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EXTENSITY INC  
Form 10-K  
April 01, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD \_\_\_\_\_ TO \_\_\_\_\_ .

Commission File Number: 000-28897

EXTENSITY, INC.  
(Exact name of Registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)

68-0368868  
(IRS Employer Identification Number)

2200 Powell Street, Suite 300, Emeryville, California 94608  
(Address of principal executive offices and zip code)

(510) 594-5700  
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12 (b) of the Act:

None

Securities Registered Pursuant to Section 12 (g) of the Act:

Common Stock, \$0.001 par value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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As of December 31, 2001, there were 24,871,147 shares of the Registrant's Common Stock outstanding. The aggregate market value of the Common Stock held by non-affiliates of the Registrant based on the closing price on December 31, 2001, as reported on the

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Nasdaq National Market System was \$26,756,226. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

### DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III is incorporated by reference to specified portions of the Registrant's definitive Proxy Statement to be issued in conjunction with the Registrant's 2002 Annual Meeting of Stockholders, which is expected to be filed not later than 120 days after the Registrant's fiscal year ended December 31, 2001.

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### EXTENSITY, INC.

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### PART I

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, INCLUDING, WITHOUT LIMITATION, STATEMENTS REGARDING THE COMPANY'S EXPECTATIONS, BELIEFS, INTENTIONS OR FUTURE STRATEGIES THAT ARE SIGNIFIED BY THE WORDS "EXPECTS," "ANTICIPATES," "INTENDS," "BELIEVES," OR SIMILAR LANGUAGE. ALL FORWARD-LOOKING STATEMENTS INCLUDED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE TO THE COMPANY ON THE DATE HEREOF, AND THE COMPANY ASSUMES NO OBLIGATION TO UPDATE ANY SUCH FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS. IN EVALUATING THE COMPANY'S BUSINESS, PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER THE INFORMATION SET FORTH BELOW UNDER THE CAPTION "RISK FACTORS" IN ADDITION TO THE OTHER INFORMATION SET FORTH HEREIN. THE COMPANY CAUTIONS INVESTORS THAT ITS BUSINESS AND FINANCIAL PERFORMANCE ARE SUBJECT TO SUBSTANTIAL RISKS AND UNCERTAINTIES.

#### ITEM I. BUSINESS

##### OVERVIEW

Extensity provides an Internet-based Employee Relationship Management (ERM) solution for the automation of employee-based financial processes. Our suite of software applications allow employees to plan business travel, file expense reports, request and approve indirect purchases, and capture time for project and payroll management. At the same time, the application enforces business policy and the use of preferred vendors. Extensity also provides reporting and analytics that leverage the collected data for vendor negotiation, policy control, and improved employee and resource utilization. A major portion

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of corporate spending is widely dispersed amongst employees making purchases as part of their day-to-day responsibilities. By automating these complex business processes through the use of our suite, companies can benefit from the centralized control of employee-initiated corporate spending.

Extensity's applications are available as licensed software or as a hosted solution. Regardless of a customer's choice of deployment, Extensity integrates with enterprise resource planning applications and other information technology systems. Furthermore, our software architecture allows our applications to be accessed by all employees on a myriad of devices, such as a networked personal computer, a laptop, a personal digital assistant (PDA) or a wireless application protocol (WAP)-enabled mobile phone.

Our products are now deployed in over 40 countries worldwide with more than 1,000,000 licensed seats. Our blue-chip customer base includes A.T. Kearney, Aventus, Bear Stearns, Cisco Systems, Fluor, Franklin Templeton Companies, GlaxoSmithKline, and Providian Financial. Extensity targets Global 2000 corporations who are seeking to realize hard-dollar cost savings through automation. Our mission is to save our customers money by automating all employee-based financial processes in a single, consolidated solution that provides efficiency, control, and effectiveness through analytics.

### MARKET OVERVIEW

#### GROWTH OF THE INTERNET AS A MEANS TO DEPLOY ENTERPRISE APPLICATIONS FOR DRIVING PRODUCTIVITY, INCREASING CORPORATE CONTROL AND REDUCING COSTS

The Internet has emerged as a universal communications medium that has become a catalyst for change in companies of all sizes. In today's intensely competitive global business environment, organizations have increasingly adopted the Internet as a means to streamline their business processes and make their employees more productive by automating a number of routine business tasks. The advantages of these Internet-based enterprise applications are clear. They are easy to deploy and maintain across an entire organization, regardless of size, and are readily adopted by employees who have come

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to expect the immediacy, self-service, ease-of-use and accessibility of content and commerce that the Internet provides.

### RECENT TRENDS IN PROCESS AUTOMATION

Businesses have traditionally made significant investments in enterprise resource planning (ERP), customer relationship management (CRM) and other enterprise software applications to automate processes in functions such as manufacturing, sales, human resources, customer support and finance. These systems typically have been focused on specific individual functional areas and address the business processes unique to each functional area. Frequently, they offer limited integration of information across functional areas. These systems have historically been limited in their ability to integrate information external to the enterprise. ERP and other enterprise software systems have also traditionally required lengthy and expensive customization and implementation and are expensive to maintain because their client-server architecture requires installation and continued maintenance on each desktop. While these systems are in place in most large companies, they have not focused historically on certain pervasive business processes that touch a high percentage of the employees in any organization, such as expense reporting, travel management, procurement and time capture.

These employee-centric business processes have been largely

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under-automated to date, resulting in processes that are time-consuming, inefficient and costly. Most companies today conduct travel planning, expense reporting, procurement and time capture through paper-based processes that require actions by many people, both inside and outside the organization. These processes involve re-keying of data, manual tracking of forms, limited data capture and limited ability to track and enforce corporate spending policies. Without business process automation, expense reporting, travel planning, procurement and time management transactions can have significant processing costs. In addition, traditional processes do not generally feature automated spending and procurement controls and, as a result, may fail to direct spending to preferred vendors and may permit spending on unapproved goods and services.

### OPPORTUNITY FOR EMPLOYEE RELATIONSHIP MANAGEMENT APPLICATIONS

A significant market opportunity exists in the developing market for ERM applications. ERM presents a new opportunity for employers to introduce efficiencies and direct cost savings into many of the key processes that involve their most valuable asset and largest expense - their workforce.

Some of the highest impact solutions within the ERM opportunity center around employee-based financial processes. These solutions are focused on providing direct cost savings to the organization and can result in a rapid Return on Investment (ROI). These significant cost-saving opportunities have driven demand for ERM solutions. The solutions provide cost-savings by:

- o Reducing, and often eliminating, the back-office resources needed to manage and audit these processes;
- o Automatically enforcing corporate policies through real-time business rules, which point end-users to approved vendors in the areas of travel and indirect procurement and compare spending to corporate guidelines;
- o Delivering integrated reporting for in-depth analysis of corporate expenses and resource utilization;
- o Providing data to purchasing decision makers for vendor contract negotiation;
- o Providing business managers with information on individual employee and overall workforce utilization, in order to manage employee productivity and profitability more effectively; and

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- o Reducing the time employees spend on general business tasks, freeing them to focus on their core responsibilities.

### THE EXTENSITY SOLUTION

Extensity provides an integrated suite of Internet-based software applications for ERM. This solution is designed to save our customers money by automating employee-based financial processes in a single, consolidated solution that provides efficiency, control and effectiveness through analytics. Our product suite currently comprises applications for expense reporting, travel management, indirect procurement and time capture. The suite shares a common user interface and can be accessed through a common HTML-based launchpad, called Extensity Connect.

The application suite is fully integrated so that each application works and shares information with all the other applications. In addition, our applications aggregate and integrate information and provide tools for reporting and analysis. Our applications are easy to learn, as users access all applications through a common, intuitive, browser-based interface. The integration of the suite to online services such as travel bookings, credit card

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feeds and content services provides a comprehensive solution for employee relationship management. Our applications are designed for rapid implementation and cost-effective deployment to end-users. With their scalable Web architecture and international features, our products can support large multinational companies.

Our ERM applications effect direct and indirect cost savings by:

- o Streamlining and automating traditional paper-based processes, thereby reducing the time and personnel requirements associated with expense reporting, travel planning, procurement and time capture;
- o Increasing accuracy through automation of error-checking, data import and business rule compliance;
- o Providing greater control of expenditure policy enforcement and administration; and
- o Supporting analysis of corporate purchasing and utilization patterns to enhance decision-making capabilities, increase leverage in negotiating vendor contracts, and promoting and enforcing the use of preferred vendors.

Our employee relationship management solution also increases productivity throughout the enterprise by:

- o Reducing employee time spent on tasks outside of their core responsibilities;
- o Enabling exception-based management that allows business managers to review only those expenditures that fall outside of a company's policies; and.
- o Supporting remote access via laptop computers, WAP-enabled mobile phones and PDAs.

### EXTENSITY STRATEGY

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Our objective is to be recognized as the leader of the rapidly developing market for ERM solutions. Our suite of applications automates employee-based financial processes that have a direct impact on the bottom line, and we intend to achieve market leadership through our focus on employee efficiency, spending analysis and policy control.

Key elements of our growth strategy include:

ENHANCING OUR SUITE OF EMPLOYEE RELATIONSHIP MANAGEMENT SOLUTIONS. In 2002, Extensity 6, a major new release of our solution, will become generally available. This release includes advances in technology as well as functionality enhancements in all of our application modules. While our expense reporting application has been widely recognized as a best-in-class solution, with this release we intend to increase the visibility and market acceptance of all of our application modules. We have also made a significant investment in improving our analytics capabilities and will continue to make this a key priority. Extensity intends to continue to enhance the Internet-based architecture of our technology platform in order to provide a comprehensive and functionally rich solution for

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employee-centric business processes. We also intend to continue to enhance the functionality of our existing application suite and leverage the existing platform to introduce additional integrated modules that address employee-based financial processes.

AGGRESSIVELY PENETRATING THE LARGE EMPLOYEE RELATIONSHIP MANAGEMENT MARKET. We believe that the market for ERM solutions is in its earliest stages. In order to address this market opportunity, we will utilize a combination of direct and indirect sales channels. We plan to focus our direct sales efforts across a variety of industries with a focus on large multinational organizations with a major presence in either North America or Europe. We will utilize our reseller partners to penetrate geographies such as Latin America and vertical industries which have unique requirements, such as the legal market.

MAKING CUSTOMER SATISFACTION OUR NUMBER ONE PRIORITY. In the second half of 2001, we increased our corporate focus on customer satisfaction. A Customer Life Cycle program, which includes regular contact and measurement of customer satisfaction metrics, was established to increase our focus on the customer. Extensity's goal is to be the most responsive vendor with which our customers do business.

### EXTENSITY PRODUCTS AND SERVICES

#### INTEGRATED SUITE FOR EMPLOYEE RELATIONSHIP MANAGEMENT

Extensity provides an ERM solution for the automation of employee-based financial processes. Our application suite currently includes Extensity Expense Reports, Extensity Travel Plans, Extensity Timesheets and Extensity Procurement. In addition, the suite includes a system administration tool designed for use by business professionals, not information technology (IT) staff, and an optional reporting and analysis module.

All applications are launched within a universal interface called Extensity Connect. This gateway to the Extensity suite provides an inbox summary, access to all Extensity applications, personal reports on items such as unattached credit card transactions, and links to external content and services, such as online travel booking or product catalogs. All Extensity applications share a consistent and easy-to-use, browser-based graphical user interface. The applications also share a common underlying technology architecture and a common data model, which allows them to work together and share information. In addition, our applications are universally accessible, allowing employees to work anywhere through a desktop computer, a laptop, a PDA, or through a WAP-enabled mobile phone.

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Our application suite provides comprehensive data regarding spending, suppliers, policy violations and resource utilization. We offer a business intelligence solution that transforms Extensity data into valuable information for proactive business management. By consolidating data from our expense reporting, travel, procurement and time capture modules into our central reporting database, our analytics solution can measure and analyze all employee-initiated corporate spending.

### COMMON FEATURES OF OUR APPLICATIONS

FEATURES

DESCRIPTION

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Approval workflow	Once submitted, documents are automatically routed to the correct approver/s. Approvers receive e-mail notification that a document awaits their approval, streamlining the process to ensure faster processing times for expense reports, travel plans, purchase requisitions and timesheets.
Real-time business rules	Real-time business rules ensure increased employee knowledge of corporate policies. By proactively notifying employees at the time of entry that the item lies outside of their corporate policy, or requires additional explanation, these rules help to improve both accuracy and compliance with business policy.
Employee self service	Employees can track in real time the status of any document that they have submitted, reducing the number of calls and inquiries to managers and processing departments.
Complete application integration	Documents can be linked. For example, a travel plan can be linked with an expense report for the trip or a time sheet can be linked with an expense report and a purchase requisition for a project.
Proxy user creation and approval	Employees can appoint another person to create and/or approve documents for them.
Project and cost center allocation	Expenses and time can be allocated across multiple cost centers and project codes as percentages or absolute dollar amounts.
Configurable interface and data capture	The application suite is fully configurable to incorporate each organization's specific data capture needs.
Intelligent personalization	Each employee's application becomes customized, maintaining previously used information, such as prior travel itineraries, cities traveled to, purposes and previously used vendors.
Online help	Context sensitive online help is provided for all applications.

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EXTENSITY EXPENSE REPORTS. Extensity Expense Reports is a full-featured application providing automation of the entire expense reporting process. Extensity Expense Reports brings accuracy, efficiency and control to this process. Using Extensity Expense Reports, employees, whether operating as a remote, off-line or local user, can quickly and easily create an expense report. This process is expedited and made more accurate through the use of online credit card data for automatic data entry. Compliance to business policy is checked as users create the expense reports. Compliant reports can be automatically approved so only noncompliant reports are routed to managers for approval. In reviewing noncompliant reports, managers need only focus on highlighted exceptions. Similarly, the accounting team spends less time re-keying data and auditing expense reports and more time analyzing travel and entertainment expense data for increased cost-savings. Employees can receive reimbursement rapidly through seamless integration with the organization's



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financial, payroll and human resources systems.

### FEATURES

### DESCRIPTION

Credit card integration and pre-population

Uses the data feed from corporate card vendors to enable travelers to select charges and automatically populate the expense report, reducing creation time and avoiding data entry errors.

Foreign currency support

Enables users to complete reports using local currencies, as well as enables automated foreign currency conversion.

Itemization and allocation

Supports expense itemization for more accurate accounting and allows allocations to be made at the line-item level without requiring a separate expense report for each project.

Receipt reconciliation

Guides users through itemizing receipts to ensure the expense is fully allocated.

Real-time policy enforcement

Ensures compliance to corporate expense policies at the time data is entered.

Integrated business intelligence

Extensity's reporting tool allows managers to analyze expenses and adherence to corporate policies.

EXTENSITY PROCUREMENT. Extensity Procurement automates and optimizes the requisitioning of non-production goods and services while enforcing a company's procurement policies. Through Extensity Procurement, employees can access their company's own purchasing catalog, or "punch out" to partner sites. The application is designed to minimize rogue purchasing and to ensure usage of preferred vendors for volume discounts. Corporate expenditure policies are automatically applied, approvals are accelerated and employees can have their orders fulfilled in a fraction of the time required for paper-based procurement. Extensity Procurement centrally captures key purchasing information that can be analyzed to continually evaluate and improve the procurement processes for further optimization and savings. Through automation, Extensity Procurement significantly reduces time-consuming administrative tasks, freeing purchasing professionals to focus on more strategic activities such as reducing redundant sources, selecting better vendors and negotiating contracts.

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### FEATURES

### DESCRIPTION

Purchase requisition templates

Accelerates document creation by pre-populating templates with frequent or common purchases such as new hire packages.

Sourcing requests

Facilitates requests for quotes from professional buyers using the organization's specific requirements.

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Commodity-based routing	Routes the line items on a purchase requisition to different approvers based on the type of commodity being purchased.
Catalog repository	Centrally created catalog with keyword and hierarchical search for easy reference by employees.
Default shipment locales	Creates default shipping locations from the user profile for additional control over corporate purchasing. Any change to a ship-to address can be treated as a policy exception.
Detailed cost allocation	Employees and managers can provide detailed cost allocation across multiple projects and cost centers at both the line item and document level.
Integrated business intelligence	Extensity's reporting tool allows managers to analyze expenses and adherence to corporate policies and approved vendor usage.

EXTENSITY TIMESHEETS. Extensity Timesheets enables quick and accurate time capture for both project management and payroll automation. Timesheets allows employees to capture their hours and paid time off efficiently and accurately so managers and payroll professionals can focus on more strategic activities, as opposed to gathering, entering or verifying employee time data. For professional services organizations that bill clients, Extensity Timesheets streamlines processes to ensure timely and accurate client billing, which helps companies reduce write-offs and enhance cash flow. Users can quickly identify charge codes with an easy-to-use project code chooser. Extensity Timesheets centralizes time information so project managers can leverage critical data to evaluate project profitability, as well as employee/resource utilization. For organizations with large numbers of non-exempt employees, Extensity can be used to automatically calculate overtime and feed that information to the payroll system with no need for additional data entry. In addition, all companies can benefit from Extensity Timesheets' ability to capture employee paid time off, eliminating payroll data entry and increasing the accuracy of paid time off reporting. Extensity Timesheets integrates with existing financial systems, as well as with Extensity Expense Reports and Extensity Procurement to ensure accurate pictures of project performance, bill-back to clients, and total employee and departmental spending.

### FEATURES

### DESCRIPTION

Overtime calculation engine	Automatically calculates overtime for hourly workers according to local labor laws and exports this information to the payroll system, eliminating payroll data entry.
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Drill-down project chooser	Enables users to quickly identify detailed project and
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	task codes from thousands of options using drill-down menus and business rules to ensure accuracy.
Multiple viewing and data entry options	Allows users to enter and track time by calendar view or by project line item.
Flexible reporting periods	Configures multiple reporting periods for various groups of users.
Integrated business intelligence	Real-time reports, accessed directly from our Connect portal, notify users of items such as delinquent time sheets. Integrated business analytics provides deeper analysis of project and payroll-related time.
Management by exception	Enables managers to review only those time sheets that require their attention by automatically approving time sheets that are within policy.

EXTENSITY TRAVEL PLANS. Extensity Travel Plans automates the planning, approval and procurement process for corporate travel. The application enables users to plan and book business travel through a streamlined method that enforces corporate travel policies before travel expenses are incurred. Extensity Travel Plans provides an immediate link to information and resources needed by a business traveler, such as corporate travel policies, online booking systems and general travel information resources. Managers can easily review travel plans, as corporate travel policies are enforced at the trip-planning stage. Extensity Travel Plans can be seamlessly integrated with Extensity Expense Reports for an end-to-end business travel solution. Working in tandem, Extensity Expense Reports and Extensity Travel Plans offer an efficient and accurate travel management system. Together, the two applications provide a seamless flow of information, from pre-trip planning to post-trip expense reimbursement and give managers a comprehensive view of projected and actual costs for variance analysis.

