OPNET TECHNOLOGIES INC
Form 10-K
June 04, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2003

OR

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

Commission file number: 000-30931

OPNET TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**52-1483235**
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification No.)**

7255 Woodmont Avenue, Bethesda, Maryland 20814-2959

(Address of principal executive offices) (Zip Code)

Registrant s telephone number; including area code: (240) 497-3000

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

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

Common Stock, $ .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 x 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 Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed using the closing sale price of the registrant s Common Stock on September 30, 2002, as reported on the NASDAQ National Market, was approximately $69.8 million.

The number of shares of the registrant s Common Stock outstanding on June 3, 2003 was 19,388,168.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s definitive Proxy Statement for the Annual Meeting of Stockholders to be held on September 9, 2003, are incorporated by reference into Part III of this Form 10-K.

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OPNET TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED MARCH 31, 2003

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This Annual Report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. The factors listed in this Annual Report under Management s Discussion and Analysis of Financial Condition and Results of Operations Certain Factors That May Affect Future Results, as well as any cautionary language in this Annual Report, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission, including our Quarterly Reports on Form 10-Q that we will file in fiscal 2004.

The forward-looking statements provided in this Annual Report represent our expectations as of June 3, 2003. We anticipate that subsequent events and developments will cause our expectations to change. However, while we may elect to update this forward-looking information at some point in the future, we specifically disclaim any obligation to do so. This forward-looking information should not be relied upon as representing our expectations as of any date subsequent to May 30, 2003. IT Guru, Netbiz, OPNET®, OPNET Modeler®, SP Guru®, OPNET WDM Guru, OPNET Technologies, OPNETWORK®, and VNE Server are trademarks or service marks of OPNET. Other trademarks or service marks appearing in this Annual Report are the property of their respective holders.

We are a Delaware corporation, and our principal executive offices are located at 7255 Woodmont Avenue, Bethesda, Maryland 20814-2959 and our telephone number is (240) 497-3000. Our web site address is www.opnet.com. The information on our web site is not incorporated by reference into this Annual Report and should not be considered to be a part of this Annual Report. Our web site address is included in this Annual Report as an inactive textual reference only.

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PART I

ITEM 1. BUSINESS

Overview

OPNET Technologies, Inc. (OPNET , we or us) is a leading provider of intelligent network management software. Founded in 1986, we continue to be a pioneer in this field. Embedded in OPNET software is expert knowledge about how network devices, network protocols, applications and servers operate. This intelligence enables users in network operations, engineering, planning, and application development to be far more effective in optimizing performance and availability of their networks and applications. We believe our software solutions generate significant return on investment to a broad customer base, including corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers by empowering them to rapidly make better use of resources, reduce operational problems and improve competitiveness.

We market focused software solutions for each of our target markets. *OPNET IT Guru*, which was launched in August 1998 and *OPNET SP Guru*, which was launched in June 2001, are our platform intelligent network management products for enterprises and service providers, respectively. *OPNET WDM Guru,* which was launched in December 2001, is an optical network planning product for equipment manufacturers and service providers. *OPNET Modeler,* our first product which was launched in 1987, is a modeling and simulation product for network R&D, mainly sold to network equipment manufacturers and the U.S. Department of Defense. *OPNET Netbiz* applications are custom solutions developed with the OPNET Development Kit (ODK), which were launched in August 1998, and are sold primarily to network equipment manufacturers. *OPNET VNE Server,* which was launched in June 2002, is our software solution for unified network data management. *OPNET VNE Server* is sold primarily to enterprises and service providers. Government and defense agencies purchase most of our software solutions, as their needs are similar to enterprises, service providers, and network equipment manufacturers.

Since inception, we have sold our products to enterprises such as Enterprise Rent-a-Car, FleetBoston Financial, Staples, RR Donnelley and Texas Utilities; service providers such as AT&T, British Telecom, France Telecom, NTT, SBC Communications and Sprint; network equipment manufacturers such as Cisco Systems, Ericsson, Motorola, Nokia, and Nortel Networks; and government agencies such as the Coast Guard, FAA, FBI, NASA, U.S. Department of State, and U.S. Department of Defense.

Industry Background

Growth and Increased Complexity of Networks

Organizations are increasingly reliant upon their communications networks and data applications to successfully execute their business strategies. The increasing use of business applications, such as enterprise resource planning, corporate intranets, online transaction processing, e-mail, and streaming multimedia, has expanded the amount of network traffic within organizations, and has resulted in significant growth in underlying network infrastructures. In addition, the proliferation and widespread adoption of the Internet has expanded the role of networks beyond organizational boundaries, and these networks now represent the fundamental infrastructure of business. As a result, organizations are recognizing that managing the growth and operation of their communications networks is critical to business success.

To support the rapidly expanding size and scope of communications requirements, network infrastructures have been developed based on a wide range of equipment, technologies, protocols, and network services. As a result, the operation of these networks is becoming increasingly complex. Enterprises and service providers must now manage the convergence of voice, data, and video traffic over traditional, wireless, and optical architectures by integrating numerous existing and emerging technologies. The growth of networks, network complexity, and network data traffic has forced organizations to confront significant challenges in the cost-effective management of networks and applications.

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Communications networks are sophisticated, dynamic systems that evolve on a daily basis. Applications are typically distributed across many clients, servers, and network segments. New and enhanced business applications are regularly being deployed and re-deployed. Because traffic levels rise steadily, constant evaluation of and improvements to the network are essential to maintaining business and application performance. However, due to the dependencies among network, server, and application configurations, it is very difficult for networking professionals to identify the true root cause of end-to-end performance problems when they occur. The data required to diagnose end-to-end problems is often not available, and when it is, specialists are required to perform manual analysis that is time consuming, and sometimes impractical. Consider the challenge facing a typical network manager when an end-user experiences performance problems with an important business application: Is there enough bandwidth available? Does the database server have enough capacity? What about the application server? Are network routing protocols tuned properly? What about protocols on the client and server? Was the application designed and configured properly?

Without a clear understanding of where problems are and what specific changes are required to solve them, network managers resort to uninformed decision-making that translates into wasteful spending on unnecessary server and network upgrades. Due to the distributed nature of enterprise applications, network professionals need solutions that enable them to focus their time and resources in the right places when problems occur to maximize the use of existing infrastructure. Since modifications to infrastructure are costly and have the potential to result in network failures or service level degradation, there is a growing need to plan and implement network changes in a controlled manner, taking into account the potential consequences of each action.

Inadequacy of Traditional Network Management Solutions

Traditional network management systems have primarily played a reporting role. These systems typically collect, store and analyze data about the traffic on the network, the status and performance of network devices and links, and the availability of network services and applications. While these traditional network management products play an important role in managing performance and availability, they are limited by their lack of understanding of the underlying technologies that support applications, and the relationships among these technologies.

Traditional network management solutions do not adequately support key network management functions, including network design and deployment, applications troubleshooting and deployment, capacity planning, contingency planning, traffic engineering, budgeting, and deployment of network policies. Each of these functions depends on a significant amount of expertise, manual effort and multiple sources of data to be done properly without the support of intelligent network management. Traditional network management products lack an operational knowledge of how network devices, applications, and traffic behave together, and are thus limited both in their ability to diagnose complex problems and also their ability to provide quantitative insight into how changes will affect performance.

In general, the troubleshooting support available from traditional products is focused on monitoring an individual data source, such as traffic volume, or application response time. The support available from traditional tools for future planning is limited to trend analysis and simple projections based on historical information, again, often from a single data source. These solutions do not generally take into account the network as a whole, the interaction among network components, and the complex behaviors that are inherent to modern networks and distributed applications.

Market Opportunity for Intelligent Network Management

Organizations need intelligent network management solutions that possess an operational understanding of network devices, protocols and applications to enable them to rapidly diagnose complex problems from live operational data sources, and to predict the impact of changes. A predictive capability allows network professionals not only to test network and application performance under a wide range of operating conditions,

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but also to determine which network technologies are best suited to ultimately solve business problems. We believe business executives and network professionals need a comprehensive network management solution that enhances their ability to:

- generate revenue;
- reduce operating and capital costs;
- increase business productivity;
- improve operational efficiency;
- reduce time-to-market; and
- manage risk.

Enterprises require intelligent network management solutions for more effectively identifying the root causes of end-to-end application performance problems, troubleshooting device configurations, validating changes, and performing critical operational and strategic planning functions.

Government and defense agencies have needs similar to those of enterprises, service providers, and network equipment manufacturers. These agencies also sometimes require specialized services to support large projects that incorporate intelligent network management technology.

Service providers require intelligent network management solutions for optimizing their investments in network infrastructure, more effectively troubleshooting network configurations, planning for services based on new technologies including wireless and optical, and making better use of network resources to increase competitiveness.

Network equipment manufacturers require intelligent network management solutions for accelerating network R&D, reducing time-to-market for new technologies, developing custom network design and analysis software, and for reducing sales cycles for sophisticated technology products.

The OPNET Solution and Products

OPNET software solutions directly address the intelligent network management needs of enterprises, government agencies, service providers, and network equipment manufacturers. Our intelligent network management solutions use a variety of advanced technologies to support the assessment of network, application, and server performance under a wide range of current and future operating conditions. Our products include model libraries that permit the simulation and analysis of major network technologies and communication protocols, such as Transmission

Control Protocol/Internet Protocol, or TCP/IP, IP-QoS, Voice over IP, SONET, CDMA, Virtual Local Area Networks, or VLANs, Frame Relay, data over cable, and ATM. We sell both off-the-shelf and customized products that offer interfaces to third party network management solutions, including those from Concord, Infovista, Network Associates, and Netscout. All of the OPNET products share a significant amount of core software based on an open architecture. Our product architecture enables us to create new products more efficiently, to foster interoperability of our products, and to provide interfaces to a wide range of external data sources including third party management tools and network topology, traffic, and configuration information.

