good news on the nonpayroll cost in the hospitals, but clearly the rate issue is the primary issue. And from our perspective at least sequentially we are starting to close the gap, if you will, on the comparisons in the margins in the hospitals, I believe if you look at third and fourth quarter of last year, the slippage was over 100 basis points in Q4 and we are starting to close that gap and, hopefully, we will have some success in doing that going forward as we try to focus on agency cost.

THE CALLER:
I guess there is more leverage, because you really had great weighted average pricing and occupancy increases so at some point should not there be some operating leverage here if you continue to increase the occupancy and the pricing?

MR. EDWARD KUNTZ:
You are right generally, but on the hospital side that leverage is a little different than, for example, on the nursing home side, particularly as it relates to labor costs because of the acuity level of the patients are so high that the best way I can explain that to you is when you get that additional patient into the hospital they really do draw proportionally more resources. When you are sapping those hospitals at 10 to 12 hours a day, it is not a question of if you are at a census of say 70 in a hospital and you get 5 more patients if you can stretch your existing labor over 75 patients you really need to add, there's a lot less flex in that area of our business than there is, for example, on the nursing home side. That is, largely, a reflection of the acuity level of the patients.

THE CALLER:
So there is not as much −−

MR. EDWARD KUNTZ:
There's not as much flex as there is in the nursing home side.

THE CALLER:
So it would be more of a fixed cost −−

MR. EDWARD KUNTZ:
If you were it to look at it that way directionally, yes, let's just say it's more fixed than it is on a nursing home side.

THE CALLER:
I was sort of curious, you had an increase 11 percent in your pharmacy business (indiscernible) your margins also dropped 200 basis points. What happened there, I was just sort of curious?

MR. RICHARD LECHLEITER:
Two things. First, we had some strong collections in Q1 of last year on some pesty customer accounts that reflected itself in the bad debt provision. We also are experiencing, as Eddie indicated earlier, a higher cost of sales ratio that is primarily tied to some of the AWP issues with respect to Medicaid funding. The cost of sales ratio was actually up year over year.

THE CALLER:
So we so should we use the 9 3 as a good number going forward?

MR. RICHARD LECHLEITER:
I will not make a specific comment on the go forward rates.

THE CALLER:
Sorry, I didn't mean to put you in that position. The other thing is, on your cash flow statement, I guess, the inventory −− the increase in inventory or the expenditure for inventory, is that for the pharmacy business I'm assuming in taking advantage of any kind of discounting you might have had or is that a normal −− that's a big swing. It might have been the only swing where you would have had a positive cash flow from operations.

MR. RICHARD LECHLEITER:
You are referring to inventory and other assets. Primarily, that is driven by the funding of our voluntary employee benefit trust for health insurance which we fund by March 15th of every year in order to get the tax deduction for our accrued health insurance. That is primarily what is driving that increase.

THE CALLER:
So that is a onetime −−

MR. RICHARD LECHLEITER:
Yeah, it's basically a onetime event in Q1 and the funding is fairly normal after that in terms of a monthly basis.

THE CALLER:
So it wasn't in last year because you were still under the predecessor company?

MR. RICHARD LECHLEITER:
There was no tax benefit to funding that last year.

THE CALLER:
Thank you very much.

THE OPERATOR:
We'll go next to Andrea Vecee (phonetic) with Solomon Smith Barney.

THE CALLER:
A couple of quick questions. First, is your Medicare census continuing to accelerate and as you laid out your guidance are you assuming a sort of patient day and revenue mix derived from Medicare?

MR. EDWARD KUNTZ:
I assuming you are referring to the nursing home side.

THE CALLER:
Yes. On nursing home side, I apologize.

MR. EDWARD KUNTZ:
Again, if you look at historical patterns in the nursing home business, historical patterns indicate that the early part of the year, the first couple of months generally are your higher water marks for your Medicare census. This year was a continuation of that trend. I think it was better frankly than we expected and I think we've done a very good job of training our people to take care of that Medicare patient. I think it is a reflection of one what is happening in the marketplace, but also I think we've done a good job building our Medicare programs within our company both in terms of our overall Medicaid pay patients and the utilization under Part B. I think what you have to see the rest of the year if historical trends hold up is that there will be a decrease Medicare percentage in the ensuing quarters, but it's a factor of the weather and the like again. Not that dissimilar from the hospital side that I said the census reaches its high watermark early in the year.

THE CALLER:
Thanks. In terms of strategically looking of your LTAC business, do you think you will be doing more sort of hospital within a hospital development or do you see more opportunities to make strategic acquisitions sort of favorable multiples some of which are freestanding?

MR. EDWARD KUNTZ:
With respect, as I said before, with respect to, if you separate the hospital development side from acquisitions from development, if you look at the acquisitions (indiscernible) candidly it's not a huge market. Again, there is some 300 LTACs in the whole United States given our size, given the size of the select medical and the like, there is not a huge market out there. There are some private companies out there so Specialty was one of those private companies. Those private companies seem to have a mix of both freestanding and hospitals within hospitals. So that is one avenue that we will explore but, again, it's not a huge, huge number of facilities literally that are out there for acquisition. That is number one. Number two, with respect to sort of development, what we have done since emerging from bankruptcy is literally rebuild a development department within our hospital division to pursue the market for the most part hospitals within hospitals as being an opportunity as we talk to other hospitals general acute hospitals throughout the United States. One of the frustrations that we had while being in bankruptcy although I think we did a good job operationally day−to−day in hospitals and nursing homes was that we were frustrated in not being able to step out there with a development program of our hospital business because as we talked to a local general acute hospital about doing something with that whether it's a hospital within a hospital or

developing a freestanding on their campus, for example, or near their campus, we were in Chapter 11 and those discussions never went anywhere so long as we were in Chapter 11. What you have seen after coming out of Chapter 11 is sort of the regaining of that momentum out there and, again, what we did in New Jersey, what we announced in Pennsylvania is simply a reflection of the work they have done in our early internal development program within the hospital division.

THE CALLER:
Thanks. What does your guidance reflect if anything in terms of new openings for the balance of the year?

MR. EDWARD KUNTZ:
Again, you're talking about hospitals. It's hedged in sort of the continuation of that effort on the hospital side. But it is frankly given the fact that it is starting now you don't have much of an impact on the hospital numbers for the whole year from these startup operations.. There is a couple of −− by the end of the year, a couple of them turned positive. You have got some startup operating losses and the like and I would tell you that the numbers are not going to move around very much in that area by the end the year. There just aren't enough to provide a big amount of juice to affect the hospital numbers for us right now. Hopefully, in 2003 it will make a difference.

THE CALLER:
Thanks very much.

THE OPERATOR:
Andrew Jones (phonetic) with Northstar Partners.

THE CALLER:
Rich, what is the negative carry on having the cash balance equal to the debt balance? Is there any ability to pay down any debts temporarily at least so that will go away somewhat?

MR. RICHARD LECHLEITER:
We do have the ability through one of our amendments our senior secured notes to reduce the outstanding balance by $100 million. At that point, Andrew, you are getting into a capacity issues and permanent reductions in capital.

THE CALLER:
And the negative carry in the quarter what would it have cost you?

MR. RICHARD LECHLEITER:
We are at LIBOR plus 4.5 which is roughly 6 percent and change. The investment yield on the overnight is roughly 3 and change.

THE CALLER:
Okay. In the general sense, can you talk at all how you guys prepare for whatever the eventuality might be of a Medicare Cliff issue? You must have contingency plans or something that you do and if you could share any of that with us. Also how you factor in that uncertainty when you are looking at making acquisitions and thinking about growing the company.

MR. EDWARD KUNTZ:
Let me address the second part first because it's perhaps easier. You are quite right in a sense that is such an important factor out there that anything you would do on the nursing home side, you clearly have to model it based upon sort of projected rates, what a cut would look like at various percentage levels because it's going to make a difference. It clearly will make a difference in terms of evaluation of any acquisition and just speaking very generally, obviously, I would be reluctant to go forward in any acquisition on the nursing home side without factoring that in. Now that becomes very difficult because we don't know the answer to it at the moment in terms of whether the rates will continue at the present level or what the extent of any cut will be. And, furthermore, not only is there a question of the rates going forward, but it's a question of how Congress fixes it. There is a big difference between as we talked about before, a one year fix and a five−year fix. Again, I remain cautiously optimistic but nevertheless if you're going to look at an acquisition, you've got to factor in something there. It probably would be very reluctant to spend money on an acquisition without at the moment knowing where that stands. It's too unclear right now to put out a lot of money and to not be able to pin that down better. So that sort of answers the specific question on acquisitions there. I forget what the first part of your question was.

THE CALLER:
Just in terms in terms of you guys operationally or whatever to respond is there any way that you can offset cuts, what are you prepared to do if on October 1st nobody does anything other than things expire.

MR. EDWARD KUNTZ:
I would tell you and I will be frank about it. I would tell you in most cases those cuts are not recoverable in a sense that what happened in the nursing homes in '97 and 98 as PPS came along, you saw tremendous cuts in trying to react to that in the therapy area and in the physical therapy and the respiratory therapy area. That sort of has been a washout of the system now and there is not a fast easy solution to this problem. I would tell you that on a very conservative basis the cuts if they were to occur for the most part are not recoverable by changes in the operation. Now, again, over a longer period of time, obviously, operations tighten up and things change a bit, but in terms of the immediate impact, unfortunately, a lot of that drops down.

THE CALLER:
I have seen it published some place people suggesting that you have some ability to offset things and I −−

MR. EDWARD KUNTZ:
If they have a magic bullet, I certainly would like to hear it frankly, but I think our position is similar to what most of the other nursing home providers have talked about on this issue. And there is not an ability to all of the sudden walk into the nursing home and cut. Remember also that the current system in order to justify the reimbursement, the reimbursement system now on the nursing home side is based on the acuity level of the patient on Medicare and you have to provide that service in order to maintain that rate. So on the one hand, you cannot simply say well I'm going to cut this, this and this because what you are going to do is your are going to reduce your reimbursement alone by that factor.

THE CALLER:
If you try to make the case that the cuts −− or the reimbursement needs to be extended so that they give back what they had intended to give back versus some middle ground where they cut some of your rates, how does that argument work? If they are supposed to give the money back do they just feel better taking some cut anyway?

MR. EDWARD KUNTZ:
I think a lot of that −− that's a good question. I think a lot of that depends upon what some people euphemistically call the food fight. And that is when we say that they feel better, some of their policy in Washington is based on sort of equal pay distributed among a lot of health−care providers not just nursing home companies. So although we talk about this in the context of nursing homes, believe me, when a Congressman is voting upon this or analyzing this, they are looking at the entirety of health−care budgets and that includes what happens with respect to doctors, hospitals, HMOs, home health and the like. So it's just not an isolated issue. We can advance our arguments very well and I think we have both as a company and as an industry, but at the end of the day, it also depends upon sort of their overall reflection of health−care policy and the magnitude of the ups and downs with respect to other health−care providers.

THE CALLER:
Thank you.

THE OPERATOR:
We will go next to Ray Garson (phonetic) with UBS Warburg.

THE CALLER:
Just a couple of clarification questions. I think earlier you said your CAPEX guidance for the year was 75 million. Will the balance of that be distributed fairly evenly throughout the quarters? Is there any specific timing issues to be factored in?

MR. RICHARD LECHLEITER:
I don't think there is any particular timing issues with regard to the balance of the year.

THE CALLER:
Just a clarification for my benefit. You gave the breakdown of the 14 million from BBRA that if nothing changes would go away, 4 −− 4 of the 14 million. In the press release, you give 11 million for BIPA, is there any breakdown there? Should we assume it's the 11 million that is in fact at risk?

MR. RICHARD LECHLEITER:
Substantially all the 11 million will be at risk in terms of September 30 Cliff.

THE CALLER:
Thank you.

THE OPERATOR:
Donald Wing (phonetic) with (indiscernible).

THE CALLER:
Can you explain the decline in private pay census at the nursing homes and second, I have a disconnect on the specialty acquisition if the business is sourced to generate overtime EBITDA margins roughly equal to the rest of the hospital business and we paid five times EBITDA for it, it should be a hell of a lot more accretive than a couple of cents, so could you explain that disconnect as well?

MR. RICHARD LECHLEITER:
In terms of −− tell me the first part of the question again.

THE CALLER:
If you look at your private pay census on the nursing home business, it has been running down now for more than a year but still running down mid single digits. What is going on there and how do we change that?

MR. RICHARD LECHLEITER:
Let me try the Specialty part. Again, the acquisition occurred on April 1st and it's going to take −− and any deal particularly a deal of this size with six facilities, it's going to take awhile to transition those facilities and cut the corporate overhead which is really I think what you are trying to get at. In terms of the impact on this year, I don't think it's meaningful. I think the real synergies that we are going to get out of the deal we're going to see next year. I don't think you're going to see much this year.

THE CALLER:
Were a lot of their facilities not certified at LTAC (indiscernible) still in transition period or all of their facilities are certified as LTACs?

MR. EDWARD KUNTZ:
They are all certified as LTACs when we acquired them. There were some transition going on in 2001 as they were building their business. But when acquired them they were all fully certified LTACs. Rich is referring, however, to the integration issues as you bring in a sizable chunk of business, as you develop and put out your systems and as you work on reducing and integrating overhead.

THE CALLER:
Then the first part of the question.

MR. EDWARD KUNTZ:
The first part of the question that you had is the census in the nursing home.

THE CALLER:
Yes, private pay census.

MR. EDWARD KUNTZ:
Sure. Look, at the end of the day what you see is −− and not an uncommon trend. As you continue to see the increase in Medicare census, there is a somewhat corresponding decrease in the private pay census because as you lessen the time in which people are appropriately qualified for Medicare in your nursing homes that means less available days in private pay. They are not independent in that sense but they are dependent. It's basically the same patient

that we're talking about that frequently will come in as a Medicare patient after three prior days of hospital and then become Medicare and then depending upon if they continue to need resources at one of our facilities depending upon their own financial situation, they become private pay or Medicaid. It is not uncommon to see us with Medicare going up and private coming down as people utilize the Medicare program more than the private pay have less available days. I would say to you that our trend on a general directional basis is probably is not any different than what you see from some other companies. I would also say is it something I would like to see improve? You bet it is. Of course it is, but on the other hand, it is kind of unusual to bill Medicare and private coincidentally at the same time.

THE CALLER:
So you would attribute it less if at all to the quality of the facilities or any of the service issues, regulatory issues that may occur at those facilities.

MR. EDWARD KUNTZ:
That is exactly correct.

THE CALLER:
Thank you.

THE OPERATOR:
(CALLER INSTRUCTIONS) Christine Manzone (phonetic) with MSP Investments.

THE CALLER:
This is actually Tom Price (phonetic) speaking. I guess in the first quarter you had a rent expense of about $65 million. And I think that there was escalation built into that annually with about a 3 percent increase. This call has focused a lot about acquisitions and (technical difficulty) but don't you think at this time or at this point in the company's evolution that there should be more focus on internalization and trying to address escalating costs on the rent side and maybe rationalizing your real estate portfolio with Ventas and trying to improve that going forward? Thanks.

MR. RICHARD LECHLEITER:
I'm not sure what you mean. Look, we organized the company in bankruptcy with Ventas. As part of the restructuring and the entire bankruptcy at looking at the company we set in place in effect those rents for the ensuing decade if you will. They are what they are. That was all part of agreeing to a tremendous rent reduction of some $52 million per year, the trade−offs involved an annual rent increase of 3.5 percent and that is baked in. There is nothing that we as a management team can do about that at this point in time. Would I love to? Of course I would love to, but there's nothing that can be done about that at this time. I don't really have an answer to your question other than what I have just said.

THE CALLER:
I guess if I look at accretion dilution analysis in using your capital or your stock in buying BTR, is that a better use of your capital or a worse use of your capital versus buying LTACs or nursing homes?

MR. EDWARD KUNTZ:
I'm not going to comment that's on better or worse at this point in time. I think we're always

going to look at what is best for this company in terms of rationalizing the capital structure as I call it and I agree with you that it will be great to have a different capital structure, but it is what it is at this point in time. And anything done regarding the capital structure obviously requires the cooperation of both parties.

THE CALLER:
Thank you.

THE OPERATOR:
Lee O'Dwyer (phonetic) with Sonz (phonetic) Partners.

THE CALLER:
I had a question, I was wondering if you could talk a little about the situation at the Golden Valley Hospital. Two things really. Have any of the other insurance carriers contacted you regarding the Medicare concerns and then also to the extent that the problems there pertain to staffing issues are they isolated to this facility or is it something you're experiencing pressure in across all your facilities?

MR. EDWARD KUNTZ:
Sorry, I did not catch the last sentence to the extent that they relate to what issues?

THE CALLER:
It seems that the problems relate to staffing issues and I'm wondering if that is in fact the case is it isolated to Golden Valley or are you experiencing problems like pressure across all of your facilities?

MR. EDWARD KUNTZ:
Golden Valley refers to a decertification that we experienced at a Minnesota hospital. I would tell you two things. First of all, in our view and we have looked at this very carefully, it is isolated to the Golden Valley. We simply did not do a good job up there. Most of the breakdowns were local. It is not systemic throughout the company and represented a problem for us. What we will probably do going forward is obviously appeal the decertification and at the same time probably work on somehow transferring that facility to another operator. And I don't think you will see much of an impact on the total overall numbers of the company for the balance of the year. It's not something I am particularly proud of believe me but these things frankly do happen once in a while when you're dealing with 60 hospitals and 300 nursing homes. But it's not systemic and I guess that is the extent of the question.

THE CALLER:
Yes. How big is the facility?

MR. EDWARD KUNTZ:
It is small. It only involves −− I think there was only 30 patients in the building. And also I think you had a question about whether the HMOs are also pulling their patients out or will change the rates. There are very few patients in that whole building that aren't Medicare. I think there are two non−Medicare patients −− there were two non−Medicare patients in the whole building.

THE CALLER:
Thank you very much.

THE OPERATOR:
We will take our next question from Ruth Upton (phonetic) with SG Cowan.

THE CALLER:
I was hoping you can clarify one thing maybe I'm a little bit confused. Your financial guidance for this year is absolutely unchanged on both the revenue and the EBITDAR from when you did your fourth quarter release until now. And I believe the current guidance includes the acquisition of Specialty and the previous guidance did not, is that correct?

MR. EDWARD KUNTZ:
That is correct.

THE CALLER:
So somewhere along the line there is a reduction in revenue?

MR. EDWARD KUNTZ:
No. I would not say that. I would say that the previous guidance was based upon a range, both in terms of the revenues, EBITDAR and the net income. And that is why you give a range and I would say that we are still within that range. So I don't think there's a reduction. I would say that we gave guidance in terms a range not a number and it's a range.

THE CALLER:
On the revenue line it is $3.2 million right. Obviously, you are doing a lot of −−

MR. EDWARD KUNTZ:
Specialty is a rounding number on that. If you want to say it's going to be 3.3 instead of 3.2, I'm not going to quibble with you.

THE CALLER:
Thanks.

THE OPERATOR:
There are no further questions.

MR. EDWARD KUNTZ:
We were just going to stop at that point anyway. Thank you very much for participating in the call. If there are any questions specifically of Rich or myself, we will be glad to speak with you on the phone. Thank you again.

THE OPERATOR:
This concludes today's Kindred Healthcare conference call. We thank you for your participation and you may disconnect at this time. (CONFERENCE CALL CONCLUDED)

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04/17/2002 01:00 pm	**ORG**	**Organogenesis Inc (ORG) − Discusses Auditors' Going Concern Opinion**

THE OPERATOR:
Welcome to the Organogenesis year−end 2001 results conference call. (CALLER INSTRUCTIONS) As a reminder, this conference is being recorded Thursday, April 11th, 2002. I would now like to turn the conference over to Laurie Doyle. Please go ahead, ma'am.