### FEATURES

### DESCRIPTION

Industry average cost data	Integrates benchmark costs into the product to create a accurate itinerary for domestic and international travel, which allows the user to better estimate travel costs.
Policy enforcement	Streamlines pre-trip approval process for cost savings and increased business efficiency, warning the user of out-of-policy items before costs are incurred.
Integrated online booking	Extensity integrates with leading travel booking tools for seamless online booking of air, lodging and car rental.
Integrated with Extensity Expense Reports	Can automatically approve expense reports that fall within the specified parameters of an approved travel plan.

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Integrated business intelligence	Extensity's reporting tool allows managers to analyze expenses and monitor adherence to corporate policies.
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EXTENSITY SYSTEM ADMINISTRATOR TOOL. The Extensity System Administration Tool is an application designed to allow the business users within an organization to maintain the Extensity suite, minimizing reliance on the internal information technology staff or outside consultants. The interface is graphical and easy to use. Single or multiple administrators can be created for various departments, groups or functional areas. All systems changes are recorded in an audit log for further security.

FEATURES	DESCRIPTION
User and group setup and maintenance	Maintains all aspects of user and group information, such as department identification, group-specific business rules and individual approval authority. Allows administrators to perform group-wide editing.
Corporate data setup and maintenance	Enables a system administrator to modify corporate data values such as cost centers, departments, mileage rates and permitted charge codes.
Business rules setup and maintenance	Enables a system administrator to modify business rules and policies.
Document viewing and modification	Allows an administrator to view and modify work items by reassigning access privileges of a particular document.

EXTENSITY BUSINESS INTELLIGENCE. Extensity's applications capture a wide range of corporate and employee data, with far more detail than is typically contained in a financial system of record. Extensity's business intelligence strategy is two-fold: real-time reporting accessible to all users and business intelligence tools for business analysts. Through our Extensity Connect interface, Extensity users can access reporting on everyday items such as unattached credit card transactions or delinquent or unapproved timesheets. For business analysis, Extensity has partnered with Business Objects, a respected leader in business intelligence, to provide world-class business intelligence. With these choices, Extensity provides organizations with comprehensive analytics that transform Extensity data into valuable information for vendor negotiation, policy compliance and enforcement, and proactive business management.

FEATURES	DESCRIPTION
Real-time user reporting	Real-time access to user-specific data, such as credit card transactions awaiting attachment to an expense report or delinquent timesheets.

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Simplified reporting database	Enables users to perform analysis of Extensity data either through the embedded Business Objects solution or through the user's own reporting solution.
Robust business analytics	Extensity uses the Business Objects product to deliver a configurable analytics solution complete with drill down capabilities and the ability for users to design reports.

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Employee spending analytics	Access to data on employee-based financial processes, including expense, procurement, travel and time capture, for comprehensive reporting. Report on spending by employee, department, project, cost center, or division, or distill valuable data for vendor negotiation or employee utilization.
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### SERVICES

We offer customers a comprehensive selection of implementation services, support and training. Our professional services organization consisted of 62 professionals as of December 31, 2001.

IMPLEMENTATION. Implementation typically requires tailoring of business rules, configuration of workflow, integration of customer data, and integration with one or more financial systems, a human resources system and an external corporate credit card system. Extensity provides a highly configurable solution, and customers can choose from a range of services, including our Extensity Advantage Best-Practices Implementation. Extensity Advantage delivers a targeted 90-day implementation utilizing our experience working with global customers to configure a solution that can be delivered quickly and inexpensively, without sacrificing functionality or control. Implementations are performed by our professional services organization or a system integrator partner and are typically billed based on a daily rate.

CUSTOMER SUPPORT AND MAINTENANCE. We provide support and maintenance services for each customer to whom we license an application. We offer three different support options for our workforce management applications, so customers can choose the level of support that best fits their business needs and resources. We have named our three support levels, Operations Support, Enterprise Support, and Mission Critical Support. Support and maintenance contracts are required for one year and can be renewed by the customer thereafter. Our customer support staff provides timely and accurate resolution of customer inquiries and is available via telephone, e-mail and fax. We also provide Extensity eSupport, a self-service Internet support option. Customers who choose Mission Critical Support, our most comprehensive support level, receive support services 24 hours per day, seven days per week.

TRAINING. Extensity offers a comprehensive set of training and learning tools. The training curriculum covers application features for all users, prepares company trainers to redeliver the training, and teaches the application administrators--accounting personnel, help desk staff and implementation teams--how to modify the dynamic aspects of the applications. Training is conducted at our training facilities, the customer site or via Web broadcast. We

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also offer Web-based reference tools, which can be used for self-paced training.

### TECHNOLOGY

Our applications are fully standards-based, designed for the Internet and built upon an underlying architecture that is written in Java. Our applications run on standard Web browsers and servers and support leading relational database management systems (RDBMS), including Oracle, Sybase, Microsoft SQL Server and IBM DB2. The multi-tier architecture connects browser-based applications to application servers and the RDBMS through a corporate local area network (LAN), wide area network (WAN), intranet or secure Internet connection. Our technology performs messaging between clients and the application engine in real time over transmission control protocol/internet protocol (TCP/IP), the suite of communications protocols used to connect hosts on the internet, and makes database connections via standard Java database drivers. Our applications are inherently scalable, due to our multi-tier architecture employing thin clients, multi-

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threaded application servers and relational databases. In addition, our Java-based architecture enables Extensity to operate across multiple platforms within an organization, including Windows 95, 98 or NT, Macintosh, Solaris and Palm operating systems. Our upcoming release, Extensity6, includes many technological advances, including moving to Java 2, the utilization of Java WebStart, and the addition of Connect portlets. Java 2 allows Extensity to make great strides in scalability and usability, while Java WebStart will enable Extensity applications to run independent of a browser and enable automatic updates to be pushed to the user seamlessly upon each connection with the server. New portlets, available through our Connect HTML interface, allow for access to real-time reports on user specific data, such as unattached credit cards.

### THE EXTENSITY ARCHITECTURE

Building on a standards-based foundation, we have designed a component-based application infrastructure composed of readily configurable business rules, a workflow system and advanced data management capabilities. Each of these core elements plays a crucial role in deploying enterprise-wide solutions that can model a company's unique policies and processes, manage key business functions and scale to meet the needs of an organization of any size.

**BUSINESS RULES SYSTEM.** Our business rules system allows each of our applications to be configured so that companies can effectively monitor their processes and policies. This system is also flexible and can be edited and modified as a company's processes and policies evolve. Employees are presented with appropriate warnings, explanations and message prompts to guide data entry and encourage conformance with corporate policies. The business rules dramatically reduce reworking of procedures, track and resolve policy exceptions online and eliminate re-keying of data into back-end systems. The business rules system permits management by exception, in which items requiring managerial attention are automatically highlighted so that managers need not review items that are clearly in compliance with established business rules.

**WORKFLOW SYSTEM.** Our workflow system ensures that information flows through the organization in a timely, secure and efficient manner. Robust enterprise applications require database-driven workflow, rather than e-mail-based messaging, to provide increased security and reliability, data and transaction integrity, real-time availability, optimization for high performance and usage reporting. Workflow processes can be configured to reflect the unique process flow of documents and business processes in any organization. Our

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applications also permit e-mail notification to users as to status of a procedure or of events requiring attention, alteration and action. For example, after an employee has submitted an expense report, the system can notify him or her where the document is in the approval and reimbursement cycle. Similarly, an e-mail notification can alert a manager of a document that requires attention.

ADVANCED DATA MANAGEMENT. Data management ensures that all our applications can be customized and extended to add, delete or modify buttons, type-in fields or other controls on an application's user interface, in each case as required by a customer's unique business objectives. New functionality can also be assigned to existing controls, or new controls, with little application modification and minimal programming. Our application suite can integrate with enterprise systems such as ERP systems and other financial, human resources (for user information and organizational structure) and project accounting systems as well as corporate credit card data feeds. These interfaces allow for the automatic exchange of data between our system and other enterprise systems and for the downloading of data managed by these enterprise systems into our application suite.

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### STRATEGIC RELATIONSHIPS

To rapidly deliver a comprehensive, robust solution to our customers, we have established strategic relationships with companies in six categories: travel management, finance, implementation services providers, resellers, e-business infrastructure providers, and e-commerce and employee services providers.

TRAVEL MANAGEMENT. We have established relationships with key partners in the travel management market, creating solutions for employee focused end-to-end travel management.

AMADEUS/E-TRAVEL--Announced in October 2001, Extensity entered into an agreement with Amadeus and e-Travel, an Amadeus company, to jointly market our travel management solutions. This agreement initially provides for joint marketing and sales between the companies. Future plans include integration of Extensity's ERM solution with e-Travel's online suite of services. Under the terms of the agreement, customers will be able to access e-Travel's online booking service through a single sign-on in Extensity Connect and complete the entire travel booking process from pre-trip approval and automatic policy enforcement through to expense reimbursement. The integration of Extensity's Employee Relationship Management (ERM) solution with e-Travel's online travel procurement and fulfillment service provides seamless business travel planning, transacting and reporting.

GETTHERE.COM--In April 2000, we partnered with Sabre Business Travel Solutions to provide an integrated e-commerce solution to approve, book, fulfill and expense corporate travel. In August 2000, Sabre acquired GetThere, Inc. Today, GetThere's online booking solution is a key integrated component in our Extensity Travel Plans application. As a leader in business-to-business online booking, GetThere.com provides airline, hotel and car rental bookings for our customers. GetThere.com and Extensity have joined forces to offer customers a completely integrated Web-based travel booking and expense reporting solution. The alliance capitalizes on the synergy between GetThere's Web-based Global Travel Manager, which links travelers and travel agencies to real-time travel information and reservations, and Extensity Travel Plans and Expense Reports. The integration between these products offer tremendous benefits to our mutual customers in supporting cost-efficient travel management from initial booking and approval through expense reporting and reimbursement, all via the Web.

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MCCORD TRAVEL MANAGEMENT--Announced in January 2002, McCord recommends Extensity to their customers, allowing the companies to provide an end-to-end travel management solution. Extensity will be a part of the overall travel management strategy that McCord creates and recommends to its customers. By including Extensity Travel Plans and Expense Reports as part of the travel solution, McCord's travel agents can concentrate on travel planning and booking rather than lengthy trip approval and reimbursement processes.

ROSENBLUTH INTERNATIONAL--Rosenbluth International continues to develop innovative business applications and integrated systems, which enable it to provide highly personalized service to its clients. By integrating with Extensity Expense Reports, Rosenbluth provides and supports an innovative, flexible travel and expense management solution that adapts well to clients' internal accounting procedures.

WORLDSPAN--As more and more companies reevaluate their traditional travel and expense processes, Worldspan and Extensity provide an automated travel management and expense reporting solution to significantly save time and processing costs. The partnership between Extensity and Worldspan is a natural extension of each company's core competencies, which translates to a high-caliber T&E solution for joint customers.

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WORLD TRAVEL PARTNERS/BTI-- This company's services span the globe through more than 1,200 offices in North America and the 2,800 locations of Business Travel International, a joint venture of more than 50 travel management companies operating in over 60 countries. Through their agreement, Extensity and World Travel Partners can offer a comprehensive business travel management solution.

We also have partnerships in place with companies, such as Runzheimer International and OANDA, which provide access to information essential to travel planning. Runzheimer provides transportation cost benchmarks, while OANDA provides a currency conversion data service.

FINANCE. Extensity Expense Reports accepts American Express, Diners Club, Visa and Master Card corporate card data feeds, allowing business travelers to select charges to automatically populate their expense reports. In the procurement card market, we work with Visa to integrate our applications suite with the Visa procurement card. American Express Purchasing Card data also feeds directly into Extensity Procurement, allowing employees to directly purchase smaller-ticket items without the complicated paperwork of traditional procurement systems. Our key finance partners also include JP Morgan Chase, GE Capital and US Bank.

INTERPLX TECHNOLOGIES-- INTERPLX Technologies provides corporations of all sizes with automated services to manage the processing of expense transactions related to corporate travel and procurement. These services include electronic funds transfer to employees and corporate charge cards, document collection, auditing, imaging and archiving, and related integration services. The combination of Extensity Expense Reports and INTERPLX's document management and auditing services dramatically reduces the cost, processing time and risk of error traditionally associated with expense report processing. Within the Extensity application, an employee creates an expense report and submits it for approvals, which are governed by the automatic business rules and workflow established through the application. From there, INTERPLX downloads the reports for processing and payment and sends an e-mail notification of payment to the employee. INTERPLX then audits, images, and archives the reports. This joint solution eliminates the time-consuming manual processes involved in the expense reporting and payment process, resulting in significant cost savings.



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IMPLEMENTATION SERVICE PROVIDERS. We have formed partnerships with implementation services providers to both enhance our implementation capacity and expand our distribution. All of our partners are certified under our Extensity Certified Program.

CAP GEMINI ERNST & YOUNG--CGEY's business solution, the "Connected Innerprise", includes leading solutions such as Extensity's integrated applications suite. The Connected Innerprise<sup>SM</sup> uses Web-based technologies to connect people, processes, data and applications across the ValueWeb<sup>SM</sup>. CGEY has a significant presence in North America, Europe and Asia.

KPMG--We have a strategic partnership with KPMG Consulting AG, Germany. Under the terms of our agreement, KPMG Consulting AG has committed to marketing and implementing our solutions for travel planning and expense management for customers within its enterprise e-business strategies in Germany.

To augment our implementation services worldwide, we have an additional network of certified implementation partners including TechSpan and Systime in the United States, and Princeton Consulting and Glue Ltd in Europe.

RESELLERS. We have established relationships with solutions providers to resell our products.

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ELITE--Elite Information Systems and Extensity have entered into a strategic alliance under which Elite resells Extensity's suite of applications. Elite provides practice management and financial software products to more than 700 customers worldwide. Extensity's ERM solutions are marketed to those customers to help them lower operating costs and improve employee productivity by automating day-to-day processes, such as expense reporting, travel planning and procurement. Both companies benefit from this alliance. Through Elite's expertise with mid-market customers, typically defined as companies with 10 to 4,000 employees, Extensity reaches a previously untapped market.

EMPLAZA--Emplaza is a 50/50 joint venture between Terra Networks and Meta4. The joint venture has been formed to create a virtual business-to-employee marketplace, while offering a comprehensive range of interactive services and products for the management of human resources and knowledge within companies. Under our agreement with Emplaza, users will be able to access our applications via a single sign-on through Emplaza, giving users one central point of access to the administrative applications they use every day. We also have an agreement whereby Emplaza can purchase our products at a discount and resell the products to its customers.

E-BUSINESS INFRASTRUCTURE. We have established relationships with key solutions providers to deliver integrated ERM solutions to our customers. Cisco Systems has selected us as one of its key solutions providers to support its workforce management effort. We have an agreement with Cisco that establishes us as Cisco's strategic Internet Business Solutions software partner and Cisco as our strategic networking partner. This relationship includes a mutual agreement to integrate each party's sales and marketing plans and obligates each party to review the other party's respective architectures for possible product integration. In this initiative, Cisco has taken an active role in communicating to its customers the benefits of Extensity Expense Reports. Cisco also supports Extensity through sales assistance, customer referrals and co-marketing activities. Other e-business infrastructure partners include IBM, Microsoft, Netigy, Sun Microsystems and Sybase.

E-COMMERCE AND EMPLOYEE SERVICES PROVIDERS. We have formed strategic

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relationships with several content, commerce and service providers to allow our network of customer employees to conduct commerce efficiently over the Internet.

DIGITAL THINK--We have long been focused on providing solutions that enable companies to control costs related to travel and entertainment. Digital Think's solution is a natural fit as it adds a cost avoidance component to our suite of applications, as well as an increasingly important component to employee retention: e-Learning. Digital Think's online catalog of courses can be easily launched from within Extensity Connect, providing employees a common user experience.

EVENTSOURCE--EventSource.com is the Internet's first online community for meeting planning. EventSource.com is used by corporate professionals to plan conferences, meetings, training, tradeshow, and sales and incentive programs.

PROACT TECHNOLOGIES--ProAct Technologies is a leader in providing an integrated suite of employee benefits, HR, and life planning solutions to large companies, allowing employees to easily make informed health, wealth, and benefits choices online. By partnering with ProAct, we can further provide automated everyday HR processes, which translates into overall cost savings and improved efficiencies for companies.

WEBEX--WebEx powers real-time meetings on the Web. Through Extensity Connect, we provide access to WebEx's Meeting Center Services providing an alternative to travel and further encouraging cost control.

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### MARKETING AND SALES

We focus our marketing efforts on achieving brand recognition, market awareness and lead generation. The market for Extensity's product suite includes Global 2000 enterprises in many industries. We typically market to the senior financial officer in an organization, such as the Chief Financial Officer or Vice President of Finance, although decisions to implement a solution such as ours are usually made by a committee with representatives from various departments including, but not limited to, IT, travel, accounts payable and human resources.

We also conduct public relations campaigns to promote market awareness of our product developments and major initiatives. Programs we use to attract customers include advertising in business and financial publications, e-newsletters, tradeshow, seminars, and direct mail. We also participate in various co-marketing initiatives with strategic partners. We maintain close relationships with industry analysts and frequently participate in industry conferences and events. Our website serves as another sales tool for prospective customers.

We sell the Extensity suite primarily through our direct sales organization operating in North America and Europe. Our North American sales force is divided into three sales regions: East, Central and West. We have sales offices in Emeryville, California; Irvine, California; Irving, Texas; Parsippany, New Jersey; Downer's Grove, Illinois; and Bethesda, Maryland. Our U.S. sales organization included 20 direct sales representatives as of December 31, 2001. Field-based sales engineers and sales development staff support our direct sales representatives. Our European offices are located in London, England and Frankfurt, Germany. Our European sales organization includes a European general manager. Three field-based engineers and sales staff support three direct sales representatives.

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### PRODUCT DEVELOPMENT

We have been developing and enhancing the Java-based architecture of our applications for the Internet since 1996. We released our first Extensity application, Extensity Expense Reports, in March 1998. Extensity Expense Reports was one of the first workforce management applications to be developed specifically for the Internet. We introduced Extensity Travel Plans in December 1998 and Extensity Timesheets and Extensity Procurement in July 1999. These four applications comprise our suite of ERM applications. In March 2000, we launched Extensity Connect, an HTML interface to our applications plus Internet content and commerce and integrated reporting functionality.