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The following chart summarizes our OPNET product suite:

Product	Description	Target Customers
OPNET IT Guru	An intelligent network management platform product for enterprises. Enables users to troubleshoot and predict the performance of networks, applications, and servers.	Large and medium enterprises, and government and defense agencies.
OPNET SP Guru	An intelligent network management platform product for service providers. Enables network service providers to troubleshoot, validate, plan and design networks.	Network service providers and very large enterprises. Networking professionals who focus on planning, operations, design, and architecture.
OPNET Modeler	A modeling and simulation product for network R&D. Enables designers to evaluate how networking equipment, technologies and protocols will perform under simulated network conditions.	Network equipment manufacturers and R&D organizations.
OPNET Netbiz and OPNET Development Kit (ODK)	Custom applications for automating network design, planning, provisioning, proposals, and analyses.	Network equipment manufacturers and the U.S. Department of Defense.
OPNET WDM Guru	Optical network planning product for designing resilient, cost-efficient optical networks.	Network equipment manufacturers and service providers. Optical transport layer design and planning engineers.
OPNET Modules	Provides enhanced functionality to our primary software products.	Entire customer base.
OPNET Model Libraries	Libraries of models that simulate the behavior of networking technologies and communication protocols.	Entire customer base.
OPNET VNE Server	Maintains a comprehensive view of a customer s network. Used as a front end for *OPNET IT Guru and SP Guru.*	Entire customer base.

OPNET IT Guru

We began commercial distribution of *OPNET IT Guru* in August 1998. *OPNET IT Guru* uses a variety of advanced technologies, including troubleshooting and predictive simulation, to analyze many aspects of network behavior. IT Guru enables our customers to identify current

problems related to application performance and

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network configurations, and also to predict the impact of changes to their networks, applications, and servers under a wide range of scenarios. *OPNET IT Guru* allows users to identify the root-cause of end-to-end performance problems and to make comparisons among alternative approaches to solving them. IT Guru s predictive component supports managing change within customers networks, such as adopting new technologies, increasing capacity, and reorganizing assets. *OPNET IT Guru* also provides detailed views of an application s performance within a network. This enables network managers and application deployment teams to understand the impact of implementing a new application on existing applications, as well as the ability of a network to support the resulting traffic. *OPNET IT Guru* supports many popular communication protocols and networking technologies that operate within wireline and wireless networks.

OPNET SP Guru

We began general commercial distribution of *OPNET SP Guru* in June 2001. *OPNET SP Guru* enables service providers and very large enterprises to manage networks cost-effectively and improve network efficiency. Its advanced configuration troubleshooting and operational validation capabilities enable network operators to identify problems sooner and reduce mistakes. *OPNET SP Guru* uses our predictive modeling and diagnostic technology to characterize and forecast many aspects of network behavior. In addition, *OPNET SP Guru* provides sophisticated design and optimization capabilities that enable service providers to automatically produce more efficient, less costly network designs. Using *OPNET SP Guru*, network operators are able to maintain a reliable infrastructure with high availability and superior service quality, accelerate deployment of new services, differentiate their services from those of competitors, reduce capital and operating costs, and manage risk.

OPNET Modeler

OPNET Modeler was our first product and was introduced in 1987. *OPNET Modeler* uses our device and protocol design environment, as well as our predictive simulation technology, to enable our customers to build software models of a broad range of network devices, communication protocols, and applications, and to combine these models to run simulations in order to predict network behavior and performance. These capabilities support the design, modeling, and development of network equipment and protocols. *OPNET Modeler* enables network equipment manufacturers to test product designs in a wide variety of scenarios prior to manufacturing. Using *OPNET Modeler*, network technology and equipment designers gain a better understanding of design tradeoffs earlier in the product development process, reducing the need for time-intensive and expensive hardware prototyping.

OPNET Netbiz and ODK

We began commercial distribution of *OPNET Netbiz* and *ODK* in August 1998. *OPNET Netbiz* and *ODK* provide network equipment manufacturers, the U.S. Department of Defense, and service providers with a platform for automating network design, provisioning, proposals, and analyses. *OPNET Netbiz* and *ODK* can incorporate customers proprietary algorithms and business policies to automatically produce and optimize network configurations and designs. *OPNET Netbiz* and *ODK* enable network equipment manufacturers to provide vendor-specific planning solutions to their service provider customers, and enable service providers to differentiate service offerings from competitors, improve proposal quality, and accelerate business cycles.

OPNET WDM Guru

We began commercial distribution of *OPNET WDM Guru* in December 2001. This product is an advanced network planning solution that enables service providers and network equipment manufacturers to create cost-effective optical networks. Its extensive, built-in network expertise provides powerful capabilities for routing, grooming and dimensioning networks to meet current and future traffic demands. Users can create and test different what-if scenarios with varying topologies, traffic loads, and configurations. *OPNET WDM Guru s* reporting features allows users to compare the results of different scenarios, and thereby determine the most cost-effective designs to meet future demands.

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OPNET VNE Server

We began commercial distribution of *OPNET VNE Server* in June 2002. This is an on-line continuously operating software product that maintains a valid comprehensive view of the network, including infrastructure, configuration and performance data. It merges and validates multiple sources of information into a cohesive model for problem resolution, problem prevention, and network planning. *OPNET VNE Server* is also used as a front end for *OPNET IT Guru, OPNET SP Guru*, and *OPNET Modeler.*

OPNET Modules

We develop and sell a variety of software modules that provide enhanced functionality to our intelligent network management software products. Currently available OPNET modules include:

Application Characterization Environment (ACE), for analyzing, diagnosing, and simulating the performance of applications within a network based on network traffic samples;

ACE Decode Module, for enhancing *ACE s* visualizations and diagnoses using a comprehensive application and protocol decode engine;

Expert Service Prediction, for the definition and compliance testing of service level agreements;

High-Level Architecture, to support building and running a federation of many simulators, each modeling some aspect of a composite system;

Flow Analysis, for determining the route taken by each circuit or traffic flow, as well as the resulting traffic loads on links, and investigating the impact of failure in selected devices or links (This module has two versions: the Service Provider version and the Enterprise version);

Multi-Vendor Import, for importing network infrastructure and traffic information from other network management software applications;

NetDoctor, for automatic validation of network and protocol configurations; and

Wireless, for modeling wireless networks and the effects of terrain on those networks;

OPNET Model Libraries

The model libraries are used by *OPNET IT Guru, OPNET SP Guru,* and *OPNET Modeler* to simulate and analyze major networking technologies and communication protocols. These libraries provide the building blocks used to generate models of networks. A network model consists of software objects that correspond to the devices, computers, and links that constitute the actual network of interest. The behavior of these objects is controlled by models of devices, computers, applications, communication protocols, and links. *OPNET IT Guru, OPNET SP Guru*, and *OPNET Modeler* include extensive libraries of popular and emerging networking technologies and communication protocols, such as TCP/IP, hypertext transfer protocol, or HTTP, Open Shortest Path First routing, or OSPF, Asynchronous Transfer Mode, or ATM, frame relay, IP-QoS, and 802.11, or Wi-Fi. Some of our model libraries are included in our base products and others are available for an additional fee.

Customers

Our customers include:

large and medium-sized enterprises that rely on networks to conduct business;

service providers, including telecommunications carriers and Internet Service Providers, or ISPs;

network equipment manufacturers; and

government agencies.

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Our software license agreements provide our customers with perpetual and annual licenses for use by a specified number of concurrent users.

For the years ended March 31, 2003, 2002, and 2001 we generated 19.2%, 20.5%, and 22.4%, respectively, of our total revenues from customers located outside the United States. For fiscal 2003 and fiscal 2002 , revenues from transactions with U.S. government agencies were approximately 39% and 23% of our total revenues, respectively. Note 16 to our consolidated financial statements presents information regarding revenues generated in the United States and internationally.

Sales and Marketing

We sell our software through our direct sales force, our international subsidiaries, third-party distributors, and a number of original equipment manufacturers and value-added resellers. To date, original equipment manufacturers have not accounted for a material portion of our revenues. In North America, the majority of our sales are made by our direct sales force. As of March 31, 2003, our sales and marketing organization consisted of 87 employees, which comprised 47 sales teams, located in our headquarters in Bethesda, Maryland and our domestic offices in Cary, North Carolina; Dallas, Texas; Santa Clara, California; and our overseas subsidiaries in France, the United Kingdom, and Australia. We intend to expand our sales and marketing organization by recruiting of additional qualified individuals.

Our direct sales force concentrates on sales opportunities in the United States. Our international sales activities are primarily conducted through our subsidiaries in Paris, France; Reading, United Kingdom; and Sydney, Australia; and our 19 distributors that resell our products in Brazil, China, France, Germany, India, Italy, Japan, the Middle East, Pakistan, Poland, Scandinavia, Singapore, South Africa, and South Korea. International sales activities are managed by our vice president of international sales. Our marketing division works internally with our engineering and sales teams to develop customer value propositions, and externally to raise awareness of our company and products in order to generate leads for sales. Our external marketing activities are aimed at existing customers, new customer and partner prospects, the media, and industry analysts. These include:

- participation in industry tradeshows;
- product seminars;
- advertisements in trade journals and websites;
- direct mailings;
- product collateral development;
- strategic support for sales teams;

briefings with industry analysts; and

a variety of public relations activities, including our annual international technology conference, OPNETWORK.