MS. LAURIE DOYLE:
Hello, everyone, and welcome to our conference call. I am Laurie Doyle, Senior Manager of Corporate Communications. with me today are Steven Bernitz, our President and Chief Executive Officer; and John Arcari, our Chief Financial Officer. Steve will discuss key achievements and events since our last conference call. He will then provide an overview of his goals for the company. John will then discuss our recent private placement completed in March and our fourth quarter and year−end 2001 financial results that were summarized in today's press release. We will then open the call for questions. If anyone has not seen the earnings press release, it is available on the company's web site at www.Organogenesis.com. Before starting, I would like to remind everyone that management's remarks, as well as management's responses to questions at the end of this conference call, may contain forward−looking statements that are subject to risks and uncertainties, including statements about recent and expected product launches, sales growth and achievement of financial goals. Actual results may differ materially from those indicated or suggested by these forward−looking statements as a result of various factors, including but not limited to, our expectation that we will incur operating losses in the near future, our reliance on Novartis for marketing of Apligraf and product development funding support, the actions of competitors and the development of competing products, uncertainties related to preclinical and clinical testing and trials, difficulties or delays in obtaining regulatory approvals to market products

resulting from our development efforts, our ability to successfully transition to full−scale production of Apligraf, our ability to protect our patents and proprietary rights, patent infringement actions, our ability to commercialize some of our products without a marketing partner and the requirement for substantial funding to conduct research and development and to expand commercialization activities. For a further list and description of uncertainties we face, please refer to our filings with the Securities and Exchange Commission, including our most recent filings on Forms 10−K and 10−Q. Let me now turn the call over to Steven Bernitz. Steve?

MR. STEVEN BERNITZ:
Thank you, Laurie. I would like to welcome everyone to my first conference call as CEO. As Laurie laid out, I would first like to highlight some of the significant events since our last call in November. Then I will outline our goals for the coming year, and then John Arcari, our CFO, will then review our financial results and recent financing activities. We will then open up the call for questions. First, let me tell you a few words on our current financial status. Last month we raised approximately $16 million in net proceeds through the private placement of preferred and common stock, which brought in a number of new institutional investors. In February of this year, we announced a restrucuring and reduction in force to focus on two core business areas −− living wound healing products and bioengineered surgical products. We expect the restructuring to result in annual cost savings of approximately $5 million. In the last six months, we have received marketing clearance for four new products, which should significantly broaden our revenue base over the coming years. The funds raised from the recent financing, together with anticipated product revenue growth from all of our products and continued cost reductions, should enable us to achieve our previously stated goal of achieving cash flow breakeven by the end of 2002. I would like to touch on Apligraf first. Apligraf revenues for 2001 grew to $8.2 million from 3 million in 2000, the result of significant increases in both units sold and our revenue per unit. Apligraf sales continue to grow, although first−quarter growth was somewhat lower than we had planned. This was a challenging time for us, as we were involved in raising the necessary cash to continue our operations. This put a strain on all aspects of our business including our relationships with partners and vendors. Nonetheless, total unit shipments were up 24 percent over the first quarter of 2001. We have recently completed patient enrollment in a pivotal trial that is assessing the ability of Apligraf to reduce scarring after skin cancer surgery. Each year in the U.S. there are approximately 450,000 skin excision surgeries, including the removal of skin cancers. Importantly, Apligraf is continuing to help to heal patients, many of whom have had limited treatment options for their often debilitating wounds. To date, Apligraf has been used to treat over 40,000 patients and continues to gain acceptance in the medical community. Now I'm going to touch of some of our new products. One new business that I would like to highlight today is our bioengineered surgical product line. Many of you may not be as familiar with these products as you are with Apligraf. There are now three products on the market derived from our FortaFlex technology −− FortaPerm, FortaGen and PuraPly. A fourth product, a rotator cuff repair patch, received FDA marketing clearance in just this March. All of these products are regulated under the FDA's 510(k) rules for medical devices. The 510(k) process tends to be much faster than the PMA (phonetic) process that Apligraf went through, and enable us to get these markets products to market quickly and cost effectively. We believe that our FortaFlex products can offer an effective off−the−shelf alternative to the use of a patient's own tissue or the use of cadaver tissue in a number of surgical procedures. These products are made of a highly purified bioengineered collagen matrix, free of the cellular materials that can cause a strong foreign−body response, as

synthetic products and harvested tissues can. Our FortaPerm tissue support product, launched in October 2001, was designed for use in uro−gynecological procedures, including stress urinary incontinence and vaginal prolapse procedures. Our FortaGen tissue repair product, launched in January of this year, was designed for the repair of soft tissue defects present in various surgical procedures, including complex or recurrent hernias and ostomy reinforcement procedures. Both FortaPerm and FortaGen are being marketed and sold by our newly formed internal sales and marketing team. This group is targeting the major markets and key hospitals and surgeons for the surgical procedures I mentioned. As sales grow, we plan to grow from our small pilot salesforce to a nationwide surgical specialty salesforce of 20 to 30 people. We are planning to conduct several clinical studies with both FortaPerm and FortaGen in 2002 to support the promotion of the two products. We have already begun to enroll patients in a multicenter study to evaluate FortaPerm for use in stress urinary incontinence procedures. Our new rotator cuff repair patch, cleared for marketing last month, is the first product developed under our collaboration with Biomet. As a reminder, in August of 2001 we signed an agreement with Biomet, a leading orthopedic firm, under which both companies will develop and Biomet will commercialize orthopedic and periodontal products which incorporate our FortaFlex technology. We expect Biomet to launch the rotator cuff repair patch in mid−2002. Under the terms of our agreement Organogenesis will receive a transfer price based onApligraf percentage of the product's selling price. We are already developing other products under our arrangement with Biomet, and feel that this will be increasingly important alliance for the company in the future. Other potential product areas include cartilage, ligament and periodontal defect repair. Biomet funds all of the development efforts in these areas. Additionally, Royce Medical Company has begun a pilot launch for PuraPly wound dressings for the nonhospital market. PuraPly has been cleared for the marketing for the management of a broad range of chronic and acute wounds. In looking at our pipeline, we have rebalanced our pipeline in favor of short− to medium−term development projects. These product development efforts will leverage our two core technologies −− mass−produced living human cells and engineered collagen matrix. We're developing FortaFill, a FortaFlex−based product, for use in soft tissue augmentation such as facial augmentation. We expect to submit an application to the FDA for 510(k) marketing clearance of FortaFill sometime this year. Another product we're developing is Revitix regenerative skin complex. We expect Revitix to be launched in mid−2002 by our own sales force for use on skin following laser resurfacing and deep chemical peel procedures. In addition we also expect to develop numerous additional products under our collaboration with Biomet. We expect to complete the Vitrix pilot study in deep diabetic foot ulcers during 2002. We're also developing other living wound healing products which are currently in preclinical development. As part of our restructuring, we decided to seek third−party funding for certain longer−term programs including our coronary vascular graft, liver assist device and pancreatic islet cell transplantation research programs. These programs have reached a stage where they require significant investment to progress into human clinical studies, and are not expected to generate revenue for at least five years. Our expenses in this area are sharply reduced, and are now focused on obtaining outside funding to further development, either through partnerships or venture investment in a new company. On the corporate front, we have recently made several senior management changes. I am excited to have the opportunity to lead the company as President and CEO during this critical time. I am also pleased that Mike Sabolinksi will serve as Executive Vice President, Medical and Regulatory Affairs, as well as Chief Medical and Scientific officer. Mike has incredible expertise in the medical and regulatory areas and in championing Apligraf to the medical community. His new role will enable him to devote his time to these critical areas for the company, both for Apligraf and for our newer products. We have made significant progress in strengthening our senior management team by developing and advancing our own people and by selective additions of new talent from the outside. I am pleased to report that Jeff Dow was appointed Vice President, General Counsel and Secretary. Jeff has been with us since 1999 and has served in both legal and business development roles. He has extensive expertise in legal affairs and business development from his work at InterNeuron (phonetic), the Kendle (phonetic) Company and American Red Cross. We have also made new personnel appointments in several other areas of the company, including product development, commercial operations, sales and manufacturing. Our mission is to be a leader in the emerging field of tissue regeneration, an area we pioneered with the introduction of Apligraf, the first mass−produced living cell product ever approved by the FDA. By leveraging our core strengths in living cells and collagen matrix technology, successfully introducing new products and focusing our efforts on select areas where technology and expertise can offer unique value to patients and their medical providers, we believe we can achieve significant growth quickly and cost−effectively. This is what we believe will build value for shareholders, our employees and our partners. I will now turn the conference ever to John Arcari, our CFO, who will discuss their year−end financial results and our recent financing.

MR. JOHN ARCARI:
Thanks, Steve. For the next few minutes I will highlight for you the comapny's financial results for the fourth quarter and year ended December 31st, 2001, the $16 million financing we completed on March 21st, 2002, and finally our financial expectations for the year 2002. Starting with our results of operations for the fourth quarter and year−end, revenues from product sales grew tremendously during the year. On a fourth−quarter comparison basis, revenues were up 164 percent. And when you compare the year 2001 to 2000, revenues were up 177 percent. This revenue growth reflects the combination of higher unit volumes and a higher unit sales price, resulting from the amended Novartis agreement which we signed in early 2001. On a units−shipped basis, comparing the fourth quarters, units are up 53 percent; and when you compare the years, they were up 73 percent. On a revenue−per−unit basis, comparing the fourth quarters, the unit revenues were up 86 percent; and on a year−over−year basis, up 64 percent. The revenue growth drivers for the year were multiple. They included FDA approval of the diabetic foot ulcer in the second quarter of 2000, which then had a full−year impact in the year 2001. We had expanded Medicare coverage; we are now approved in all 50 states, and that is effective in the third quarter of 2001. We had added Novartis sales resources during the year. And then FortaFlex revenues kicked in in the fourth quarter of 2001. Revenues from research, development and the milestone payments were 264,000 in the fourth quarter of both years, as that represents the straight−line amortization of previously−deferred revenues under the SEC's Staff Accounting Bulletin Number 101. In year 2001 we also had a $5 million milestone payment from Novartis for our achieving FDA approval of the diabetic foot ulcer in the second quarter of that year. There were no such milestone payments in the year 2001. Product costs also improved. Comparing the fourth quarters, costs were up 44 percent on revenue growth of 164 percent; and comparing the years, costs were up 94 percent on revenue growth of 177 percent. On a unit−cost basis, comparing the fourth quarters, unit costs decreased 6 percent; and when you compare the years, they increased 13 percent. The improvements in cost were less than expected, and this was due to the increased investments in capacity we made during the year in anticipation of future increased product demand. Had we not done this, we would have plateaued our capability to deliver in 2002. And so the investment had to be made in that point of time. Our current cost structure supports a 50,000 unit capacity, while we are currently shipping at an

annual rate of 28,000 units. We expect that our unit cost will drop significantly in 2002 as a result of unit volume increases and reductions in cost from cost reduction programs which are being completed at this time. We believe that we can increase capacity at our existing facility from its current 50,000 unit level to a level over 200,000 units with further capital expenditures. So we're not capacity−limited. Research development expenses decreased 11 percent when you compare the fourth quarters, and 6 percent for the full year. This was primarily due to a decrease in clinical trial costs from completing the Apligraf diabetic foot ulcer pivotal trial. We expect that our research development expenses will decrease significantly in 2002, due to the 16 percent reduction in force which we executed on February 25th, 2002. Most of this reduction was in the RDarea, and we expect annual savings of 5 million from this reduction. While we continue to fund our shorter−term RDprograms, we're actively seeking third−party funding for our longer−term RDprograms, which include our coronary vascular graft, liver assist device and pancreatic islet cell programs. Looking at selling, general administrative expenses, they increased 25 percent from the fourth quarter of last year and 14 percent for the full year. Selling, general administrative expenses will increase in 2002 as we expand our internal salesforce and marketing efforts for selling the FortaFlex family of products. So the years won't be so comparative. The net result of it all on a PLbasis −− comparing the fourth quarters, we had a loss per share of 20 cents this year versus 21 cents a year ago; and on a full−year basis, we lost 86 cents a year versus 85 cents in the prior year. Turning to the balance sheet, cash and investments −− cash and equivalents and investments decreased 8.9 million from last year. However, on March 21st, 2002, we received net proceeds of approximately 16 million from the sale of preferred and common stock. Inventory increased by 700,000 from last year from added levels of collagen and other solutions as well as the beginning of an investment in the FortaFlex products inventory family. Receivables from a related party −− that is Novartis −− increased by 1.1 million. However, 800,000 of this increase was collected in the first week of January 2002. Property and equipment increased 6.6 million for the year, reflecting a 3.5 million decrease for depreciation an a 10.2 million increase in newly purchased assets, of which 8.8 million was funded by Novartis for the expansion of manufacturing facilities and process development improvement programs. Accounts payable increased by 2.6 million over last year, due to higher−volume purchase levels and cash constraints. Today, all vendors are being paid on standard payment terms. We repaid a 4.3 million term loan, and we issued a $10 million convertible note to Novartis as a result of exercising the put. The cash burn for the fourth quarter was distorted by two events. It was actually 10.4 million. And the distorting events were, one, 3 million of liabilities which we should have paid in the third quarter were delayed and paid in the fourth quarter, and an $800,000 receivable collection that should have occurred in the fourth quarter was received in the first week of January 2002. So on a normalized basis, our fourth−quarter cash flow would have been 6.6 million if you factor out the two events I talked about. If you looked at our cash burn for the third quarter, it was 4.9 million. So you can see that we did some transferring of how we paid vendors, and then it had an impact. On a full−year basis, our cash burn was 24.8 million. Let me turn to the financing, which we completed on March 21st, 2002. Net proceeds were approximately 16 million. We sold 6.5 million at gross value of convertible preferred stock, which is convertible into common stock at $1.45 per share. We sold a one−year option to purchase an additional 1.3 million of convertible preferred stock, which is also convertible into common stock at $1.45 a share. We sold 10.5 million gross value of common stock at $1.45 per share, and, finally, sold four−year warrants to purchase 3.6 million common shares at $2.25 a share. With this financing we broadened our institutional shareholder base. We expect that the proceeds from this financing and the execution of our 2000 business plan should enable the company to reach cash−flow breakeven by the end of 2002. Looking at the 2002 business plan, just to give you the major assumptions of the plan, in terms of revenues, we are looking for Apligraf to grow at its historical annual growth rate. We're looking to FortaFlex for successful product launch, with significant growth in the second half of 2002. On the expense side, looking at total expenses, with the February reduction in force and other cost reduction programs that have been put in place, we expect that total annual expenses will be reduced by 10 to 15 percent in the year. In terms of breakeven, we look to both cash flow and PLbreakeven by the end of 2002, and a cash burn based on the plan of somewhere between 15 and 16 million for the year. Having now talked about the business plan, I want to remind you of Laurie's earlier comments about forward−looking information. Our plan may not be achieved for a number of reasons. We will now move to the question−and−answer part of this call.

THE OPERATOR:
(CALLER INSTRUCTIONS) Bruce Brewster (phonetic) with Brewster Asset Management.

THE CALLER:
Over the last number of years, it seems to me that you have been very successful from a medical point of view and from the point of view of sales of Apligraf. But I don't think we can say the same thing about the business results. It seems to me that the underlying reason for your lack of success, from a business point of view, is your original deal with Santos (phonetic) or Novartis and the amount of revenue that you get from the sale of Apligraf. You did adjust that recently. You're entering into new transactions with other partners. Are these transactions organized in such a way that you will have more possibility of overall profitability, and therefore business success, for the company?

MR. STEVEN BERNITZ:
This is Steven Bernitz. The transactions we have entered into with Biomet, with Royce, others, are mostly based on the FortaFlex technology. FortaFlex, one, is manufactured outside of the company. And we have no significant scale−up costs. Our gross margins on those products are immediately positive. They're not scale−dependent, as Apligraf has been. Our fixed costs on those products are extremely low. Our share of revenues on those products contributes significantly to our profitability on a gross−margin basis immediately on an operating basis, as the product grows to cover the selling and marketing costs associated with those products for our internal salesforce, which we expect to occur in the second half of this year. And the collaborative part of that technology with Biomet, with Royce −− those contribute positive cash flow as soon as products start to be sold.

THE CALLER:
So you are confident that, if you're successful medically, that it will be profitable for you in the near−term?

MR. STEVEN BERNITZ:
On the collaborative programs there is no way for them not to be profitable, as we have −−

THE CALLER:
Well, you could have other obligations, such as to develop new product −−

MR. STEVEN BERNITZ:
Biomet funds the development in our collaboration with them, and with Royce, which is a

much lower−expense area of products, that has already been virtually completed.

THE CALLER:
And your re−cutting of the deal with Novartis −− is that going to facilitate return to −− not to return, but achievement of profitability on Apligraf?

MR. STEVEN BERNITZ:
We're getting pretty close to the level of volume. And through volume increases and active cost reduction programs, we expect that product to crossover into positive cost contribution, again, in the second half of this year. So there's a confluence of events of the different product lines starting to contribute profits around the same time. And that is how we base our plan to be able to achieve breakeven by the end of the year. And it really takes contributions from a number of different areas to achieve that. But they're all, at this point, on track to do that.

THE CALLER:
Your approval by Medicare in 50 states is very encouraging. What is your current −− do you think is your current penetration of practitioners who could be using Apligraf? I understand that when they do, they do seem to like it −− and therefore, by the end of this year, when you're projecting cash flow positive, what penetration would you have? And therefore what kind of growth can we look for down the road?

MR. STEVEN BERNITZ:
I think we've barely scratched the surface of Apligraf potential at this point. If you look at the two indications for which we are approved, diabetic foot ulcers and venous leg ulcers, there are approximately 1.5 million incidences per year. I believe last year we sold −− well, Novartis sold −− approximately 25,000 units with an average number of units per case between 1 and 1.5. So you can see that we can meet our growth goals for many years before we have any significant penetration of the available patient population. So we feel this is still very young in the growth curve.

THE CALLER:
You have been out educating practitioners on the use of Apligraf. Is this the primary impetus that you're looking for, for acceptance of the product? And if it is, what portion of practitioners have been put through the program?

MR. STEVEN BERNITZ:
I can't answer the second part because, really, Novartis is responsible for that. I would say, in terms of pushing sales, that is a combination of educational programs as well as accumulated experience and word−of−mouth; that, as you mentioned, physicians, once they use the product and start using it, will tend to see the results of the product that the product produces, and be favorably inclined to use it more. Now, it's a relatively small percentage of the physician population that tends to try what are considered very new products and new technology. And as something becomes more accepted by that group and used more routinely, it then starts penetrating into the broader segments of the physician population. I think this is fairly typical if you look at any new fundamental medical technology that has launched in recent years; that there is a somewhat extended initial uptake until opinion leaders get comfortable with the technology and incorporate it into routine use, and until it becomes a reasonably accepted standard of care and is adopted by the rest of the physician population. So I think we're very much still in that early−adopter phase.

THE CALLER:
Thank you.

THE OPERATOR:
Richard Carlow (phonetic) with Oppenheimer.

THE CALLER:
I certainly am pleased to hear of approval by the 50 states and hope that that word gets out to the doctors, many of whom −− at least in our limited experience in Boston −− are not completely aware. But the other part which is a question −− some doctors that I have spoken to are very happy and satisfied with using Apligraf on complex cases. But they complain on less complex cases, Apligraf is a rather expensive procedure to use compared to other procedures. Do we have any way out broadening the market by means of price? Could you comment upon that, please?