As of December 31, 2001, our engineering organization consists of 56 employees and is grouped according to the following areas of focus: product development, core technology, release engineering, mobile engineering, architecture, tools development, quality assurance and technical documentation. Each group within our engineering organization regularly shares resources and collaborates with other groups on code development, quality assurance and documentation. Our engineering organization includes a number of key individuals that have developed Internet applications and services and have extensive experience with Java-based application development. We believe that a technically skilled and experienced engineering organization is a key factor in the market acceptance of our applications and, accordingly, we plan to continue to make significant investments in our engineering organization and efforts to promote the success of our products.

To date, we have made significant investments in our technology architecture and applications, and we believe they provide us with a significant competitive advantage.

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Our research and development expenses, excluding amortization of non-cash stock based compensation, totaled \$11.9 million in 2001, \$13.3 million in 2000, \$7.1 million in 1999 and \$4.4 million in 1998. We intend to maintain our competitive advantage by continuing to focus on and refine our development efforts. Our engineering organization employs a defined product development methodology to each application, which includes technology and architectural roadmaps, product planning, requirement specifications, prototyping, design specifications, code review, identified program review points and beta testing.

To implement our business strategy successfully, we must provide software applications and related services that meet the demands of our customers and prospective customers. We expect that competitive factors will create a continuing need for us to improve and add to our suite of software solutions. We will have to expend significant funds on engineering and other resources to continue to improve our suite of applications, and to properly anticipate and respond to consumer preferences and demands. As organizations' needs change with respect to their enterprise applications, our existing suite of software applications may require modifications or improvements. The addition of new products and services will also require that we continue to improve the technology underlying our applications.

### COMPETITION

The market for Internet-based ERM applications is intensely competitive. The key competitive factors affecting this market include a significant base of reference customers, the breadth and depth of products and product features, the quality and performance of our products, the core technology underlying our applications, a high level of customer service and the ability to implement our solutions rapidly. With respect to these factors, we believe that our ERM

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applications compete favorably.

Our competitors in this market vary in size and in the scope and breadth of the products and services they offer. Companies offering one or more products that compete directly with our products include Ariba, Captura Software, Concur Technologies, IBM, Oracle Corporation, PeopleSoft Corporation and SAP Corporation. We also expect future competition from other established and emerging companies.

### EMPLOYEES

As of December 31, 2001, we had a total of 216 employees, including 56 in research and development, 68 in sales, marketing and business development, 62 in professional services and 30 in finance and administration. None of our employees are subject to a collective bargaining agreement and we believe our relationship with our employees is good.

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### RISK FACTORS

THE FOLLOWING IS A DISCUSSION OF CERTAIN FACTORS THAT CURRENTLY IMPACT OR MAY IMPACT OUR BUSINESS, OPERATING RESULTS AND/OR FINANCIAL CONDITION. ANY INVESTMENT IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD CONSIDER CAREFULLY THE FOLLOWING INFORMATION ABOUT THESE RISKS IN EVALUATING OUR BUSINESS. THE MARKET PRICE OF OUR COMMON STOCK COULD DECLINE, AND YOU MAY LOSE ALL OR PART OF THE MONEY YOU PAID TO BUY OUR COMMON STOCK.

#### RISKS RELATED TO OUR BUSINESS

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OUR LIMITED OPERATING HISTORY AND THE FACT THAT WE OPERATE IN A NEW INDUSTRY MAKE OUR BUSINESS PROSPECTS DIFFICULT TO EVALUATE.

We were incorporated in November 1995 and commenced licensing of our software applications in March 1998. An investor in our common stock must consider the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets such as the market for employee relationship management software applications. Risks and difficulties include our ability to:

- expand our base of customers with fully installed and deployed systems that can serve as reference accounts for our ongoing sales efforts;
- expand our pipeline of sales prospects in order to promote greater predictability in our period-to-period sales levels;
- continue to offer new products that complement our existing product

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line, in order to make our suite of applications more attractive to customers;

- continue to develop and upgrade our technology to add additional features and functionality;
- continue to attract and retain qualified personnel;
- expand direct sales channels and indirect channels such as relationships with OEM customers and distributors;
- increase awareness of our brand; and
- maintain our current and develop new third-party relationships, including but not limited to third-party implementers.

The Company may not be able to successfully address these risks or difficulties and our business strategy may not be successful. If we fail to address these risks or difficulties adequately, our business will likely suffer.

WE HAVE A HISTORY OF LOSSES AND NEGATIVE CASH FLOW AND EXPECT THIS TO CONTINUE INTO THE CURRENT FISCAL YEAR.

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Our business is new; we have offered products for a relatively short period of time; and our base of customers and prospective customers is still relatively small. We have spent significant funds to date to develop our current products and to develop our sales and market resources. We have incurred significant operating losses and have not achieved profitability. As of December 31, 2001, we had an accumulated deficit of \$100.4 million. We expect to continue to invest in research and development to enhance current products and develop future products and support our current sales and marketing efforts that promote our company and our products in the marketplace. As a result, we will need to increase our revenues significantly to achieve profitability. In addition, because we expect to continue to invest in our business ahead of anticipated future revenues, we expect that we will continue to incur operating losses into the current fiscal year.

OUR BUSINESS IS CHANGING RAPIDLY, WHICH COULD CAUSE OUR QUARTERLY OPERATING RESULTS TO VARY AND OUR STOCK PRICE TO FLUCTUATE.

Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are beyond our control. We expect to continue to make expenditures in all areas of our business, particularly in our sales and marketing operations, in order to promote future revenue growth. Because the expenses associated with these activities are relatively fixed in the short-term, we will be unable to adjust spending quickly enough in any particular quarter to offset any unexpected shortfall in revenue. As a result, we expect our quarterly operating results to fluctuate. Our financial results may, as a consequence of quarterly revenue fluctuations, fall short of the expectations of public market analysts or investors. If this occurs, the price of our common stock may drop.

We also seek to develop and maintain a significant pipeline of potential sales prospects, but it is difficult to predict when individual customer orders will be closed. Our base of customers and the number of additional customer licenses we enter into each quarter are still relatively small. Accordingly, the loss or deferral of a small number of anticipated large customer orders in any quarter could result in a significant shortfall in revenues for that quarter and future quarters, which could result in a drop in the price of our stock.

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Other important factors that could cause our quarterly results and stock price to fluctuate materially include:

- our ability to grow our customer base and our base of referencing customers, in light of our relatively limited number of customers to date;
- our ability to successfully develop alternative sales channels for our products, such as sales through OEM customers or distributors;
- our ability to expand our implementation and consulting resources through third-party relationships, in light of the fact that we have limited third-party implementation and consulting relationships currently in place;
- technical difficulties or "bugs" affecting the operation of our software; and
- delays in the introduction of new or enhanced versions of our products.

Due to our limited operating history, the early stage of our market and the factors discussed above, you should not rely on quarter-to-quarter comparisons of our results of operations as indicators of our future performance.

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WE FACE INTENSE COMPETITION, WHICH COULD AFFECT OUR ABILITY TO INCREASE REVENUE, MAINTAIN OUR MARGINS AND INCREASE MARKET SHARE.

The market for our internet-based employee relationship management software applications is intensely competitive and we expect competition to increase in the future. Competitors vary in size and in the scope and breadth of the products and services they offer. Companies offering one or more products directly competitive with our products include Ariba, Captura Software, Concur Technologies, IBM, PeopleSoft and Oracle. As a result of the large market opportunity for employee relationship management solutions we also expect competition from other established and emerging companies.

Many of our current and potential competitors have longer operating histories, significantly greater financial, technical, marketing and other resources, significantly greater name recognition, and a larger installed base of customers than us. In addition, many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of our industry. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address customer needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We also expect that competition will increase as a result of industry consolidation. Increased competition may result in price reductions, reduced margins and loss of market share, any one of which could seriously harm our business.

IF WE DO NOT PROVIDE SOFTWARE APPLICATIONS AND RELATED SERVICES THAT MEET THE CHANGING DEMANDS OF OUR CUSTOMERS, THE MARKET FOR OUR PRODUCTS WILL NOT GROW OR MAY DECLINE, AND OUR PRODUCT SALES WILL SUFFER.

To successfully implement our business strategy, we have to provide

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software applications and related services that meet the demands of our customers and prospective customers as the market and customer requirements evolve. We expect that competitive factors will create a continuing need for us to improve and add to our suite of software applications. Not only will we have to expend additional funds and other resources to continue to improve our existing suite of applications, but we must also properly anticipate, address and respond to customer preferences and demands. As organizations' needs change with respect to their enterprise applications, our existing suite of software applications may become obsolete or inefficient relative to our competitors' offerings and may require modifications or improvements. The addition of new products and services will also require that we continue to improve the technology underlying our applications. These requirements could be significant, and we may fail to fulfill them quickly and efficiently. If we fail to expand the breadth of our applications quickly in response to customer needs or if these offerings fail to achieve market acceptance, the market for our products will not grow or may decline, and our business may suffer significantly.

Our employee relationship management software products and related services have accounted for substantially all of our revenues to date. We anticipate that revenues from these products and related services will continue to constitute substantially all of our revenues for the foreseeable future. Consequently, our future financial performance will depend, in significant part, upon the successful development, introduction and customer acceptance of enhanced versions of our employee relationship management software applications and any new products or services that we may develop or acquire. We cannot assure you that we will be successful in enhancing, upgrading or continuing to effectively market our employee relationship management software applications or that

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any new products or services that we may develop or acquire will achieve market acceptance.

EVOLVING TECHNOLOGICAL DEVELOPMENTS AND EMERGING INDUSTRY STANDARDS WILL REQUIRE US TO ENHANCE THE FUNCTIONALITY OF OUR EMPLOYEE RELATIONSHIP MANAGEMENT SOFTWARE APPLICATIONS, AND ANY INABILITY TO ENHANCE FUNCTIONALITY COULD CAUSE OUR SALES TO DECLINE.

Because the market for our products is subject to rapid technological change and evolving industry standards, the life cycles of our products are difficult to predict. Competitors may introduce new products or enhancements to existing products employing new technologies, which could render our existing products and services obsolete and unmarketable. For example, our currently available software applications are written entirely in the Java computer language. While we believe that this provides our solution with significant advantages in terms of functionality and flexibility, it is not clear whether Java-based systems will continue to maintain commercial acceptance.

To be successful, our products and services must keep pace with technological developments and emerging industry standards, address the ever-changing and increasingly sophisticated needs of our customers and achieve market acceptance. Our results of operations would be seriously harmed if we are unable to develop, release and market new software product enhancements on a timely and cost-effective basis, or if new products or enhancements do not achieve market acceptance or fail to respond to evolving industry or technology standards.

In developing new products and services, we may also fail to develop and market products that respond to technological changes or evolving industry standards in a timely or cost-effective manner, or experience difficulties that

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could delay or prevent the successful development, introduction and marketing of these new products and services.

IN ANY GIVEN QUARTER, OUR REVENUES HAVE BEEN DERIVED FROM A RELATIVELY SMALL NUMBER OF CUSTOMERS, AND THE LOSS OF A SMALL NUMBER OF MAJOR CUSTOMERS OR POTENTIAL CUSTOMERS COULD ADVERSELY IMPACT OUR QUARTERLY REVENUES OR OPERATING RESULTS.

We expect that we will continue to derive a significant portion of our revenues from a relatively small number of customers in the future. Accordingly, the loss of a small number of major customers could materially and adversely affect our business, and the deferral or loss of anticipated orders from a small number of prospective customers could materially and adversely impact our quarterly revenues and operating results in any period.

IF WE FAIL TO MAINTAIN POSITIVE MARGINS ON SERVICE REVENUES IN THE FORESEEABLE FUTURE, OUR RESULTS OF OPERATIONS COULD SUFFER.

For the year ended December 31, 2001, our service margins were positive. While we anticipate that our margins will continue to be positive in the future, we cannot guarantee that they will remain positive. Failure to maintain positive margins on service revenues would cause our business to suffer. For more information related to our costs associated with our service revenues, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

IF WE FAIL TO EXPAND OUR RELATIONSHIPS WITH THIRD PARTIES THAT CAN PROVIDE IMPLEMENTATION AND CONSULTING SERVICES TO OUR CUSTOMERS, WE MAY BE UNABLE TO GROW OUR REVENUES AND OUR BUSINESS COULD BE HARMED.

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In order for us to focus more effectively on our core business of developing and licensing software solutions, we must continue to establish relationships with third parties that can provide implementation and consulting services to our customers. Third-party implementation and consulting firms can also be influential in the choice of employee relationship management software applications by new customers. To date, we have established relationships with several third-party implementation and consulting firms. In general, however, if we are unable to establish and maintain effective, long-term relationships with implementation and consulting providers, or if these providers do not meet the needs or expectations of our customers, we may be unable to grow our revenues and our business could be seriously harmed. As a result of the limited resources and capacities of many third-party implementation providers, we may be unable to attain sufficient focus and resources from the third-party providers to meet all of our customers' needs, even if we establish relationships with these third parties. If sufficient resources are unavailable, we will be required to provide these services internally, which could limit our ability to expand our base of customers. A number of our competitors have significantly more established relationships with these third parties and, as a result, these third parties may be more likely to recommend competitors' products and services rather than our own. Even if we are successful in developing additional relationships with third-party implementation and consulting providers, we will be subject to significant risk, as we cannot control the level and quality of service provided by third-party implementation and consulting partners.

OUR EXPECTATIONS OF FUTURE GROWTH DEPEND ON OUR ABILITY TO EXPAND INTERNATIONALLY, AND FACTORS SPECIFIC TO OUR INTERNATIONAL EXPANSION MAY PREVENT US FROM ACHIEVING OUR ANTICIPATED GROWTH.



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Over time, we intend to expand our international operations to achieve our anticipated growth, but we may face significant challenges to our international expansion. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. To achieve broad acceptance in international markets, our products must be localized to handle a variety of factors specific to each international market, such as tax laws and local regulations. The incorporation of these factors into our products is a complex process and often requires assistance from third parties. We may not adequately address all of the factors necessary to achieve broad acceptance in our target international markets. Further, to achieve broad usage by employees across international organizations, our products must be localized to handle native languages and cultures in each international market. Localizing our products is also a complex process and we intend to continue working with third parties to develop localized products. To date, we have localized our product for the markets where the English language is the native language and completed translations for the German, French, Italian and Spanish languages.

We have only a limited history of marketing, selling and supporting our products and services internationally. In 1999, we opened a regional office in the United Kingdom. In 2000, we expanded our European Operations through opening a second office in Frankfurt, Germany. As of December 31, 2001, we had a total of 13 employees in our international operations. For the twelve months ended December 31, 2001, we derived approximately 10% of our revenues from our international operations. To succeed internationally, we must react quickly to the business environment in which we operate overseas. Thus we must effectively monitor the size of our international workforce and make adjustments as necessary. During periods of growth we must hire and train experienced international personnel as well as recruit and retain qualified domestic personnel to staff and manage our international operations. However, we may experience difficulties in recruiting and training additional international staff. We must also be able to enter into strategic relationships with companies in international markets.

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If we are not able to maintain successful strategic relationships internationally or recruit additional companies to enter into strategic relationships, our future growth could be limited. We also face other risks inherent in conducting business internationally, such as:

- difficulties in collecting accounts receivable and longer collection periods;
- seasonal business activity in certain parts of the world;
- fluctuations in currency exchange rates; and
- trade barriers.

Any of these factors could seriously harm our international operations and, consequently, our business.

OUR SALES CYCLES ARE LONG AND UNPREDICTABLE, WHICH MAKES PERIOD-TO-PERIOD REVENUES DIFFICULT TO PREDICT.

Because the market for our employee relationship management software products and related services is relatively new, we experience long and unpredictable sales cycles. The sales cycle for our employee relationship

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management software applications typically ranges from two to nine months. In the early stages of this market, our customers have frequently viewed the purchase of our products as part of a long-term strategic decision regarding the management of their workforce-related operations and expenditures. This decision process has sometimes resulted in customers taking a long period of time to assess alternative solutions by our competitors or deferring a purchase decision until the market evolves. Sales cycles continue to be long and the timing of purchase decisions by individual customers remain at times uncertain. We must continue to educate potential customers on the use and benefits of our products and services, as well as the integration of our products and services with additional software applications utilized by the individual customers. Because the sales cycle is long and the time of individual orders is uncertain, our period-to-period revenues are difficult to predict.

WE MAY BE UNABLE TO ATTRACT AND RETAIN HIGHLY SKILLED EMPLOYEES THAT ARE NECESSARY FOR THE SUCCESS OF OUR BUSINESS PLAN.

Our ability to execute our business plan and be successful also depends on our continued ability to attract and retain highly skilled employees. We depend on the services of senior management and other personnel, particularly Robert A. Spinner, our Chief Executive Officer. Over time, we will need to hire additional personnel in all operational areas. Competition for personnel in our industry is intense. We have in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we do not succeed in attracting or retaining personnel, our business could be adversely affected.

SOFTWARE DEFECTS COULD LEAD TO LOSS OF REVENUE OR DELAY THE MARKET ACCEPTANCE OF OUR APPLICATIONS.

Our enterprise applications software is complex and, accordingly, may contain undetected errors or failures when first introduced or as new versions are released. This may result in loss of, or delay in, market acceptance of our products. We have in the past discovered software errors in our new releases and new products after their introduction. In the event that we experience significant software errors in future releases,

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we could experience delays in the release, customer dissatisfaction and lower revenues and service margins during the period required to correct these errors. We may in the future discover errors, and additional scalability limitations, in new releases or new products after the commencement of commercial shipments. Any of these errors or defects could cause our business to be materially harmed.

WE MAY BECOME INCREASINGLY DEPENDENT ON THIRD-PARTY SOFTWARE INCORPORATED IN OUR PRODUCTS AND, IF SO, IMPAIRED RELATIONS WITH THESE THIRD PARTIES, ERRORS IN THIRD-PARTY SOFTWARE OR INABILITY TO ENHANCE THE SOFTWARE OVER TIME COULD HARM OUR BUSINESS.

We incorporate third-party software into our products. Currently, the third-party software we use includes application server software that we license from BEA Systems, off-line database software from Pointbase, off-line client server software from PUMATECH, synchronization software from AETHER Systems and reporting software from BUSINESS OBJECTS. We may incorporate additional third-party software into our products as we expand our product line and broaden the content and services accessible through our gateway. The operation of our products would be impaired if errors occur in the third-party software that we license. It may be more difficult for us to correct any errors in third-party

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software because the software is not within our control. Accordingly, our business would be adversely affected in the event of any errors in this software. Furthermore, it may be difficult for us to replace any third-party software if a vendor seeks to terminate our license to the software.

OUR SUCCESS DEPENDS IN PART UPON OUR ABILITY TO PROTECT OUR INTELLECTUAL PROPERTY AND WE MAY NOT BE ABLE TO DO SO ADEQUATELY.