For each of the last six years, we have sponsored OPNETWORK, an annual international technology conference convened in Washington, D.C. that focuses on intelligent network management for professionals in all areas of networking and information technology. OPNETWORK 2002, held in August 2002, included more than 500 hours of classes, labs and panels led by OPNET employees and outside experts. Approximately 1,000 people attended OPNETWORK 2002.

Service and Support

Our service and support offerings include:

consulting and customization services;

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software maintenance, which includes providing software updates for major and minor revisions;

technical support by telephone, e-mail, or fax; and

training, which includes courses that enable our customers to more effectively use our products.

We offer consulting services to assist our clients in customizing their OPNET products. In particular, our customers typically buy customization services with their purchase of *OPNET Netbiz*. Customization services are performed by our consulting staff, which consists of software development engineers, quality assurance engineers, technical documentation specialists, and product managers. Some customers also choose to engage our consulting services for troubleshooting application performance problems, network planning, network design, and communication protocol design.

Software maintenance and technical support may be purchased by our customers, generally on an annual basis. Purchasers of maintenance are provided with unspecified updates to the software they license from us as the unspecified updates are released. The fee for this service is generally determined as a percentage of the current price of product licenses. Beginning in July 2001, our customers have been able to separately purchase periodic unspecified product updates without purchasing technical support. Customers purchasing technical support are still required to purchase periodic unspecified product updates.

We provide customer support from our support center at our headquarters in Bethesda, Maryland, as well as from support staff in France, the United Kingdom, and Australia. Our technical support services are supported by a comprehensive information system designed to ensure that customer inquiries are addressed promptly, tracked until fully resolved, and recorded for future reference. Reports on the overall responsiveness of the technical support infrastructure, and the status of pending customer inquiries, are provided regularly to our technical support staff, technical support management, and executive management.

We have a core team of technical support staff supplemented by a number of product developers and consultants who perform technical support on a rotational basis. This staffing approach ensures that customers have access to the best available product expertise, while simultaneously providing product developers with direct customer feedback, which in turn helps us improve our products.

We regularly offer training courses to our customers to assist them in maximizing the benefit they receive from using our products. Our training classes cover a broad range of topics. Training classes are offered at our headquarters in Bethesda, Maryland, our facilities in Santa Clara, California; Cary, North Carolina; Paris, France; and Reading, United Kingdom; and at our customers locations. As of March 31, 2003, our full time training staff consisted of 3 employees.

Research and Development

We believe that our ability to enhance our current products, and create new products in response to the needs of our customer base will be an important factor for our future success. Accordingly, we intend to continue to commit significant resources to product research and development. We expect to accomplish a large part of our product improvements and new product development through internal development efforts. New

capabilities may also be integrated into our product lines through the acquisition of technologies or businesses, or the licensing of externally developed technologies.

Our total expenses for research and development for fiscal 2003, 2002, and 2001 were $12.9 million, $12.3 million, and $8.3 million, respectively. Our research and development efforts to date have been conducted at our offices in Bethesda, Maryland; Cary, North Carolina; and Ghent, Belgium. All related costs have been expensed as incurred. As of March 31, 2003, our research and development staff consisted of 105 engineers and technical professionals.

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Our research and development efforts are directed at increasing our revenues by expanding the scope of our solutions to address additional customer requirements. Our existing customers provide a meaningful source of information, which we use in order to guide our future product development. In addition, we invest in research and analysis of trends in our industry and our product markets, and we expect that our future products will reflect the results of these analyses.

Competition

The market for our products is evolving rapidly and is highly competitive. We believe that this market is likely to become more competitive as the demand for intelligent network management solutions continues to increase. Although none of our competitors offers a solution that is identical to ours, we are subject to current and potential competition from:

- software vendors with networked application troubleshooting and predictive analysis offerings, such as Compuware;
- consultants who offer advisory services related to intelligent network management; and
- customers who develop their own intelligent network management capabilities, either internally or through outsourcing.

In addition, it is possible that other vendors as well as some of our customers or distributors will develop and market competitive solutions in the future. Many of our current and potential competitors are larger and have substantially greater financial and technical resources than we do.

We believe the principal competitive factors affecting the market for our software products are the following:

- scope, quality, and cost-effectiveness of network management solutions;
- industry knowledge and expertise embedded in the software;
- the interoperability of solutions with existing network management solutions;
- product performance, accuracy, technical features, ease of use, and price; and
- customer service and support.

Intellectual Property

We rely on a combination of copyright, trademark, patent, and trade secret laws, confidentiality agreements, and contractual provisions to protect our intellectual property. However, we believe that these laws and agreements afford us only limited protection. Despite our efforts to protect our intellectual property, unauthorized parties may infringe upon our proprietary rights. In addition, the laws of some foreign countries do not provide as much protection of our proprietary rights as do the laws of the United States.

We currently hold registered trademarks in the United States for *OPNET*, *OPNET Modeler,* and *SP Guru.* We have pending applications in the United States for the trademark registrations of *IT Guru, Netbiz, and WDM Guru*. We also hold additional registered trademarks in the United States and have additional pending applications. If not renewed, our registered trademarks will expire at various times between April 2007 and August 2010. We have applied for trademark protection in a number of international jurisdictions, and hold a registered trademark in France for OPNET that will expire in 2010, if not renewed. In addition, we have one patent granted by the Patent and Trademark office of the United States for technology related to the OPNET product suite that will expire in 2017, and three pending patent applications that if granted would expire twenty years from the filing date of the applications. We believe that, because of the rapid pace of change in our industry, the intellectual property protection for our products will be a less significant factor for our future success than the knowledge, abilities, and experience of our employees.

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Employees

As of March 31, 2003, we had 265 full-time employees, 250 of whom were located in the United States. These included 90 in sales and marketing, 39 in professional services, 105 in engineering, research, and development, and 31in finance and administration. Our employees are not represented by a collective bargaining agreement and we consider our relations with our employees to be good.

Web Site Access to SEC Reports

Our web site address is www.opnet.com. We make available free of charge on our web site our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. The information on our web site is not incorporated by reference into this Annual Report and should not be considered to be a part of this Annual Report. Our web site address is included in this Annual Report as an inactive textual reference only.

ITEM 2. PROPERTIES

Our corporate office and principal facility is located in Bethesda, Maryland and consists of approximately 60,000 square feet of office space held under a lease that expires on January 31, 2011, exclusive of renewal options. We also lease office space in the following locations: Cary, North Carolina; Dallas, Texas; Santa Clara, California; Ghent, Belgium; Paris, France; and Reading, United Kingdom.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various claims and legal proceedings arising from our normal operations. We do not regard any of those matters to be material.

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

No matters were submitted to a vote of our stockholders during the fourth quarter of fiscal 2003.

EXECUTIVE OFFICERS AND DIRECTORS OF THE REGISTRANT

Our executive officers and directors, and their ages as of May 30, 2003, are as follows:

Name	Age	Position
Marc A. Cohen	39	Chairman of the Board and Chief Executive Officer
Alain J. Cohen	36	President, Chief Technology Officer and Director
Joseph W. Kuhn	43	Vice President and Chief Financial Officer
Pradeep K. Singh	34	Senior Vice President of Engineering, Model Research and Development
Steven G. Finn, PhD(1)(2)	56	Director
William F. Stasior(1)(2)	62	Director

(1) Member of the Audit Committee
(2) Member of the Compensation Committee

Set forth below is information regarding the professional experience for each of our executive officers and directors. These executive officers and directors were elected to serve until their successors have been elected. Marc A. Cohen and Alain J. Cohen are brothers. There is no other family relationship between any of our other executive officers or between any of these officers and any of our directors.

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Marc A. Cohen, one of our founders, has served as our chairman of the board since our inception in 1986 and as our chief executive officer since 1994. From 1986 to 1992, Mr. Cohen was also a consultant with Booz Allen Hamilton Inc., an international management and consulting company. Mr. Cohen received a bachelor s degree in engineering science from Harvard University and a master s degree in electrical engineering from Stanford University.

Alain J. Cohen, one of our founders, has served as our president and chief technology officer and as a member of our board of directors since our inception in 1986. Mr. Cohen received a bachelor s degree in electrical engineering from the Massachusetts Institute of Technology (M.I.T.).

Joseph W. Kuhn has served as vice president and our chief financial officer since January 2002. From March 2001 until joining OPNET, Mr. Kuhn served as executive vice president and chief financial officer of Wisor Telecom Corporation, a provider of communications software systems. From April 1997 to March 2001, Mr. Kuhn served as executive vice president, chief financial and operating officer and a member of the board of directors of Ciraden, Inc., a provider of business services and software systems to dental practices. Prior to April 1997, Mr. Kuhn served as an officer at Alaris Medical, Inc., a publicly traded corporation that develops, manufacturers and provides integrated intravenous infusion therapy and patient monitoring instruments and related disposables. Mr. Kuhn is a graduate of Rutgers University and a certified public accountant.

Pradeep K. Singh has served as our senior vice president of engineering, model research and development since March 2000. From March 1999 to March 2000, Mr. Singh served as our vice president of engineering, model research and development. From September 1995 to February 1999, he served as our director of model research and development. From October 1994 to August 1995, he was one of our software engineers. Mr. Singh received a bachelor s degree in electrical engineering from Delhi College of Engineering (India) and a master s degree in electrical engineering from Clemson University.

Steven G. Finn has served as a member of our board of directors since March 1998. Dr. Finn has been a principal research scientist and lecturer at M.I.T. since 1991. Dr. Finn has also served as a consultant with Matrix Partners, a venture capital firm, since 1991.