COMPANY REPRESENTATIVE:
I think the major impetus in looking at the costs of the product should be in looking at the pharmacoeconomics of the product rather than the price of the product. If you look at the complications associated with diabetic foot ulcers, in terms of bone infections and amputations and actual mortality associated with the complications from these wounds, while I would like to say that we have done rigorous studies and could show that, I think, one, that there's an opportunity to do so −− and I think that is an important area for both companies going forward. There have been some studies with venous leg ulcers that show that Apligraf can be a very cost effective treatment for those, and actually, given that, one would expect the data for diabetic foot ulcers to be more compelling. And I think that you also touched on another important point, which is the knowledge and confidence in the reimbursement process, which is that a doctor may have tried the products a year or so ago, or heard from a doctor that tried the product a year or more ago and had some difficulty or had to go through a rigorous approval process to get the product reimbursed. And it takes some time, I think, for the salesforce to really educate the community that there has been a change. And in some institutions they have to experience the change before they can really accept it.

THE CALLER:
I thank you and I wish you well.

THE OPERATOR:
Larry Solomon (phonetic) with Solomon Capital Management.

THE CALLER:
Just with regard to the growth rate of that Apligraf in the '02 period, you said it was consistent with the past. Can you put that into numbers? So are you talking about the growth rate of last year or the previous year?

COMPANY REPRESENTATIVE:
If you look at the growth rate in any of the prior three years, they're pretty consistently into the 40 to 50 percent range, Larry. Last year we −− well, for 2001 the number was like 25,000. The year before, it was like 14,000. You have all of the data points by year. But if you do the percentages, as I have obviously done, it is like in the 40 to 50 percent increased units each year.

THE CALLER:
It seemed like you are early enough in a product that the growth rate or the ramp should be much steeper than that.

COMPANY REPRESENTATIVE:
As I mentioned a few minutes ago, I think that it is important to −− this is not a next−generation drug, or a second or third or fourth in class drug in which the treatment modality is already well accepted and understood. This is a brand−new medical technology, and I think if you look at other innovative medical technologies, with fundamental technology shifts, the ramp that we are on is very consistent with those technologies, many of which have then gone on to be very large markets. So I think it's really important, and perhaps even the company didn't look at it that way in the past. But I think that if you look at it from that perspective, at least from my analysis, it looks to me to be a product that is growing quite nicely. In the first quarter of this year the sales were a little bit lower than we had hoped, and I think that was largely based on our financial condition, and conservatism on the part of our partner and ourselves in pushing for new orders. And I think that is now behind us. And I would also just caution that this is a very young product in the scheme of things, and it is very easy to overreact to short−term swings and what happens in one quarter versus the previous quarter. I think it's still pretty early to be looking at −− we still don't really understand the full seasonality of the product. And we are still dealing with a relatively small number of customers. And small behavior changes can result in meaningful differences in sales. So I think it is still going to be a little while before, like with a drug, we have very predictable sales growth.

THE CALLER:
Just one follow−up. As far as Europe, when should we be looking for that to start?

MR. STEVEN BERNITZ:
It's a very good question. We are currently reevaluating that along with Novartis; they have significant European regulatory expertise, mostly on the drug side. We're talking with outside experts as well to understand the best path forward there. We felt at the time that some of the questions that we anticipated receiving from European regulatory bodies were not ones that could be sufficiently answered in the time allotted. And we chose to −− Novartis and us chose to −− withdraw that application, and are reevaluating when we should resubmit that. I don't have a firm answer for you on that at this point. None of our projections at this point include European sales.

THE CALLER:
Thank you.

THE OPERATOR:
John Berger (phonetic) with A.G. Edwards.

THE CALLER:
Assuming we have the same type of sales growth that we have had in the past, as you have stated, or slightly worse, and your projections of breakeven don't materialize, what are your thoughts about an additional financing to keep the company solvent beyond the end of the year? And would you comment on what type of contingency plan you would be putting in place for financing, so that we don't fall into the same problems that we have had in the third

and fourth quarter of this year? Thank you.

COMPANY REPRESENTATIVE:
An excellent question, and one we speak about frequently. There are inherent risks in this business, as (indiscernible) pointed out, and as have many of our public filings. We feel that we have given ourselves some cushion with this financing where it was not done on the expectation that everything goes perfectly. On the other hand, I cannot say for certain that we will not have to do any further financings if we encounter obstacles. We, I wouldn't say, have been −− as many companies haven't been in the last year −− very successful at timing the market. The market has been fairly difficult for quite some time now. And I think that we showed in this financing, by doing a rather large financing, that we were prepared to do what it took to put our company on solid footing. That being said, I think as our new products are launched and we diversify our revenue bases, we become a little less risky of an investment; we have become a little less risky for potential short−term debt financing. All of our revenues are not coming from one source or one product. And we hope that will even out our growth as well as reduce the perceived risk by financial sources, should some short−term financing be required to bridge a small gap.

THE CALLER:
Could you also go over, briefly, the encumbrances on the second tranche of capital that's available from Novartis? And when that tranche would be available to be utilized, since this latest financing?

COMPANY REPRESENTATIVE:
The second put is equal in amount to the first; it's 10 million. The time period between exercising a put and receiving money is a minimum of 90 days, but the thing that really distinguishes the second put from the first is the hurdles you have to get through on the second put. And they are inherently more difficult; there are more hoops to jump through. And so it is just much more difficult to access that money than was the first tranche.

MR. STEVEN BERNITZ:
So we look at that as an upside, if it is available. There is nowhere in our plans that we are counting on that money, and we don't anticipate exercising that put.

THE CALLER:
Thank you.

THE OPERATOR:
I'm showing no further questions. I would now like to turn the conference back over to Laurie Doyle.

MS. LAURIE DOYLE:
I would like to thank you all again for your participation. Thank you.

THE OPERATOR:
(CONFERENCE CALL CONCLUDED)

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04/17/2002 04:30 pm **TMWD** **Tumbleweed Communications (TMWD) − TMWD Q1 2002 Earnings Conference Call**

COMPANY REPRESENTATIVE:
Good afternoon everyone. As noted in our press release, for the first quarter ended March 31, revenue was 8.1 million, or a 100 percent improvement of the revenue in the same quarter a year ago and within our guidance range that was provided on our call in January. Like last quarter, new bookings and backlogs both contributed to revenue this quarter. Backlog and new bookings include license fees, transaction fees, maintenance, and consultant fees. Product revenue includes licensing fees from software and intellectual property, as well as transaction fees. Service revenue includes consulting and maintenance fees. Our gross margin continued to improve in the first quarter coming in at 73 percent, which is up from 69 percent gross margin in Q4. This is a metric we continued to focus on and as a result we have seen positive sequential increases each quarter for the last four quarters. Improvement in gross margin has come mainly from our professional services organization. Operating expenses for Q1 were $10.4 million excluding stock compensation expense. Including stock compensation expense, operating expenses were $10.7 million. Operating expenses were below our targeted range in Q1 of $11 to 12 million. This is primarily due to our focus on managing costs aggressively across the company. Pro forma net operating loss for the first quarter was $4.1 million or $0.13 per basic and diluted share ahead of Street consensus estimate of $0.17 per share. This represent an improvement of 29 percent over the fourth quarter pro forma loss of 19 cents. In addition, this represents an improvement of 70 percent over the first quarter of 2001. Including stock compensation, the company reported a net loss for the first quarter ended March 31 of $4.4 million or 14 cents per basic and diluted share, an improvement of 38 percent over the fourth quarter in 2001. Our balance sheet improved again. Our DSO declined 21 percent from last quarter and 65 percent from the first quarter of 2001. Calculating DSO by adding the change in deferred revenue to the top line, we reduced DSOs to 50 days, down

from 63 days in Q4 and 142 days in the first quarter of last year. Deferred revenue grew from $7.9 million in Q4 to $9.7 million in Q1. The majority of the increase was from short term deferred revenue, which grew from $6.3 million in Q4 to $8.1 million in Q1. Tumbleweed's cash balance at March 31, was $40.5 million. In Q1, we paid out $2.3 million in cash to terminate our lease agreement. For the remainder of 2002, you can expect our cash balance to fluctuate throughout the year, based upon the timing of collections and seasonality. We expect our cash balance to exceed $35 million at the end of the year. With respect to revenue targets for the second quarter of 2002, as we mentioned in our press release, we expect recognized revenue to be in the range of $7.5 to $8.5 million and a pro forma net loss per basic and diluted share should be in the range of $0.12 to $0.14. We expect that operating expenses in Q2 to be within the range of $10 to 11 million. We are reiterating our objective for Q4 profitability with the annual revenues for 2002 increasing 20 to 30 percent over 2001. Now I would like to turn the call over to our President and COO, Douglas Sabella.

MR. DOUGLAS SABELLA:
Thanks Betsy. Q1 was a good quarter for Tumbleweed in a challenging environment. This is the fourth quarter of solid sequential improvement across our key financial metrics. Gross margin, operating margin, and our per share performance have all exceeded our targeted goal every quarter for the past four quarters. We have not been untouched by the macro−economic environment and we remain cautious. But our results clearly indicate that we are doing an excellent job of managing our business through these tough times and that we are taking a long view to establish Tumbleweed as a world−class enterprise software company. We entered 2002 with a framework in place for a solid sustainable business model for the company. Clearly, CIOs are still seeking opportunities to cut budgets and they are still making more prudent investing decisions. This quarter Tumbleweed made the cut with a particular success in the government and financial services sectors. We also went through this year with a focus on growing our business. This intent has not changed, we are targeting 20 to 30 percent growth this year in revenue. We intend to achieve this by improving our sales execution, customer development, and bringing in new innovations to the market. On this front, our past quarter, our new head of sales, in North America, William Pollak, has begun to execute on sales objectives. He is focused on upgrading our team with enterprise sales expertise. In addition, he has made changes to enhance our sales coverage model with direct sales focusing mainly on large accounts and positioning our reseller partners to partner with direct sales in penetrating these key accounts. Our goal is to ensure that we are identifying both the tactical and strategic drivers for purchases of our software. This is particularly important as we navigate the company through the current spending climate. As I have discussed before, existing customers represent an enormous opportunity for Tumbleweed. In fact new contracts for their installed base, either in the form of renewals, upgrades, or new product additions have constituted the core of our business in this constrained capital spending environment. We are in the process right now of finalizing a customer satisfaction survey so we can better align our engineering work, our support efforts, and our sales process with the goals and expectations of our customers. With the introduction of Secure Guardian, we now have the opportunity to transition existing tactical deployments within global 2000 accounts into strategic enterprise wide deployments. Understanding customer expectations, in addition to becoming more consultative in our sales process is critical to this transition. Finally, I am proud of the fact that we are targeting our −− we are still targeting our goal of profitability in Q4 2002. This has been a constant for the last five quarters and we continue our steady progress towards that goal. While we are more conservative in our expectations for the remainder of 2002, we feel good about the company's position and future. With that, I

would like to turn the call over to Jeffrey Smith, our CEO.

MR. JEFFREY SMITH:
Thank you Douglas. I will briefly comment on customer developments, some product initiatives in the context of overall market trends, and then offer some perspective on the competitive landscape. Subsequent to these comments, we will open the call to your questions. First on the customer development front. We saw some interesting expansion in our business across a variety of verticals. One noteworthy example was the Federal government sector. The Department Of Energy is the first example of a site wide license of our full Secure Guardian framework. This was an important milestone for our company to achieve and we are thrilled we achieved it in such close proximity to the introduction of that framework. We also saw continued expansion in the financial services sector, with some noteworthy accounts, including folks (indiscernible) like American Sentries Securities, JP Morgan, Capital One, Citigroup Diners, and Wachovia Bank. We are pleased with our expansion in the insurance, in pharmaceutical, and healthcare sectors. Some noteworthy accounts there include Abbott Laboratories, Vision Service Plan, Amgen, Massachusetts Mutual Life, and CNA Life (phonetic). We are thrilled that we saw our expansion across other sectors in the economy including legal and expanded our more general platform in places like Nexen, National Semiconductors, Safeway, Kinder Morgan, and even Peoplesoft.(phonetic) So we are continuing to sign up on new customers and we are continuing to expand our position in some key verticals and we continue to see our business expand with our existing customers as Douglas mentioned. And in reference to our customer cash satisfaction survey, the results exceeded our internal expectations and perhaps what was most interesting was across the board to the extent which our customers value, the solutions they have procured from us. The information from the survey is helping us to better focus and channel our efforts, to provide better service to our customers, as well as focus on the product initiatives and opportunities that are most important to our customers today as opposed to years past. Switching over to those product initiatives, we have a healthy pipeline of solutions coming out of our RDorganization, an RDorganization that has recently been augmented with significant offshore development capabilities providing more cost effective RIn Q1 we saw the introduction of our Secure CRM solution. Importantly, the Secure CRM solution is targeted at today's customers that more often want to enhance the customer service they provide to their customers by moving more voice or paper base process online and seek to ensure customer privacy in the process. Coming out of this we see Tumbleweed really restating its intention of remaining focused on business process automation where security is one of many key requirements and we consider Tumbleweed as an application security company, less so a security infrastructure provider. And perhaps this is one reason why our business is growing right now. In Q2 we will expand our footprint (indiscernible) and capability of our policy engine into new applications involving employee productivity and security for EDI types of applications. Stay tuned for some exciting announcements for pending products coming out in Q3. On the competitive landscape, it appears we are growing our share at the expense of our competitors during this period in time. Our customer satisfaction in a (indiscernible) research survey indicated the bulk of our competitions still comes from a very large list of small, mostly private competitors. Now we perceive that Q2 is an opportunity that if the capital markets continue to mature and we continue to execute and roll out innovative solutions, we would expect to gain ground against these competitors in Q2 and coming quarters. In summary, our customer expansion continues, our market expansion continues, we are seeing validation for initiatives we kicked off on the product front in 2001. We have a healthy pipeline of new and compelling solutions that are timely in their release in

Q2 and Q3 and our competitive position remains strong. With those comments, I would now like to open up the call to your questions.

COMPANY REPRESENTATIVE:
Simon (phonetic)? We are now ready for questions.

THE OPERATOR:
Thank you very much Ms. Reddart (phonetic). (CALLER INSTRUCTIONS) Our first question comes from Mr. Sigmond. Please proceed with your question.

THE CALLER:
Hey guys, I was wondering if you can give out some of the metrics related to customer win activity in the quarter, number of new contracts, average deal size, etc?

MR. JEFFREY SMITH:
Sure Stephen. This is Jeffrey. I will take that question. Average deal size first was flat−to−slightly up and we are seeing the average deal size still come in the low 6 per year area. In terms of number of contracts, north of 30 new customer wins, around 150 contracts with existing customers including upgrades, maintenance, and renewals. And that's about what we expected to come in for the quarter. So, reasonably robust in terms of the number of deals and the customer expansion, certainly a lot of growth of business in the installed base and ASPs appeared to be trending up slightly and they are holding constant.

THE CALLER:
So, Jeffrey, with the continuing large number of follow−on orders, can you walk us through what kind of contracts those look like or those upgrades to Secure Guardian and how do you see the revenue playing out?

MR. JEFFREY SMITH:
So it is all of the above. We see a healthy number of customers that have bought from us in the past they are doing maintenance and up on renewals of support contracts and that has been a pretty nice and growing business for us frankly over the past several quarters. We are seeing an increasing number of our customers that have deployed one solution for example, our secure mail, that are now coming back in an exploring opportunities to use that same policy framework to expand out into other areas, such as our redirect product, which combines our policy gateway with our staging server or our Web Filter product, in which we really had a significant new generation of this product in the second quarter of 5.5 release. And so, yeah we are seeing a healthy uptick in customers coming back in scaling out their implementation on top of our platform, which was partly what we are trying to do with our Secure Guardian framework to allow our customers to really have a single policy framework to address a variety of security or customer privacy issues. And then we are seeing some healthy growth on this customer service side, which was partly, was justified in the introduction of our Secure CRM. We are seeing some of the new wins related to how we are helping customers layer new secured communication channels on top of the existing customer service apps to enhance customer service, either by moving a paper process online or what is becoming increasingly common is moving some of the call centre process online by using messaging as a substitute for voice−based customer support.

THE CALLER:
Okay, thanks and then just a quick follow−up for Betsy. Can you speak to the expense structure heading into the second half of this year? You have reiterated guidance for profitability and I guess, I am trying to figure out how much of that is revenue driven and how much of that is expense reduction driven?

MS. ELIZABETH JORDAN:
Hi, Stephen, it is really both. We are going to continue to drive our operating expenses lower and do anticipate some top line growth.

THE CALLER:
Okay, thanks.

THE OPERATOR:
Thank you Mr, Sigmond. Our next question comes from Mr. Todd Raker. Please proceed with your question.

THE CALLER:
Hey guys, can you hear me? I apologize as I am on a cell.

COMPANY REPRESENTATIVE:
Yeah, (indiscernible) Todd

THE CALLER:
Can you just walk us through metrics for us on head count and the sales force? Any changes since the end of the year?

COMPANY REPRESENTATIVE:
You know, as Betsy indicated we continue to optimize the business for, you know, for the −− for our revenue steam. So we are continuously upgrading and also optimizing the amount −− number of head count we have in the organization. So, right now we have approximately 180 employees and we have 35 or as, you know, approximately 35 quota bearing reps. And one of the key differentiators from Q4 to Q1 on the quota bearing reps is that actually we spent a lot of time since William Pollak has come in as head of sales to upgrade the folks to, you know, to individuals that have enterprise software selling experience.

THE CALLER:
If I look at that 35 quota bearing reps Douglas, if I read the 10−K you said 80 people on the sales organization, I am sure that's, you know also supporting some technical service, so how, you know, what is the number at the end of this quarter versus that 80 people total sales?

COMPANY REPRESENTATIVE:
I would probably say about 65 people.

THE CALLER:
Okay. COMPANY REPRESENTATIVE So it is −− and the part of the benefit we have been getting as we even released new products is, you know, improved installability and improved maintenance etc. So we have actually been able to skinny down our professional services component, which is also obviously led to increased improvements in our margins in the

services sector.

COMPANY REPRESENTATIVE:
Yeah, part of the uptick you saw in gross margin was a ramification of us reducing deployment cycles for our customers and therefore having a larger proportion of the revenue come in the form of licensing versus service.

THE CALLER:
Should we anticipate head count continuing to decline here over Q2, Q3 or you think it is going stay stable on 180?

COMPANY REPRESENTATIVE:
And it will be stable around 180.

THE CALLER:
Okay. Can you talk about the linearity in the quarter nice improvement on DSOs? What do you guys see and what you expect here in the second quarter from, you know, linearity perspective?

COMPANY REPRESENTATIVE:
So, in Q1 actually we had very good linearity and obviously that provides benefits on DSO and everything else. So we were probably at 50 percent bookings done, you know, revenue done by the end of February, which was our goal. So we are feeling good about that and we have got the same objectives for this quarter. And that has been an ongoing objective, which, you know, will bounce anywhere around 35 percent and sometimes will exceed 50 percent. Yeah, visibility is comparable to the last quarter. So we feel good about the guidance we do expect the DSOs to creep up a bit in Q2 based on where we are looking at the timing of deals coming in and cash coming in from those deals?

THE CALLER:
It looks like the deferred revenue was up, you know, nicely sequentially here. I am a little surprised that in guidance for Q2 you are not, you know, forecasting sequential growth, you know, the bottom of the range would imply sequentially down Q2. Can you talk really what you have seen on deferred revenue line and why you think you may go (indiscernible) Q2?

COMPANY REPRESENTATIVE:
Not sure we expect deferred to contract in Q2. We are busy trying to build out long term visibility for the business and as such we think it is healthy to provide conservative guidance.

THE CALLER:
And can you guys also just talk about the ZixIt agreement that was released a week or two ago?