Our success depends in large part upon our proprietary technology. We rely on a combination of copyright, trademark and trade secret protection, confidentiality and nondisclosure agreements and licensing arrangements to establish and protect our intellectual property rights. We license rather than sell our solutions and require our customers to enter into license agreements, which impose restrictions on their ability to utilize the software. In addition, we seek to avoid disclosure of our trade secrets through a number of means, including requiring those persons with access to our proprietary information to execute nondisclosure agreements with us and restricting access to our source code. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and while we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States of America. Our means of protecting our proprietary rights may not be adequate and our competitors may independently develop similar technology, duplicate our products, or design around our proprietary intellectual property.

SECURITY AND OTHER CONCERNS MAY DISCOURAGE CUSTOMERS FROM PURCHASING OUR HOSTED PRODUCT.

If customers determine that our hosted product is not scalable, does not provide adequate security for the dissemination of information over the Internet, or is otherwise inadequate for Internet-based use, or if for any other reason customers fail to accept our hosted products for use on the Internet or on a subscription basis, our business will be harmed. As a hosted provider, we expect to receive confidential information including credit card, travel booking, employee, purchasing, supplier, and other financial and

accounting data, through the Internet and there can be no assurance that this information will not be subject to computer break-ins, theft, and other improper activity that could jeopardize the security of information for which we are responsible. Any such lapse in security could expose us to litigation, loss of customers, or otherwise harm our business. In addition, any person who is able to circumvent our security measures could misappropriate proprietary or confidential customer information or cause interruptions in our operations. We may be required to incur significant costs to protect against security breaches or to alleviate problems caused by breaches. Additionally, in the past, computer viruses and software programs that disable or impair computers have been distributed and have rapidly spread over the Internet. Computer viruses could be introduced into our systems or those of our customers or suppliers, which could disrupt our software solutions or make them inaccessible to customers or suppliers. Further, a well-publicized compromise of security could deter people from using the Internet to conduct transactions that involve transmitting confidential information. Our failure to prevent security breaches, or well-publicized security breaches affecting the Internet in general, could

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significantly harm our business, operating results and financial condition.

WE MAY FACE COSTLY DAMAGES OR LITIGATION COSTS IF A THIRD PARTY CLAIMS THAT WE INFRINGE ITS INTELLECTUAL PROPERTY.

There has been a substantial amount of litigation in the software industry and the Internet industry regarding intellectual property rights. It is possible that in the future, third parties may claim that we or our current or potential future products infringe upon their intellectual property. We expect that software product developers and providers of Internet-based software applications will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all, which could seriously harm our business.

WE ARE THE TARGET OF A SECURITIES CLASS ACTION COMPLAINT AND ARE AT RISK OF SECURITIES CLASS ACTION LITIGATION, WHICH MAY RESULT IN SUBSTANTIAL COSTS AND DIVERT MANAGEMENT ATTENTION AND RESOURCES.

In November 2001, the Company and certain of its officers and directors, as well as certain of the underwriters from the Company's initial public offering, were named as defendants in a class action shareholder complaint filed in the United States District Court for the Southern District of New York and captioned FELZEN V. EXTENSITY, INC., ET AL., Case No. 01-CV-11246. In the complaint, the plaintiffs allege that the Company, certain of its officers and directors and its initial public offering underwriters violated the federal securities laws because the Company's registration statement and prospectus for its initial public offering contained untrue statements of material fact or omitted material facts regarding the compensation to be received by, and the stock allocation practices of, the underwriters. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against numerous public companies that conducted initial public offerings of their common stock since the mid-1990s. This action may divert the efforts and attention of our management and, if determined adversely to the Company, could have a material impact on our business.

ANY FUTURE ACQUISITIONS OF COMPANIES OR TECHNOLOGIES MAY RESULT IN DISTRACTION OF OUR MANAGEMENT AND DISRUPTIONS TO OUR BUSINESS.

We may acquire or make investments in complementary businesses, technologies, services or products if appropriate opportunities arise. From time to time we may engage

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in discussions and negotiations with companies regarding our acquiring or investing in such companies' businesses, products, services or technologies. We cannot make assurances that we will be able to identify future suitable acquisition or investment candidates, or if we do identify suitable candidates, that we will be able to make such acquisitions or investments on commercially acceptable terms or at all. If we acquire or invest in another company, we could have difficulty assimilating that company's personnel, operations, technology or products and service offerings. In addition, the key personnel of the acquired company may decide not to work for us. These difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our results of operations. Furthermore, we may incur indebtedness or issue equity securities to pay for any future acquisitions. The issuance of equity securities could be dilutive to our existing stockholders.

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WE HAVE ANTI-TAKEOVER PROVISIONS IN OUR CHARTER AND IN OUR CONTRACTS THAT COULD DELAY OR PREVENT AN ACQUISITION OF OUR COMPANY, EVEN IF SUCH AN ACQUISITION WOULD BE BENEFICIAL TO OUR STOCKHOLDERS.

Provisions of our certificate of incorporation, our bylaws, Delaware law and the employment agreements of some of our key officers could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders.

OUR BUSINESS MAY FACE ADDITIONAL RISKS AND UNCERTAINTIES NOT PRESENTLY KNOWN TO US, WHICH WOULD CAUSE OUR BUSINESS TO SUFFER.

In addition to the risks specifically identified in this Risk Factors section or elsewhere in this Annual Report, we may face additional risks and uncertainties not presently known to us or that we currently deem immaterial which ultimately may impair our business, results of operations and financial condition.

### RISKS RELATED TO OUR INDUSTRY

OUR SUCCESS WILL DEPEND UPON THE GROWTH AND ACCEPTANCE OF THE MARKET WE ADDRESS AND OUR ABILITY TO MEET THE NEEDS OF THE EMERGING MARKET FOR EMPLOYEE RELATIONSHIP MANAGEMENT SOFTWARE APPLICATIONS.

The market for our employee relationship management software applications and services is at an early stage of development. Our success will depend upon the continued development of this market and the increasing acceptance by customers of the benefits to be provided by employee relationship management applications and services. In addition, as the market evolves, it is unclear whether the market will accept our suite of applications as a preferred solution for employee relationship management needs. Accordingly, our products and services may not achieve significant market acceptance or realize significant revenue growth. Unless a critical mass of organizations and their suppliers use our solutions and recommend them to new customers, our solutions may not achieve widespread market acceptance, which may cause our business to suffer.

MARKET PRICES OF TECHNOLOGY COMPANIES HAVE BEEN HIGHLY VOLATILE, AND THE MARKET FOR OUR STOCK MAY CONTINUE TO BE VOLATILE AS WELL.

The stock market has experienced significant price and trading volume fluctuations and the market prices of technology companies generally, and Internet-related software companies particularly, have been extremely volatile. Investors may not be able to resell their shares at or above the price they paid for the stock. In the past, following periods of volatility in the market price of a public company's securities, securities class action

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litigation has often been instituted against that company. Such litigation would likely result in substantial costs and diversion of management's attention and resources

INCREASING GOVERNMENT REGULATION COULD LIMIT THE MARKET FOR, OR IMPOSE SALES AND OTHER TAXES ON THE SALE OF, OUR PRODUCTS AND SERVICES.

As Internet commerce evolves, we expect that federal, state or foreign agencies will adopt regulations covering issues such as user privacy, pricing, taxation of goods and services provided over the Internet, and content and quality of products and services. It is possible that legislation could expose

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companies involved in electronic commerce to liability, which could limit the growth of electronic commerce generally. Legislation could dampen the growth in Internet usage and decrease its acceptance as a communications and commercial medium. If enacted, these laws, rules or regulations could limit the market for our products and services.

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### ITEM 2. PROPERTIES

Our primary administrative, sales, marketing, research and development facility is located in Emeryville, California. Our primary office space is held under a lease agreement. In addition, we also lease sales offices in Boston, Chicago, Los Angeles and Mahwah, NJ. We also lease sales and support offices outside of North America including locations in London and Frankfurt. We believe our existing facilities meet our current needs and that we will be able to obtain additional commercial space as needed.

### ITEM 3. LEGAL PROCEEDINGS

In November 2001, the Company and certain of its officers and directors, as well as certain of the underwriters from the Company's initial public offering ("IPO"), were named as defendants in a class action shareholder complaint filed in the United States District Court for the Southern District of New York and captioned FELZEN V. EXTENSITY, INC., ET AL., Case No. 01-CV-11246. In the complaint, the plaintiffs allege that the Company, certain of its officers and directors and its IPO underwriters violated the federal securities laws because the Company's IPO registration statement and prospectus contained untrue statements of material fact or omitted material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against numerous public companies that conducted IPOs of their common stock since the mid-1990s (together with FELZEN V. EXTENSITY, INC., ET AL., the "IPO Lawsuits").

On August 8, 2001, the IPO Lawsuits were consolidated for pretrial purposes before United States Judge Shira Scheindlin of the Southern District of New York. Judge Scheindlin held an initial case management conference on September 7, 2001, at which time she ordered, among other things, that the time for all defendants to respond to any complaint be postponed until further order of the court. Thus, the Company has not been required to answer any of the complaints, and no discovery has been served on the Company.

At a further status conference on March 11, 2002, Judge Scheindlin stated that she would appoint lead plaintiffs counsel in the IPO Lawsuits in mid-March 2002, and would require the appointed lead plaintiffs counsel to file amended, consolidated complaints by April 17, 2002. Defendants will not be expected to

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file motions to dismiss the amended, consolidated complaints until the summer of 2002. The Company, with the assistance of its legal counsel, intends to defend its position in this matter vigorously.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no matters submitted to a vote of security holders.

### EXECUTIVE OFFICERS AND OTHER OFFICERS OF THE REGISTRANT

The executive officers and other officers of Extensity are as follows:

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NAME	AGE	POSITION
Robert A. Spinner	44	President and Chief Executive Officer and Director
Sharam I. Sasson	47	Chairman of the Board of Directors and Founder
Kenneth R. Hahn	35	Chief Financial Officer
Elizabeth A. Ireland	43	Vice President of Marketing
Allen F. Nordgren	56	Vice President of Professional Services
Mark K. Oney	44	Vice President of Engineering
Donald E. Smith	43	Vice President of Hosted Operations & Customer Advocacy
David A. Yarnold	42	Vice President of Worldwide Sales
Rick L. Spickelmier	42	Chief Technology Officer
Jennifer H. Burt	40	Vice President of Human Resources

ROBERT A. SPINNER has served as Extensity's President, Chief Executive Officer and director since April 1999. Prior to joining Extensity, from January 1995 to January 1999, Mr. Spinner served as Senior Vice President of Worldwide Sales and International Operations at Clarify, Inc., a provider of integrated sales and service solutions for the front office. From October 1988 to December 1994, Mr. Spinner served as Director of Western Regional Sales at Sybase, Inc., a relational database management software company. Mr. Spinner has also held technical positions at Applied Data Research, Inc. and Chevron Corporation. Mr. Spinner received a B.A. in mathematics from Washington University.

SHARAM I. SASSON is the founder and Chairman of the board of directors of Extensity and has served as a director since our inception in 1995. Mr. Sasson served as our President and Chief Executive Officer until March 1999. Prior to founding Extensity, Mr. Sasson was an executive at Scopus Technology, a provider of enterprise customer information management systems which he co-founded in 1991. Mr. Sasson has also served as a research scientist at Lockheed Missile and Space Company and as a developer of structural modeling software at PMB/Bechtel Corporation. Mr. Sasson received a B.S. in civil engineering from Queen Mary College, University of London, an M.S. in structural engineering from City University in London, and a Master in Engineering from the University of California at Berkeley.

KENNETH R. HAHN was appointed Extensity's Chief Financial Officer in December 1999, has served as Vice President of Finance and Administration since January 1999 and previously served as Corporate Controller from January 1998 to January 1999. From September 1995 to December 1997, Mr. Hahn was employed as a

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management consultant with The Boston Consulting Group, a strategy consulting firm. Mr. Hahn attended the Stanford Graduate School of Business, where he earned an MBA and was named an Arjay Miller Scholar. Mr. Hahn also held various positions at Price Waterhouse LLP, most recently as an Audit Manager. He received a B.A. in business administration from California State University, Fullerton and is a Certified Public Accountant and has held a Certified Management Accountant's license.

ELIZABETH A. IRELAND has served as Extensity's Vice President of Marketing since January 1998. Prior to joining Extensity, Ms. Ireland was employed at MapInfo Corporation, a software company, from 1989 to October 1997, most recently as Vice President and General Manager of Internet Businesses. Additional positions held by Ms. Ireland at MapInfo Corporation include Vice President of Marketing and Business Development and Vice President of Information Products. Ms. Ireland received a B.S. in business administration from the University of South Carolina and has held a Certified Public Accountant's license.

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ALLEN F. NORDGREN has served as Extensity's Vice President of Professional Services since November 1997. Prior to joining Extensity, Mr. Nordgren was employed from June 1996 to November 1997 at Logica, Inc., a systems integrator, as Vice President and General Manager of Western U.S. Operations. From October 1992 to May 1996, Mr. Nordgren was employed at Sybase, Inc., a relational database management software company, most recently as Practice Director of Professional Services for the Northwest Region. Mr. Nordgren attended Bernard Baruch University and served four years in the U.S. Military.

MARK K. ONEY has served as Extensity's Vice President of Engineering since July 1999. Prior to joining Extensity, from May 1999 to June 1999, Mr. Oney served as the Vice President of Engineering for Ringer Software, a consumer information Internet company. From September 1998 through January 1999, Mr. Oney was a co-founder of and served as Vice President of Software Engineering for Crag Technologies, Inc., a developer and supplier of data storage solutions. Crag Technologies was acquired by Western Digital Corporation in February 1999. From July 1997 through May 1998, Mr. Oney was a co-founder of and served as Vice President of Software Engineering for Ridge Technologies, a Windows NT storage company which was acquired by Adaptec, Inc., in May 1998. Prior to founding Ridge, from May 1988 through June 1997, Mr. Oney served in a variety of engineering and management roles at Apple Computer, Inc., most recently as Director of Software Development for the PowerBook line of business. Mr. Oney received a B.S. in electrical engineering from Rochester Institute of Technology.

DONALD E. SMITH has served as Extensity's Vice President of Hosted Operations and Customer Advocacy since January 2000. Mr. Smith co-founded Clarify, Inc. in 1990, and held various management positions at Clarify until January 2000, including Vice President of Sales Engineering and Director of Quality Assurance, Product Design and Customer Support. Mr. Smith received a B.S.E.E. from the University of Nebraska at Lincoln.

DAVID A. YARNOLD has served as Extensity's Vice President of Worldwide Sales since January 2002; previously, he served as Vice President of North American Sales from January of 2001 to December 2001, and Vice President of Business Development from August 1999 to January 2001. Prior to joining Extensity, from January 1996 to July 1999, Mr. Yarnold was employed at Clarify, Inc., most recently as Vice President of Northern American Sales. From January 1993 to October 1995, Mr. Yarnold served as Regional Vice President of Platinum Software Corporation, a financial software provider. Mr. Yarnold received a B.S.



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in accounting from San Francisco State University and has held a Certified Public Accountant's license.

DR. RICK L. SPICKELMIER has served as Extensity's Chief Technology Officer since July 2000, and prior to this position he was Extensity's Server Architect. Prior to joining Extensity, from 1990 to 1998, Dr. Spickelmier served as the Director of Development at Objectivity, a supplier of object database management systems, and from 1988 to 1990 managed CAD framework development at the University of California at Berkeley. Dr. Spickelmier holds a Ph.D. and an M.S. in Electrical Engineering and Computer Sciences from the University of California at Berkeley and a B.S. in Electrical Engineering from Oregon State University.

JENNIFER H. BURT has served as Extensity's Vice President of Human Resources since September 2000. Prior to joining Extensity, from May 2000 to September 2000, Ms. Burt served as Senior Director of Human Resources at Fatbrain, an online retailer, and from August of 1985 to May of 2000, at Viking Freight Inc., an overnight delivery company, she served as a Director of Human Resources.

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### PART II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our Common Stock commenced trading on the Nasdaq National Market on January 27, 2000 under the symbol "EXTN" following our initial public offering at an offering price of \$20.00 per share. Our present policy is to retain earnings, if any, to finance future growth. We have never paid a cash dividend and do not have plans to pay cash dividends in the foreseeable future. As of December 31, 2001, there were approximately 200 stockholders of record and the price per share of our common stock was \$2.18.

The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported by the Nasdaq National Market:

	High (\$)	Low (\$)
	-----	-----
Year Ended December 31, 2001		
First Quarter	9.500	4.250
Second Quarter	10.300	4.938
Third Quarter	10.090	2.475
Fourth Quarter	3.490	1.800
Year Ended December 31, 2000		
First Quarter	83.500	39.000
Second Quarter	51.500	9.500
Third Quarter	44.750	14.000
Fourth Quarter	20.750	3.781

## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes to the consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations." The consolidated statements of operations data for each of the three years ended December 31, 2001, 2000 and 1999 and the consolidated balance sheet data at December 31, 2001 and 2000 are derived from our audited consolidated financial statements. The consolidated statements of operations data for the year ended 1998 and 1997 are derived from our audited consolidated statement of operations not included herein. The selected consolidated balance sheet data as of December 31, 1999, 1998 and 1997 are derived from our audited balance sheets not included herein.

SELECTED CONSOLIDATED FINANCIAL DATA  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEARS ENDED DECEMBER 31			
	2001	2000	1999	1998
	-----	-----	-----	-----
Revenues:				
Licenses	\$ 20,790	\$ 14,596	\$ 3,750	\$
Services and maintenance	14,091	10,272	3,064	
Hosted	199	--	--	
	-----	-----	-----	-----
Total revenues	\$ 35,080	\$ 24,868	\$ 6,814	\$
	=====	=====	=====	=====
Gross profit (loss)	\$ 20,203	\$ 9,251	\$ 1,517	\$
Loss from operations	(28,556)	(39,575)	(23,555)	(1)
Restructuring, impairment loss and other	6,174	--	--	
Non-cash stock based compensation expense	509	3,977	4,352	
In-process research and development	--	318	--	
Net loss	(25,953)	(34,509)	(23,389)	(1)
Dividend relating to the beneficial conversion of Series F preferred stock	--	--	1,500	
Net loss attributable to common stockholders	(25,953)	(34,509)	(24,889)	
Basic and diluted net loss per share	\$ (1.09)	\$ (1.63)	\$ (11.20)	\$
Shares used in computing basic and diluted net loss per share	23,840	21,206	2,222	
Excluding restructuring, impairment loss and other amortization of non-cash stock based compensation and in-process research and development				
Net loss	\$ (19,270)	\$ (30,214)	\$ (20,537)	\$ (1)
Pro forma basic and diluted net loss per share	\$ (0.81)	\$ (1.36)	\$ (1.45)	\$

- See Note 1 to the Consolidated Financial Statements for an explanation of the determination of the number of shares used to compute basic and diluted net loss per share.