William F. Stasior has served as a member of our board of directors since March 1998. Since October 1999, he has served as senior chairman of Booz Allen Hamilton Inc. From 1991 to 1999, he served as chairman and chief executive officer of Booz Allen Hamilton Inc. Mr. Stasior currently serves on the boards of directors of Rare Medium Group, Inc., an Internet services company.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Market for Common Stock

Our common stock began trading on the NASDAQ National Market on August 2, 2000, under the symbol OPNT. The following table sets forth, on a per share basis, for the indicated periods, the high and low sale prices of our common stock as reported by the NASDAQ National Market.

	Quarterly Common Stock-Price for the Year Ended March 31,			
	2003		2002	
Quarter ended	High	Low	High	Low
June 30	$ 10.98	$ 7.55	$ 21.06	$ 14.44
September 30	9.31	5.68	18.74	4.75
December 31	10.01	4.74	15.00	5.55
March 31	8.51	5.00	19.50	8.13

Number of Stockholders of Record

As of June 3, 2003, we had approximately 76 holders of record of common stock. Because many of these shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these holders of record.

Dividends

We have never paid or declared any cash dividends on our common stock or other securities. Our loan agreement with a commercial bank prohibits the payment of dividends. We currently intend to retain all future earnings, if any, for use in the operation of our business, and therefore, do not anticipate paying cash dividends in the foreseeable future.

Use of Proceeds

In August 2000, we closed an initial public offering of our common stock. The Registration Statement on Form S-1 (No. 333-32588) was declared effective by the Securities and Exchange Commission on August 1, 2000 and we commenced the offering on that date. After deducting the underwriting discounts and commissions and the offering expenses, the net proceeds from the offering were approximately $54.1 million.

As of March 31, 2003, the proceeds from the offering had been used to fund approximately (i) $7.6 million of general corporate expenses, working capital and capital expenditures, including $4.8 million for capital expenditures and leasehold improvements related to our headquarters facility in Bethesda, Maryland, (ii) $6.2 million of acquisition costs and expenses related to our acquisition of the NetMaker division of Make Systems, Inc. in March 2001 and (iii) $1.4 million of the purchase price related to our acquisition of WDM NetDesign BVBA in January 2002. None of these amounts were paid to any of our directors, officers, or their associates, persons owning 10% or more of any class of our equity securities, or any of our affiliates. We have not allocated any of the remaining net proceeds to any identifiable uses. We may also use a portion of the net proceeds to acquire businesses, products, or technologies that are complementary to our business. Pending their use, we have invested the net proceeds in investment grade, interest-bearing securities.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and the related notes and Management s Discussion and Analysis of Financial Condition

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and Results of Operations included elsewhere in this Annual Report. The statement of operations data for the years ended March 31, 2003, 2002, and 2001 (referred to as fiscal 2003 , fiscal 2002 , and fiscal 2001 , respectively), and the balance sheet data as of March 31, 2003 and 2002, are derived from, and are qualified by reference to, our audited consolidated financial statements included in this Annual Report. The balance sheet data as of March 31, 2001, 2000 and 1999, and the statement of operations data for the years ended March 31, 2000 and 1999 are derived from our audited consolidated financial statements that are not included in this Annual Report. Historical results are not necessarily indicative of results that may be expected for any future period.

	Year Ended March 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
Statement of Operations Data:					
Revenues:					
Software licenses	$ 31,223	$ 27,003	$ 18,939	$ 10,577	$ 6,715
Services	15,228	17,753	14,005	8,658	5,288
Total revenues	46,451	44,756	32,944	19,235	12,003
Cost of revenues:					
Software licenses	900	459	395	728	133
Services	6,276	5,863	4,750	2,875	1,249
Total cost of revenues	7,176	6,322	5,145	3,603	1,382
Gross profit	39,275	38,434	27,799	15,632	10,621
Operating expenses:					
Research and development	12,909	12,339	8,263	5,696	4,850
Sales and marketing	18,245	16,866	13,745	7,510	4,056
General and administrative	4,897	4,655	3,362	2,093	1,984
Amortization of acquired technology	504	434			
Purchased in-process research and development			770		
Total operating expenses	36,555	34,294	26,140	15,299	10,890
Income (loss) from operations	2,720	4,140	1,659	333	(269)
Interest and other income, net	879	1,740	2,788	414	376
Income before provision for income taxes	3,599	5,880	4,447	747	107
Provision (benefit) for income taxes(1)	841	1,380	1,567	172	(100)
Net income	$ 2,758	$ 4,500	$ 2,880	$ 575	$ 207
Basic net income applicable per common share	$ .14	$ .24	$ .18	$ .04	$ .02
Diluted net income per common share	$ .14	$ .22	$ .16	$ .04	$ .02
Weighted average shares outstanding (basic)	19,273	18,953	16,440	12,912	12,831
Weighted average shares outstanding (diluted)	19,974	20,014	17,977	14,367	13,626
Balance Sheet Data:					

Cash and cash equivalents	$ 70,251	$ 62,240	$ 62,623	$ 8,765	$ 6,414
Total assets	100,428	95,156	92,180	16,828	13,205
Long-term debt	300	150			
Redeemable convertible preferred stock				6,948	6,934
Total stockholders equity	86,742	82,995	76,454	3,468	2,737

(1) The provision for income taxes for the year ended March 31, 2002 includes non-recurring tax credits for incremental research and development expenditures totaling $372, or $.02 per common share.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes included elsewhere in this Annual Report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under Certain Factors That May Affect Future Results and elsewhere in this Annual Report.

Overview

Revenues. We generate revenues principally from licensing our intelligent network management software products and providing related services, including maintenance and technical support, consulting and training. Our software license revenues consist of perpetual and term license sales of our software products and fees associated with periodic unspecified product updates (license updates).

Our service revenues consist of fees from maintenance and technical support agreements, consulting services and training. The maintenance agreements covering our products provide for technical support and license updates. In July 2001, we changed our business practice to allow our customers to separately purchase license updates without purchasing technical support. Revenue related to license updates is now included in software license revenue. Revenue related to technical support is included in service revenue. Software license revenue from license updates was approximately $8.2 million and $1.9 million in fiscal 2003 and fiscal 2002, respectively. We offer consulting services, generally under fixed-price agreements, primarily to provide product customization and enhancements and to facilitate the adoption of our technology. We provide on-site training to our customers on a daily fee basis.

Revenues from sales outside of the United States represented 19.2%, 20.5%, and 22.4% of our total revenues in fiscal 2003, 2002, and 2001, respectively. Sales outside the United States were primarily made through our Paris, France and Reading, United Kingdom offices as well as third-party distributors and value-added resellers, who are generally responsible for providing technical support and service to customers within their territory. We expect revenues from sales outside the United States to continue to account for a significant portion of our total revenues in the future. We believe that continued growth and profitability will require further expansion of our sales, marketing and customer service functions in international markets.

NetMaker Acquisition. In March 2001, we acquired the NetMaker division of Make Systems, Inc. (NetMaker) for consideration of $5.0 million and 650,000 shares of our common stock. NetMaker offered a sophisticated suite of products that address the operational and engineering needs of traditional and next-generation network service providers. The acquisition contributed key components that enabled us to broaden our product suite for the service provider market. The acquisition was accounted for using the purchase method. See Note 2 to our consolidated financial statements for additional information related to our acquisition of NetMaker.

WDM NetDesign Acquisition. In July 2001, we acquired a 20% interest in WDM NetDesign BVBA (WDM NetDesign) for consideration of $399,000 and purchased an option for consideration of $1,000 to acquire all remaining shares of WDM NetDesign. Through this acquisition, we collaborated on the development of optical network planning products with Comsof N.V., the owner of WDM NetDesign. In December 2001, we exercised our option to purchase the remaining shares of WDM NetDesign for approximately $1.3 million. In January 2002, we purchased these shares by paying Comsof N.V. $925,000 and issuing them 25,000 shares of our common stock. As a result of this acquisition, we now own WDM NetDesign s core technology in optical networking design and, with the addition of WDM NetDesign s employees, have greater

engineering depth and technical expertise. See Note 2 to our consolidated financial statements for additional information related to our acquisition of WDM NetDesign.

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Results of Operations

The following table sets forth items from our statements of operations expressed as a percentage of total revenues for the periods indicated:

	Year Ended March 31,		
	2003	2002	2001
Revenues:			
Software licenses	67.2 %	60.3 %	57.5 %
Services	32.8	39.7	42.5
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Software licenses	1.9	1.0	1.2
Services	13.5	13.1	14.4
Total cost of revenues	15.4	14.1	15.6
Gross profit	84.6	85.9	84.4
Operating expenses:			
Research and development	27.8	27.5	25.1
Sales and marketing	39.3	37.7	41.7
General and administrative	10.5	10.4	10.2
Amortization of acquired technology	1.1	1.0	
Purchased research and development			2.4
Total operating expenses	78.7	76.6	79.4
Income from operations	5.9	9.3	5.0
Interest and other income, net	1.8	3.9	8.5
Income before provision for income taxes	7.7	13.2	13.5
Provision for income taxes	1.8	3.1	4.8
Net income	5.9 %	10.1 %	8.7 %

The following table sets forth, for each component of revenues, the cost of these revenues as a percentage of the related revenues for the periods indicated:

	Year Ended March 31,		
	2003	2002	2001
Cost of software license revenues	2.9 %	1.7 %	2.1 %
Cost of service revenues	41.2	33.0	33.9

Revenues

Software License Revenues. Software license revenues were $31.2 million, $27.0 million, and $18.9 million in fiscal 2003, 2002, and 2001, respectively, representing increases of 15.6% in fiscal 2003 from fiscal 2002 and 42.6% in fiscal 2002 from fiscal 2001. For fiscal 2003, the growth in sales was due to revenue contributions from (i) the change in business practice in July 2001 to allow customers to separately purchase license updates without purchasing technical support (contributing approximately $6.3 million of incremental software license revenue for fiscal 2003 over fiscal 2002), and (ii) higher sales volumes to enterprise and U.S. government customers of OPNET IT Guru, ACE, ACE Decode Module, NetDoctor, Flow Analysis, OPNET SP Guru, and OPNETVNE Server, which was launched in fiscal 2003. However, revenue contributions from the latter were more than offset by discounts associated with pricing strategies and product bundling in fiscal 2003. For fiscal 2002, the growth in sales was due to increased overall demand for our products, revenue contribution

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from new products, increased penetration of international markets, expansion of marketing and direct sales force, increased average transaction size, and license update revenue (contributing approximately $1.9 million of incremental software license revenue for fiscal 2002 over fiscal 2001). For fiscal 2002, a substantial growth in sales to enterprises of OPNET IT Guru, ACE, and modules launched in fiscal 2002, such as ACE Decode Module, NetDoctor, and Flow Analysis, combined with sales to service providers of two products launched in fiscal 2002, OPNET SP Guru and OPNET WDM Guru, offset a significant decline in sales to network equipment manufacturers of OPNET Modeler.