COMPANY REPRESENTATIVE:
Yes, as you know IP licensing is a component of our business and something that has been a component of our business over the past several quarters and will continue to be a component of our business. There are a variety of folks who we perceive need a license to those patents and have come in and licensed those patents. We do not have at this point for example any outstanding litigation for any patent licensing and by and large anyone who has been offered

a patent license has taken one thus far, that would include ZixIt. What was unusual about ZixIt though was the framework put in place for the licensing of future patents to avoid any litigation. And I view that as a positive step for both of the firms. The specific terms however, we have not disclosed.

THE CALLER:
Hey Betsy, could you give us a feel in terms of the product revenue, the $5.5 million? How much is that, you know, actual patent licensing? How much of an impact is that having on gross margins?

MS. ELIZABETH JORDAN:
Well, the amount of product license revenues has been pretty consistent quarter−over−quarter and it is not a number we have really disclosed. But license revenue and licenses of our intellectual properties both have high gross margins, it is very similar.

COMPANY REPRESENTATIVE:
Yeah, on the IP side it is a 100 percent and on the product side it is about 97.5 percent. But we have not broken it out but what we can say it is comparable from the way it has been in the past several quarters and we expect more of the same in coming quarters.

THE CALLER:
Okay, thanks Jeffrey.

COMPANY REPRESENTATIVE:
Okay.

THE OPERATOR:
Thank you Mr. Raker. Our next question comes from Mr. Bob Lamb (phonetic). Please proceed with your question, sir.

THE CALLER:
Thank you guys. Nice job on the expense control and the balance sheet guys. Can you guys talk about are you guys seeing any pricing pressure out there? And also on the macro front, do you see the current environment worse or better than say Q3 of last year? And in terms of government, you had a nice win at the Department Of Energy and how much of the government vertical is the percentage of revenue last quarter? Thanks.

MR. JEFFREY SMITH:
So, Bob, I will take a crack at this and then try to get Douglas to provide some comments on the macro side of it. First on pricing, again ASPs were flat−to−up. That isn't to say there isn't more competitive pressure and there is more scrutiny. There is, but with our Secure Guardian launch and the fact that we are doing more strategic deals that is offsetting some of the pricing pressure that perhaps would adversely affect our average sales price. We are just −− have opportunities to do larger and more strategic deals. Again nothing substantive changing there as it relates to our overall average sales price, however. On the government side, we estimated that for 2001 roughly 5 percent of the business would come from the government. For this year we guessed it would be closer to 10 percent and given Q1 results and our forecast for the remainder of the year that still seems like a pretty good estimate for the entire year. Douglas, any comments on the macro side?

MR. DOUGLAS SABELLA:
Well, on the macro side and it kind of relates back to the pricing pressure although our ASPs were fairly stable. It is, you know, it is a competitive world out there and we continued to have to compete for business and you're competing for business in a number of fronts. First with, third party competition, but also even in generally, as IT departments try to get every nickel out of the current infrastructure and technology that they currently have. So, it's a case of when you are doing deals you are truly selling value propositions, and values of the business, and things like PCOs, cost savings, and customer and revenue enhancement around things like our Secure CRM are critical to us and to our customers.

COMPANY REPRESENTATIVE:
Yeah, so Bob as in the quarter related to say quarters of 2001, I would characterize Q1 as probably a more difficult environment than Q1 of a year ago and so that is one of the reasons why we were pleased that even with a significantly reduced cost structure we saw improvement across deferred and top line and certainly cash flow. So we were happy to see the year−over−year growth as Q1 of this year relates to Q3 and Q4 of last year. Again I would say that it is a little bit rougher. I think part of that is just the seasonality of Q1 coming out of the previous year in resizing priorities and budgets. But I think part of it was a component just by where the capital spending cycle may be right now. We are not forecasting a significant uptick of that spending in future quarters. And we are trying to be reasonably prudent here, but we would hope for better.

THE CALLER:
Do you think your sales force should put more focus on smaller deals, more like upon solutions rather than selling the Guardian platform given the current environment?

COMPANY REPRESENTATIVE:
I think we need to need to do both. I think that in our installed base we want to do more strategic deals and with respect to new customers it is logical for us to have entry points into those customers at lower price points.

THE CALLER:
Okay, thanks.

COMPANY REPRESENTATIVE:
Okay.

THE OPERATOR:
Thank you Mr. Lamb (phonetic). (CALLER INSTRUCTIONS) Ms. (indiscernible) there appears to be no further questions at this time. I would like to turn the call back over to you for the closing statement.

MR. JEFFREY SMITH:
So this is Jeffrey. On behalf of Douglas, Betsy, and Jennifer, thank you all for joining the Tumbleweed conference call. We look forward to following up with you in the future. Have a good day. (CONFERENCE CALL CONCLUDED)

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THE OPERATOR:
Welcome to your conference call today with Patty Dickerson. (CALLER INSTRUCTIONS) At this time, I'll turn the conference call over to Ms. Dickerson. And I would like to remind everyone that this conference is being recorded.

MS. PATTY DICKERSON:
Good morning, everyone. We appreciate your visiting us this morning. We know that your time is valuable. Welcome to our fourth−quarter and year−end 2001 conference call. We have our CEO here today. We have Dr. Helms, who will talk to you about products and customers, and our CFO Rob Capps will bring you up to date on the financial condition of the Company. First we have a little (indiscernible) to get out of the way. Except for the historical information contained herein, the statements in this announcement are forward−looking statements which involve risks and uncertainties that could cause actual results to differ materially from those discussed or implied by the forward−looking statements. Factors that might cause such a difference include, but not limited to, those relating to general economic conditions in the markets in which the Company operates, (indiscernible) development and market acceptance of new and existing products, (indiscernible) from suppliers, third−party manufacturers and channels of distribution, (indiscernible) liability, customer and product concentration, fluctuations in customer demand, maintaining access to external forces of (indiscernible), ability to attract and retain key management and technical personnel, issues regarding intellectual property rights, overall management of the Company's (indiscernible) and other risk factors detailed from time to time in the Company's filings with the Securities and Exchange Commission. The Company does not utilize electronic bulletin boards as a means of disseminating information (indiscernible) forms in regard to the Company. I would

also like to remind you that often we maintain an e−mail and fax list for investors. That means as soon as it is available, if you would like to be on that or your clients would, call me or e−mail me and I'll make sure you are. At this time, here's our Chief Executive Officer Herman Frietsch.

MR. HERMAN FRIETSCH:
Thank you, Patty. Welcome to our meeting. Our commentary will cover results for 2001 and highlight recent developments and factors that we believe support a positive outlook for the Company for 2002. Over the past year, we have almost completely changed the focus of the Company's operations and prospects. Fundamentally, we continue to execute the new corporate strategy we adopted going into 2001, and we also changed the name of the Company to TeraForce Technology Corporation. In practice, this meant concentrating our internal strengths and expertise in order to commercialize technology into products that would be applicable to the new convergence of telecommunications and computing. This has been a challenging and momentous process. I regret that may also have seemed perplexing and uncertain for our shareholders to watch. Looking back, I don't think anyone foresaw the severity and the breadth of the downturn in markets for telecommunications technology (indiscernible). While dealing with these economic realities, we persevered because we believe it was the right course. First, to preserve the Company, and second, to create a new profitability for regaining equity value to benefit our shareholders. Here's a rundown of (indiscernible) actions that were taken. In response to disappearing telecommunications equipment from OpEx (phonetic), we first materially curtailed the operations of Intellect Network Technologies. Then in August, we sold the OmniLynx product line and related assets to a new venture we formed with Singapore Technology Electronics Ltd. This enterprise continues to focus on (indiscernible) network applications such as highway systems (indiscernible) systems, airport communication systems and (indiscernible) networks. We retain a 33−percent minority interest in this business, but no involvement in day−to−day operations or any financial obligations. In a roundabout way, the Enron collapse suddenly turned away our lead prospects for a strategic investment in our Aegean project. (indiscernible) now (indiscernible) attracted new investment opportunities in their own core energy businesses that they were continuing their broadband activities and interests, including the participating in Aegean Networks. Thereafter, as we encountered the broader phenomenon of an overwhelming lack of interest among strategic venture investors for new telecom products, we thought it prudent during the fourth quarter of 2001 to curtail the development effort for Aegean. I an analogous environment, (indiscernible) comes to mind, a combination of the same hesitancy among venture investors and the obvious overcapacity and uncertain recovery prospects for Internet data centers and processing capacity. Seen before close, any near−term outside investment interest in Centauri is a next−generation technology. Accordingly, we suspended this project in March of this year. In both instances, however, I want to be clear and emphatic that we have reserved the intellectual property and patent filings for the possibility of reactivating these projects, as market opportunities may recover and investment interest may return. But we have no active current prospects. During the third and fourth quarters of 2001, the continuing uncertainties and inertia that were affecting both telecommunications markets and new venture activities effectively removed any justification for continuing to sustain our contract design services organization, DNA Enterprises. In January of 2002, we proceeded to sell substantially all the assets related to this business, Flextronics International, Ltd.. Accumulatively, these actions and transactions potentially eliminated our operations directly involved in telecommunications businesses. Despite the difficulties and declines in our telecommunications−related businesses, we have gradually

continued to support and expand our DNA Computing Solutions business. We did encounter a dramatic but apparently temporary slowdown in orders for parts going into telecommunications applications, and we experienced delays in military prospects while the new Bush administration reviewed its defense budget. But overall, we were seeing strong long−term growth factors and increasing interest in our products, especially as the bottom line was enhanced with new versions introduced during the year. We felt these developments and prospects justified continuing investments in hardware and software development, marketing activities and production and testing capabilities. Because of our commitment to this business and the dedication and stamina of its leadership and employees, I feel we are now at the bright end of the tunnel that we've been driving through basically since the closing month of 2000. By necessity and by choice, we have restructured and downsized the Company in order to concentrate on our continuing operations in designing, developing, producing and selling high−density computing platforms and visual signal processing products. (indiscernible) applications currently are in the defense electronics industry. We believe this business is progressing and appears to have attractive growth potential. Dr. Gene Helms is our founding architect of the convenient (phonetic) solutions business model and has both nurtured and directed its formation and implementation. In today's presentation, he will describe current products, applications, customers and coming attractions in these technologies and markets. It may also be useful to note that Dr. Helms was previously successfully engaged in developing (indiscernible) product initiatives before he joined the Company in 1996. And he actually brought his core design team with him to seek (phonetic) out early prospects within DNA Enterprises. From a financing perspective, we require capital for all of these activities and operations to maintain some that are being sold, to progress some while working to attract outside investors, and grow others into self−sustaining and profitable operations. The financings we were able to accomplish under these circumstances had to take the form of debt and were event−oriented and could only be short term in nature. As we now progress beyond past difficulties and uncertainties, it's important that we undertake the restructure of finances to support the growth of our ongoing operations. In this regard, in March of this year we were able to achieve a major benefit by settling our claims against Cadence Design Systems for our net cash recovery. These proceeds provided much−needed funding to begin relieving our debt obligations and to cover our working capital requirements. More recently, we concluded last week arrangements with certain warrant holders to exchange 2 million newly issued shares of common stock for the return to the Company of outstanding warrants to purchase approximately 26 million shares of common stock. And this is my queue for Rob Capps to continue our presentation with his comments about our activities and operations and our intent regarding the undertaking to restructure (indiscernible).

MR. ROBERT CAPPS:
Thanks, Herman. In the (indiscernible) today on (indiscernible), I want to talk about 2001 results briefly and talk about the first−quarter 2002 event which Herman had mentioned and give you some comment about our existing debt position. I also want to address the auditors' opinion that was in the 10−K that we have just filed. Then I'll give you some insight into our first−quarter 2002 expectations and then finally give a few comments about the debt restructuring that Herman mentioned. As far as 2001 is concerned, the results for 2001 have been out for some time now. We issued a press release several weeks ago. So I won't spend much time going over the specific details there. There are a couple of matters that I would like to point in particular to you. The results related to the engineering design services business that we sold in January of 2002 has been treated as discontinued operations in the financial statements. This treatment is required under generally−accepted accounting

principles. Under this treatment, the net operating income from engineering design services is shown as a single line item instead of (indiscernible) operations that is entitled logged discontinued operations. Reported revenues and expenses for 2001 and 1999 in the financial statements do not include any amounts related to the engineering design services business. In addition, as of December 31st, 2001, we recognized a loss that was incurred upon the sale from January of 2002. This was a statement of operations in 2002; it will not reflect any amounts related to the sale. I think another thing to point out to you is that the operating loss from continuing operations in 2001 does include amounts related to the OmniLynx product line, even though these assets were (indiscernible) 2001. Approximately 5.8 (phonetic) million of the operating loss in 2001 is related to the OmniLynx operations. Therefore, this won't be returned. Also included in the 2001 operating loss is approximately 2.1 million in engineering development costs related to the Aegean and Centauri projects. As Herman mentioned to you, in the fourth quarter of last year we significantly curtailed the Aegean project activities. In the first quarter of this year −− in March, actually −− we suspended all activity related to Centauri. So (indiscernible) we saw last year will either not recure or we substantially reduced from the amount we saw last year. I'll briefly note that first−quarter event again that Herman mentioned to you. (indiscernible) in January (indiscernible) January 14th, we completed the sale of our engineering design services business to Flextronics International. Flextronics is one of the largest, if not the largest, EMS provider in the industry. The purchase price of the businesses was $2.8 million. We received 1.66 million in cash at the closing and will receive another $140,000 in July to the extent that this amount is not offset by any indemnity claims which Flextronics has in the agreement. The balance of Flextronics (phonetic) is a $1 million prepayment for services that Flextronics will be providing to us during 2002. As part of the vertical (phonetic) sale agreement, we and Flextronics (indiscernible) as a partner, we entered also an engineering and services agreement whereby Flextronics will provide us with approximately $1 million worth of engineering and design services. And we have had the (indiscernible) to utilize these services, primarily in the defense electronics business. (indiscernible) adding additional staff internally or RDservices from someone else. The other significant amount I want to talk about in the first quarter is one that Herman mentioned in terms of (indiscernible) finances. Again in March, we (technical difficulty) with them under the settlement agreements which totaled $9.4 million. We received 6.3 million in cash net of these (indiscernible). And we have received that cash as of now. Next, let me address our debt position. As of December 31st, we have (indiscernible) borrowings of about $7.5 million. Now in March of 2002, we repaid about 900,000 of that which was due on demand. Therefore, we currently have borrowings of about $6.6 million, of which 6 million is due May 31st of this year and the balance of 600,000 is due during October. (indiscernible) little bit more normal (phonetic). We're working to restructure or otherwise refinance this debt. And again, I will talk more about that in a moment. (indiscernible) target (indiscernible) auditors' opinion (indiscernible) financial statements for 2001. In the opinion, they've included an explanatory four paragraphs regarding the uncertainties. This is (indiscernible) common courtesy (indiscernible) altercation. The uncertain results (indiscernible) refinancing (indiscernible) I just talked about. Now, as a result of the (indiscernible) continued improvement in the defense electronics business, the cost reductions that we've implemented and as well the proceeds from the Flextronics and Cadence transaction, management believes that the Company has adequate working capital to operate the business. However, we have not yet restructured or refinanced the borrowings that are due this year. The auditors had no objective evidence that the auditing (indiscernible) require on which to base the lack of (indiscernible) refinancing or the terms under which it will be accomplished. Therefore, they felt they had no choice but to highlight the uncertainty in their opinion. Next, let me talk a bit about the first quarter of 2002. I don't want to go into too many specifics (indiscernible) premature, but I want to give you an indication of what we expect to see. The (indiscernible) the most significant thing or one of the most significant things was that as a result of the Cadence transaction, we will report a gain of $6.3 million in first quarter. And also, I'll point out that the first quarter will not include any amounts related to the engineering design services business (indiscernible) back to last year. Next, we do expect to report significantly higher revenues from the sale of the defense electronics business in the first quarter of 2002. And the final thing that I'd like to highlight is that because of a reduction in expenditures related to Centauri and Aegean as well as other cost reductions that we've implemented, we do expect expense levels in general to be lower than we've seen in previous periods. And finally, I want to talk to you a bit about our debt restructuring activities. We do expect to accomplish restructuring or refinancing of (indiscernible). But of course, it would be premature at this point for me to comment on cost of structure (phonetic) or terms that we might accomplish. Again, as Herman mentioned earlier, we have made some significant progress (indiscernible) and some matters. Changed the name of Capital Partners to LLC and its affiliate, SJMB (phonetic) LLC, as well as the (indiscernible) Corporation pension trusts have agreed to exchange warrants that they hold for common stock. Under this exchange, they will surrender and we will cancel warrants for the purchase of approximately 26 million shares of our common stock. In return, we will issue them 2 million shares of common stock at volume exchange. And then if the stock we traded (indiscernible) percent (phonetic) for an extended period of time prior to October of this year, then we would issue an additional 3 million shares. We believe this exchange is a very significant development and will facilitate our restructuring and refinancing efforts. Those are all my comments at this point, so I'll turn the call over to Dr. Helms.