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- The Company paid no cash dividends during the 5 year period

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	DECEMBER 31,			
	2001	2000	1999	1998
	(IN THOUSANDS)			
CONSOLIDATED BALANCE SHEET DATA				
Cash, cash equivalents and short-term investments	\$ 46,339	\$ 79,620	\$ 24,285	\$ 10,883
Working capital	41,403	62,721	13,151	7,237
Total assets	59,222	99,762	31,661	13,811
Notes payable and capital lease obligations, noncurrent	54	368	1,285	2,471
Mandatorily redeemable convertible preferred stock	--	--	49,648	21,269
Total stockholders' equity (deficit)	46,195	70,246	(35,061)	(15,012)

### ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, INCLUDING, WITHOUT LIMITATION, STATEMENTS REGARDING THE COMPANY'S EXPECTATIONS, BELIEFS, INTENTIONS OR FUTURE STRATEGIES THAT ARE SIGNIFIED BY THE WORDS "EXPECTS," "ANTICIPATES," "INTENDS," "BELIEVES," OR SIMILAR LANGUAGE. ALL FORWARD-LOOKING STATEMENTS INCLUDED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE TO THE COMPANY ON THE DATE HEREOF, AND THE COMPANY ASSUMES NO OBLIGATION TO UPDATE ANY SUCH FORWARD-LOOKING STATEMENTS. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS. IN EVALUATING THE COMPANY'S BUSINESS, PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER THE INFORMATION SET FORTH BELOW UNDER THE CAPTION "RISK FACTORS" IN ADDITION TO THE OTHER INFORMATION SET FORTH HEREIN. THE COMPANY CAUTIONS INVESTORS THAT ITS BUSINESS AND FINANCIAL PERFORMANCE ARE SUBJECT TO SUBSTANTIAL RISKS AND UNCERTAINTIES.

The following discussion and analysis of the financial condition and results of operations of Extensity should be read in conjunction with "Selected Consolidated Financial Data" and our consolidated financial statements and related notes appearing elsewhere in this report.

#### OVERVIEW

Extensity was formed in November 1995 and introduced its first commercial product for general availability in March 1998. During this period, our operating activities consisted of the design and development of our product architecture and our first application, the building of our corporate infrastructure, and the development of our professional services and customer support organizations. Our first application, Extensity Expense Reports, was released for general availability in March 1998. We released Extensity Travel Plans in December 1998 and Extensity Timesheets and Extensity Purchase Reqs in July 1999. Extensity Connect, our portalized application front end, role-based reporting tool, and content and commerce gateway was released in March 2000. We

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expect to introduce the newest version of our suite of products, Extensity 6.0, in the first half of 2002.

We generate revenue principally from licensing our applications and providing related services, including product installation, maintenance and support, consulting and training. We license our applications individually or as an integrated suite of products. The pricing of our software and services fluctuates on a per transaction basis

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depending on various factors, such as the number of seats covered by a contract and the degree of customization requested by the particular customer. The dollar amounts of our contracts depend on the number of users and applications being used and the professional services requested. In the third quarter of 2001, we began recognizing revenue from our hosted offering. Under this offering, customers pay a monthly usage fee based on the number of users and a one-time set-up fee to access the Extensity application on our servers.

We promote and sell our software products through our direct sales force and through indirect channels, including Elite Information Group and Emplaza, S.A., a joint venture between Terra Networks and Meta4. We also have marketing referral arrangements in place with Cisco Systems, IBM, US Bank, Amadeus/eTravel, Rosenbluth Travel, WebEx, Digital Think, Visa, GetThere.com, and Pro Act Technologies.

In February 2001, we opened a sales office in Sydney, Australia; however, we closed the Sydney office in July of 2001, as part of our restructuring plan. We continue to support our European operations, however, as part of our restructuring plan implemented in July 2001, we significantly reduced our resources in this region to match the current business environment. For the twelve months ended December 31, 2001 and 2000 revenues derived from our international operations represented approximately 10% and 11%, respectively, of total revenues. In 1999, all of the Company's revenues were derived from U.S. customers.

### CRITICAL ACCOUNTING POLICIES

Our critical and significant accounting policies are more fully described in Note 2 to our consolidated financial statements. However, certain of our accounting policies are particularly important to an understanding of our financial position and results of operations. Application of many of these policies requires our management to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosures. In general, these estimates or judgments are based on the historical experience of our management, prevailing industry trends, information provided by our customers and information available from other outside sources, each as appropriate. Actual results may differ from these estimates under different conditions. Our critical accounting policies include:

#### Revenue recognition

Revenues are derived from software licenses and related services, which include implementation and integration, technical support, training and consulting. For contracts with multiple elements, and for which vendor-specific objective evidence of fair value for the undelivered elements exists, revenue is recognized for the delivered elements based upon the residual contract value as prescribed by Statement of Position No. 98-9, "Modification of SOP No. 97-2 with Respect to Certain Transactions".

Revenue from license fees is recognized when persuasive evidence of an agreement

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exists, delivery of the product has occurred, the fee is fixed or determinable and collectibility is probable. Arrangements for which the fees are not deemed fixed or determinable are recognized in the period they become due.

Services revenue primarily comprises revenue from consulting fees, maintenance contracts and training. Services revenue from consulting and training is recognized as the service is performed.

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Maintenance contracts include the right to unspecified upgrades and ongoing support. Maintenance revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related contract, which is typically one year.

In the event the Company enters into a contract involving significant implementation, customization or services which are essential to the functionality of the software, license and service revenues are recognized over the period of each engagement, using the percentage-of-completion method. Labor hours incurred is used as the measure of progress towards completion. Revenue for these arrangements is classified as license revenue and services revenue based upon our estimates of fair value for each element and recognizes the revenue based on the percentage-of-completion ratio for the arrangement. A provision for estimated losses on engagements is made in the period in which the loss becomes probable and can be reasonably estimated.

The Company has entered into agreements under which value added resellers receive unspecified future products during the terms of the arrangements (typically two years) in consideration for upfront non-refundable fees. Consistent with the provisions of SOP 97-2, the Company recognizes such fees ratably, on a subscription basis, over the terms of the arrangements.

The Company has accumulated relevant information from contracts to use in determining the availability of vendor-specific objective evidence and believes that such information complies with the criteria established in Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2") as follows:

- o Customers are required to pay separately for annual maintenance. Future renewal rates are included as a term of the contracts. The Company uses the renewal rate as vendor-specific objective evidence of fair value for maintenance.
- o The Company charges standard hourly rates for consulting services based upon the nature of the services and experience of the professionals performing the services. The Company has a history of selling services separately.
- o For training, the Company charges standard course rates for each course based upon the duration of the course, and such courses are separately priced in contracts. The Company has a history of selling such courses separately.
- o Customer billing occurs in accordance with contract terms. Customer advances and amounts billed to customers in excess of revenue recognized are recorded as deferred revenue.

Bad Debt Allowance:

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The Company bills its customers only if collectibility is reasonably assured. The Company estimates the amount of uncollectible receivables each period and establishes an allowance for uncollectable amounts. The amount of the allowance is based on the age of unpaid amounts, information about the ongoing creditworthiness of customers, and other relevant information. Estimates of uncollectable amounts are revised each period, and changes are recorded in the period they become known.

### Deferred Tax Assets:

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The Company has provided a full valuation reserve related to its net deferred tax assets. In the future, if sufficient evidence of the Company's ability to generate sufficient future taxable income becomes apparent, the Company may be required to reduce its valuation allowance. Management evaluates the realizability of the deferred tax assets and the need for a valuation allowance quarterly.

### Restructuring:

The calculation of the estimated sublease loss reserve for vacated facilities requires that management must make estimates of potential future sublease income. Management analyzes current market conditions for real estate with the assistance of reputable commercial real estate brokers. However, future actual sublease income may materially differ from estimated amounts.

### Recent Accounting Pronouncements:

In July of 2001, the FASB issued SFAS No. 141 "BUSINESS COMBINATIONS" and SFAS No. 142 "GOODWILL AND OTHER INTANGIBLE ASSETS". SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separately from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than its fair value. The provisions of each statement, which apply to goodwill and intangible assets acquired prior to June 30, 2001, were adopted by the Company on January 1, 2002. The adoption of these accounting standards did not result in a significant impact on our financial position or results of operations for any historic transactions.

In October 2001, the FASB issued SFAS No. 144, "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS". SFAS No.144 supersedes SFAS No. 121, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF" and applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principles Board Opinion No. 30 ("APB 30"), "REPORTING RESULTS OF OPERATIONS REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS." SFAS No. 144 develops one accounting model (based on the model in SFAS No. 121) for long-lived assets that are to be disposed of by sale, as well as addresses the principal implementation issues. SFAS No.144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. That requirement eliminates APB 30's requirement that discontinued operations be measured at net realizable value or that entities include under "discontinued

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operations" in the financial statements amounts for operating losses that have not yet occurred. Additionally, SFAS No.144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. SFAS No.144 is effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company does not expect the adoption of SFAS No.144 to have a material impact on the Company's financial position or results of operations.

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In November 2001, the FASB Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue 01-09, "Accounting for Consideration Given to a Customer or a Reseller of the Vendor's Products". This issue presumes that consideration from a vendor to a customer or a reseller should not be recorded as revenue unless (1) the vendor receives an identifiable benefit in return for the consideration paid that is sufficiently separable from the sale to the customer, such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products and services in order to receive that benefit and (2) the benefit's fair value can be reasonably estimated. This Issue is to be adopted no later than in annual or interim financial statements for periods beginning after December 15, 2001. We adopted the provisions of this consensus in the fourth quarter of fiscal 2001. Such adoption had no impact on our financial position or results of operations.

In November 2001, the FASB issued Announcement D-103, which states that out-of-pocket expenses should be recorded as revenue in fiscal periods commencing after December 15, 2001. We will adopt the provisions of this Announcement as of January 1, 2002.

### RESULTS OF OPERATIONS

The following table sets forth certain statements of operations data in absolute dollars for the periods indicated. The data has been derived from the consolidated financial statements contained in this report. The operating results discussed below do not include the amortization of non-cash stock based compensation. These amounts are discussed separately within this discussion.

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### SUMMARY CONSOLIDATED FINANCIAL DATA (IN THOUSANDS)

YEARS ENDED DECEMBER 31,  
-----

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	2001	2000	1999
	-----	-----	-----
Revenues:			
Licenses	\$20,790	\$14,596	\$ 3,750
Services and maintenance	14,091	10,272	3,064
Hosted	199	--	--
	-----	-----	-----
Total revenues	\$35,080	\$24,868	\$ 6,814
	=====	=====	=====
Cost of revenues: (*)			
Licenses	\$ 1,430	\$ 705	\$ 195
Services and maintenance	12,960	14,236	4,758
Hosted	422	--	--
	-----	-----	-----
	\$14,812	\$14,941	\$ 4,953
	=====	=====	=====
Operating expenses: (*)			
Sales and marketing	\$23,453	\$26,783	\$11,202
Research and development	11,932	13,288	7,052
General and administrative	6,756	5,136	2,810
Restructuring, impairment loss and other	6,174	--	--
In-process research and development	--	318	--
Interest income, net	\$ 2,621	\$ 5,111	\$ 166

(\*) Amounts exclude the amortization of non-cash stock based compensation as follows:

Cost of revenues:			
Services and maintenance	\$ 65	\$ 677	\$ 344
Operating expenses:			
Sales and marketing	244	1,279	989
Research and development	76	774	1,045
General and administrative	124	1,247	1,974
	-----	-----	-----
	\$ 509	\$ 3,977	\$ 4,352
	=====	=====	=====

REVENUES

Total revenues were \$35.1 million, \$24.9 million and \$6.8 million in 2001, 2000 and 1999, respectively, representing increases of 41% from 2000 to 2001 and 265% from 1999 to 2000. For the year ended December 31, 2001, no customer accounted for 10% or more of total revenues. For the years ended December 31, 2000 and December 31, 1999 sales to one customer accounted for 10% and 11%, respectively, of total revenues.

LICENSE REVENUES. License revenues were \$20.8 million, \$14.6 million and \$3.8 million in 2001, 2000 and 1999, respectively, representing increases of 42% from 2000 to 2001 and 289% from 1999 to 2000. The increase in these periods was attributable to our growing customer base, an increase in amount of license revenue recognized upon shipment (while continuing to recognize revenue from our deferred balances for contracts initiated prior to the third quarter of 2001), an increase in the revenue attributable to our indirect sales channels and to a lesser extent, an increase in the average size of the sales



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contracts entered into by our customers. Revenues from our indirect channels may decrease in 2002.

**SERVICE AND MAINTENANCE REVENUES.** Service and maintenance revenues were \$14.1 million, \$10.3 million and \$3.1 million in 2001, 2000 and 1999, respectively, representing increases of 37% from 2000 to 2001 and 235% from 1999 to 2000. The increase in these periods were attributable to our growing customer base, an increase in professional services revenues recognized on a time and materials basis, an increase in revenues recognized from work performed on partner integration, and to a lesser extent, an increase in the average size of the sales contracts entered into by our customers.

**HOSTED REVENUES.** Our hosted revenues were \$199,000 for the year ended December 31, 2001. This is the first fiscal year the Company has recognized revenue from this offering. The Company does not believe these revenues will be a significant percentage of total revenues in the near term. As discussed in Note 12 of the Notes to the Financial Statements, we incurred an impairment charge associated with our hosted offering.

### COST OF REVENUES

Total cost of revenues were \$14.8 million, \$14.9 million and \$5.0 million in 2001, 2000 and 1999, respectively, representing approximately no increase from 2000 to 2001 and an increase of 202% from 1999 to 2000.

**COST OF LICENSE REVENUES.** Cost of license revenues consists primarily of third-party license and support fees and, to a lesser extent, costs of duplicating media and documentation and shipping. Cost of license revenues were \$1.4 million, \$705,000 and \$195,000 in 2001, 2000 and 1999 respectively, representing increases of 103% from 2000 to 2001 and 262% from 1999 to 2000. The increase in both periods was due primarily to increased sales activity. As a percentage of license revenues, cost of license revenues was 6.9%, 4.8% and 5.2% in 2001, 2000 and 1999, respectively. Cost of revenues as a percentage of license revenue may increase over the current level in the future as we incorporate additional third-party products in our offerings.

**COST OF SERVICE AND MAINTENANCE REVENUES.** Cost of service and maintenance revenues consists of compensation and related overhead costs for personnel engaged in consulting, training, maintenance and support services for our customers as well as costs for third parties contracted to provide such services to our customers. Cost of service and maintenance revenues were \$13.0 million, \$14.2 million and \$4.8 million in 2001, 2000 and 1999, respectively, representing a decrease of 9% from 2000 to 2001 and an increase of 199% from 1999 to 2000. As a percentage of service and maintenance revenues, cost of service and maintenance revenues were 92%, 139% and 155% in 2001, 2000 and 1999. The decrease from 2000 to 2001 was attributed to a 246% decrease in third party consulting costs offset in part by 40% higher payroll costs as the Company replaced third party consultants with permanent employees. Approximately 34% of the increase from 1999 to 2000 was attributed to our hiring of additional service and maintenance personnel, and approximately 49% was due to an increase in costs for third party contractors. Total service and maintenance revenues exceeded costs of service and maintenance revenues in 2001. Total cost of service and maintenance revenues exceeded our service and maintenance revenues in 2000 and 1999, as we have built our consulting and customer support groups in advance of growing contract volume. We are seeking to reduce our cost of service revenues as a percentage of total revenues and are also seeking to engage third parties to provide services related to our applications.

**COST OF HOSTED REVENUES.** Cost of hosted revenues consists primarily of compensation and related overhead costs for personnel engaged in supporting the hosted customer base, server costs, and telecommunications charges. We started

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recognizing revenue for the hosted product in the third quarter of 2001. The cost of hosted revenues for 2001

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was \$422,000, representing expenses for the third and fourth quarters of 2001 therefore, on a year-to-year comparison, cost of hosted revenues will increase. However, on a quarter-to-quarter basis, the Company does not expect these costs to significantly increase.

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### OPERATING EXPENSES

**SALES AND MARKETING.** Sales and marketing expenses consist primarily of compensation and related costs for sales and marketing personnel, including commissions and marketing program costs. Sales and marketing expenses were \$23.5 million, \$26.8 million and \$11.2 million in 2001, 2000 and 1999 respectively, representing a decrease of 12% from 2000 to 2001 and an increase of 139% from 1999 to 2000. As a percentage of total revenues, sales and marketing expenses were 67%, 108% and 164% in 2001, 2000 and 1999. Approximately 63% of the decrease from 2000 to 2001 was attributed to lower marketing program spending and 21% to lower payroll costs associated with our restructuring plan implemented in July of 2001. Approximately 67% of the increase from 1999 to 2000 was attributable to increased compensation, commissions and other related costs associated with hiring additional sales representatives, management and marketing personnel and 19% of the increase was attributable to increased spending on marketing programs. Commission charges will vary depending upon the sales activity. Sales and marketing expenses may increase in the long term if we expand our domestic and international sales force and increase our marketing efforts.

**RESEARCH AND DEVELOPMENT.** Research and development expenses consist primarily of compensation and related personnel costs and fees associated with contractors. Research and development expenses were \$11.9 million, \$13.3 million and \$7.1 million in 2001, 2000 and 1999, respectively, representing a decrease of 10% from 2000 to 2001 and an increase of 88% from 1999 to 2000. As a percentage of total revenues, research and development expenses were 34%, 53% and 103% in 2001, 2000 and 1999. Approximately 60% of the decrease from 2000 to 2001 was attributed to lower costs for third party consultants. Approximately 66% of the increase from 1999 to 2000 was attributed to the addition of

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personnel and 19% due to an increase in consulting services. These increases resulted from our continuing efforts to add enhancements to our existing software applications and to develop software applications that incorporate new functionality into our integrated suite. Research and development expenses may increase in the long term if we make additional investments in our technology and products.

GENERAL AND ADMINISTRATIVE. General and administrative expenses consist primarily of compensation and related costs for our executive, finance and administrative personnel and other related expenses. General and administrative expenses were \$6.8 million, \$5.1 million and \$2.8 million in 2001, 2000 and 1999, respectively, representing increases of 32% from 2000 to 2001 and 83% from 1999 to 2000. As a percentage of total revenues, general and administrative expenses were 19%, 21% and 41% in 2001, 2000 and 1999. The increase from 2000 to 2001 was primarily attributed to hiring additional human resources and internal information technology personnel. Approximately 60% of the increase from 1999 to 2000 was attributable to hiring additional executive and financial personnel and 40% to general administrative costs. General and administrative expenses may increase in the long term if we expand our operations.