We may experience a slower rate of growth, or even a decline, in overall software license revenues in the near-term due to potentially lower spending levels by enterprise IT organizations, service providers and network equipment manufacturers as a result of a challenging economy.

Service Revenues. Service revenues were $15.2 million, $17.8 million, and $14.0 million in fiscal 2003, 2002, and 2001, respectively, representing a decrease of 14.2% in fiscal 2003 from fiscal 2002 and an increase of 26.8% in fiscal 2002 from fiscal 2001. For fiscal 2003, the decrease resulted from the adverse impact on service revenues from the change in business practice in July 2001 to allow customers to separately purchase license updates (software license revenue) and technical support (service revenue). This decrease was partially offset by growing demand for our consulting services, including engagements with U.S. government agencies, renewals of technical support contracts by our installed base of customers, and additional technical support contracts related to new license sales. A consulting contract with the U.S. Department of Defense that contributed 21.4% of service revenue for the nine months ended December 31, 2002 expired on December 31, 2002. The U.S. Department of Defense issued a request for proposal for this program and we were awarded a new contract in January 2003. The initial funding under this contract for calendar year 2003 is $2.2 million, compared to $3.2 million in calendar year 2002. There are four successive option years under this contract which may be exercised by the U.S. Department of Defense in its discretion. In the event that we are not awarded additional funding under this contract, our results of operations could be adversely impacted. For fiscal 2002, the increases in service revenues was primarily due to growing demand for our consulting services, increased renewals for maintenance contracts by our installed base of customers, and additional technical support contracts related to new software license sales. For fiscal 2002, these increases were partially offset by our change in business practices in July 2001 to allow customers to purchase unspecified periodic product updates (software license revenue) and technical support (service revenue) separately. Engagements with U.S. government agencies contributed significantly to the growing demand for our consulting services in fiscal 2003, 2002 and 2001, respectively.

We do not expect significant growth in our service revenues in the near-term due to the mix of consulting contracts and the conversion of our installed customer base to the business practice implemented in July 2001 of purchasing license updates separately from technical support. Our ability to grow service revenues will be dependent on our ability to expand our installed base of customers and our ability to maintain several large consulting contracts with U.S. government agencies.

International Revenues. Our international revenues decreased 2.8% to $8.9 million, or 19.2% of total revenue, for fiscal 2003 from $9.2 million, or 20.5% of total revenues, for fiscal 2002. Our international revenues increased 24.3% during fiscal 2002 from $7.4 million, or 22.4% of total revenues, for fiscal 2001. Our international revenues are primarily generated in Europe and Japan. During fiscal 2003 and 2002, we expanded our operations outside the United States. International revenue in fiscal 2002 benefited from our expansion. The decline in fiscal 2003 reflects the challenging global economy and the shift of our customer base to enterprises. We believe that we will need to further expand our international sales, marketing and customer service functions to increase international revenue, and we expect to continue experiencing fluctuations of international revenues in the future.

Cost of Revenues

Cost of software license revenues consists primarily of royalties, media, manuals, and distribution costs. Cost of service revenues consists primarily of personnel-related costs in providing technical support, consulting,

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and training to our customers. Gross margin on software license revenues is substantially higher than gross margin on service revenues, due to the low materials, packaging and other costs of software products compared with the relatively high personnel costs associated with providing services.

Cost of Software License Revenues. Cost of software license revenues were $900,000, $459,000, and $395,000 in fiscal 2003, 2002, and 2001, respectively. Gross margin on software licenses revenue decreased to 97.1% for fiscal 2003 from 98.3% for fiscal 2002. The increase in cost of software license revenues and the resulting lower gross margins in fiscal 2003 were primarily due to an increase in sales requiring royalty payments under licensing agreements. Gross margin on software licenses revenue increased to 98.3% for fiscal 2002 from 97.9% for fiscal 2001. The cost of software license revenues increased in fiscal 2002 primarily due to an increase in sales requiring royalty payments; however, the mix of licensing agreements resulted in higher gross margins.

Cost of Service Revenues. Cost of service revenues were $6.3 million, $5.9 million, and $4.7 million in fiscal 2003, 2002, and 2001, respectively. Cost of service revenues increased 7.0% in fiscal 2003 from fiscal 2002. Gross margin on service revenues decreased to 58.8% for fiscal 2003 from 67.0% for fiscal 2002. For fiscal 2003, the increase in cost of services revenues and the resulting lower gross margins are primarily due to a higher proportion of service revenues derived from consulting services, which provide lower gross margins than maintenance services. Cost of service revenues increased 23.4% in fiscal 2002 from fiscal 2001. Gross margin on service revenues increased slightly to 67.0% in fiscal 2002 from 66.1% in fiscal 2001 due to a higher level of profitability in consulting and training services and an increased volume of maintenance services, which provide higher gross margins than consulting and training services, as the maintenance services are less labor intensive. We expect cost of service revenues as a percentage of service revenues to vary based primarily on the profitability of individual consulting engagements.

Operating Expenses

Research and Development. Research and development expenses were $12.9 million, $12.3 million, and $8.3 million in fiscal 2003, 2002, and 2001, respectively, representing increases of 4.6% in fiscal 2003 from fiscal 2002 and 49.3% in fiscal 2002 from fiscal 2001. These increases were primarily due to increased headcount as a result of the NetMaker acquisition in March 2001 and the WDM NetDesign acquisition in January 2002, and increased staffing levels for developing new products as well as sustaining and upgrading existing products. The increase in fiscal 2002 was partially offset by a decrease in discretionary bonuses for fiscal 2002 compared to fiscal 2001.

We believe that a significant level of research and development investment will be required to maintain our competitive position and broaden our product lines, as well as enhance the features and functionality of our current products. We expect the absolute dollar amount of these expenditures will continue to grow but generally decrease as a percentage of total revenues in future periods. Our ability to decrease these expenses as a percentage of revenue will depend upon our revenue growth, among other factors.

Sales and Marketing. Sales and marketing expenses were $18.2 million, $16.9 million and $13.7 million in fiscal 2003, 2002, and 2001, respectively. Sales and marketing expenses increased 8.2% in fiscal 2003 from fiscal 2002 and, as a percentage of total revenues, increased to 39.3% in fiscal 2003 from 37.7% in fiscal 2002. These increases are primarily due to an increase in the average size of our direct sales force in fiscal 2003 compared to fiscal 2002 due to the addition of sales offices in the United Kingdom and Australia in the second half of fiscal year 2002, and increases in international sales commissions to third parties and certain marketing costs. The increases were partially offset by lower travel and entertainment expenses, conference costs and advertising expenses. The 22.7% increase in fiscal 2002 from fiscal 2001 was primarily due to an increase in the size of our direct sales force, increased commissions associated with the growth in revenues, and higher conference costs. As a percentage of total revenues, sales and marketing expenses decreased to 37.7% in fiscal 2002 from 41.7% in fiscal 2001. This decrease resulted from a proportionally smaller increase in costs associated with developing market awareness for our new products relative to the higher level of revenues in fiscal 2002.

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We anticipate that we will continue to commit substantial resources to sales and marketing in the future and that sales and marketing expenses may increase both in absolute dollars and as a percentage of total revenue in future periods.

General and Administrative. General and administrative expenses were $4.9 million, $4.7 million, and $3.4 million in fiscal 2003, 2002, and 2001, respectively. The 5.2% increase in fiscal 2003 from fiscal 2002 is primarily due to higher personnel costs, insurance expense, and software maintenance costs associated with new financial systems. The increase in fiscal 2003 was partially offset by a decrease in professional fees for fiscal 2003 compared to fiscal 2002. The 38.5% increase in fiscal 2002 from fiscal 2001 was primarily due to higher legal, accounting and other professional fees, bad debt expense and personnel costs. The increase in fiscal 2002 was partially offset by a decrease in discretionary bonuses for fiscal 2002 compared to fiscal 2001.

We expect the dollar amount of general and administrative expenses to increase as we continue to expand our operations but generally decrease as a percentage of total revenues in future periods. Our ability to decrease these expenses as a percentage of revenues will depend upon our revenue growth, among other factors.

Amortization of Acquired Technology. In connection with our acquisitions of NetMaker in March 2001 and WDM NetDesign in January 2002, we recorded acquired technology of $2.5 million. Beginning in fiscal 2002, these acquired technologies are being amortized on a straight-line basis over five years. Amortization of acquired technology was $504,000 and $434,000 in fiscal 2003 and 2002, respectively.