DR. EUGENE HELMS:
Thank you, Rob. The focus of my comments today relate to our DNA Computing Solutions business. Anyone who has participated in our conference call over the past two years knows that our board−level business has been a consistent frame of mind at each call. I've long felt that this endeavor, now addressed by DNA Computing Solutions, has the potential to grow to be a significant business component. At this juncture, I am more convinced than ever of the opportunity we have made for ourselves through diligence and developing proprietary core technology, leading products and key customers, core capabilities to provide vital computing solutions to growing markets. Each of our products provides our customers with a degree of embedded computing capability that was determined by what level of product was purchased. I should note that what is meant by embedded computing here is that our products are integrated by our customers along with their application software into a system they felt that performed some specific task. These embedded computing products of ours consist of highly−complex circuit boards that have one, two or four processors on them. We offer our products with several varieties of video signal processors or VSPs from Texas Instruments as well as (indiscernible) varieties of PowerPC RISC processors from Motorola, including the G4. By using one or more of our circuit boards in their system, a customer can deploy a massive amount of parallel computing power in their applications. The applications that demand this kind of computing power define who our customers are and the market that our products address. The broadest need for the level of embedded computing power are all products that provide (indiscernible) the defense sector. Defense electronics represents a market that has long had and should continue to have an insatiable need for massive embedded computing power. No other application areas exist for DNA Computing Solutions' products such as commercial communications and avionics, telecom, seismic processing and

medical imaging. Nothing compares today to the opportunity presented by the spectrum of defense applications. Within the realm of defense applications is the traditional array that consists of things like airborne surveillance, like AWAC (phonetic), ground−based and airborne radar, shipboard navigation, submarine−based sonars, satellite communications, signal intelligence, electronic countermeasures, secure radio communications and target acquisition. In addition to these is emerging a new class of applications made possible by new generations of embedded computing products (indiscernible). These include unmanned aerial vehicles like Global Hawk, high−resolution imaging, pinpoint missile guidance, smart bombs like the J−band(phonetic) joint direct attack munitions used so commonly in Afghanistan, infrared search and tracking, missile interceptions, space station missions and automated fire finders, to name a few. Each application I have mentioned here, both traditional and new ones, are ones that we're addressing in one mannor or another through the various programs (indiscernible) currently underway. The principal part of the DNA Computing Solutions is clearly that of the embedded computing segment of the defense electronics market. This is also referred to at times as defense COTS market, where COTS is an acronym for commercial off−the−shelf. There are several points concerning the state of this market that are important to note. First, not only is defense spending growing rapidly, even more so with recent events, but it is particularly significant that the electronics content in defense−oriented systems is skyrocketing. It's all about putting more intelligence into the defense systems. By doing so, traditional applications like I mentioned earlier are expanding in scope and (indiscernible) new uses are emerging as the move towards electronic warfare further accelerates. What this adds up to is that well over $60 (phonetic) billion of the defense budget is projected to go toward electronics content this year alone. It is my belief that we are just beginning to witness the profound growth this market segment will experience. The DNA Computing Solutions business model is tailored to this new era of defense procurement packages based on COTS. COTS is a global initiative by defense contractors to rely on outsourced components and subsystems to build their systems. This reliance has been driven by defense contractors' customers, namely military and intelligence organizations, to control development costs while having access to leading−edge technologies through off−the−shelf solutions. Additional advantages are derived in reduced time to market and the ability for defense contractors to focus on principal value−added components of their applications. These considerations have become increasingly acute as quicker deployment of new intelligence gathering weapons systems is demanded. This outsourcing practice has grown to account for about 75 percent of defense contractors' budgets today. COTS is a formula for success for companies that can go over new and innovative technologies while working closely with customers to ensure the successful integration of their product into customers' systems. Today's press release is a good example of this model. This business typically centers around highly−technical solution sales, and with that comes the need to solve our customers' problems which often relate both to technological and scheduled issues. Being selected to be a component supplier of customer systems remains the principal objective and usually involves providing significant integration support. This support may take place at our facilities, our customers' facilities, or in some cases at the location of a third party who might also be providing part of the customers' overall solution. Securing these design wins requires that we endure a sometimes arduous and often lengthy assessment, integration and selection process. The sales cycle in the COTS business is (indiscernible) that requires tremendous effort to be expended well ahead of significant revenue being generated. The significance of design wins is more that they lead to significant future revenue streams than that immediate revenue is realized. We have built the DNA Computing Solutions organization to be a leader in the COTS embedded computing industry. The management, sales, support, production and development teams are tuned to the nature of this business and focus on developing and delivering superior products, developing and maintaining close working relationships with key customers, and extending new technologies to the defense−oriented applications of embedded computing that I mentioned earlier. Speaking of new technologies, we have three new products slated for release this year in DNA Computing Solutions. Why we are staying ahead in this business is a dogged determination to keep pushing the performance envelope so we will continue to have compelling products for our customers to adopt for their future applications. Next month, we will announce the availability of our new higher−speed, lower−power version of our (indiscernible) control board. To meet customers needs for lower−power consumption along with the ever−present desire for higher performance, we will announce this new product based on the 7410 version of the G4 at the (indiscernible) tradeshow to be held in Baltimore. We'll also announce then the rugged version of this product scheduled for release later this year. This product is designed to operate across a wide range of harsh environmental conditions, encompassing thermal shock leverage and considerations. This product will open up a significant new layer of opportunities for us where operating conditions are environmentally demanding. The third new product in development is slated for release at the end of the year. This product line will embody a whole new technological approach designed to give our customers a dramatic performance advantage of current products for certain classes of high−volume applications. Under development for over a year, we have recently begun the early−stage marketing of this to select customer (indiscernible) on a restricted basis and have been extremely pleased with the response we have received. I'm particularly excited about this new generation solution and anticipate it will find widespread adoption as it becomes available. Sales in DNA Computing Solutions have reflected a pronounced fall off of orders related to commercial applications, particularly in the telecom arena. Our defense−related businesses is in stark contrast to this and accounts now for the vast majority of our recent product sales. Prospects for future sales are getting brighter every day as we continue to fan out our products for acceptance (phonetic) and integration activities in an ever−broader array of defense programs. Each of these early sales will ultimately lead, if successful, to a design win which in turn will lead to a significant revenue stream when the program goes into full production. Our intense focus on DNA Computing Solutions today affords us some insulation from the forces at work in the commercial sector. As the commercial sector rebounds, we expect there to be opportunities that reemerged for these products in that arena. In the meantime, COTS presents us with an opportunity to be successful in the defense electronic business. Our business model and our products appear to be on target with today's market as well as what we believe will be tomorrow's industry needs. So with that, we'll turn it over for some questions.

THE OPERATOR:
(CALLER INSTRUCTIONS) John Bowers (phonetic).

THE CALLER:
Congratulations on getting things turned around, Rob, Gene and Herman. Gene, could you broadly discuss the capabilities of our firm versus our chief competitor's? Are we significantly advanced over those offered currently? And can you take us through the events from start to finish of things like, how do we first contact the people? Is there a big sales effort? And can you give a generalized timeline of when we actually will have revenues coming in the door?

MR. EUGENE HELMS:
Let me address the sales cycle question; I guess that was your second one. As I mentioned in my comments, the sales process in this business is a typically elongated one. Oftentimes, it follows a pattern of a program having a particular computing need, then looking for what kind of solutions exist out there in an off−the−shelf manner. And then talking to the various suppliers that have products that appear to fit the bill. Deciding which one or ones they want to acquire a sample of to test, and do their own assessment. (indiscernible) decide which one appears to be the frontrunner from a performance standpoint, they usually begin to do some prototyping of their system with that product working in some capacity with that system. And that integration effort can be relatively short on the order of a week or a couple of months, and in some cases it can be on the order of a year or more. After they've done their integration effort and in some cases done field trials and flight testing, with their system, and have sold their customer on their system, then they will make a decision to go ahead with procurement of further (indiscernible) further testing or to begin to move into a production phase. The length of time that exists from start to finish on these things can vary. But generally it is not on the short end of the scale. But a point to be made here is that on the Global Hawk program, for instance, we first (indiscernible) technology in that program in 1998. This is not −− has not been a consistent activity over that period of time, but that gives you a sense of how long we've been working that program. With regard to competitors, we feel like we are becoming more and more (indiscernible) people for the class of products that we currently offer.ors out there (indiscernible). But I would say more times than not, we end up emerging in the pole position of who our customers really want to go with. And once they have decided which one they would like to go with, the front runner, one last step in that process that I failed to mention is the business negotiations where the pricing and availability and schedule and all that stuff enters the picture. But from a competitive landscape standpoint, I feel very good about the products that we have right now. And the products that are coming down the road I think will accelerate our relative position to others, particularly our new−generation products slated for end−year release. THE OPERATOR:Rob, when can we get some guidance on revenues? We're all very happy about the lower expenses we have and the margins that we enjoy on a gross basis, but when might we expect some kind of report in the future so that we can keep track of revenue progress for the Company?

APPS:
We'll report the first quarter in the next three weeks or four weeks or so. (indiscernible) the auditors (indiscernible) things. Again, we do expect that the first quarter will see significantly higher revenues than we have seen in the last few quarters. I realize we're not gettting real specific at this point other than to say that it's materially higher.

THE OPERATOR:
Anthony Spedham (phonetic).

THE CALLER:
Congratulations, guys. Can you give us any better timeframe as to when you think you might restructure the debt?

COMPANY REPRESENTATIVE:
(indiscernible) we're working on actively. Certainly, I'd love to (indiscernible) done tomorrow. But we want to make sure we (indiscernible) the right done and structure (indiscernible) through the long−term. So we don't have any firm deadline that we feel like

we have to meet, necessarily. (indiscernible) talk about now, but we'll take care of that.

THE CALLER:
And is there a quarter in which you expect to return to profitability?

COMPANY REPRESENTATIVE:
As we said in the K, we think by the time we get into the third quarter, we'll start to be cash flow positive, which implies net income profitability shortly after that, in the next quarter or so. Now, I want to point out that we are still relatively small, obviously. And therefore, minor delays and minor shifts from month to month and quarter to quarter can have a big impact on that. So there is some sensitivity just based on your one or two projects; it can have a big impact just because (indiscernible) numbers right now. But we do have increasing and better visibility as to the projects we're involved in and the (indiscernible) shipment timing and things of that nature. So we're having more confidence. As of right now, we're looking at third or fourth quarter.

THE CALLER:
Do you have tax loss carry forward to offset the gain that you've got coming in the first quarter?

COMPANY REPRESENTATIVE:
No (phonetic) sir, we don't (phonetic). (indiscernible)

THE CALLER:
−− a taxable event?

COMPANY REPRESENTATIVE:
No, a nontaxable event. Yes. (indiscernible) general (phonetic) income taxes are not (indiscernible).

THE CALLER:
In this current environment with defense being as important as it is, have you had any overtures from any larger corporations looking at you to bring it (phonetic) out? To bring you all as in buyout?

COMPANY REPRESENTATIVE:
(indiscernible) is just our policy; we don't really comment one way or the other on that. Certainly, if something like that every happened, (indiscernible) we'd make that public. But we just can't comment on anything like that. Nobody (indiscernible) either.

THE OPERATOR:
(CALLER INSTRUCTIONS) Mike Sternback (phonetic).

THE CALLER:
Would you restate the exchange of warrants? I heard the first part where you exchanged the warrant for 2 million shares. I missed the second part related to the 75 cents.

COMPANY REPRESENTATIVE:
Again, we will be getting back warrants for 26 million shares. We will issue on the exchange

2 million shares. Then there is a contingent consideration in that if the stock trades at 75 cents (phonetic) for an extended period before or by October of this year, then we would issue an additional 3 million shares.

THE OPERATOR:
John Bowers (phonetic).

THE CALLER:
Rob, when you were talking about the positive cash flow, you were talking on an operating basis when you said third or fourth quarter, right?

MR. ROBERT CAPPS:
That's correct.

THE CALLER:
So we'll be profitable prior to then probably, but on an operating basis then?

MR. ROBERT CAPPS:
We will be profitable in the first quarter (indiscernible). But from an operating income standpoint, we expect operating cash flow in the near−term to exceed net income or operating income. So we will be cash flow positive, we believe, before we are net income (indiscernible).

THE CALLER:
But you were speaking of net income earlier when you talked?

MR. ROBERT CAPPS:
Yes, that's right.

THE OPERATOR:
John Corb (phonetic).

THE CALLER:
Rob, we've talked about balance sheet issues. How else can we strengthen the balance sheet?

MR. ROBERT CAPPS:
I think the key thing here is debt restructuring and making sure we have that for working capital (indiscernible) either our (indiscernible) business or (indiscernible) business and either eliminate or push out any debt obligations that might remain. So I think that is the way to do it.

THE CALLER:
We've also talked about strategic partners versus financial partners. Has any of that come to light?

COMPANY REPRESENTATIVE:
I think those discussions were most likely in the process of the Aegean and Centauri projects. And we were opened (phonetic) up for strategic as well as financial partners and determine (indiscernible). (indiscernible) just is not very promising right now (indiscernible). So we

think it is very unlikely that any more will come to light in the near term.

THE CALLER:
You said something about post July. I haven't seen that.een that.

COMPANY REPRESENTATIVE:
This Cope (phonetic) Corporation pension trust is a holder of (indiscernible) the largest stockholders (indiscernible) warrants to purchase common stock. And so they were part of the exchange with (indiscernible) group.

THE OPERATOR:
(CALLER INSTRUCTIONS) We have no further questions.

COMPANY REPRESENTATIVE:
Before we finish, I would like to make a few comments in closing. First, I would like to acknowledge again our empathy for the concerns and questions expressed by our shareholders as we transition the Company through the quite period of uncertainty and change. And then I would like to add from a second point of view that I hope that today's session bolstered really by the greater scope and detail that is provided in our 10−K now on file with the SEC, that our shareholders as well as possible new investors might begin to see TeraForce actually emerging with proven products and important customers and advancing technology as a particularly strong value participant in a leading segment of a long−term growth industry. That is the view we take of the business currently, and that is how we are applying our energies to move forward. Thank you again for your interest and for your attendance on the call. (CONFERENCE CALL CONCLUDED)

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04/17/2002 07:00 pm	SPNC	Spectranetics Inc (SPNC) − Q1 2001

THE OPERATOR:
Ladies and gentlemen, thank you for standing by. Welcome to the Spectranetics First Quarter Results Conference Call. (CALLER INSTRUCTIONS). I would now like to turn the conference over to your host, Ms. Sharon Sweet (phonetic). Please go ahead.

MS. SHARON SWEET:
Hello. I am Sharon Sweet, Vice President of Corporate Relations, with Spectranetics. With me on this call are Mr. Joseph Largey, our CEO, and Mr. Paul Samek, our CFO. First of all I want to welcome all of you that are listening to our first quarter 2002 earnings release conference call via the phone lines and over the Internet. The purpose of the call is to review our financial results for this quarter in more detail, to update outlook information for 2002, and to provide an update on our clinical trials. Hopefully, you have received a copy of today's press release. If you did not, it is available on our web site or you may call my office after the conference and we will be glad to fax it to you. After my short health−keeping announcement, Joseph Largey, our CEO and Paul Samek, our CFO will provide comments on our first quarter performance and full year outlook. We will then open up the call for questions and answers. The conference administrator will tell you how to enter the queue for questions, at that time. Before proceeding with today's call, I need to get some legal requirements out of the way. During the course of this conference call we may make projections or other forward−looking statements regarding future events or the expected future financial performance of the company. We wish to caution you that such statements are just predictions, and that actual results or events may differ materially. We refer you to the document of Spectranetics files from time to time with the SEC specifically our most recent Form 10−K for the year ended December 31, 2001, and Form 10−Q for the quarter ended

September 30, 2001. These documents identify important risk factors that could our actual results to differ materially from those contained in our projections or forward−looking statements. Actual results may be affected by, among other things, risks and uncertainties related to new product development cycles, research and development activities, regulatory approvals of new products, introduction of competitive products by others, third−party reimbursement programs, and success of our strategic effort, physician training and other factors. The forward−looking statements made during this conference call reflect the opinion of management as of the date of this call, which is April 17, 2002. Please be advised that developments subsequent to this call are likely to cause these statements to become outdated with the passage of time. We do not intend however, to update the guidance provided today prior to our next quarterly conference call in July. I will now turn the call over to Joseph Largey, our CEO. Joseph?

MR. JOSEPH LARGEY:
Thank you Sharon. I'm going to save the bulk of my comments until after Paul has run through with the financial results, but do want to start with a few overview comments. From my perspective, there were two solid accomplishments in the quarter: 1) Strong financial results driven by Laser placement and the early success of our $90,000 Laser promotion; 2) Momentum in our LACI trial. I will discuss each briefly. Our 20 percent revenue growth, well managed operating expenses, maintenance of cash levels, and fourth quarter in the black (phonetic) were gratified. But more important is the double−digit growth in net new Laser placements at 11. These Laser placements provide an annuity to the company with annualized recurrent revenue per Laser in the United States at about $91,000 currently, and with $100,000 level readily obtainable. Furthermore, a large base of installed Lasers in the field will allow us to capitalize more quickly once we receive approval from the FDA for peripheral atherectomy. These were the underlying reasons behind our decision to offer the $90,000 Laser program and so far it is working well. Equally important, momentum is growing within LACI, our clinical trial that utilizes Excimer Laser atherectomy to improve circulation to the lower leg. We reached the enrollment target of 137 patients in LACI Phase II in less than a year. Over the last few months, we have averaged nearly one LACI case per day. That run rate led to our decision to ask for authority to treat 300 patients at 20 sites forward LACI Phase III. Since the number of patients requested is typically a year's work at the current run rate, LACI Phase III is a continuation registry. The FDA typically allows such trials to be continued in order for potential new products to maintain momentum during the period of time between conclusion of enrollment in the trial and receive the FDA approval. We are also delighted to have received FDA approval to include our new and improved Extreme II Peripheral Excimer Laser catheters in the LACI trial. That approval led us to extend LACI Phase II by a few weeks in order to include some of the new products in LACI Phase II. We will conclude its enrollment no later than April 30. After the 6−month follow−up period, we then prepare the FDA submission, which can take a few months. So, we expect to submit the LACI indication to the FDA in early 2003 and that leaves us on track to receive FDA approval in the second half of the year. The Extreme II's were specifically developed to facilitate the maneuvers necessary in peripheral atherectomy based on comments from doctors practicing in Germany, who have performed thousands of Laser leg atherectomy procedures. The outer tubing of the Extreme II's are stiffer and thicker than our current coronary catheters and the fibre optic glass strands within them are wound into a spiral making the catheter tip more flexible. As a result, these catheters are more pushable and maneuverable around curves, which is necessary in the typical leg procedure. I'll save the rest of my comments until later. Paul?

MR. PAUL SAMEK:
Thanks Joseph. Those of you who follow us closely know that Spectranetics has made tremendous strides financially over the last couple of years. Our success is evidenced by our fourth consecutive quarter of profitability and our expectation that we will be profitability for the year ending December 2002, adequate cash reserves to enable Spectranetics to implement our current strategy and operating plans, steady increases in productivity, a stable productive and profitable European operation, and continued development and validation of our current business model which is designed to drive shareholder value to both profitability and growth. But, we certainly have challenges ahead of us. The key ones are expanding our market penetration, increasing net new Laser placements consistently at a double−digit pace recorder, continuing to build a stable and experienced employee base, building our clinical expertise in continuing to make progress in clinical trials and timely regulatory approvals, maintaining our expense model in light of expanding opportunities, and always continuing to improve our productivity. We think we are up to the task. Our first quarter results were on track. Sales in the quarter were $7.2 million, up 20 percent from the first quarter 2001. The increase was across the board with higher Laser equipment, disposable products, and service revenue. As shown on the supplemental chart in the earnings release, we placed 11 net new Lasers during the quarter compared with three in the first quarter of 2001. For those of you keeping the tally, we ended the quarter with 338 Lasers worldwide and 239 in the United States. We added several significant new customers in the first quarter. Among them the Strong Memorial of the University of Rochester, New York, one of the nations top teaching and research hospitals. Spectranetics trained 24 physicians in the first quarters of both 2002 and 2001. We expect our trainee numbers to increase throughout the year on the strength of new Laser placements. Laser revenue of $1.5 million was up 110 percent compared with the first quarter a year ago reflecting success of our Laser promotion program. Disposable products revenue was up 8 percent to $4.7 million from $4.3 million in the first quarter last year, and a 16 percent increase in atherectomy products offset by flat revenue in lead removal products. Recurring revenue for Laser in the quarter was $72,000 on a consolidated basis, consistent with $71,000 last year. In the United States recurring revenue for Laser in the quarter was $91,000 down slightly from $93,000 last year. We expect recurring revenues for Laser to start heading higher due to the seasoning and recent expansion of our sales force, expanded marketing programs for 2002, and our targeting of high potential accounts. Spectranetics gross margin in the first quarter of 2002 was 67 percent of sales, down from 71 percent in the first quarter a year ago. Decline was due to our $90,000 Laser price promotion and a higher proportion of equipment revenue in our sales mix. Operating expenses during the quarter were $4.9 million in both 2002 and 2001. However, operating expenses as a percent of sales demonstrated improved operating efficiency at 68 percent of revenue in the first quarter of 2002 compared with 81 percent in year ago quarter. Net income in the quarter was $58,000 or 0 cents per diluted share, compared with a loss of $556,000 or 2 cents per share in the year ago quarter. Our European business was profitable for the fifth consecutive quarter. Our outlook has not changed except for more confidence on the part of the management team that we will achieve our goal. We continue to expect revenue to increase 10 to 15 percent this year on the strength of placing 30 to 50 new Lasers and supporting catheter sales associated with those placements. We expect our gross margins to be in the high 60s, we expect to be profitable in each of the ensuing quarters of 2002, and to be cash flow neutral for the year. Now, Joseph will provide further insights on the quarter just completed and the year ahead. Joseph?