RESTRUCTURING, IMPAIRMENT LOSS AND OTHER. For the year ended December 31, 2001, restructuring, impairment loss and other expenses were \$6.2 million comprised of \$4.5 million in restructuring, a \$1.3 million impairment of assets associated with building the hosted offering and \$377,000 of other expenses. The \$4.5 million in restructuring charges were made up of \$2.2 million in lease costs, a \$1.6 million write-off of property and equipment and \$700,000 in severance and benefits.

### AMORTIZATION OF NON-CASH STOCK BASED COMPENSATION

Prior to our IPO, we granted certain stock options to our officers and employees at prices deemed to be below the fair value of the underlying stock. The cumulative difference between the deemed fair value of the underlying stock at the date the

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options were granted and the exercise price of the granted options was \$12.1 million as of the IPO date. This amount is being amortized, using the accelerated method of the Financial Accounting Standards Board ("FASB") Interpretation No. 28, "ACCOUNTING FOR STOCK APPRECIATION RIGHTS AND OTHER VARIABLE OR AWARD PLANS", over the four-year vesting period of the granted options. Accordingly, our results from operations will include deferred compensation expense at least through 2003. We recognized \$509,000, \$4.0 million and \$4.4 million of this expense in 2001, 2000 and 1999, respectively. The lower expense in 2001 is primarily attributable to the impact of forfeitures and the use of an accelerated method of amortization. The remaining expense to be recognized in 2002 and 2003 is \$504,000. We estimate that we will recognize approximately \$450,000 of expense in fiscal 2002; however, this amount may change as employee terminations and accelerated vesting impact the amortization schedule.

### IN-PROCESS RESEARCH AND DEVELOPMENT

In process research and development expense was \$318,000 for the year ended December 31, 2000. This expense was incurred in connection with the acquisition of a company. Substantially the entire purchase price was allocated to in-process research and development as technological feasibility of the acquired product had not been established and no future alternative use existed at the time of purchase. Furthermore, the acquired company had no revenues, no other tangible or intangible assets and only one employee. There were no

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acquisitions made in 2001 or 1999.

### INTEREST INCOME, NET

Interest income, net was \$2.6 million, \$5.1 million and \$166,000 in 2001, 2000 and 1999, respectively. The decrease from 2000 to 2001 was attributed to lower interest rates and lower cash, cash equivalent and short-term investment balances. The increase from 1999 to 2000 was attributed to interest earned on the proceeds from the Company's IPO. Interest income will fluctuate depending upon the overall interest rate environment and our cash, cash equivalent and short-term investment balances.

### PROVISION FOR INCOME TAXES

Since inception, we have incurred net losses for federal and state tax purposes and have not recognized any material tax provision or benefit. As of December 31, 2001, we had net operating loss carryforwards of \$82.7 million and \$33.9 million for federal and state income tax purposes, respectively. The federal and state net operating loss carryforwards, if not utilized, expire through 2021 and 2011, respectively. We also have research and development credit carryforwards of \$2.7 million for federal and state tax purposes. The federal research and development credits expire through 2021 and the state credits expire when exhausted. Federal and state tax laws will impose significant restrictions on the utilization of net operating loss carryforwards in the event of a shift in our ownership that constitutes an ownership change, as defined in Section 382 of the Internal Revenue Code.

We have placed a valuation allowance against our net deferred tax assets due to the uncertainty of the realization of these assets. The allowance totaled \$33.0 million at December 31, 2001, resulting in no net deferred tax asset. We evaluate on a quarterly basis the recoverability of net deferred tax assets and the level of valuation allowance. When we have determined that it is more likely than not that the deferred tax assets are realizable, we will reduce the valuation allowance.

### LIQUIDITY AND CAPITAL RESOURCES

Since inception, we have financed our operations and funded our capital expenditures through proceeds from our IPO completed in January 2000 and the private

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sale of equity securities, supplemented by loan facilities and equipment leases. Aggregate net proceeds to date from private equity financings totaled \$42.3 million and proceeds from the Company's IPO were \$83.3 million, net of offering costs of approximately \$2.2 million. As of December 31, 2001, we had \$46.3 million in cash, cash equivalents and short-term investments and \$41.4 million in working capital.

Net cash used in operating activities was \$30.9 million for the year ended December 31, 2001, and \$22.1 million for the year ended December 31, 2000. For the year ended December 31, 2001 cash used in operating activities was primarily attributed to a net loss of \$26.0 million, adjusted for a non-cash charge associated with the write-off of computer equipment and software of \$2.9 million, depreciation and amortization of \$2.4 million, a decrease in deferred revenue of \$12.6 million, a decrease of \$2.8 million in accounts payable and a decrease in accrued liabilities of \$1.1 million offset by a decrease in accounts receivable of \$2.9 million, a decrease in prepaids of \$1.4 million and an increase in other current and noncurrent liabilities of \$1.3 million. For the year ended December 31, 2000 net cash used in operating activities was primarily

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attributable to a net loss of \$34.5 million, adjusted for the amortization of deferred stock compensation of \$4.0 million and offset by an increase in deferred revenue of \$6.0 million, an increase in accounts payable of \$4.6 million and an increase in accrued liabilities of \$3.0 million. We expect that net cash used in operating activities will decrease in the year ending December 31, 2002.

Net cash provided by investing activities was \$9.6 million for the year ended December 31, 2001 and net cash used in investing activities was \$32.2 million for the year ended December 31, 2000. Excluding capital expenditures of \$2.4 million and \$5.7 million in 2001 and 2000, respectively, investing activities consisted of short-term investment maturities in 2001 and purchases of short-term investments in 2000.

Net cash provided by financing activities was \$100,000 for the year ended December 31, 2001, due to payments on notes payable and capital lease obligations of approximately \$1.4 million, offset by proceeds from employee stock plans of approximately \$1.5 million. Net cash provided by financing activities was \$84.4 million for the year ended December 31, 2000, primarily due to the net proceeds of \$83.3 million from the Company's IPO.

Presently, we anticipate that our existing capital resources will meet our operating and investing needs for at least the next twelve months. We have \$46.3 million in cash, cash equivalents and short-term investments. As discussed in Note 5 to the consolidated financial statements, we have approximately \$12.7 million in capital and operating lease commitments coming due through 2006. In particular, we believe that our current uncommitted cash balances are sufficient to fund any existing cash obligations or commercial commitments as well as any cash needed for planned operating activities. After that time, we cannot be certain that additional funding will be available on acceptable terms or at all. Furthermore, should our operating results be worse than expected, we could use more cash in funding operating activities which would diminish our capital resources. While we do not presently anticipate a need for additional capital, if we do require additional capital resources to grow our business, execute our operating plans, or acquire complementary technologies or businesses, at any time in the future, we may seek to sell additional equity or debt securities or secure additional lines of credit, which may result in additional dilution to our stockholders.

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### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

#### FOREIGN CURRENCY EXCHANGE RATE RISK

We develop products in the United States and market our products in North America and, to a lesser extent, in Europe and the rest of the world. As a result, our financial results could be affected by factors such as changes in foreign currency rates or weak economic conditions in foreign markets. Because our revenues are typically denominated in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

#### INTEREST RATE RISK

We have an investment portfolio of money market funds and fixed income certificates of deposit. The fixed income certificates of deposit, like all fixed income securities, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in short-term securities. In view of the nature and mix of

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our total portfolio, a 10% movement in market interest rates would not have a significant impact on the total value of our portfolio as of December 31, 2001.

### ITEM 8. FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

The following consolidated financial statements, and the related notes thereto, of Extensity and the Report of Independent Accountants are filed as part of this Form 10K.

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Consolidated Statements of Operations for the years ended December 31, 2001, 2000 and 1999	42
Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 2001, 2000 and 1999	43
Consolidated Statements of Cash Flows for the years ended December 31, 2001, 2000 and 1999	44
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#### REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Extensity, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive loss, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Extensity, Inc. and its subsidiary at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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PricewaterhouseCoopers LLP

San Jose, California

January 15, 2002, except for the last paragraph of Note 9  
as to which the date is March 6, 2002

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## EXTENSITY, INC. CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	December 31,	
	2001	2000
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,456	\$ 40,695
Short-term investments	26,883	38,925
Trade accounts receivable, net of allowance for doubtful accounts of \$676 and \$466, respectively	5,393	8,527
Prepaid and other current assets	1,835	3,443
	-----	-----
Total current assets	53,567	91,590
Property and equipment, net	3,657	6,279

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Restricted long-term investments	1,397	1,436
Other assets	601	457
	-----	-----
Total assets	\$ 59,222	\$ 99,762
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 3,672	\$ 6,434
Accrued liabilities	3,977	5,125
Deferred revenue	3,488	16,041
Capital lease obligations, current portion	240	486
Notes payable, current portion	--	783
Sublease loss accrual and other current liabilities	787	--
	-----	-----
Total current liabilities	12,164	28,869
Capital lease obligations, noncurrent portion	54	368
Sublease loss accrual and other noncurrent liabilities	809	279
	-----	-----
Total liabilities	13,027	29,516
	-----	-----
Commitments and Contingencies (Note 5)		
Stockholders' equity:		
Common stock, \$0.001 par value		
75,000,000 shares authorized and 24,871,147 and 24,144,938 shares		
outstanding as of December 31, 2001 and 2000, respectively	25	24
Additional paid-in capital	147,394	147,475
Deferred stock compensation	(504)	(2,679)
Notes receivable from stockholders	(433)	(380)
Accumulated comprehensive income	155	295
Accumulated deficit	(100,442)	(74,489)
	-----	-----
Total stockholders' equity	46,195	70,246
	-----	-----
Total liabilities and stockholders' equity	\$ 59,222	\$ 99,762
	=====	=====

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

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EXTENSITY, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	YEARS ENDED DECEMBER 31,		
	2001	2000	1999
	-----	-----	-----
Revenues:			
Licenses	\$ 20,790	\$ 14,596	\$ 3,750
Services and maintenance	14,091	10,272	3,064
Hosted	199	--	--
	-----	-----	-----



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Total revenues	35,080	24,868	6,814
	-----	-----	-----
Cost of revenues: (*)			
Licenses	1,430	705	195
Services and maintenance	13,025	14,912	5,102
Hosted	422	--	--
	-----	-----	-----
Total cost of revenues	14,877	15,617	5,297
	-----	-----	-----
Gross profit	20,203	9,251	1,517
	-----	-----	-----
Operating expenses: (*)			
Sales and marketing	23,697	28,063	12,191
Research and development	12,008	14,062	8,097
General and administrative	6,880	6,383	4,784
Restructuring, impairment loss and other	6,174	--	--
In-process research and development	--	318	--
	-----	-----	-----
Total operating expenses	48,759	48,826	25,072
	-----	-----	-----
Loss from operations	(28,556)	(39,575)	(23,555)
Interest income	2,768	5,460	667
Interest expense	(147)	(349)	(501)
Provision for income taxes	(18)	(45)	--
	-----	-----	-----
Net loss	\$ (25,953)	\$ (34,509)	\$ (23,389)
	=====	=====	=====
Dividend relating to the beneficial conversion feature of Series F preferred stock	--	--	(1,500)
	-----	-----	-----
Net loss attributable to common stockholders	\$ (25,953)	\$ (34,509)	\$ (24,889)
	=====	=====	=====
Other comprehensive loss:			
Change in cumulative translation adjustment	(140)	300	(5)
	-----	-----	-----
Total comprehensive loss	\$ (26,093)	\$ (34,209)	\$ (23,394)
	=====	=====	=====
Basic and diluted net loss per share	\$ (1.09)	\$ (1.63)	\$ (11.20)
Shares used in computing basic and diluted net loss per share	23,840	21,206	2,222
(*) Amounts include non-cash stock based compensation as follows:			
Cost of revenues:			
Services and maintenance	\$ 65	\$ 677	\$ 344
Operating expenses:			
Sales and marketing	244	1,279	989
Research and development	76	774	1,045
General and administrative	124	1,247	1,974
	-----	-----	-----
	\$ 509	\$ 3,977	\$ 4,352
	=====	=====	=====

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

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EXTENSITY, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

(IN THOUSANDS, EXCEPT SHARE DATA)

	Common Stock		Additional Paid-in Capital	Notes Receivable from Stockholders	De S Comp
	Shares	Amount			
Balance at December 31, 1998	2,350,815	\$ 2	\$ 77	\$ --	\$
Issuance of common stock upon exercise of stock options	1,855,091	2	621	(230)	
Deferred stock compensation	--	--	10,205	--	(
Amortization of deferred stock compensation	--	--	--	--	
Repayment of note receivable from stockholder	--	--	--	100	
Beneficial conversion feature- Series F preferred stock	--	--	--	--	
Cumulative translation adjustment	--	--	--	--	
Net loss	--	--	--	--	
Balance at December 31, 1999	4,205,906	4	10,903	(130)	
Issuance of common stock in initial public offering, net of underwriters discount and issuance costs of \$2.2 million	4,600,000	4	83,352	--	
Issuance of common stock upon conversion of convertible preferred stock	14,594,549	15	49,633	--	
Issuance of common stock upon exercise of stock options	432,966	1	1,068	(250)	
Issuance of commons stock upon exercise of Warrants	175,038	--	34	--	
Issuance of common stock in connection with the employee stock purchase plan	136,479	--	1,682	--	
Deferred stock compensation	--	--	1,881	--	
Forfeiture of unvested stock options	--	--	(1,078)	--	
Amortization of deferred stock compensation and other	--	--	--	--	
Cumulative translation adjustment	--	--	--	--	
Net loss	--	--	--	--	
Balance at December 31, 2000	24,144,938	24	147,475	(380)	
Issuance of common stock upon exercise of stock options	414,009	1	445	--	
Issuance of common stock in connection					

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with the employee stock purchase plan	292,200	--	1,045	--
Issuance of common stock for services rendered	20,000	--	95	--
Forfeiture of unvested stock options	--	--	(1,666)	--
Amortization of deferred stock compensation and Other	--	--	--	--
Interest earned on notes receivable from stockholders	--	--	--	(53)
Cumulative translation adjustment	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 2001	<u>\$24,871,147</u>	<u>\$25</u>	<u>\$ 147,394</u>	<u>\$ (433)</u>

	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	-----	-----
Balance at December 31, 1998	\$ (15,091)	\$ (15,012)
Issuance of common stock upon exercise of stock options	--	393
Deferred stock compensation	--	--
Amortization of deferred stock compensation	--	4,352
Repayment of note receivable from stockholder	--	100
Beneficial conversion feature- Series F preferred stock	(1,500)	(1,500)
Cumulative translation adjustment	--	(5)
Net loss	(23,389)	(23,389)
Balance at December 31, 1999	<u>(39,980)</u>	<u>(35,061)</u>
Issuance of common stock in initial public offering, net of underwriters discount and issuance costs of \$2.2 million	--	83,356
Issuance of common stock upon conversion of convertible preferred stock	--	49,648
Issuance of common stock upon exercise of stock options	--	818
Issuance of commons stock upon exercise of Warrants	--	34
Issuance of common stock in connection with the employee stock purchase plan	--	1,682
Deferred stock compensation	--	--
Forfeiture of unvested stock options	--	--
Amortization of deferred stock compensation	--	--

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and other	--	3,977
Cumulative translation adjustment	--	300
Net loss	(34,509)	(34,509)
	-----	-----
Balance at December 31, 2000	(74,489)	70,246
Issuance of common stock upon exercise of stock options	--	446
Issuance of common stock in connection with the employee stock purchase plan	--	1,045
Issuance of common stock for services rendered	--	95
Forfeiture of unvested stock options	--	--
Amortization of deferred stock compensation and Other	--	509
Interest earned on notes receivable from stockholders	--	(53)
Cumulative translation adjustment	--	(140)
Net loss	(25,953)	(25,953)
	-----	-----
Balance at December 31, 2001	\$ (100,442)	\$ 46,195
	=====	=====

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

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EXTENSITY, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

	Years Ended December 31,		
	2001	2000	1999
	-----	-----	-----
Cash flows from operating activities:			
Net loss	\$ (25,953)	\$ (34,509)	\$ (23,400)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization	2,361	1,772	1,772
Allowance for doubtful accounts	210	266	266
Amortization of deferred stock compensation and other	509	3,977	4,000
In-process research and development	--	318	318
Common stock issued for services rendered	95	--	--
Interest earned on notes from stockholders	(53)	--	--
Amortization of debt discount and lease line issuance costs	48	100	100
Write-off of computer equipment and software	2,882	--	--
Changes in operating assets and liabilities:			
Accounts receivable	2,924	(5,617)	(2,693)
Prepays and other current assets	1,420	(2,165)	(1,745)

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Other assets	(144)	80	
Accounts payable	(2,762)	4,600	1
Accrued liabilities	(1,148)	2,980	1
Deferred revenue	(12,553)	5,990	7
Other current liabilities	757	--	
Other noncurrent liabilities	530	78	
	-----	-----	-----
Cash used in operating activities	(30,877)	(22,130)	(11)
	-----	-----	-----
Cash flows from investing activities:			
Purchases of short-term investments	(48,649)	(81,305)	(21)
Maturities of short-term investments	60,691	56,249	13
Capital expenditures	(2,433)	(5,742)	(1)
Business acquisition	--	(90)	
Restricted long-term investments	39	(1,360)	
	-----	-----	-----
Cash provided by (used in) investing activities	9,648	(32,248)	(9)
	-----	-----	-----
Cash flows from financing activities:			
Payments on notes payable	(819)	(1,228)	(1)
Payments on capital lease obligation	(572)	(306)	
Proceeds from sale-lease back	--	--	
Proceeds from exercise of stock options and warrants	446	853	
Net proceeds from issuance of preferred stock	--	--	26
Net proceeds from issuance of common stock for the ESPP	1,045	1,682	
Net proceeds from issuance of common stock	--	83,356	
	-----	-----	-----
Cash provided by financing activities	100	84,357	26
	-----	-----	-----
Effect of exchange rate on cash and cash equivalents	(110)	300	
Increase (decrease) in cash and cash equivalents	(21,239)	30,279	5
Cash and cash equivalents, beginning of year	40,695	10,416	5
	-----	-----	-----
Cash and cash equivalents, end of year	\$ 19,456	\$ 40,695	\$ 10
	=====	=====	=====
Supplemental cash flow information:			
Interest paid	\$ 147	\$ 349	\$
	=====	=====	=====
Income taxes paid	\$ 18	\$ 45	\$
	=====	=====	=====
Noncash investing and financing activities:			
Notes & interest receivable from stockholders	\$ 53	\$ 250	\$
	=====	=====	=====

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

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Extensity, Inc. (the "Company") provides Internet-based workforce optimization software applications designed to improve the productivity of employees across the enterprise and to enhance enterprise operating efficiency. The Company was incorporated in Delaware in November 1995.