Purchased In-Process Research and Development. In connection with the NetMaker acquisition, we obtained an independent valuation to determine the fair value of the net assets acquired and to allocate the purchase price. As a result of the purchase price allocation, we recorded an expense of $770,000 in the fourth quarter of fiscal 2001 representing the write-off of the fair value of acquired in-process research and development that had not reached technological feasibility and had no alternative future use.

Interest and Other Income, Net

Interest and other income, net were $879,000, $1.7 million, and $2.8 million in fiscal 2003, 2002 and 2001, respectively. The decrease in each period was primarily due to a reduction in interest income earned on our cash and cash equivalents due to the decline in interest rates throughout the periods.

Provision for Income Taxes

Our effective tax rates were 23%, 23% and 35% for fiscal 2003, 2002 and 2001, respectively. The effective tax rate differs from the statutory tax rate and varies from period to period due principally to the amount of income before taxes from various tax jurisdictions and the amount of tax credits available to us in each period from incremental research expenditures. In fiscal 2002, we conducted a review of our costs to determine their qualification for the increased research tax credit. As a result of this review, we generated an additional $372,000 in non-recurring tax credits resulting from incremental research expenditures.

We expect our effective tax rate in the near-term to range from 22% to 30%; however, future provisions for taxes will depend, among other things, on the mix and amount of worldwide income, the tax rates in effect for various tax jurisdictions and the amount of increased research tax credits.

Liquidity and Capital Resources

Since inception, we have funded our operations primarily through cash provided by operating activities and through the sale of equity securities. In August 2000, we completed our initial public offering in which we raised approximately $54.1 million, net of underwriting discounts and offering expenses payable by us. As of March 31, 2003, we had cash and cash equivalents totaling $70.3 million.

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Cash provided by operating activities was $8.2 million, $4.4 million, and $10.5 million for fiscal 2003, 2002 and 2001, respectively. Cash provided by operating activities is primarily derived from net income, as adjusted for non-cash items such as depreciation and amortization expense and changes in operating assets and liabilities. The increase in cash provided by operations in fiscal 2003 from fiscal 2002 was attributable to a decline in accounts receivable due to the timing of customer payments, a reduction in refundable taxes due to receipt of payments from tax authorities and the fiscal 2003 current tax provision, and an increase in deferred revenue from our software arrangements and growth in our installed customer base. The decrease in cash provided by operations in fiscal 2002 from fiscal 2001 was attributable to a decline in accrued liabilities, resulting from a decrease in accrued bonus compensation, an increase in billed accounts receivable due to our revenue growth, and an increase in refundable income taxes due to non-recurring tax credits for incremental research expenditures.

Cash used in investing activities was $965,000, $5.7 million, and $11.1 million for fiscal 2003, 2002, and 2001, respectively. The funds were used to purchase property and equipment for our corporate headquarters in Bethesda, Maryland and to pay the cash portion of the purchase price of the NetMaker acquisition in March 2001 and the purchase price of the WDM NetDesign acquisition, net of cash acquired, in January 2002.

Cash provided by financing activities was $778,000, $913,000, and $54.4 million for fiscal 2003, 2002, and 2001, respectively. Cash provided by financing activities reflects the proceeds received from the exercise of stock options, the sale of common stock under our 2000 Employee Stock Purchase Plan, the issuance of notes payable in fiscal 2003 and fiscal 2002, and the proceeds received in fiscal 2001 from our initial public offering, net of underwriting discounts and offering expenses.

We have a $10.0 million credit facility with a commercial bank, which expires in June 2004. Borrowings under this line of credit bear interest at an annual rate equal to LIBOR plus 2% to 2.5%. We have currently used $3.4 million of this facility for a letter of credit that secures the lease for our headquarters in Bethesda, Maryland. We had no outstanding borrowings under this line of credit facility as of March 31, 2003. See Note 12 to our consolidated financial statements for more information related to our credit facility.

As of March 31, 2003, our contractual commitments include operating leases for office facilities, notes payable in the amount of $300,000, and a letter of credit in the amount of $3.4 million. See Notes 11 and 12 to our consolidated financial statements for more information related to our contractual commitments.

We expect working capital needs to increase in the foreseeable future in order for us to execute our business plan. We anticipate that operating activities, as well as planned capital expenditures, will constitute a material use of our cash resources. In addition, we may utilize cash resources to fund acquisitions or investments in complementary businesses, technologies or products.

We believe that our current cash and cash equivalents and cash generated from operations, along with available borrowings under our line of credit facility, will be sufficient to meet our anticipated cash requirements for working capital and capital expenditures for at least the next 12 months.

Critical Accounting Policies

The preparation of our financial statements in conformity with generally accepted accounting principles requires us to utilize accounting policies and make estimates and assumptions that affect our reported amounts. Future results may differ from these estimates under different assumptions or conditions. We consider the following accounting policies to be both important to the portrayal of our financial position and results of operations and require the exercise of significant, subjective, or complex judgment and/or estimates.

*Revenue Recognition***.** We recognize revenue in accordance with Statement of Position (SOP) No. 97 2, Software Revenue Recognition , as amended by SOP No. 98-9, Modification of SOP No. 97-2, Software

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Revenue Recognition, With Respect to Certain Transactions , SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts and the Securities and Exchange Commission Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements.

For our software arrangements, a determination needs to be made for each arrangement regarding whether the percentage-of-completion contract accounting method should be used to recognize revenue or whether revenue can be recognized when the software is delivered and all of the conditions of SOP 97-2 are met. Contract accounting is required if our services are essential to the arrangement. In many cases, our services are essential to the arrangement because they involve customization and enhancements, and our fees are paid in stages based upon the completion of defined service deliverables. As a result, we typically recognize revenue from these arrangements using contract accounting, which generally results in recording revenue over a longer period of time. In other cases, our services are not essential to the arrangement and the realization of our license fee is not dependent on the completion of such services. In these situations, we recognize software license revenue when (1) persuasive evidence of an arrangement exists, (2) the product has been delivered, (3) the fee is fixed or determinable, and (4) collectibility is probable, which generally results in recording revenue earlier than when contract accounting is used. The determination of whether our services are essential involves significant judgment and could have a material impact on our results of operations from period to period to the extent that significant new arrangements are not accounted for using contract accounting.

Under the percentage-of-completion contract accounting method, we recognize revenue from the entire arrangement based on the percentage of hours actually incurred related to our services at any given time compared to the total hours we estimate will be required to perform such services. Using the percentage-of-completion method requires us to make estimates about the future cost of services and estimated hours to complete, which are subject to change for a variety of internal and external factors. A change in these estimates could result in a material adjustment to the amount of revenue recorded in any period under the arrangement.

*Allowance for Doubtful Accounts***.** We maintain an allowance for doubtful accounts receivable for estimated losses resulting from the inability of our customers to make required payments and for the limited circumstances when the customer disputes the amounts due us. Our methodology for determining this allowance requires significant estimates. In estimating the allowance, we consider the age of the receivable, the creditworthiness of the customer, the economic conditions of the customer s industry and general economic conditions. While we believe that the estimates we use are reasonable, should any of these factors change, the estimates made by management will also change, which could affect the amount of our future allowance for doubtful accounts as well as future operating income. Specifically, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments to us, additional allowances could be required. As of March 31, 2003, accounts receivable totaled $6.4 million, net of an allowance for doubtful accounts of $333,000.

*Valuation of Intangible Assets and Goodwill***.** We account for our goodwill and intangible assets in accordance with Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets . Our intangible assets consist of acquired technology related to our acquisition of NetMaker in March 2001 and WDM NetDesign in January 2002. They are recorded at cost and amortized on a straight-line basis over their expected useful lives of five years. We use the projected discounted cash flow method in valuing our acquired technology, using certain assumptions including revenue growth, cost levels, present value discount rate and working capital requirements. While we believe the assumptions used are reasonable, actual results will likely differ from those assumptions. Future cash flows are subject to change for a variety of internal and external factors. We will periodically review the value of acquired technology for reasonableness. Changes in our assumptions at the time of future periodic reviews could result in impairment losses. As of March 31, 2003, intangible assets totaled $1.6 million, net of accumulated amortization of $935,000. No impairment losses have been recorded to date.

Goodwill is recorded when the consideration paid for acquisitions exceeds the fair value of net tangible and intangible assets acquired. Goodwill is not amortized. We perform an annual review during our fourth quarter to

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identify any facts or circumstances that indicate the carrying value of goodwill is impaired. The review is based on various analyses including cash flow and profitability projections and the market capitalization of our common stock. Impairment, if any, is based on the excess of the carrying amount of goodwill over its fair value. As of March 31, 2003, we had goodwill of $12.2 million. No impairment has been indicated to date.

Accounting for Software Development Costs. Costs incurred in the research and development of new software products are expensed as incurred until technological feasibility is established. Development costs are capitalized beginning when a product s technological feasibility has been established and ending when the product is available for general release to our customers. Technological feasibility is reached when the product reaches the working model stage. To date, products and enhancements have generally reached technological feasibility and have been released for sale at substantially the same time and all research and development costs have been expensed. Consequently, no research and development costs were capitalized in fiscal 2003, 2002 and 2001.

Certain Factors That May Affect Future Results

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report and presented elsewhere by management from time to time.

Our operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our stock to decline.