MR. JOSEPH LARGEY:
Thank you Paul. Regarding revenue for the quarter, we are not only pleased with the number but, actually, quite pleased with the make up. As some of you may know, for the last two years, we have had strong regions in the Southeast and Southwest and significantly less strength elsewhere. In the first quarter of 2002, we started to show signs of improvement in the Northeast, Mid−Atlantic State, and in California. We believe this improvement is due to a number of factors, but certainly the seasoning of our district sales managers and clinical advisors in their territories is a major contributor. As you may recall, clinical advisors provide onsite presence at hospitals and perform an important training role by standing in on cases and helping to advise the physicians about techniques in catheter selection. We are increasingly confident that we have made the right field sales model in the United States, with seven district sales managers and a target of 1 clinical advisor per 10 active accounts. At the end of the quarter we have 22 clinical advisors with an average tenure of 13 months on the job. We have also added two equipment sales specialists halfway through the quarter, who contributed to our double−digit Laser placements in the first quarter, and should have even more impact throughout the remainder of the year. Regarding marketing, we have a more aggressive medical convention schedule this year and are getting more podium exposure and better booth traffic than in 2001. We can't completely control the amount of attention our technology will receive at medical conferences; a higher profile reflects momentum in the marketplace as well as the efforts of our marketing team. I went to most of the big conferences for the last few years, and I can tell you that I believe the winter and spring of 2001 were turning points for us with extensive exposure and excitement at Dr. Dietrich's Conference, in Scottsdale, Arizona in February 2001, followed by a strong showing at the prestigious Paris Course (phonetic) in May 2001. This year, our momentum has continued to build. The highlights in 2002 so far include the ISET conference in Miami in January, Dr. Dietrich's ISET conference in Scottsdale, Arizona in February, and the American College of Cardiology in Atlanta in March. At each of these conferences, we had live Laser cases and many instances where the Laser was featured positively in a presentation or panel discussion. It is noteworthy that this was the −− this year marked the first live Laser case at the American College of Cardiology. It was a difficult leg atherectomy procedure with a good outcome. We also attended the SDIVR (indiscernible) Interventional Radiology Conference in Baltimore, a few weeks ago for the first time in several years and had wonderful booth traffic. Looking forward, we have reason to believe that the Paris Course in May will be a great show for us with several live cases and presentations by doctors, Bemeno (phonetic), Laird (phonetic), Frankenberg (phonetic) and Diethrich (phonetic). In addition, Dr. Wilkoff at the Cleveland Clinic is scheduled to give two presentations at the NASB (phonetic) conference in May, which is the biggest conference of the year for a lead removal product line. We have plans to introduce our next generation laser sheath at NASB this year. Some of you have asked about the new Medicare reimbursement guidelines. Application of these guidelines can vary widely and predicting their impact on our business is difficult. Nevertheless, we are pleased to see that the Medicare reimbursement guidelines for outpatient procedures went into effect on April 1st, as anticipated. As discussed on last quarter's call, this year's course for outpatient procedures, which involve a hospital stay of less than 24 hours, favored coronary laser atherectomy over plain balloon or cutting balloon angioplasty. Last year, the opposite was the case. Payment factors vary by hospitals and part of the country, but the national average payment for a laser atherectomy procedure is $1655 more than the payment for an ordinary balloon or cutting balloon. The difference is even more dramatic when radiation therapy or brachytherapy is involved. The national average reimbursement for atherectomy prior to radiation therapy is $3000 more than the payment for cutting balloon prior to radiation

therapy. This reimbursement preference augments the fact that we are the only radiation pretreatment with a specific PMAAS (phonetic) approval from the FDA. So, to sum up, we had a good first quarter and are optimistic about the remainder of the year. Our strategy for the rest of the year remains intact. In addition to striving to achieve our financial targets, we are doing everything we can to expedite and prepare for peripheral atherectomy approval from the FDA. We are confident in our strategy, our tactics, our technology And we have the human and financial resources in place. In short, we anticipate good things for Spectranetics and our stockholders. Now on to questions.

COMPANY REPRESENTATIVE:
Stacy, will you give the instructions to how to enter the queue for questions?

THE OPERATOR:
Sure. (CALLER INSTRUCTIONS). And the first question will come from the line of George Boyer, H.G. Wellington (phonetic). Please go ahead.

THE CALLER:
Hi Joseph, Paul. Great quarter. Could you address the size of the market in the lower leg procedures and how that could translate for us?

COMPANY REPRESENTATIVE:
Sure. Thanks for coming George. This one is incredibly interesting to us, lower leg. For background, we have two leg FDA trials underway as everyone knows: PELA above the knee and LACI below the knee. Critical limb ischemia, which is part of what we are attacking with the LACI program below the knee, is a very specific (indiscernible) for class for patients. We have built our market potential for LACI around the most difficult cases. Specifically, we are looking at patients that undergo amputations below the knee. The number in the United States that we have been utilizing to build that market potential is approximately 80,000 patients on an annual basis. We believe from our research overseas, in Europe specifically, that that number is somewhere around 70, 000, so giving us a grand total of about 150,000 people who have the terrible situation of having part of their lower anatomy amputated. Interestingly enough, yesterday, if any of you happened to read the newspaper USA Today, in their Life Section on Page 1 and 2, they actually targeted in on a patient population that many times are part of this particular program. The article was about diabetes and there was a rather global article in the sense that it covered many aspects of diabetes. Unfortunately, many of the patients that we deal with, in not only LACI but many of our other procedures are also diabetic. On Page 2 of that article, I found a fascinating graph that they utilized to show the different elements of diabetes and where it affects the anatomy, that they actually focused in on lower limb amputations, which is the same item that we are talking about here. And they actually gave an annualized number, which pretty well correlates to the number that we have. They show on that graph, from 1997 through 1999 on an annualized basis, 82,000 amputations in the United States. And so, as such, we saw that as an interesting confirmation of our number. Now, that 80,000 that we use, plus the 70, the way we are building our market potential is to simply look at one catheter per use per patient. And our average selling price of this catheter, which is about $1500, so we just simply multiply it out. And what you see is in the United States alone, that market potential comes out too, when you do that multiplication, somewhere between $200 to $300 million. And of course, with Europe also thrown in there. So, that is kind of how we build it. We have taken a look at US and European market potential based upon lower limb amputations, and we assume one catheter per use. We will

tell you that is probably a conservative estimate because in our initial LACI Phase I trial, somewhere between 20 to 30 percent of the patients actually had to have 2 catheters used because of the different size vessel that the physician had to go through −− he had to choose different sizes to help him attain the −−or her, attain the goal that they wanted. So, George, a rather lengthy answer, but probably one of the most important aspects of our business right now, what the opportunity might be for critical limb ischemia and lower limb. Are there any other questions?

THE OPERATOR:
Thank you. Our next question will come from the line of William Graf, RBC (indiscernible). Please go ahead.

THE CALLER:
Yes, sir, I was just curious as to the receptivity on the change in price on your Laser. Is there a more −− trying to come with the terminology here −− but is it easier to get approval at a hospital at $95,000 than it is at $200,000 as an example. I was just curious as to that pricing strategy is really starting to spawn here a little bit?

COMPANY REPRESENTATIVE:
Interesting question, and easier to get approval. Let me, if I can, I have to kind of bifurcate the answer. If you talk to our sales force, it is never easy to get an approval for a product. Right? Whether it is $90,000 or $200,000 and that is because they really are two different processes that we have to go through. 1) The first thing that we have to do is we have to convince the technical people, the physicians, and the cardiology staff that the technology merit their consideration and that is one sale process, that generally has to happen first. Once that happens and then the professional team is willing to endorse bringing in our technology into the hospital, we then have to go through a financial sale, which is a totally different conduit and process in the hospital. Just because the professionals want it, it doesn't necessarily mean that the hospital is going to buy it. Now, once we get to that one, it goes without saying that to some degree it is easier to sell an item for $90,000 to $200,000. And I think what we have seen −− and we only introduced this to our sales force on January 30th of this year. So we have only had two months worth of actual selling time on this process and we have seen our net placements go from last year in the entire first quarter from a total of 3 net to this year to a total of 11. So I have to answer your question by saying, yes, price makes a difference, and when you make a decision to lower price on something, is it somewhat easier to get the placement to occur, the answer is yes, but it's actually never a cakewalk here. You really have to go through it and you have to touch all the bases anyway.

THE OPERATOR:
Thank you. Our next question will come from the line of Tom Monson, US bancorp Piper Jaffray. Please go ahead.

THE CALLER:
Good morning. A couple of questions, number one on lead removal. Can you comment about the flat revenues and what you anticipate that going forward? And then secondly, could you go over the recurring revenues? It seems to me that the number is down and can you discuss that again?

MR. JOSEPH LARGEY:
Sure, this is Joseph, Tom, and I am going to have Paul answer your second question first and then I will come back and talk about the lead removal. Paul?

MR. PAUL SAMEK:
The recurring revenue question? Our recurring revenue is, you know, slightly down to flat. There are a lot of factors that we (indiscernible) on this. From our view most importantly is how we are going to get that to continue to grow. I think we have to bear in mind in the first quarter that we are coming off of a 3 percent growth last year. As most people know that we didn't have a particularly high expectation for the year 2001, relative to growth. So, there is several things that we are working on right now relative to getting recurring revenue re−established, the marketing programs that we have going on, targeting of accounts, and the further placements of new laser in those new accounts.

MR. JOSEPH LARGEY:
On the other part of it, Tom, thinking about lead removals in the first quarter. I think we said in our report that lead removal quarter to quarter was flat and that basically is correct. There is a couple of things that, I think, we are going to have to get used to as we go through these quarter−by−quarter reports. As we are starting to talk about three different businesses; the heart business, the leg business, and lead removal business, what I have been finding is that we have different things to report on a different quarterly basis. Sometimes we are high in one and low in another and in this particular case, this particular quarter, we are flat in the lead removal. Now, there is a couple of things that we are doing that candidly are impacting that and let me describe to you what that is. I mentioned in my call that we have an important conference coming up which is NASB and that one deals mostly with electrophysiologists and we have a brand new generation of our lead removal Laser sheaths being introduced at that particular time. As a matter of fact, just in checking with our logistics team and our marketing team, our actual schedule date for beginning to sell the new 16−French Laser sheath is May 1st. So, it is just around the corner. And I must tell you that when we do something like this, we do not like to introduce a new product and have old inventory out in the field because, people being what they normally are, they normally do not want to use the old stuff any longer because the new stuff is better. So our sales force and our marketing team have been consciously working with our larger lead removal customers and minimizing their inventory trying to keep it as low as possible without risking any, you know, run outs there. But keep it as low as possible because we are really quite excited about the performance of this new Laser sheath. We have tested it very extensively in Europe and we have received great input on its performance from one of the leading lead removal physicians in Europe. And we have actually had to hand samples in front of some of the top sellers here in the United States. And the anticipation level is quite high on it, a pretty unique design it has, a bevel (phonetic) front, allows to get across some torturous anatomy very nicely, and also has some −− the ability to be just a little bit easier to push around the corner. So, we are expecting to have a great response for that and candidly, we just did not want to be in a position where hospitals are asking us to take back the older product in favor of them keeping the newer product.

THE OPERATOR:
(CALLER INSTRUCTIONS). And Ms. Sweet, there are no questions in the queue. Please continue.

MS. SHARON SWEET:
(indiscernible) and thank you so much for your participation in this call. If you have any follow−up questions Paul and Joseph and I will all be in our −−in the office at least for today, and I will be there for the next several days. So thank you and here is to a good second quarter.

THE OPERATOR:
Thank you. Ladies and gentlemen, this conference will be available for replay after 2.30 p.m. today through Sunday, April 28th, midnight. You may access the ATTTeleconference replay at any time by dialing 320−365−3844 and entering the access code of 634311. Again, that number is 320−365−3844 and the access code 634311. That does conclude our conference for today. Thank you for your participation and for using ATTExecutive Teleconference. You may now disconnect. (CONFERENCE CALL CONCLUDED).

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04/17/2002 06:30 pm	**TMBS**	**Timberline Software Inc (TMBS) − Q1 2002**

THE OPERATOR:
Ladies and gentlemen, I would like to welcome you to the Timberline Software Corporation Conference Call to review the operating results for the quarter ended March 31, 2002. Your hosts today will be Mr. Curtis Peltz and Mr. Carl Asai. During the course of the discussion today, Timberline may make statements that constitute projections, expectations, belief or similar forward−looking statements. Timberline would like to caution you that the company's actual results could differ materially from the results anticipated or projected in any such forward−looking statement. Additional detailed information concerning some of the important factors that could cause actual results to differ materially from the information given you today is readily available in the company's annual report on Form 10−K for the year ended December 31st, 2001, under the heading ?Risks and Uncertainties?. Copies of this document are on file with the SEC at www.sec.com. I would now like to turn the call over to your host, Mr. Curtis Peltz.

MR. CURTIS PELTZ:
Hello everyone. Here are the first quarter results. Revenue decreased 4 percent to $13.6 million from $14.2 million for the first quarter of 2001. Net income decreased to $222,000 or 2 cents per diluted share from $594,000 or 5 cents per diluted share for the same quarter last year. Software license revenue for the quarter was $4,828,000, a 25 percent decrease from first quarter last year. By product line, accounting software revenue was down 23 percent and estimating down 29 percent from first quarter 2001. The current economic uncertainty appears to be impacting sales regionally. For example, New York City which comprised 12 percent of our 2001 software revenue continues to struggle to get out from under 9/11, with software revenues down $327,000 or 40 percent from first quarter 2001 while Florida which

represents 7 percent of 2001 software revenues actually increased $52,000 or 16 percent over the same period. If you remember from our last conference call, fourth quarter leads were slightly up over the third quarter of 2001, but referrals, those leads qualified and indicating purchase within 3 months, were down. This obviously impacted first quarter software sales. On the brighter side, service revenue continues to excel. We once again achieved record quarterly revenues, $8,479,000 in quarter one 2002 versus $7,495,000 in quarter one 2001, a 13 percent increase. This important component of revenue has experienced quarterly year−over−year growth for over 10 years. Maintenance and support which comprises 87 percent of service fee revenue was up 14 percent. Billings for service plans increased 27 percent averaging $3,062,000 per month during first quarter 2002 versus $2,408,000 per month during 2001's first quarter. Also, consulting revenues were up 28 percent. After seeing the immediate effect of 9/11, we implemented an expense reduction program as a contingency against the continued weak economic environment. This effort has resulted in the reduction of our operating expense level which has saved us over $500,000 in this quarter alone. Gross operating expenses before capitalized software development costs decreased $732,000 from first quarter last year. As a result, we were able to remain profitable for the first quarter. We will continue to watch expenses as we move forward into the year. In summary, considering the economic situation, our first quarter financial performance was in line with our expectations. As for the quarter's news. In March, we were recognized by Oregon Business Magazine as one of the 100 best companies to work for. People are our most valuable asset, and we strive to provide an excellent working environment to retain quality people. We delivered two new estimating products this quarter, CAD Integrator and our new modeling knowledge base. As we discussed in the last conference call, these products are key to furthering our efforts at penetrating the owner market. We also attended two major trade shows, ConExpo, a civil commercial construction show, and NAHB, the National Association of Home Builders residential show. Attendance at both shows was excellent, and we received many new leads. Interestingly, there was little talk of the recession. Two weeks ago, we hosted our solution providers (phonetic) at our winter−spring sales conference. We introduced pre−released versions of our Timberline Office Project Management Suite and began initial training efforts which will be reinforced in July at our annual summer sales conference. Both (phonetic) exciting, our solution providers went home with CDs containing demonstrable products and a renewed level of energy. Looking ahead, our future prospects remain exciting on a number of fronts, the economy not withstanding. Our foray into the owner market with our capital budgeting solution consisting of Modeling, our new construction knowledge base, and the investment management product is getting a great reception. While these deals are larger in skills and have more lead time, the pipeline is definitely filling for activity in the second half of the year. And, we are finally seeing the light at the end of the tunnel, and it's not a freight train. Our Educative (phonetic) Project Management Suite is still on target for end of July. Our solution providers were particularly excited to receive their CDs containing live shows (phonetic). We are preparing our third and fourth quarter sales campaign into our existing user base for this exciting new suite of products. Two key indicators of future sales activity are showing improvement for the next three to six months. Leads are up again, increasing 9 percent over the first quarter last year, but most importantly, referrals, again those leads qualified and indicating purchase within 3 months are up 53 percent over fourth quarter. These are both good times for future sales. A recent tax law change has given companies increased incentive to purchase software and make other capital expenditures. Companies making these purchases can immediately take a tax bonus depreciation deduction equal to 30 percent of the cost of those purchases and take normal tax depreciation on the remainder. This is a significant tax incentive that we hope will result in increased technology spending. It's an interesting market place. For the most part, the construction industry appears to remain on an even heel although recent developments in the Middle East have introduced more economic uncertainty. Yesterday, housing starts and building permits were released for the month of March and showed a modest decline from previous levels. The March levels remain strong and should be helped by the continued favorable interest rate environment. The economic recovery predicted by some earlier in the year hasn't materialized. We continue to see many prospects delaying their purchase decisions, yet at the same time, there has been a lot of renewed interest as indicated by the increase in leads and referrals. We continue to remain cautiously optimistic. Again, our strategy has been predicated on the construction industry performing at the same level as last year. If this can continue, then our new product introductions this year in addition to our normal business should enable us to improve our performance. We expect earnings this year to be heavily backhanded as our new products are introduced and gain traction with the channel. We don't expect second quarter earnings per share to exceed last year, but our guidance for the year remains the same, that we should exceed 2001 earnings and may exceed earnings for 2000, representing a range of 17 cents to 27 cents per share. As an added note, starting in May, we will begin a concerted effort to gain greater visibility in the investment community. We have retained the services of a consultant who will help us target Buy Sell−Side (phonetic) analysts and portfolio managers who would be most likely to have an interest in Timberline. We think we have an exciting story, and now it's time that we are close to delivering on our promise of the last couple of years, to take this story and market it. Our entire company is dedicated to serving our customers and delivering greater shareholder value. As our results develop over the next several quarters, we expect to gain greater recognition for the value being built here at Timberline. At this time, Carl Asai, CFO, will present financial highlights for the quarter. Carl?