On January 27, 2000, the SEC declared effective the Company's Registration Statement on Form S-1. Pursuant to this Registration Statement, the Company completed an initial public offering ("IPO") of 4,600,000 shares of its common stock (including 600,000 shares sold pursuant to the exercise of the Underwriters' over-allotment option) at an initial offering price of \$20.00 per share (the "Offering"). Proceeds to the Company from the Offering, after calculation of the Underwriters discounts, commissions, and concessions, totaled approximately \$83.3 million, net of offering costs of approximately \$2.2 million.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Extensity Europe Limited, which commenced operations in September 1999. All significant intercompany balances and transactions have been eliminated in consolidation.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Revenue recognition

Revenues are derived from software licenses and related services, which include implementation and integration, technical support, training and consulting. For contracts with multiple elements, and for which vendor-specific objective evidence of fair value for the undelivered elements exists, revenue is recognized for the delivered elements based upon the residual contract value as prescribed by Statement of Position No. 98-9, "Modification of SOP No. 97-2 with Respect to Certain Transactions".

Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collectibility is probable. Arrangements for which the fees are not deemed fixed or determinable are recognized in the period they become due.

Services revenue primarily comprises revenue from consulting fees, maintenance contracts and training. Services revenue from consulting and training is recognized as the service is performed.

Maintenance contracts include the right to unspecified upgrades and ongoing support. Maintenance revenue is deferred and recognized on a straight-line basis as services revenue over the life of the related contract, which is typically one year.

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In the event the Company enters into a contract involving significant implementation, customization or services which are essential to the functionality of the software, license and service revenues are recognized over the period of each engagement, using the percentage-of-completion method. Labor hours incurred is used as the measure of progress towards completion. Revenue for these arrangements is classified as license revenue and services revenue based upon our estimates of fair value for each element and recognizes the revenue based on the percentage-of-completion ratio for the arrangement. A provision for estimated losses on engagements is made in the period in which the loss becomes probable and can be reasonably estimated.

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The Company has entered into agreements under which value added resellers receive unspecified future products during the terms of the arrangements (typically two years) in consideration for upfront non-refundable fees. Consistent with the provisions of SOP 97-2, the Company recognizes such fees ratably, on a subscription basis, over the terms of the arrangements.

The Company has accumulated relevant information from contracts to use in determining the availability of vendor-specific objective evidence and believes that such information complies with the criteria established in Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2") as follows:

- o Customers are required to pay separately for annual maintenance. Future renewal rates are included as a term of the contracts. The Company uses the renewal rate as vendor-specific objective evidence of fair value for maintenance.
- o The Company charges standard hourly rates for consulting services based upon the nature of the services and experience of the professionals performing the services. The Company has a history of selling services separately.
- o For training, the Company charges standard course rates for each course based upon the duration of the course, and such courses are separately priced in contracts. The Company has a history of selling such courses separately.
- o Customer billing occurs in accordance with contract terms. Customer advances and amounts billed to customers in excess of revenue recognized are recorded as deferred revenue.

### CONCENTRATION OF CREDIT RISK AND CERTAIN RISKS

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, short-term investments and accounts receivable. The Company's accounts receivable are derived from revenue earned from customers located primarily in the United States. The Company performs credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company maintains an allowance for doubtful accounts receivable based upon the expected collectibility of accounts receivable. The Company wrote off approximately \$164,000 and \$60,000 in accounts receivable in 2001 and 2000, respectively.

At December 31, 2001, no customers accounted for 10% or more of accounts receivable. At December 31, 2000, two customers accounted for 32% and 10% of total accounts receivable.

No customer accounted for 10% or more of total revenue in 2001. One customer accounted for approximately 10% and 11% of total revenues in 2000 and 1999, respectively. Approximately 10% and 11% of the Company's revenues were derived from our international business, primarily in Europe, in 2001 and 2000, respectively. In 1999, all of the Company's revenues were derived from U.S. customers.

The market in which the Company competes is characterized by changing customer needs, frequent new software product introductions and rapidly evolving industry standards. Significant technological change could adversely affect the Company's operating results.

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The Company operates in one single reportable business segment and, therefore, no disclosures under SFAS No.131, "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION", are necessary. Virtually all of our long-lived assets are located in the United States of America.

### USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### FOREIGN CURRENCY TRANSLATION

The functional currency for the Company's international subsidiary is the local currency of the country in which it operates. Assets and liabilities are translated using the exchange rate at the balance sheet date. Revenue, expenses, gains and losses are translated at the exchange rate on the date those elements are recognized. Translation adjustments are included in other comprehensive income (loss).

### CASH AND CASH EQUIVALENTS

The Company considers all investments with an original maturity of three months or less to be cash equivalents. The Company periodically maintains cash balances at banks in excess of the Federal Deposit Insurance Corporation insurance limit of \$100,000.

### SHORT-TERM INVESTMENTS

The Company accounts for its investments in quality corporate debt securities under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES". The Company has classified all marketable debt securities as held-to-maturity and has accounted for these investments at amortized cost. As of December 31, 2001, the Company's carrying value of its short-term investments approximated their amortized cost basis.

### RESTRICTED LONG-TERM INVESTMENTS

The restricted long-term investments consist of several one-year certificates of deposit required as collateral for the Company's letters of credit (Note 5).

### SOFTWARE DEVELOPMENT COSTS

The Company capitalizes software development costs under the provisions of SFAS No. 86, "ACCOUNTING FOR COSTS OF COMPUTER SOFTWARE TO BE SOLD, LEASED OR OTHERWISE MARKETED". Capitalization of computer software development costs begins upon the establishment of technological feasibility, which the Company has defined as completion of a working model. The Company has not capitalized any software

development costs to date as costs that would qualify were immaterial and has charged software development costs as incurred to research and development



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expense in the accompanying consolidated statements of operations.

### ADVERTISING COSTS

Amounts received under co-marketing agreements with strategic partners are recorded as a reduction of advertising expenses incurred in connection with such agreements. Immaterial amounts have been received during the three-year period ended December 31, 2001.

### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation and amortization are calculated using the straight-line method over estimated useful lives of the assets. Currently, our computer hardware and software and assets under capital lease are amortized over three years and furniture and fixtures, leasehold improvements and office equipment are amortized over six years (Note 3).

When assets are sold or retired, the cost and related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is included in operations. Maintenance and repairs are charged to operations as incurred.

### IMPAIRMENT OF LONG - LIVED ASSETS

The company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of any asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount of fair value less costs to sell (Note 12).

### INCOME TAXES

Income taxes are accounted for in accordance with SFAS No. 109, "ACCOUNTING FOR INCOME" TAXES. Under SFAS No. 109, deferred income tax liabilities and assets are determined based on the difference between the financial reporting amounts and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates in effect for the years in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

### STOCK BASED COMPENSATION

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES" (APB No. 25) and complies with the disclosure provisions of SFAS No. 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION". Under APB No. 25, compensation expense is based on the difference, if any, between the fair value of the Company's stock and the exercise price of the option on the measurement date, which is typically the date of grant.

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In March of 2000, the Financial Accounting Standards Board ("FASB") issued FIN 44, "ACCOUNTING FOR CERTAIN TRANSACTIONS INVOLVING STOCK COMPENSATION," an interpretation of APB No.25. FIN 44 was effective July 1, 2000. In June of 2001, the Company executed a stock option exchange program and accounted for the stock options exchange program according to FIN 44 (Note 9).

The Company accounts for options granted to non-employees under SFAS No. 123. Under SFAS No. 123 and EITF 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services", options are recorded at their fair value on the measurement date, which is typically the date of grant.

### NET LOSS PER SHARE

Basic and diluted net loss per share are computed using the weighted average number of common shares outstanding. Options, warrants and convertible preferred stock were not included in the computation of diluted net loss per share because the effect would be antidilutive.

Diluted net loss per share does not include the effect of the following potential common shares for the periods presented (in thousands):

	Years End December 31,		
	2001	2000	1999
Shares issuable under stock options	4,467	5,089	2,943
Shares of unvested stock subject to repurchase	147	699	1,139
Shares issuable pursuant to warrants to purchase common and convertible preferred stock		20	184
Shares of convertible preferred stock on an "as if converted" basis	--	--	14,594
	4,614	5,808	18,860

The weighted-average exercise price of stock options outstanding was \$4.29, \$9.73 and \$2.10 as of December 31, 2001, 2000 and 1999, respectively. The weighted average repurchase price of unvested stock was \$2.22, \$1.50 and \$0.38 as of December 31, 2001, 2000 and 1999, respectively. The exercise price of warrants outstanding was \$14.50 as of December 31, 2001 and 2000 and \$3.08 as of December 31, 1999.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July of 2001, the FASB issued SFAS No. 141 "BUSINESS COMBINATIONS" and SFAS No. 142 "GOODWILL AND OTHER INTANGIBLE ASSETS". SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separately from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of

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operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of

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goodwill and certain intangibles is more than its fair value. The provisions of each statement, which apply to goodwill and intangible assets acquired prior to June 30, 2001, were adopted by the Company on January 1, 2002. The adoption of these accounting standards did not result in a significant impact on our financial position or results of operations for any historic transactions.

In October 2001, the FASB issued SFAS No. 144, "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS". SFAS No.144 supersedes SFAS No. 121, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF" and applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principles Board Opinion No. 30 ("APB 30"), "REPORTING RESULTS OF OPERATIONS REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS." SFAS No. 144 develops one accounting model (based on the model in SFAS No. 121) for long-lived assets that are to be disposed of by sale, as well as addresses the principal implementation issues. SFAS No.144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. That requirement eliminates APB 30's requirement that discontinued operations be measured at net realizable value or that entities include under "discontinued operations" in the financial statements amounts for operating losses that have not yet occurred. Additionally, SFAS No.144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. SFAS No.144 is effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company does not expect the adoption of SFAS No.144 to have a material impact on the Company's financial position or results of operations.

In November 2001, the FASB Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue 01-09, "Accounting for Consideration Given to a Customer or a Reseller of the Vendor's Products". This issue presumes that consideration from a vendor to a customer or a reseller should not be recorded as revenue unless (1) the vendor receives an identifiable benefit in return for the consideration paid that is sufficiently separable from the sale to the customer, such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products and services in order to receive that benefit and (2) the benefit's fair value can be reasonably estimated. This issue is to be adopted no later than in annual or interim financial statements for periods beginning after December 15, 2001. We adopted the provisions of this consensus in the fourth quarter of fiscal 2001. Such adoption had no impact on our financial position or results of operations.

In November 2001, the FASB issued Announcement D-103 which states that out-of-pocket expenses should be recorded as revenue in fiscal periods commencing after December 15, 2001. We will adopt the provisions of this Announcement as of January 1, 2002.

### 3. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

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	December 31,	
	2001	2000
	(In thousands)	
Computer hardware and software	\$ 4,256	\$ 6,013
Furniture and fixtures	1,479	1,209
Leasehold improvements	705	385
Office equipment	219	219
Assets under capital leases	1,847	1,847
	8,506	9,673
Less accumulated depreciation and amortization	(4,849)	(3,394)
Total property and equipment, net	\$ 3,657	\$ 6,279

Accumulated amortization relating to assets under capital leases amounted to \$1,846,950 and \$1,291,437 as of December 31, 2001 and 2000, respectively.

4. INCOME TAXES

The provision for income taxes for the years ended December 31, 2001 and 2000 relate to foreign income tax associated with the Company's European subsidiary. The difference between the amount of income tax benefit recorded of zero and the amount of income tax benefit calculated using the federal statutory rate of 34% is primarily due to net operating losses being fully offset by a valuation allowance. Significant components of the Company's deferred tax balances are as follows (in thousands):

	December 31,	
	2001	2000
Deferred tax assets:		
Net operating loss carry forwards	\$ 30,100	\$ 23,000
Research and development credit carryforwards	2,650	1,900
Other	200	300
Total deferred tax assets	32,950	25,200
Valuation allowance	(32,950)	(25,200)
Net deferred tax assets	\$ --	\$ --

Due to the uncertainty of realization, a valuation allowance has been provided to offset net deferred tax assets at December 31, 2001 and 2000. The increase in the valuation allowance was \$7.7 million, \$11.4 million and \$8.0 million during the years ended December 31, 2001, 2000 and 1999, respectively.

As of December 31, 2001, the Company had net operating loss carryforwards of approximately \$82.7 million and \$33.9 million for federal and state income tax purposes, respectively. Such carryforwards expire through 2021 and 2011 for federal and state income tax purposes, respectively. At December 31, 2001, the Company also had research and experimentation tax credit carryforwards of \$2.7

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million for federal and state purposes, respectively. The federal research and experimentation credits expire through 2021 and the state credits expire when exhausted.

Under the Tax Reform Act of 1986, the benefits from net operating loss and tax credit carry-forwards may be impaired or limited in certain circumstances including as a result

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of a cumulative ownership change of more than 50%, as defined, over a three-year period. The issuance of the Company's convertible preferred securities may have resulted in a limitation on utilization of such net operating loss carryforwards.

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### 5. COMMITMENTS AND CONTINGENCIES

The Company leases certain equipment under various non-cancelable capital leases. The capital leases expire through 2003. The Company leases office space under various non-cancelable operating leases expiring through 2006. Rental expense was approximately \$3,021,000, \$2,212,000 and \$864,000 for the years ended December 31, 2001, 2000 and 1999, respectively, net of sublease income of approximately \$156,000 in 2001. Minimum future rental payments under capital and operating leases at December 31, 2001 are as follows (in thousands):

DECEMBER 31, 2001	CAPITAL	OPERATING
2002	\$ 257	\$ 3,067
2003	55	2,622
2004	--	2,688
2005	--	2,688
2006	--	1,687
	312	12,752
Total minimum lease payments		(350)
Less sublease income		(350)
	(18)	\$12,402
Less amount representing interest and discount		\$12,402
Present value of minimum lease payments	294	=====

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Less current portion of capital lease obligations	(240)
	-----
Long term portion	\$ 54
	=====

In connection with certain capital lease transactions, in 1999, the Company granted to the lessor warrants to purchase 22,425 shares of Series D preferred stock at an exercise price of \$3.30 per share. Such warrants were valued at approximately \$44,000 using the Black-Scholes valuation model with the following assumptions: expected volatility of 40%, risk-free interest rate of 6% and expected life of 10 years. The value of these warrants was recorded as a long-term asset, which is being amortized over the capital lease term of 4 years. Such amortization amounted to \$17,000, \$11,000 and \$11,000 during the years ended December 31, 2001, 2000 and 1999, respectively. On the effective date of the company's IPO all outstanding preferred stock was converted to common stock. These warrants were exercised in 2000 in exchange for common stock. There were no outstanding warrants as of December 31, 2001.

The Company has established letters of credit totaling \$1,397,000 for the benefit of the Company's office space lessor and credit card processor. These letters of credit are collateralized by certificates of deposit amounting to \$1,397,000. As of December 31, 2001, no amounts were outstanding under these letters of credit.

The Company and certain of its officers and directors, as well as certain of the underwriters from the Company's initial public offering were named as defendants in a class action shareholder complaint filed in the United States District Court for the Southern District of New York and captioned FELZEN V. EXTENSITY, INC. ET AL., CASE NO. 01-CV-11246. The plaintiffs seek unspecified monetary damages and other relief. The Company believes these charges to be without merit and therefore, has not accrued any amounts in connection with this matter.

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### 6. DEBT

In March 1998, the Company entered into a loan and security agreement with a lender for \$3,500,000. Borrowings under this loan accrued interest at an average rate of 11.4% per annum and matured through December 31, 2001. The agreement provided the lender with the right to exercise warrants to purchase 137,878 shares of Series D preferred stock at an exercise price of \$3.30 per share. The Company recorded the loan at a discount of approximately \$265,000, which was allocated to the warrants. The debt discount was calculated in accordance with the provisions of APB No. 14, "ACCOUNTING FOR CONVERTIBLE DEBT AND DEBT ISSUED WITH STOCK PURCHASE WARRANT". The fair value of the warrants was estimated on the date of grant using the Black-Scholes valuation model with expected volatility of 40%, risk-free interest of 6% and expected life of 10 years. Amortization of the debt discount was recorded as interest expense and amounted to \$36,000, \$88,000 and \$88,000 for the years ended December 31, 2001, 2000 and 1999. On the effective date of the company's IPO all outstanding preferred stock was converted to common stock. These warrants were exercised in 2000 in exchange for common stock. There were no outstanding warrants as of December 31, 2001. The loan was repaid in full during fiscal 2001.

7. MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK AND PREFERRED STOCK WARRANTS

MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK

Mandatorily Redeemable Convertible Preferred Stock consists of the following (in thousands except share data):

	OUTSTANDING SHARES	AMOUNT
	-----	-----
Balance at December 31, 1998	10,361,729	21,269
Issuance of Series E preferred stock	3,732,820	22,379
Issuance of Series F preferred stock	500,000	4,500
Series F beneficial conversion feature	--	1,500
	-----	-----
Balance at December 31, 1999	14,594,549	49,648
Conversion to common stock	(14,594,549)	(49,648)
	-----	-----
Balance at December 31, 2000	--	\$ --
	=====	=====

On December 16, 1999, the Company sold 500,000 shares of its Series F Preferred Stock at a price of \$9.00 per share for gross proceeds of \$4.5 million in cash to an investor. The difference between the deemed fair value of the series F preferred stock of \$12.00 and the price per share of \$9.00 was deemed to be a beneficial conversion feature analogous to a dividend to the preferred stockholders as prescribed under the provisions of EITF 98-5, "ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OR CONTINGENTLY ADJUSTABLE CONVERSION RATIOS". The value of the beneficial conversion feature of \$1.5 million was recognized immediately at the date of issuance as the preferred stockholders had the right to convert their preferred shares at their option.

On January 27, 2000, the SEC declared effective the Company's Registration Statement on Form S-1. Pursuant to this Registration Statement, the Company completed an initial public offering ("IPO") of 4,600,000 shares of its common stock (including 600,000 shares sold pursuant to the exercise of the Underwriters' over-allotment option) at an initial offering price of \$20.00 per share (the "Offering"). All preferred stock was converted to common stock on the effective date of the company's IPO. Each share of Series A, B, C, D, E, and F preferred stock was converted into common stock at the option of the stockholder on a one-for-one basis, subject to certain adjustments. Holders of preferred stock received one vote for each share of common stock into which such shares were converted.