Our operating results have fluctuated in the past, and are likely to fluctuate significantly in the future. Our financial results may as a consequence fall short of the expectations of public market analysts or investors, which could cause the price of our common stock to decline. 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. Factors that could affect our operating results include:

- the timing of large orders;
- changes in the proportion of software arrangements requiring contract accounting;
- changes in the mix of our sales, including the mix between higher margin software products and lower margin services and maintenance, and the proportion of our license sales requiring us to make royalty payments;
- the timing and amount of our marketing, sales, and product development expenses;
- the cost and time required to develop new software products;
- the introduction, timing, and market acceptance of new products introduced by us or our competitors;

changes in network technology or in applications, which could require us to modify our products or develop new products;

general economic conditions, which can affect our customers purchasing decisions, the length of our sales cycle, and our customers ability to pay us on time, if at all;

changes in our pricing policies or those of our competitors; and

the timing and size of potential acquisitions by us.

We expect to make significant expenditures in all areas of our business, particularly sales and marketing operations, in order to promote future growth. Because the expenses associated with these activities are relatively fixed in the short term, we may be unable to adjust spending quickly enough to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. In addition, our revenues in any quarter depend substantially

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on orders we receive and ship in that quarter. We typically receive a significant portion of orders in any quarter during the last month of the quarter, and we cannot predict whether those orders will be placed and shipped in that period. If we have lower revenues than we expect, we probably will not be able to reduce our operating expenses quickly in response. Therefore, any significant shortfall in revenues or delay of customer orders could have an immediate adverse effect on our operating results in that quarter.

For all of these reasons, quarterly comparisons of our financial results are not necessarily meaningful and you should not rely on them as an indication of our future performance.

The market for intelligent network management software is new and evolving, and if this market does not develop as anticipated, our revenues could decline.

We derive all of our revenues from the sale of products and services that are designed to allow our customers to manage the performance of networks and applications. Accordingly, if the market for intelligent network management software does not continue to grow, we could face declining revenues, which could ultimately lead to our becoming unprofitable. The market for intelligent network management software solutions is in an early stage of development. Therefore, we cannot accurately assess the size of the market and may be unable to identify an effective distribution strategy, the competitive environment that will develop, and the appropriate features and prices for products to address the market. If we are to be successful, our current and potential customers must recognize the value of intelligent network management software solutions, decide to invest in the management of their networks, and, in particular, adopt and continue to use our software solutions.

Our customers are primarily in four target groups and our operating results may be adversely affected by changes in one or more of these groups.

Our software solutions and services are designed to meet the needs of enterprises, U.S. government agencies, service providers, and network equipment manufacturers, and we market our solutions and services to those four customer groups. Consequently, our financial results depend, in significant part, upon the economic conditions of enterprises, U.S. government agencies, service providers, and network equipment manufacturers. An economic downturn or adverse change in the regulatory environment or business prospects for one or more of these customer groups may decrease our revenues or lower our growth rate.

The U.S. Department of Defense may not extend one consulting contract with us, which could harm our business.

In January 2003, we were awarded a consulting contract with the U.S. Department of Defense. The initial funding under this contract for calendar year 2003 is $2.2 million, and there are four successive option years under the contract that may be exercised by the U.S. Department of Defense in its discretion. Our results of operations could be adversely affected if we do not receive additional funding under this contract.

A decline in information technology spending may result in a decrease in our revenues or lower our growth rate.

A decline in the demand for information technology among our current and prospective customers may result in decreased revenues or a lower growth rate for us because our sales depend, in part, on our customers budgets for new or additional information technology systems and services. A continued economic downturn may cause our customers to reduce or eliminate information technology spending and force us to lower prices of our solutions, which would substantially reduce the number of new software licenses we sell and the average sales price for these licenses. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues.

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Our sales to U.S. government agencies subject us to special risks that could adversely affect our business.

We derive a substantial portion of our revenues from sales directly or indirectly to U.S. government agencies. Transactions with U.S. government agencies accounted for approximately 39% and 23% of our total revenues for fiscal 2003 and 2002, respectively. Government sales entail a variety of risks including:

Government contracts are subject to the approval of appropriations by the U.S. Congress to fund the expenditures by the agencies under these contracts. Congress often appropriates funds for government agencies on a yearly basis, even though their contracts may call for performance over a number of years.

A significant decline in government expenditures generally, or a shift in budget priorities away from agencies or programs that we support, could cause a material decline in our government business. In particular, a decline in government spending on information technology or related services could hurt our government business.

Our products and services are included on a General Services Administration (GSA) schedule. We believe that the GSA schedule facilitates our sales to U.S. government agencies. The loss of the GSA schedule covering our products and services could adversely affect our results of operations.

We must comply with complex federal procurement laws and regulations in connection with government contracts, which may impose added costs on our business.

Some of our government business requires that we maintain facility security clearances, and requires some of our employees to maintain individual security clearances. If we were to lose these clearances, our government business might decline.

The federal government audits and reviews the performance of federal contractors on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. An audit of our work could result in a finding that we overcharged the government, which could result in an adjustment to our previously reported operating results. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies.

Many of our government contracts are firm fixed-price contracts. To the extent that the assumptions we have used in pricing these contracts prove inaccurate, we could incur losses on contracts, which would adversely affect our operating results.

A portion of our sales to the U.S. government are made indirectly as a subcontractor to another government contractor, referred to as the prime contractor, who has the direct relationship with the government. We also team with prime contractors to bid on competitive government opportunities for which we hope to serve as a subcontractor. If prime contractors lose existing business on which we serve as a subcontractor, or fail to win the competitive bids on which we team with them, our government business would be hurt.

We could face expense and delay if any or our competitors, or competitors of the prime contractors to which we serve as a subcontractor, protest or challenge contract awards made to us or our prime contractors pursuant to competitive bidding.

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to terminate existing contracts, with short notice, for convenience without cause; reduce or modify contracts or subcontracts; and claim rights in products, systems, and technology produced by us.

If our newest products, particularly those targeted primarily for enterprises and U.S. government agencies, do not gain widespread market acceptance, our revenues might not increase and could even decline.

We expect to derive a substantial portion of our revenues in the future from sales to enterprises and U.S. government agencies of version 9.1 of *OPNET IT Guru,* which was released in December 2002, and its

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associated modules including *Application Characterization Environment*, *ACE Decode Module*, *NetDoctor* and *Flow Analysis*, and *OPNET VNE Server*, which was released in June 2002. Our business depends on customer acceptance of these products and our revenues may not increase, or may decline, if our target customers do not adopt and expand their use of our products. In addition, if our *OPNET Modeler* product, which we have been selling since 1987, continues to encounter declining sales, which could occur for a variety of reasons, including market saturation and the financial condition of network equipment manufacturers, and sales of our newer products do not grow at a rate sufficient to offset the shortfall, our revenues would decline.

We may not be able to grow our business if service providers do not buy our products.

An element of our strategy is to increase sales to service providers of *OPNETSP Guru* and *OPNET WDM Guru*, both launched in fiscal 2002, and *OPNET VNE Server*, which was launched in fiscal 2003. Accordingly, if our products fail to perform favorably in the service provider environment, or fail to gain wider adoption by service providers, our business and future operating results could suffer.

Our lengthy and variable sales cycle makes it difficult to predict operating results.

It is difficult for us to forecast the timing and recognition of revenues from sales of our products because prospective customers often take significant time evaluating our products before licensing them. The period between initial customer contact and a purchase by a customer may vary from three months to more than a year. During the sales process, the customer may decide not to purchase or may reduce proposed orders of our products for various reasons, including changes in budgets and purchasing priorities. Our prospective customers routinely require education regarding the use and benefit of our products. This may also lead to delays in receiving customers orders.

If we do not successfully expand our sales force, we may be unable to increase our sales.

We sell our products primarily through our direct sales force, and we must expand the size of our sales force to increase revenues. If we are unable to hire or retain qualified sales personnel, if newly hired personnel fail to develop the necessary skills to be productive, or if they reach productivity more slowly than anticipated, our ability to increase our revenues and grow our business could be compromised. Our sales people require a long period of time to become productive, typically three to nine months. The time required to reach productivity, as well as the challenge of attracting, training, and retaining qualified candidates, may make it difficult to meet our sales force growth targets. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our sales force or we may be unable to manage a larger sales force.

Our ability to increase our sales will be impaired if we do not expand and manage our indirect distribution channels.

To increase our sales, we must, among other things, further expand and manage our indirect distribution channels, which consist primarily of international distributors and original equipment manufacturers and resellers. If we are unable to expand and manage our relationships with our distributors, our distributors are unable or unwilling to effectively market and sell our products, or we lose existing distributor relationships, we might not be able to increase our revenues. Our international distributors and original equipment manufacturers and resellers have no obligation to market or purchase our products. In addition, they could partner with our competitors, bundle or resell competitors products, or internally develop products that compete with our products.

We may not be able to successfully manage our expanding operations, which could impair our ability to operate profitably.

We may be unable to operate our business profitably if we fail to manage our growth. Our rapid growth has sometimes strained, and may in the future continue to strain, our managerial, administrative, operational, and

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financial resources and controls. We plan to continue to expand our operations and increase the number of our full-time employees. Our ability to manage growth will depend in part on our ability to continue to enhance our operating, financial, and management information systems. Our personnel, systems, and controls may not be adequate to support our growth. In addition, our revenues may not continue to grow at a sufficient rate to absorb the costs associated with a larger overall employee base.

If we are unable to introduce new and enhanced products on a timely basis that respond effectively to changing technology, our revenues may decline.

Our market is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements, and evolving industry standards. If we fail to develop and introduce new and enhanced products on a timely basis that respond to these changes, our products could become obsolete, demand for our products could decline and our revenues could fall. Advances in network management technology, software engineering, and simulation technology, or the emergence of new industry standards, could lead to new competitive products that have better performance, more features, or lower prices than our products and could render our products unmarketable.

Our future revenue is substantially dependent upon our existing customers continuing to license additional products, renew maintenance agreements and purchase additional services.