MR. CARL ASAI:
Hi. Thanks Curtis and good afternoon everyone. Although software revenue declined from a year ago, there were some bright spots this quarter. Our service management software applications generated software orders totaling over 600,000 for the quarter, about a 110,000 more than in the first quarter last year. These software applications released after the first quarter last year, such as modeling, digitizer, and investment management, partially offset some of the shortfall in software revenue, adding about 170,000 towards software revenue for the quarter. Additionally our internal telesales (phonetic) group established in the third quarter last year generated 150,000 in software revenue this quarter. In the service fee revenue area, Curtis has already mentioned most of the highlights. Curtis stated that service plan billings are up 27 percent this quarter compared to the first quarter last year which amounts to over 1.9 million in additional billing. Part of this increase in billing is due to increase in pricing for our service plan. Most of the effect of this increase in service plan billings will impact service fee revenue in future quarters. We expect service fee revenues to continue to grow in 2002. Cost of revenue as a percentage of revenue came in at 10.4 percent for the quarter compared to 9.4 percent in Q1 last year. The increase was primarily due to high royalty cost. Operating expenses decreased 123,000 or 1 percent to 11.9 million, from 12 million in the first quarter last year. Curtis mentioned earlier that we took some action in the fourth quarter last year to reduce our operating expense level. These actions include a small reduction for across−the−board waste reduction, the sublease of some office space we are currently leasing, and other miscellaneous cost reductions. As Curtis mentioned, these actions saved us over 500,000 in the first quarter. Product development expenses decreased six tenth (phonetic) of 1 percent from last year's first quarter. Our gross expenses in product development actually decreased 633,000 from Q1 last year, but because we capitalized

609,000 less development cost this quarter compared to Q1 last year, our overall expenses in product development only decreased slightly. The decrease in this area was primarily due to the use of fewer contract developers this year and the wage reduction instituted late last year. Client services expenses declined about 8 percent compared to Q1 last year, and as a percentage of service fee revenue declined to 38 percent from 47 percent in the first quarter a year ago. Some additional technical support staff will be required later this year to handle the calls related to our project management software applications which was scheduled for release this summer. Our sales and marketing expenses increased 4 percent over the first quarter last year, and as a percentage of revenue increased to 22 percent from 20 percent. Sales expenses increased less than 3 percent compared to Q1 last year. The increase was primarily due to increased personnel as we added five people to our direct sales group during the quarter. Also as we previously mentioned in earlier conference calls, we added an inside telesales (phonetic) group in mid year 2001, so we are incurring expenses for this group in Q1 for which we have no expenses in Q1 last year. I should note here that our telesales (phonetic) group has been a net revenue contributor since the first month of its inception. Our sales expenses related to the personnel increase was partially offset by lower sales commission due to lower software license revenue. Marketing expenses increased 90,000 for the quarter compared to Q1 last year. Most of this increase is due to expansion of our (indiscernible) development and referral efforts for our solution providers and direct sales staff. This was partially offset by lower advertising and trade show cost. General and administrative expenses increased 67,000 or 4 percent over last year's first quarter. As a percentage of revenue, GAexpenses increased 13.7 percent from 12.7 percent in the same quarter last year. Most of the increase is due to higher insurance and depreciation expenses. This was partially offset by lower personnel cost due to the wage reduction last year. The number of personnel in the GAarea has not increased since March of last year. Our effective income tax rate for the quarter was 33 percent which is the same rate we used in Q1 last year. This is our best estimate of the effective tax rate we expect for the year. It is subject to change based on our future level of profitability for the remainder of the year. Our financial position continues to be strong. We have no long−term debt, and we have 9.7 million in cash and temporary investments at the end of the quarter. Accounts receivable amounted to 5.8 million at the end of March compared to 6.1 million at the end of 2001. Most of this decrease is due to a decrease in billings for software in the month of March compared to last December. Days sales outstanding increased slightly to 39 at the end of March compared to 38 at the end of 2001. Counter (phonetic) sale for March 31 increased 331,000 since the end of 2001, primarily due to some marketing and user conference expenses in March that were unpaid at quarter end. We did not have similar expenses of that nature at the end of 2001. Deferred revenues which comprise 68 percent of our total liabilities increased 1,410,000 since the end of 2001 to 18.3 million, primarily due to the increased billings for our annual maintenance and support service plans. Most of this deferred revenue will be recognized (indiscernible) over the next 12 months. This concludes our comments on our first quarter operating results. As Curtis mentioned, our financial results for the quarter were close to our expectations. It was a difficult economic environment for selling software, but we were very pleased with the continued growth in our service revenue. The action we took in the fourth quarter last year to reduce our operating expense level was the right decision and allowed us to remain profitable in the first quarter. We also continue to believe that the new products we have released during the last year, combined with the scheduled release of our project management applications this summer put us in an excellent position to take advantage of the economic recovery when it does take place. We would now like to answer any questions you may have.

THE OPERATOR:
(CALLER INSTRUCTIONS) Your first question comes from Ken Heller (phonetic).

THE CALLER:
Good afternoon.

COMPANY REPRESENTATIVE:
Hi, how are you?

THE CALLER:
Doing well, thank you. I am with (indiscernible) Capital. I was curious, you talked about kind of this more positive outlook on software license revenue growth sequentially through the balance of the year, and I guess one of the things you point to is the increase in the referral from the end of 4Q of about 52 percent. I was curious as to whether there was any linearity? What the linearity was in terms of increase in the referrals, in other words, is it something that really started coming on toward the end of the quarter, beginning of the quarter, or just steadily increasing activity throughout?

MR. CURTIS PELTZ:
We actually had a decrease in the fourth quarter of referrals, somewhere (indiscernible) was about 40 some percent or somewhere in that area. I think 46 percent. What we saw was, in the last conference call, I mentioned that referrals had started turning around and that happened right at the end of the fourth quarter, and then what we have seen throughout this quarter is that generally, as you mention linear line, in which the referrals are simply slowly been adding, I would guess that there was a bit of, you know, maybe a greater bump in March or so as they started, you know, there is a lot of talk about the economy getting better. But we did start seeing that at the very end of the fourth quarter and that continued on through the quarter. Also I will say that February usually has a bit of a blimp because that's where some of our trade show responses are concentrated.

THE CALLER:
Okay, that's helpful, thank you.

THE OPERATOR:
Your next question comes from Bill Robber (phonetic).

THE CALLER:
(indiscernible) you on that subject of referrals, you say that referrals this quarter were up 53 percent versus Q4 of last year right?

MR. CURTIS PELTZ:
Right.

THE CALLER:
Do you have any comparison to how they fare versus Q1 of last year?

MR. CURTIS PELTZ:
You know, good question. I have that stat. You know, our overall leads are up I think about 9 percent −−. COMPANY REPRESENTATIVE Yeah, 8 percent of leads. On referrals, it is a

higher number than it was first quarter last year, but I am sorry I don't have the exact stat.

THE CALLER:
Okay, and in terms of the guidance, once again, I think I asked this back in January the last conference call, and I didn't pick up on exactly what you said today, but what kind of an economic environment or what is your assumption in terms of this range? 6 to 17 to 27 cents (indiscernible)

MR. CURTIS PELTZ:
We are assuming that if business stays, you know, if the construction industry remains neutral, in other words compared to last year, if we see a level playing field this year in terms of that industry, then we should at least match last year's number, and then add to that what we see coming out of our new product line, we should see an improvement over that, and then if the economy takes off, we tend to see ourselves performing on the higher end of that scale.

THE CALLER:
Okay so, and referring to last year, I am not trying to get too picky here, but last year had 9/11 and you think that −− are you factoring that into −−?

MR. CURTIS PELTZ:
Yes. Because remember, last year started out much better in the first two quarters before 9/11, so we had a much better January etc. and so if you level that off you have the better first part of the year, you have the worser second half of the year. We look at that as we take that line straight across as to what we have been performing here in the first quarter with the economy the way it is, we are seeing that as a straight line, the average of those.

THE CALLER:
Okay, and in terms of this consulting arrangement this year, you are starting in May, and you are going to go on the road to talk to the investment community, can you give us a general idea how that works with this consultant, is this a −− what you are paying these people, how it's structured?

MR. CURTIS PELTZ:
Well, perhaps I will be free to get into that the next call. We are just finishing up the paper work here and before I have an agreement actually penned, I would be reluctant to go on record. But suffice to say that it is, we feel commensurate or possibly even better deal than what you would typically find in the industry out there in terms of we've researched for investor relation sale, and the goal here will be to develop, you know, my target is list the people to approach, as well as reach out to the people that we already have as major shareholders and get out on the street and start marketing the company. So it will be an effort to develop the targeted list and reach some of the companies that investor groups that have not perhaps classically followed us or heard of us. If we can target those that are carrying stocks that are of similar type and value to Timberline, those would be the ones we would want to go after in addition to those that we already (indiscernible) now.

THE CALLER:
And this is the national effort rather than a regional?

MR. CURTIS PELTZ:
Yeah, this is the national effort.

THE CALLER:
And this company that you've yet to finalize your agreement with, they have quite a bit of expertise in working with software companies, is this a specialty of theirs?

MR. CURTIS PELTZ:
Yeah, that's our understanding, and there is a broad range of experience there across a lot of houses and some great references, so we think we got the right talent here.

THE CALLER:
Okay, I know you are not there and one last point on that question, can you in 60 seconds or less summarize what the story is going to be that you are going to take to the street?

MR. CURTIS PELTZ:
Well, you know −− you're right, I haven't laid out the entire story, but essentially, you know, as many have said, a somewhat of a −− what's the word −− not−well−known stock, right? Our company story is well known. We are micro cap or small cap, and we haven't reached the $100 million mark. However, we have a tremendous amount of opportunity coming up with the story that we do have in the sense that we have created an investor here in a significant new product line. We believe that it is in response to what people are asking for in the industry. We believe that we will have a position that's relatively unique because we have very few competitors if any who are able to deliver the same story. We have an e−commerce angle, you know, (indiscernible) angle in the future as I have discussed with the commerce side of this thing. So we have a model that changed in terms of how the company is presenting itself. We will present a vision, you know, a 3 to 5 year vision of where we are going. We will talk about e−commerce side and new revenue model opportunities. We will probably, you know, put a little bit of effort in describing where our history has been in terms of the 5−year run we had from I think it was about 93 to 99 or so when we had about almost a 1000 percent return in investment according to the (indiscernible) story, and carry forward the notion that while we hit the downside, you know, with starting at Y2K and then everything that ensued here in the last several years. We have been reinvesting in technology to prepare ourselves for a turn in the economy which is just what happened back in 93 when we came out with our windows product. So part of the story would be we think we can do this again. And that's some of the notion of we are going to take to street. As well as I think a lot of the individual key elements of our success in terms of our service revenues and what we have done in the company to become leaner and meaner and the re−engineering efforts we have done in the last several years. That sounds fair?

THE CALLER:
Very good. Thank you.

THE OPERATOR:
Your next question comes from Mr. Lynk Mossip (phonetic).

THE CALLER:
Hi Curtis.

MR. CURTIS PELTZ:
(indiscernible) how are you doing?

THE CALLER:
Fine, thank you. You know in view of everything that has happened, I know it's been a tough role to hold. I think you guys are doing a pretty good job. My question −− my comments, I think echo and perhaps and then I will press the button, I wouldn't need to make it, but it seems to me that you are taking a fairly aggressive stance in going out and telling your story in May when you have had a difficult first quarter. You are not looking to see much in the second quarter and because of the new product introduction and hopefully a reviving economy in the construction business, and a greater willingness for construction companies to make their purchases, that you feel confident because the last thing you want to do obviously is to go out and say, ?Hey, you know, we really think we've got a tiger by the tail?, and then fall flat in your face in the second half. So I am perhaps making a statement rather than asking a question. It seems to me that you do have a lot of inner confidence with the product line, with the referrals, the fact that you do have unique product lines, and I just heard you comment the fact that your competitors just don't have your product line. So as I hang up here, you can agree or disagree, but you must be very confident that things are going to look significantly better in the second half, and the one last statement I am going to make, and I made it to you before, but I'd like to make it is I do want to congratulate you people on the salary cuts that you took in '01. I think that that was in contrast to the rest of the world out there, you set high standards. That's all I got to say Curtis.

MR. CURTIS PELTZ:
Well, thank you, I appreciate that. You are right, you know, we do have a lot of confidence on what is happening. (indiscernible) you know, I suppose something happening in the Middle East could throw oil prices into a quandary and who knows what could happen to the economy, but right now, from our perch, we see things leveled, and if that's true, then the things we are bringing to the market and the things we have in mind to do, we don't see any other way, but to improve our numbers simply because of the (indiscernible) of the user base we have and this opportunity to sell back into that base, as well as new customers, this vision of an integrated product suite. Right, we are starting in May. May will just be the beginning of that. I am assuming that by the time we actually get all this work done and we actually get out on the street. Our first engagement is in May. But this will continue on through the year, and the notion is that we didn't want to do it earlier, and I know there are some who felt we might have done that, and maybe a high side 20:20, but we certainly didn't want to go out in the street without being able to deliver on what we are going to promise. And we just feel good about that right now and hence the reason we are making the move at this time, we think we can meet our road show with perhaps performance to prove it as we go through the remainder of the year.

THE OPERATOR:
(CALLER INSTRUCTIONS) Thank you for participating in today's Timberline Software Conference Call. This call will be available for replay beginning at 7:30 p.m. eastern standard time today through 11:59 p.m. eastern standard time on April 30, 2002. The conference ID number for the replay is 378−3611. Again the conference ID number for the replay is 378−3611. The number to dial for the replay is 1−800−642−1687 or 706−645−9291. Thank you, you may now disconnect. (CONFERENCE CALL CONCLUDED)

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THE OPERATOR:
Good Afternoon. My name is Chris (phonetic) and I'll be your conference facilitator today. At this time, I would like to welcome everyone to the iManage Q1 Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer period. (CALLER INSTRUCTIONS) Thank you. Ms. Kaplan, you may begin your conference.

MS. CAROL KAPLAN:
Thank you. Good afternoon and thank you for joining us, as iManage discusses its results for the 1st quarter of 2002. I am Carol Kaplan, Director of Investor Relations. With me today are Max Panjwani, iManage's President and Chief Executive Officer; Joe Campbell, our Chief Operating Officer; and John Calonico, our Chief Financial Officer. If you have not yet received today's press release, a copy can be accessed on iManage's website at www.imanage.com in the news and event section. Before we begin, I would to remind you that this conference call contains (indiscernible) to this information that is accurate as of the date of the broadcast, April 17, 2002, only. This prepared statement and any recordings of it are the property of iManage Incorporated. Any unauthorized redistribution or rebroadcast of this statement in any form is prohibited. This conference call contains forward−looking statement regarding the Company's financial results, products, and other business development that are subject to risk, uncertainties, and other factors that could cause actual results to differ materially from those referred to in the forward−looking statement. Such risks are set forth in the company's press announcement released today, to accompany this conference call. Further details on these risk are set forth in iManage's periodic filings with the Securities and Exchange Commission, including its Annual Report on Form 10−K and its

Quarterly Report on Form 10−Q under the heading tax recently and tax future result. Forward−looking statements in this conference call are generally identified by words such as "expect", "project", "will", "believe", "continue" and other similar words and expression. The statements made during conference call are based on the information available to iManage today and the company does not undertake any obligation to update or correct them before its regularly scheduled call, in July. Now, I am pleased to turn the call over to iManage's Chief Executive Officer, Max Panjwani.

MR. MAHMOOD PANJWANI:
Thank you, Carol. Good afternoon everyone. I am very pleased to report that we've successfully delivered quarterly revenues −− sorry, I'll start again. I am very pleased to report, we've successfully delivered revenue growth in key vertical market and achieved pro forma profitability earlier than anticipated. We've continued to be pleased with our execution in the 1st quarter, as evidence by our active results. For the 1st quarter, revenues totaled 11.8 million, at the high−end of our previous guidance. This represents 36 percent growth year−over−year and 5 percent sequential growth from the 4th quarter. We are especially pleased this growth was achieved despite the traditional seasonality, we experienced in the 1st quarter and continued softness in the global economy. We are also happy to report that we achieved profitability in a pro forma basis in Q1 earlier than anticipated. Our bottomline results were achieved through a combination of sustained revenue growth and the company's ongoing successful control and management of operating costs. The balance sheet as of March 31st, 2002 remains very strong in all key areas. Cash and investment totaled 42.2 million, day sales outstanding at 73 days. We're well below our stated targeted range and deferred revenues increased to 12.4 million. As with the 4th quarter, we again generated cash flow in Q1. 61 new customers signed−on the iManage in Q1. Our new customers represent many leading global businesses in targeted industry segment which are financial services, government agencies, high−tech manufacturing, and, of course, legal. In the 1st quarter, we continued our momentum in the financial services industry across the United States and Europe. New customers selecting iManage WorkSite included: Tower Insurance, General Atlantic Partners, and Lloyds Member Agency Services. We also signed iManage's largest financial customer today. A leading international insurance services firm, which you'll hear more about in a future joint press release. Additionally, we continue to deepen our relationship with Bear Stearns, Rothschild, Deloitte Touche, and Charles Schwab. We introduce new WorkSite functionality, for the financial services sector, further increasing iManage's value in this targeted vertical. Our unique product features including −− include OLE and (indiscernible) linking, which is going to help our customers create and present sophisticated and accurate financial analysis for their client. iManage is increasing its market presence in local, state, and Federal Government agencies with its newest strategic alliance partner, Computer High−tech Management Inc. and Ciber Inc.. Both partners used iManage WorkSite to meet the requirements of their public sector client for centralized, secured, collaborative cost (indiscernible). iManage joins customers with these partners include: the Office of the Inspector General, the US Army, and the Department of Justice. Other customers in the government market include the California Heath and Human Services Data Center and Fraser Valley Regional District in Canada, which is using our iManage WorkSite to link municipalities and share contents effectively. Our core legal market, again, was strong in the 1st quarter. In the past two years alone, more than 90 percent of new document management and collaboration system selected by leading AmLaw 100 Law Firm were iManage solution. These include purchases by some of the largest law firm including Jones Day, a U.S. based law firm ranking number three by the AmLaw 100 and one of the top 5

firms in the world Freshfields Bruckhaus Deringer. Additional new law firms to select iManage WorkSite includes: Porter Hedges, Hinshaw Culbertson, Wildman, Harrold, Allen Dixon. Additionally, iManage continues to deepen its legal functionality with new integrated invoicing capabilities enabled through iManage's partner Whitehill Technologies. Other notable links for the quarter includes a mix of corporate customers. Some of these customers are Motorola, AG Hines Company, Capella University, and Cooper Tire. Customers continue to purchase iManage WorkSite as their core technology. For example, Bear Stearns even established in Western banking firm with offices worldwide. Its investments banking group with almost 1000 team members globally work primarily with Fortune 500 companies for advice on mergers and acquisition, public offering, and other investment need. Since purchasing iManage WorkSite last year, Bear Stearns has experienced the benefit of a secure, stable, scalable, collaborative content management system. For example, common uses include the ability to share ideas, reuse ideas, and save time in looking up (indiscernible) work. Overall, work gets done more efficiently, geographic distance within groups is bridged by bringing team members together in the same work site. Since its initial purchase in 2001, Bear Stearns has continued to extend iManage WorkSite usage throughout this firm resulting in repeat order. Jones Day, is one of the world's largest international general practice law firms with over 4000 employees in 26 locations worldwide. Its structure is composed of major practice group in business policy and procedures, government regulations, litigation, and tax, supplemented by a multi−disciplinary team, as well as, interdisciplinary industry specialists. The ability to efficiently bring the talent and experience of all practice and industry group, together, to bear our method originating in any office is the key benefit to its client. Jones Day needed to leverage its collective talent and experience as effectively as possible. Because of this the firm chose to replace its previous document management system to add tightly integrated collaboration and management and capability. iManage is providing the core content repository for all of Jones Day document management collaboration and knowledge management initiative. One of our marketing teams in legal space is tying document management and collaboration to this company's growth strategy. Yesterday, we conducted a seminar on this topic in Washington, D.C. targeted a small and mid−size law firm. The featured speaker, Mark Vitalie of McKee Nelson and Ernst Young discussed how iManage WorkSite helps McKee Nelson grow exponentially in two years. The result was a very interesting session, interactive session attended by prospect truly interested in a collaborative content management system. In the 1st quarter, iManage's technology leadership was demonstrated by several accomplishments in product and business development. We launched WorkSite MP, the first application suite to combine document management, collaboration, work flow, and portal access in a single, integrated Java−based solution that operates seamlessly across Windows NT Linux and Solaris Operating System environment. Cross platform compatibility extends WorkSite access to the fullest possible number of workers. The combination of collaboration and content enabled companies to streamline business processes, reduce the need for travel, and leverage organization knowledge and information across partners and suppliers to do more with net. WorkSite MP is designed for a wide variety of applications across many industries including supplier relationship management, contract management, asset and wealth management, wholesale banking and regulatory compliance. We already have customers installing WorkSite MP. In its 1st quarter of general availability, over 10,000 suites have been purchased. In responding to customer's feedback, we are constantly working to bring new features and functionality to help our customers work more productively and efficiently. Business development continued with the introduction of a newly branded product iManage WorkSite Report Manager. Now, iManage customers can easily add fully integrated enterprise report storage and retrieval capabilities to WorkSite. Additionally in Q1, iManage announced general availability of iManage Work Knowledge, a new knowledge management application that provides the availability to search (indiscernible) to identify knowledge (indiscernible) and business context. iManage has an ever−increasing dedicated partner networks. In the 1st quarter, the iManage global channel and alliances team hosted a very successful two−day partner training session entitled, "Empowering Partners to Sell iManage WorkSite". This comprehensive training covered iManage's corporate positioning, review of our WorkSite products suite, vertical market solutions and composition, as well as iManage's sale (indiscernible). More than 50 partners from around the nation attended the (indiscernible). We also added new partners to our strategic alliance roster in Q1. Our strategic alliance was established with Roundarch Consulting, a joint venture company developed by Deloitte Consulting, WPP group and BroadVision for the purpose of delivering customer−relationship solution to Deloitte Consulting's client base. We continue to sign iResell and iDevelop partners in Q1 and a significant number of them are already closing business. Internationally, we also added new partners in the 1st quarter. Tikit Group, PLC is a provider of consultancy services and software solutions principally to U.K. law firm. Forty three of 100 largest U.K. law firm are Tikit clients. The company has developed a proficient, technical skill−based focused on the requirement of major legal practices and have established a strong reputation in its market sector. Additionally, SAW System Management AG in Widnau, Switzerland is a new iManage partner. The Swiss systems integrator will provide Internet−based document management in collaboration covering the German−speaking part of Switzerland. It's customers include medium and large−sized companies from the manufacturing, financial and transportation sector. iManage's commitment to market expansion continued with new global customers. In 2001, iManage recruited a seasoned team to oversee sales and operations in the Europe, Middle East and Africa region. Since then, there has been substantial iManage international customer growth. Under the leadership of Patrick Baudouin, Vice President of EMEA, the team made a substantial impact on vertical market wins this quarter, including Freshfields Bruckhaus Deringer, Lloyds Member Agency Services and Cooper Gay. Our investments in the international arenas are gaining traction and diversifying our business worldwide. For the quarter, roughly 30 percent of our chosen revenues came from customers outside the United States. We expect this contribution to fluctuate in future periods. I am extremely proud of our achievements in the 1st quarter with record revenue, pro forma profitability, key global customer wins and continued execution in our targeted vertical market. Now, I'd like to introduce our Chief Financial Officer, John Calonico, who will discuss the financial results of the 1st quarter in greater detail. John? .S1 MR. JOHN CALONICO