PREFERRED STOCK WARRANTS ISSUED IN CONNECTION WITH FINANCINGS

On January 29, 1997, the Company entered into a loan and security agreement with a bank. During fiscal 1997, \$250,000 was drawn on the loan and

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was repaid in the same year. This loan expired on June 15, 1997. In conjunction with this loan agreement, the Company issued to the lender a warrant to purchase 23,585 shares of Series B preferred stock at an exercise price per share of \$1.59. The Company recorded the loan at a discount of \$24,000 which was allocated to the warrant and amortized as interest expense during 1997. The fair value of the warrant was estimated on the date of grant using the Black-Scholes valuation model with expected volatility of 60%, risk-free interest of 5.50% and expected life of 5 years. On the effective date of the company's IPO all outstanding preferred stock was converted to common stock. These warrants were exercised in 2000 in exchange for common stock. There were no outstanding warrants in connection with this transaction as of December 31, 2001.

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During 1998, the Company entered into financing agreements with a financial institution (see Note 6). In conjunction with these transactions, the Company issued to the financial institution warrants to purchase shares of Series D preferred stock at an exercise price of \$3.30 per share. On the effective date of the company's IPO all outstanding preferred stock was converted to common stock. These warrants were exercised in 2000 in exchange for common stock. There were no outstanding warrants in connection with this transaction as of December 31, 2001.

### 8. COMMON AND PREFERRED STOCK

During 2000, the Company's Board of Directors approved an amendment to the Company's Certificate of Incorporation to increase the number of its authorized shares of common stock to 75,000,000 and authorized 5,000,000 shares of preferred stock.

During the year ended December 31, 1999, the Company loaned to three officers an aggregate of \$230,000 to exercise options to purchase 933,439 shares of the Company's common stock. The officers paid \$193,750 in cash in conjunction with these exercises. A promissory note of \$100,000 to one of the officers, bearing interest at 4.77% and due on February 28, 2004 was repaid in full, including interest of \$3,000, in November of 1999. The notes of the other two officers bear interest at 5.87%, are due on July 16, 2004 and are collateralized by their personal assets.

During the year ended December 31, 2000, the Company loaned \$250,000 to an officer to exercise options to purchase 90,000 shares of the Company's stock. The officer paid \$560,000 in cash in conjunction with this exercise. The promissory note is due January 17, 2005 and bears interest at a rate of 6.12% per annum and is collateralized by the officer's personal assets.

### COMMON STOCK WARRANTS

In October of 2000, The Company granted warrants to a service provider to purchase 20,000 shares of the Company's common stock at an exercise price of \$14.50 per share. These warrants vest ratably over a two-year period and expire in October 2007. The Company is accounting for these warrants under the variable accounting provisions of FIN 44. The charge for fiscal 2001 and 2000 amounted to \$66,000 and \$10,500, respectively, using the Black Scholes valuation model with the following variables: expected volatility of 90%, risk free interest of 6% and expected life of 7 years. The warrants were not exercised as of December 31, 2001.



9. STOCK OPTIONS

1996 STOCK OPTION PLAN

In 1996, the Company adopted the 1996 Stock Option Plan (the 1996 Plan) under which eligible employees, directors, and consultants can receive options to purchase shares of the Company's common stock at a price generally not less than 100% of the fair value of the common stock on the date of the grant for incentive stock options and nonstatutory stock options. The 1996 Plan, as amended through December 31, 2001, allows for the issuance of a maximum of 8,960,462 shares of the Company's common stock and an annual replenishment of the shares of common stock authorized for issuance there under equal to the lesser of (a) 1,300,000 shares, (b) 4% of the outstanding shares on such date or (c) a lesser amount to be determined by the Board. The options granted under the 1996 Plan vest according to varying schedules determined by the 1996 Plan Administrator, currently the Board of Directors. Options generally vest over four years and expire ten years from the date of grant.

2000 NONSTATUTORY STOCK OPTION PLAN

In August 2000, the Board of Directors adopted the 2000 Nonstatutory Stock Option plan (the 2000 Plan) under which eligible employees can receive options to purchase shares of the Company's common stock at a price generally not less than 100% of the fair value of the common stock on the date of grant for non statutory options. The 2000 Plan as amended through December 31, 2001, allows for a maximum of 3,394,845 shares of the Company's common stock and an annual replenishment of the shares of common stock authorized for issuance on the first day of the Company's fiscal year (the "calculation date") beginning on January 1, 2002, equal to 4% of the outstanding shares on the calculation date. The Board may act, prior to the first day of any fiscal year of the Company, to increase the share reserve by such number of shares as the Board shall determine, which number shall be less than 4% of the outstanding shares on the calculation date. The options granted under the 2000 Plan vest according to varying schedules determined by the 2000 Plan Administrator. Options generally vest over four years and expire ten years from the date of grant. The 2000 plan explicitly excludes Officers and Directors, however, the company may grant Options to Officers in connection with the Officer's initial employment.

A summary of the activity under the 1996 and 2000 Plans since inception is set forth below:

Options Outstanding		
Number of Shares	Price Per Share	Aggregate Price

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			(In thousands)
Balance at December 31, 1997	1,012,923	\$0.100 - \$ 0.160	\$ 149
Options granted	1,066,500	\$0.160 - \$ 0.330	280
Options exercised	(357,001)	\$0.100 - \$ 0.160	(53)
Options forfeited	(115,874)	\$0.100 - \$ 0.160	(18)
Balance at December 31, 1998	1,606,548	\$0.050 - \$ 0.330	359
Options granted	3,495,872	\$0.330 - \$ 9.000	6,336
Options exercised	(1,855,091)	\$0.050 - \$ 1.500	(623)
Options forfeited	(304,747)	\$0.160 - \$ 9.000	(134)
Balance at December 31, 1999	2,942,582	\$0.100 - \$ 9.000	5,938
Options granted	2,959,950	\$5.375 - \$38.813	46,853
Options exercised	(432,966)	\$0.100 - \$ 9.000	(1,068)
Options forfeited	(381,127)	\$0.100 - \$38.813	(2,205)
Balance at December 31, 2000	5,088,439	\$0.100 - \$38.813	49,504
Options granted	3,398,950	\$2.150 - \$ 9.090	13,935
Options exercised	(414,009)	\$0.100 - \$ 7.500	(446)
Options forfeited	(3,039,429)	\$0.160 - \$38.813	(41,422)
Balance at December 31, 2001	5,033,951	\$0.160 - \$37.250	\$ 21,571

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The following table summarizes information with respect to stock options outstanding at December 31, 2001:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.160 - \$ 1.500	1,066,993	7.22	\$ 0.635	394,591	\$ 0.611
\$2.150 - \$ 2.280	1,995,638	9.94	\$ 2.275	290,626	\$ 2.280
\$2.450 - \$ 8.820	1,405,107	7.87	\$ 6.417	421,624	\$ 6.931
\$9.000 - \$37.250	566,213	8.38	\$12.954	230,318	\$12.498
\$0.160 - \$37.250	5,033,951	8.61	\$ 4.285	1,337,159	\$ 5.339

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The Plans allows certain option holders to exercise their options prior to vesting. However, such exercises are subject to repurchase by the Company if not vested. The Company's repurchase right lapses over a four year period. As of December 31, 2001, 146,873 shares of common stock acquired by option holders are subject to repurchase by the Company.

The Company accounts for employee and board of director stock options in accordance with the provisions of APB No. 25 and complies with the disclosure provisions of SFAS No. 123.

Under APB No. 25, compensation expense is recognized based on the amount by which the fair value of the underlying common stock exceeds the exercise price of the stock options at the measurement date, which in the case of employee stock options is typically the date of grant. For financial reporting purposes, the Company has determined that the deemed fair market value on the date of grant of certain employee stock options issued prior to the IPO was in excess of the exercise price of the options. This amount is recorded as deferred compensation and is classified as a reduction of stockholders' equity and is amortized as a charge to operations over the vesting period of the applicable options. The vesting period is generally four years. The fair value per share used to calculate deferred compensation was derived by reference to the preferred stock values and the Company's initial public offering price range. Consequently, the Company Recorded deferred stock compensation of \$1,881,000 and \$10,205,000 during the years ended December 31, 2000 and 1999, respectively. Amortization recognized for the years ended December 31, 2001, 2000 and 1999 totaled \$509,000, \$3,977,000 and \$4,352,000, respectively.

The weighted average fair values of the options granted in fiscal 2001, 2000 and 1999 were \$4.10, \$15.83 and \$1.80, respectively.

Had compensation cost for option grants to employees been determined consistent with SFAS No. 123, the Company's net loss would have been as follows (in thousands, except per share data):

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	Years Ended December 31,		
	2001	2000	1999
Net Loss:			
As reported	\$ (25,953)	\$ (34,509)	\$ (24,889)
Pro forma net loss	\$ (27,765)	\$ (38,042)	\$ (24,762)
Pro forma net loss per share, basic and diluted	\$ (1.16)	\$ (1.79)	\$ (11.14)

The above pro forma disclosures are not necessarily representative of the effects on reported income or loss for future years as additional grants are made each year and options vest over several years.

The fair value of each option grant was estimated on the date of grant using the minimum value options pricing model with the following weighted average assumptions by period:

	Years Ended December 31,		
	2001	2000	1999

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Risk-free interest rate	3.7%	6.2%	5.6%
Expected volatility	108%	189%	--
Expected life (in years)	1.7	1.5	4
Dividends	--	--	--

Because the Company was not publicly traded until January 27, 2000, the date of the IPO, volatility was not considered in the determining the value of options granted to employees in the 1999.

### STOCK OPTION EXCHANGE

Pursuant to a Tender Offer Statement filed with the SEC on May 4, 2001, employees surrendered for cancellation 1,744,400 options to purchase shares of the Company's common stock at exercise prices ranging from \$5.44 to \$38.81. In exchange, the Company on June 6, 2001 granted short-term options to purchase 174,440 shares of the Company's common stock at an exercise price of \$8.82 covering ten percent (10%) of the number of shares that were cancelled.

The grant of short-term options was accounted for as prescribed under the provisions of FIN No. 44, "ACCOUNTING FOR CERTAIN TRANSACTIONS INVOLVING STOCK COMPENSATION". For the twelve months ended December 31, 2001, the Company did not incur any compensation expense associated with such options.

On December 12, 2001 the Company granted new options equal to ninety percent (90%) of the number of shares that were cancelled on June 5, 2001. The number of new options actually granted on December 12, 2001, totaling 1,366,560 shares is less than the amount cancelled on June 5, 2001 as a result of employee terminations related to our restructuring plan implemented in July 2001. The exercise price of the new options is \$2.28, the closing price of the Company's Common Stock on the date of grant. The new

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options have the same vesting schedule as the cancelled options and will expire if not exercised ten years from the grant date or earlier if employment is terminated.

The short-term options vested on December 6, 2001 and expired unexercised on March 6, 2002.

### 10. EMPLOYEE SAVINGS AND INVESTMENT PLANS

#### 401(K) PLAN

In January 1998, the Company adopted a 401(k) plan for employees. All employees who meet certain service requirements are eligible to participate. Matching contributions are at the discretion of the Company. The Company made no matching or discretionary contributions during 2001, 2000 or 1999.

#### EMPLOYEE STOCK PURCHASE PLAN

The Company's 2000 Employee Stock Purchase Plan was adopted by the board of directors and stockholders of Extensity in November 1999 and became effective upon the closing of the IPO in January of 2000. A total of 1,235,241 shares have been reserved for issuance under the purchase plan. The purchase plan provides for automatic annual increases in the number of shares reserved for issuance under the plan in an amount equal to the lesser of 1) 1.5% of the outstanding

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shares on such date, 2) 500,000 shares or 3) such lesser amount as may be determined by the board. Under the purchase plan, eligible employees may purchase common stock in an amount not to exceed 15% of the employee's cash compensation. The purchase price will be 85% of the common stock fair value at the lower of certain plan-defined dates. As of December 31, 2001, there have been 428,679 shares issued and 805,910 shares reserved for future issuance.

### 11. ACQUISITION

In September of 2000, Extensity acquired all the outstanding shares of a company. The total acquisition cost was approximately \$343,000 primarily comprised of \$265,000 in cash, 2,500 shares of the Company's stock valued at \$53,000 and approximately \$25,000 in transaction costs. The transaction was accounted for as a purchase business combination. Substantially the entire purchase price was allocated to in-process research and development as technological feasibility of the acquired product had not been established and no future alternative use existed at the time of purchase. Furthermore, the acquired company had no revenues, no other tangible or intangible assets and only one employee.

### 12. RESTRUCTURING, IMPAIRMENT LOSS AND OTHER

In response to the continuing economic slowdown, the Company implemented a restructuring plan in the third quarter of fiscal 2001 and recorded a restructuring charge of \$4.5 million. The goal of the restructuring plan is to reduce costs and improve operating efficiencies in order to match the current business environment. The restructuring charge consisted of severance and benefits of \$729,000 related to the involuntary termination of 70 employees. These terminations were from all functions across the Company. In addition, the Company accrued for lease costs of \$2.2 million pertaining to the estimated obligations for non-cancelable lease payments for excess facilities in the United States, Europe and Australia. The Company also wrote off computer equipment and software with a net book value of \$1.6 million as these assets were taken out of service because they were deemed unnecessary due to the reductions of workforce.

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The following table sets forth an analysis of the components of the restructuring charge and the payments made against the accrual through December 31, 2001 (in thousands):

	Severance and Benefits	Computer Equipment and Software	Accrued Lease Costs
	-----	-----	-----
Restructuring provision:			
Severance and benefits	\$ 729	\$ --	\$ --
Accrued lease costs	--	--	2,187
Property and equipment write-off	--	1,577	--
	-----	-----	-----
Total	729	1,577	2,187
Cash paid	(729)	--	(901)
Non-cash charges	--	(1,577)	--
	-----	-----	-----
Accrual balance at December 31, 2001	\$ --	\$ --	\$ 1,286
	=====	=====	=====

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The Company expects to pay the remaining obligations relating to the non-cancelable lease obligations over the remaining lease terms through 2006.

In the third quarter of 2001, the Company incurred an impairment loss of \$1.3 million. This charge was attributed to the impairment of assets acquired in conjunction with building the hosted offering. These assets were written down to a level commensurate with the expected future cash flows as prescribed by SFAS No. 121 "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF".

During the first quarter of 2001, the Company incurred \$377,000 in connection with exploring potential merger and acquisition transactions.

### 13. QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is unaudited financial data for 2001 and 2000 (amounts in thousands, except for per share amounts).

Revenues	Q4'01	Q3'01	Q2'01	Q1'01	Q4'00	Q3'00
	-----	-----	-----	-----	-----	-----
License	\$ 4,231	\$ 4,886	\$ 5,651	\$ 6,022	\$ 5,316	\$ 4,021
Service and maintenance	3,657	3,174	3,480	3,780	3,470	3,005
Hosted	151	48	--	--	--	--
	-----	-----	-----	-----	-----	-----
Total revenues	8,039	8,108	9,131	9,802	8,786	7,026
Gross profit	\$ 4,884	\$ 4,612	\$ 5,424	\$ 5,283	\$ 4,433	\$ 2,847
Net loss	(2,342)	(9,379)	(6,733)	(7,499)	(7,605)	(8,702)
Basic and diluted net loss per share	\$ (0.10)	\$ (0.39)	\$ (0.28)	\$ (0.32)	\$ (0.33)	\$ (0.38)

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### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.

None

PART III.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

See the information in "Proposal No. 1 - Election of Directors" in Extensity's Proxy Statement for the 2002 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of Extensity's fiscal year ended December 31, 2001 (the "2002 Proxy Statement") which is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

See the information set forth in the section entitled "Executive Compensation" in the 2002 Proxy Statement, which is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

See the information set forth in the section entitled "Security Ownership of Certain Beneficial Owners and Management" in the 2002 Proxy Statement, which is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

See the information set forth in the section entitled "Certain Transactions" in the 2002 Proxy Statement, which is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, AND REPORTS ON FORM 8-K

1) FINANCIAL STATEMENTS.

The financial statements filed as part of this report are listed on the Index to Consolidated Statements on page 39

2) FINANCIAL STATEMENT SCHEDULES

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Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

### 3) EXHIBITS

Exhibit ----- Number -----	
3.2.(1)	Amended and Restated Certificate of Incorporation of the Registrant.
3.3.(1)	Bylaws of the Registrant.
4.1.(1)	Registrant's Common Stock Certificate
10.1.(1)	Form of Indemnification Agreement entered into by and between the Registrant and each of its directors and executives.
10.8.(1)	Lease agreement by and between the Registrant and Spieker Properties, Inc.
10.8.1(4)	Amended Lease agreement dated December 12, 2000 by and between the Registrant and Spieker Properties, Inc.
10.9.(1)	Offer letter dated February 16, 1999 by and between the Registrant and Robert A. Spinner.
10.10(1)(3)	1996 Stock Option Plan, as amended.
10.11(1)(3)	2000 Employee Stock Purchase Plan and related agreements.
10.11.1(2)	2000 Nonstatutory Stock Option, as amended.
10.12(4)	Note Dated January 17, 2000 by and between the Registrant and Donald E. Smith
10.13(4)	Note dated August 20, 1999 by and between the Registrant and Mark K. Oney.
23.1	Consent of PricewaterhouseCoopers LLP, Independent Accountants.

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- (1) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (No. 333-90979) and incorporated herein by reference.
  - (2) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (No. 333-45748) and incorporated herein by reference.
  - (3) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (No. 333-36336) and incorporated herein by reference.
  - (4) Filed as an exhibit to the Registrant's Annual Report on Form



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10-K (No. 000-28897) and incorporated herein by reference.

- (b) Reports on Form 8-K  
None
- (c) Exhibits

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

April 1, 2002

EXTENSITY, INC.

By /s/ Kenneth R. Hahn

-----  
Kenneth R. Hahn  
Chief Financial Officer (Principal Financial  
and Accounting Officer)

KNOW ALL PERSONS BY THESE PRESENTS that each person whose signature appears below constitutes and appoints Robert A. Spinner and Kenneth R. Hahn, and each of them, his true and lawful attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with Exhibits thereto and other documents in connection therewith the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

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SIGNATURE -----	TITLE -----	DATE ---
/s/ ROBERT A. SPINNER ----- Robert A. Spinner	President and Chief Executive Officer and Director (Principal Executive Officer)	April
/s/ KENNETH R. HAHN ----- Kenneth R. Hahn	Chief Financial Officer (Principal and Accounting Officer)	April
/s/ SHARAM I. SASSON ----- Sharam I. Sasson	Chairman of the Board of Directors	April

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/s/	CHRISTOPHER D. BRENNAN	Director	April
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	Christopher D. Brennan		
/s/	JOHN R. HUMMER	Director	April
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	John R. Hummer		
/s/	DAVID A. REED	Director	April
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	David A. Reed		
/s/	TED E. SCHLEIN	Director	April
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	Ted E. Schlein		