MS. CAROL KAPLAN:
Thank you Max, as mentioned, 1st quarter revenues were 11.8 million, at the high−end of our previous guidance. Our 1st quarter revenues 60 percent was generated from software license fees and 40 percent was from customer support and professional services. Software license revenues increased 21 percent over the 1st quarter of 2001 and were essentially flat with the 4th quarter, reflecting the typical seasonality of our 1st quarter. Support and service revenues increase 65 percent over last year and 17 percent over the 4th quarter, primarily due to increased maintenance revenues from our growing installed base of customers. Maintenance renewal rate continued to exceed 90 percent, which we believe are at the high−end of our industry. First quarter gross margin was 84 percent, consistent with the 4th quarter and up slightly from the 81 percent a year ago. Gross margin on license revenues remained at 95 percent while support and services gross margin increased slightly to 67 percent of related

revenues. We continue to aggressively manage our operating expenses during the 1st quarter. Pro forma operating expenses, excluding deferred stock compensation and intangible asset amortization were 9.9 million, a decrease of 200,000 or 2 percent from the 10.1 million reported in Q4. Headcount remained a significant driver of cost in our business and we ended the quarter with 227 employees flat with the 4th quarter. Our pro forma operating gross decreased substantially from the $3 million loss a year ago to almost break even at $64,000. This was also a decrease of approximately $600,000 from the results reported in Q4 2001. We are very pleased to report that we achieved bottom line profitability on a pro forma basis in Q1. Net income on a pro forma basis was a 165,000 or 1 cents per share better than our previous guidance. These figures compare favorably to the pro forma net loss of 335,000 or 1 cents per share in the 4th quarter and the pro forma net loss of 2.6 million or 11 cents per share a year ago. Including deferred stock compensation and intangible asset amortization of approximately 500,000, our net loss was 1 penny, an improvement over a net loss of 11 cents per share on the 4th quarter and 22 cents per share in the 1st quarter a year ago. Turning to the balance sheet, our financial position remains strong with 67 percent of our total assets, residing in cash, cash equivalent and short and long−term investments securities. At quarter end, we had cash and investment of 42.2 million and for the quarter, we generated approximately 1.4 million in cash, substantially all of which was from operations. Day sales outstanding for the 1st quarter were 73 days as compared to 77 days in the 4th quarter and a 102 days a year ago. This performance was better than the low end of our targeted range demonstrating our continued focus on cash flow as a key metric of the business. And as importantly, low DSOs is a reflection of our overall customer satisfaction. Deferred revenues increase to 12.4 million at quarter end, up from 10.7 million last quarter. This was primarily due to an increase in software maintenance renewal, which continue to demonstrate that once customer's purchase our solution, they use it and it works. Now, let me briefly comment on our outlook for the 2nd quarter and the remainder of 2002. While, our execution has been strong. We must recognize. We must be cognizant of the weak, global economic condition and the challenges being experienced by other enterprise software companies including those in our space. Accordingly, we expect 2nd quarter revenues to increase in the mid to high 20 percent range year−over−year. We expect overall gross margin percentage to be more or less consistent with 1st quarter level. From an operating expense perspective, we anticipate that we will continue to aggressively manage overall operating cost and as a result, overall operating expenses are anticipated to increase only slightly over Q1. We further anticipate pro forma bottom line result of 1 to 2 cents per share profit and we have assumed a weighted average share count of approximately 26 million shares. For the full 2002−year, we expect year−over−year growth in the high 20s to low 30 percent range. We expect to continue to aggressively manage the cost of our business over the year. We further expect to be profitable on a pro forma basis throughout the remainder of the year. Now, let me turn the call back to Max.

MR. MAHMOOD PANJWANI:
Thank you John. As you can see, we are off with a solid start in 2002, specially in light of the tight economic environment, many technology companies including some of those in our space are experiencing. Last quarter, we committed to the continuation of growing our company to increase revenues, managing our overall operating cost and achieving breakeven bottom line performance. We delivered not only on our financial objective but also on our customer acquisition and retention goals. We are proud that iManage is delivering on its commitment. Now, I would like to open the call to questions. Operator, please open the line.

THE OPERATOR:
(CALLER INSTRUCTIONS) The first question is from Mike Marsol (phonetic) of US Bancorp Piper Jaffray.

THE CALLER:
Hi guys, good afternoon. Could you give us a little bit of insight into what's driving the (indiscernible) diversification in revenues outside illegal and just follow that up with a legal to non−legal percentage?

MR. JOHN CALONICO:
I'm sorry Mike, the first part of your question, what is driving?

THE CALLER:
Yes, just looking for some insight into what's driving the diversification. I know there are some things on the direct side that you guys are doing actively. I'm wondering if the channel efforts are also contributing to the diversification of revenue?

MR. JOHN CALONICO:
Yes, I think it is Mike, thank you. There are several factors: one, is we continue to invest in our partners and relationships within the channel and we are starting to see some of the rewards of that coming in. Also, I think one of the things that we've talked about on other calls and we continue to see success is, we are getting much deeper rooted within other verticals. And we've talked about them before, financial services, high−tech manufacturing, is the other, and also we are seeing some success within government. I think that is adding to it. Legal continues to be strong. I don't think there's any difference on that front. The second part of the question, I think was more of a mix questions Mike?

THE CALLER:
Correct. Correct.

MR. JOHN CALONICO:
I think the mix continues to be strong towards legal. I will say this, out of the new accounts, 40 percent of the new account basis this quarter can directly be contributed outside of legal.

THE CALLER:
Then John, on the DSO, what was the primary driver there? Was it linearity, what was linearity like or was it more along the lines of collection efforts that drove that down?

MR. JOHN CALONICO:
Well, it's a good question Mike. We've been focusing obviously, pretty significantly on the collection as part of our cash management efforts and have, you know, dedicated this proportion of resources to making sure that we are collecting so, that's a piece of it. We also, as you know, have a fairly strong renewal quarter in Q1 from our maintenance base and that contributed as well. And as we mentioned in the prepared remarks, you know, compared to other businesses, we tend to see in the 90 mid 90 percent renewal, so, it helps us from a cash flow perspective.

THE CALLER:
Then both DSO and on deferred, where should we target that going forward?

MR. JOHN CALONICO:
Well, we've consistently said on the DSO front that we believe that a healthy day sales outstanding is the high 70s to mid−80 day range. And so, from the stand point of what our targets are, clearly, we like to exceed that target, which we did this quarter but that what we would consider to be healthy. And I don't think, specifically we've given any guidance on deferred revenues. However, we are pleased that number grew quarter−over−quarter in the way that it did.

THE CALLER:
And just a question for Joe and Max. In the current environment, what tactics are working for you guys? We are seeing a lot of tactics that are not working with other companies. What's working out there in getting the purse string open and then, may be you could just follow that up Joe by −− you talked about 30 percent international I believe this quarter? How much of that is partner−driven?

MR. JOHN CALONICO:
Okay. Let me try, I think there are three questions in there Mike, let me make sure I get them. The first one is success in this environment, the second one is purse strings, and the third one is international front and partnerships. Okay, the first one, success in environment really is a two−part answer. The first one, I think, we talked about it about this time last year, is a targeted average selling price which we think is reasonable and fair and allows companies to get up on WorkSite and we've stuck to that, we've been successful with that. So, our sweet spot of the selling price is in the mid−100s. The second that I think has really helped us is further focusing on value−add within the vertical. So we developed unique value proposition and applications within specific verticals. This has helped us. I think drive within to some of those verticals. The second one, from the standpoint within international. So I think that's probably killing two birds with one stone. We've been able to get in, we've been able to put, you know, really get the whole company behind that type of initiative, not just sales, but marketing and RDas well. The last one, I think, a lot of the fruits of our efforts for last year is beginning to pay−off in international and we are delighted to say both on the direct and indirect front, in the whole (indiscernible) we are starting to see some of the success of that. So, we got partnerships both on to getting us in, and the partnerships once we are in helping us get installed. So, I think we've seen success on both of that Mike. I think that gives you a real fair answer to the question. I think the (indiscernible) to success has been just a very well−low rounded front partnerships hiring a really good group of people within the last year, and the (indiscernible) market taking them away from some pretty significant companies.

THE CALLER:
Great. Thanks guys. Nice job.

MS. CAROL KAPLAN:
Thank you.

MR. JOHN CALONICO:
Thank you.

THE OPERATOR:
Your next question is from Nate Swanson (phonetic) of ThinkEquity.

THE CALLER:
Hi guys, great job on the quarter.

MR. JOHN CALONICO:
Thanks Nate.

MR. MAHMOOD PANJWANI:
Thank you.

THE CALLER:
You, I would have imagine have a pretty interesting viewpoint looking at companies around. Can you comment competitively what you are seeing? You're operating two spaces everybody wants to get to on structured content management and collaboration. Do you see anything different this quarter in terms of who you are running up against the pricing pressure or anything in that nature?

MR. MAHMOOD PANJWANI:
Well you know, Nate this is Max. As you know, for those people who have seen our competitive slide (indiscernible) picture where we have three columns. You know, we've been showing that picture for about a year and a half almost two years right now. And I'm happy to say that I think, as time goes by, more and more of the people within that chart and also, outside the chart are beginning to recognize that the web content management is only about one aspect of the solution or one side of the equation. More of the work needs to be done on the content that is inside the firewall internal to a company. That has nothing to do with our website and when you start dealing with the contents like that, collaboration automatically and absolutely necessarily plays a major role. I think we were probably amongst the first to recognize that and we have built the whole and our products and our vision around that. And I'd like to think that some of that vision is now being recognized as real, and people who are on the left side which is under web content management side of the equation are beginning to feel that what we have is something real and true and very necessary, and so partly, hard reason for our success is because of that and the part of the reason why I think we are weathering the storm a little bit better than some of the others is because we have a slightly differentiated offering and product suite, not the traditional, you know, web content management but a little bit more which is on the right side or the private content of the company's side of the equation. So, you know, overall I'm very pleased, I'm very (indiscernible), I'm very happy. You know, competitively, we're seeing new players, no, the same old players come up, you know, if the question is -- if the customer needs us from a pure content side then we'll see more of the end content management players. If the customers need more from the collaboration side then we'll see the traditional collaboration side of the people.

THE CALLER:
Okay. And do you think from a buyers' standpoint, buyers recognized how you're different than everybody else better than they did, say 6 or 12 months ago?

MR. MAHMOOD PANJWANI:
Oh, certainly, certainly. I mean, you know, clearly our buyers are recognizing that this is a need that's emerging. I wish that the economic conditions will better. My personal feeling is that, you know, if we were in a better economic condition environment right now, we'd be

doing a hell of a lot better. But you know, not every wish can come true, and so, I'm hoping that sooner than later, this ugly environment that we are in will just turn around and so, when that happens I think we'll be a huge beneficiary of that.

THE CALLER:
Okay. Maybe looking ahead a few quarters. Assuming we pull out of this and start generating growth economy again, what sectors do you think would lead?

MR. MAHMOOD PANJWANI:
I think legal will continue to stay strong and we want it to be strong. Financial services is absolutely, absolutely without any doubt something that I think will come up very strong as we start coming out of the doldrums of the loss that we are in right now. You know, high−tech manufacturing, supply chain type, you know, that has been so beaten down that I have, have to say that as things improve that sector has to improve. And government continues to also be very, very strong so, to the areas that we have traditionally targeted, I think we'll only get better as the economic conditions improve.

THE CALLER:
Okay. Great. You mentioned head count flat at 227. What was your sales head count at the end of the quarter?

MR. JOE CAMPBELL:
We left the quarter, Nate at 33.

THE CALLER:
Thirty three? And how does that compare with Q4?

MR. JOE CAMPBELL:
Well, actually a net down one but that's due to the −− what we talked about before. We're typically churned somewhere about 15 percent of the sales force on a global basis on any different quarter.

THE CALLER:
Okay. And what would you expect that to be maybe at year−end?

MR. JOE CAMPBELL:
Year−end this year?

THE CALLER:
Yes.

MR. JOE CAMPBELL:
I don't think we can publish that Nate.

THE CALLER:
Okay. Question for John. The license services mix was a little more skewed towards services and your gross margin and services were strong, it didn't affect your overall gross margin. Should we expect more of a 60, 40 mix going forward?

MR. JOHN CALONICO:
Looking at Q2, Nate I think it's, you know, we'd be comfortable with the mix (indiscernible) all around where we are right now.

THE CALLER:
Okay. And can you hold services margin up around 65, 66?

MR. JOHN CALONICO:
Well, as you know, it's our point. I mean the majority of our services revenue comes from maintenance and that's high−margin business for us. So, as I've mentioned in the prepared remarks, we're looking to keep margins, overall gross margin more or less consistent with was you saw in Q4, Q1, which is the 84 percent number, 83, 84, 85 percent number.

THE CALLER:
Okay. Great job. That's all I got. Thanks.

MR. JOHN CALONICO:
Thanks Nate (multiple speakers).

THE OPERATOR:
The next question is from Keith Gaye (phonetic) of Thomas Weisel Partners.

THE CALLER:
Hi, guys. Good quarter.

MR. JOHN CALONICO:
Thank you (multiple speakers).

THE CALLER:
Can you comment a little bit more in the linearity of the quarter by month, (indiscernible) on a percentage basis and also talk a little bit about the conversion rate near the end. We've heard some number of companies that there was lack of customer (indiscernible). Obviously, you guys, seem like you were able to overcome that issue.

MR. JOE CAMPBELL:
Hi, Keith. This is Joe Campbell. Keith, we are in the enterprise software market. So, we do see the linearity that is at the tail end. We're not totally immune to what's going on in the economic market. So, we did see some of that ourselves but I think the way we're planned here is we're going into the quarters knowing that that's out there, plus the fact that we are selling deep into a lot of these environment such as the vertical alignments. So, we're lining up, line up business people as well as the CIO and I think that has helped in the past and has helped this quarter as quarter as well.

THE CALLER:
Okay. And also, can you comment on average deal sizes? What the trend has been there and perhaps, what's some of your largest deal sizes were during the quarter?

MR. JOHN CALONICO:
Okay. First of all, with the average selling price, we're right in the middle of our sweet spot

here, which we try targeting between 140 and 160. So, we're probably no different than the last 3 or 4 quarters since we established that. I think we did −− every quarter we have customers of all sizes. This quarter is no different. We did experience one deal that came in which was greater than 10 percent.

THE CALLER:
Okay. And can you just kind of give some color on what the pipe line is looking like in Q1 going into Q2 and perhaps compare that to, sort of, the way things look at the end of the last quarter.

MR. JOHN CALONICO:
Yes. A good question. I think our pipeline is ample to support a business plan for Q2. And as I think a lot of you know and I think as you know Keith, we put a lot on emphasis on pipelines and ratio and conversion rates and this looks very, very similar to the way it did ending the year last year.

THE CALLER:
Okay. And then finally, you know, offering the content document management capability and collaboration, are you seeing customers −− does customer demand shifted more to the document and content side versus collaboration or you know, on this type of environment customers are kind of getting back to basics. So, are you seeing any trend in that area?

MR. JOHN CALONICO:
Actually, what we're seeing is interesting. I don't know if I've seen a trend away from collaboration at all, but we are seeing trend that people would like a single vendor application that can solve multiple problems as opposed to going four or five vendors for the same solution. So, what I think we see in a lot of different environment, there maybe centricity towards one or the other, but typically what we do is we market−sell an application that gives people flexibility in all fours. So, I think that worked to our advantage. I think everything is pretty much rooted in content document management out from there. So, you just have an offering that's collaboration as a stand−alone, I've seen that not have as much merit. So, where we may have got interest a year ago from collaboration by itself, now, the collaboration that we see is winning is collaboration that is rooted and seeded in either document or content management.

THE CALLER:
Okay. Thanks a lot.

MR. JOHN CALONICO:
Thanks Keith.

THE OPERATOR:
Your next question is from Katherine Moore (phonetic) of Unterberg.

THE CALLER:
Congratulations on a quarter, guys.

MR. JOHN CALONICO:
Thank you (multiple speakers).

THE CALLER:
I wanted to ask about the government business. Is that mostly off−the−shelf software or is there any customization and can you kind of give us a feel for those ongoing, kind of, service contracts and what might margins look like in government? You know, the reason I ask is that government doesn't look like a strong vertical for a lot of people right now but some people are getting some more margin business out of that vertical.

MR. JOHN CALONICO:
Right. Yes, I think all of our business into the several government has been off−the−shelf but it does get integrated and (indiscernible) typically by a partner. Our success in the government business across the board has all been partner−related. We are not seeing any highly complex applications coming out of the government market but we are seeing some of our partners actually enjoying a little bit of reward on the margin side for their own businesses. But our margin business in government looks identical to the other businesses and it's definitely off−the−shelf products.

THE CALLER:
Great. Now, did I hear correctly that there was one deal greater than 10 percent in this quarter?

MR. JOHN CALONICO:
Correct (multiple speakers).

THE CALLER:
And in the pipeline for the upcoming quarter, the June quarter might there be a similar large deal in that quarter?

MR. JOHN CALONICO:
Actually, that's a good question. We really don't track on that way. I think we're a conservative business. What we do if there's any deal sitting out there that is over 10 percent, we try to factor it in the pipeline at a lower aggregate number. We just see this −− in this type of economy that's dangerous to evaluate at whole strength.

THE CALLER:
Okay. Great. And then, looking out into June again would. Does it again look like financial services in government are the nice complimentary businesses to you core legal market?

MR. JOHN CALONICO:
Yes. Absolutely. Absolutely. I think they're doing well. We still have a lot of interest and some of the problems we solved was in between DMS and OEMs. But I think, you definitely (indiscernible) the top three for us.

THE CALLER:
Thanks very much.

MR. JOHN CALONICO:
Thanks Kathy.

THE OPERATOR:
(CALLER INSTRUCTIONS) At this time there are no further questions.

MS. CAROL KAPLAN:
Thank you for joining us today. We look forward to speaking with you again in July. Goodbye.

THE OPERATOR:
That concludes today's conference call. You may now disconnect. (CONFERENCE CALL CONCLUDED)