Our existing customers have traditionally generated additional revenue from consulting services, renewed maintenance agreements and purchase of additional software licenses, which represents a majority of our annual revenue. The maintenance agreements are generally renewable at the option of the customers and there are no mandatory payment obligations or obligations to license additional software. In addition, customers may decide not to purchase additional products or services. If our existing customers fail to renew their maintenance agreements or purchase additional products or services, our revenues could decrease.

Increases in service revenues as a percentage of total revenues could decrease overall margins and adversely affect our operating results.

We realize lower margins on service revenues than on software license revenues. As a result, if service revenues increase as a percentage of total revenues, our gross margins will be lower and our operating results may be adversely affected.

If we fail to retain our key personnel and attract and retain additional qualified personnel, we might not be able to maintain our current level of revenue.

Our future success and our ability to maintain our current level of revenue depend upon the continued service of our executive officers and other key sales and research and development personnel. The loss of any of our key employees, in particular Marc A. Cohen, our chairman of the board and chief executive officer, and Alain J. Cohen, our president and chief technology officer, could also adversely affect our ability to pursue our growth strategy. We do not have employment agreements or any other agreements that obligate any of our officers or key employees to remain with us.

We must also continue to hire highly qualified individuals, particularly software engineers and sales and marketing personnel. Our failure to attract and retain technical personnel for our product development, consulting services, and technical support teams may limit our ability to develop new products or product enhancements. Competition for these individuals is intense, and we may not be able to attract and retain additional highly qualified personnel in the future. In addition, limitations imposed by federal immigration laws and the availability of visas could impair our ability to recruit and employ skilled technical professionals from other countries to work in the United States.

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Our international operations subject our business to additional risks, which could cause our sales or profitability to decline.

We plan to increase our international sales activities, but these plans are subject to a number of risks that could cause our sales to decline or could otherwise cause a decline in profitability. These risks include:

- difficulty in attracting distributors that will market and support our products effectively;
- greater difficulty in accounts receivable collection and longer collection periods;
- the need to comply with varying employment policies and regulations that could make it more difficult and expensive to manage our employees if we need to establish more direct sales or support staff outside the United States;
- potentially adverse tax consequences;
- the effects of currency fluctuations; and
- political and economic instability.

We expect to face intense competition, which could cause us to lose sales, resulting in lower profitability.

Increasing competition in our market could cause us to lose sales and become unprofitable. We believe that the market for intelligent network management software is likely to become more competitive as it evolves and the demand for intelligent network management solutions continues to increase. At least one of our current competitors and many of potential competitors are larger and have substantially greater financial and technical resources than we do. In addition, it is possible that other vendors as well as some of our customers or distributors will develop and market solutions that compete with our products in the future.

If our products contain errors and we are unable to correct those errors, our reputation could be harmed and our customers could demand refunds from us or assert claims for damages against us.

Our software products could contain significant errors or bugs that may result in:

- the loss of or delay in market acceptance and sales of our products;

the delay in introduction of new products or updates to existing products;

diversion of our resources;

injury to our reputation; and

increased support costs.

Bugs may be discovered at any point in a product s life cycle. We expect that errors in our products will be found in the future, particularly in new product offerings and new releases of our current products.

Because our customers use our products to manage networks that are critical to their business operations, any failure of our products could expose us to product liability claims. In addition, errors in our products could cause our customers networks and systems to fail or compromise their data, which could also result in liability to us. Product liability claims brought against us could divert the attention of management and key personnel, could be expensive to defend, and may result in adverse settlements and judgments.

Our software products rely on our intellectual property, and any failure to protect our intellectual property could enable our competitors to market products with similar features that may reduce our revenues and could allow the use of our products by users who have not paid the required license fee.

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could reduce our revenues. In addition, we may be unable to

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prevent the use of our products by persons who have not paid the required license fee, which could reduce our revenues. Our success and ability to compete depend substantially upon the internally developed technology that is incorporated in our products. Policing unauthorized use of our products is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as those in the United States. Others may circumvent the patents, copyrights, and trade secrets we own. In the ordinary course of business, we enter into a combination of confidentiality, non-competition and non-disclosure agreements with our employees.

These measures afford only limited protection and may be inadequate, especially because our employees are highly sought after and may leave our employ with significant knowledge of our proprietary information. In addition, any confidentiality, non-competition and non-disclosure agreements we enter into may be found to be unenforceable, or our copy protection mechanisms embedded in our software products could fail or could be circumvented.

Our products employ technology that may infringe on the proprietary rights of others, and, as a result, we could become liable for significant damages.

We expect that our software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionalities of products in different industry segments overlap.

Regardless of whether these claims have any merit, they could:

- be time-consuming to defend;
- result in costly litigation;
- divert our management s attention and resources;
- cause us to cease or delay product shipments; or
- require us to enter into royalty or licensing agreements.

These royalty or licensing agreements may not be available on terms acceptable to us, if at all. A successful claim of product infringement against us or our failure or inability to license the infringed or similar technology could adversely affect our business because we would not be able to sell the affected product without redeveloping it or incurring significant additional expense.

Future interpretations of existing accounting standards could adversely affect our operating results.

The American Institute of Certified Public Accountants and its Software Revenue Recognition Task Force continue to issue interpretations and guidance for applying the relevant standards to a wide range of sales contract terms and business arrangements that are prevalent in the software industry. Future interpretations of existing accounting standards or changes in our business practices could result in future changes in our revenue recognition accounting policies that could have a material adverse effect on our results of operations.

As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely affect our operating results.

We have in the past had to, and in the future may have to, defer recognition for license fees due to several factors, including whether:

software arrangements include undelivered elements for which we do not have vendor specific evidence of fair value;

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- we must deliver services for significant customization, enhancements and modifications of our software;
- the transaction involves material acceptance criteria or there are other identified product-related issues;
- the transaction involves contingent payment terms or fees;
- we are required to accept a fixed-fee services contract; or
- we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under accounting principles generally accepted in the United States for software revenue recognition, we must have very precise terms in our software arrangements in order to recognize revenue when we initially deliver software or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery.

If we undertake acquisitions, they may be expensive and disruptive to our business and could cause the market price of our common stock to decline.

We completed the NetMaker and WDM NetDesign acquisition in March 2001 and January 2002, respectively. We may continue to acquire or make investments in companies, products or technologies if opportunities arise. Any acquisition could be expensive, disrupt our ongoing business, distract our management and employees, and adversely affect our financial results and the market price of our common stock. We may not be able to identify suitable acquisition or investment candidates, and if we do identify suitable candidates, we may not be able to make these acquisitions or investments on commercially acceptable terms or at all. If we make an acquisition, we could have difficulty integrating the acquired technology, employees, or operations. In addition, the key personnel of the acquired company may decide not to work for us.

We also expect that we would incur substantial expenses if we acquired other businesses or technologies. We might use cash on hand, incur debt, or issue equity securities to pay for any future acquisitions. If we issue additional equity securities, our stockholders could experience dilution and the market price of our stock may decline.

Our products are subject to changing computing environments, including operating system software and hardware platforms, which could render our products obsolete.

The evolution of existing computing environments and the introduction of new popular computing environments may require us to redesign our products or develop new products. Computing environments, including operating system software and hardware platforms, are complex and change rapidly. Our products are designed to operate in currently popular computing environments. Due to the long development and testing periods required to adapt our products to new or modified computing environments, our research and development efforts could be distracted and we could experience significant delays in product releases or shipments, which could result in lost revenues and significant additional expense.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We consider all highly liquid investments purchased with a maturity of three months or less to be cash equivalents, and those with maturities greater than three months are considered to be marketable securities. Cash equivalents and marketable securities are stated at amortized cost plus accrued interest, which approximates fair value. Cash equivalents consist primarily of investment grade securities with high credit ratings of relatively short duration that trade in highly liquid markets. Accordingly, we have no quantitative information concerning the market risks and believe that the risk is minimal. Our outstanding notes payable have fixed interest rates and their carrying values approximate fair value. We currently do not hedge interest rate exposure, but do not believe that an increase in interest rates would have a material effect on the value of our cash equivalents, marketable securities or notes payable.

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Substantially all of our revenue transactions outside the United States are denominated in U.S. dollars. The operating expenses of our foreign subsidiaries are denominated in local currencies. We currently do not hedge foreign exchange rate risk. Due to the limited nature of our foreign operations, we do not believe that a 5% change in exchange rates would have a material effect on our business, financial condition, or results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements together with the related notes and the report of Deloitte & Touche LLP, independent auditors, are set forth in the Index to Financial Statements at Item 15.

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

None.

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PART III

Certain information required by Part III is omitted from this Annual Report as we intend to file our definitive Proxy Statement for our Annual Meeting of Stockholders to be held on September 9, 2003, pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, not later than 120 days after the end of the fiscal year covered by this Annual Report, and certain information included in the Proxy Statement is incorporated herein by reference.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

(a) Executive Officers and Directors The information in the section entitled Executive Officers and Directors of the Registrant in Part I hereof is incorporated herein by reference.

(b) Directors The information in the section entitled Election of Directors in the Proxy Statement is incorporated herein by reference.

The disclosure required by Item 405 of Regulations S-K is incorporated by reference to the section entitled Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

The information in the sections entitled Compensation of Executive Officers , Compensation of Directors and Compensation Committee Interlocks and Insider Participation in the Proxy Statement is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the sections entitled Equity Compensation Plan Information and Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement are incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information in the section entitled Certain Transactions in the Proxy Statement is incorporated herein by reference.

ITEM 14. CONTROLS AND PROCEDURES

We maintain a system of internal controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of a date within 90 days before the filing of this Annual Report, and have each concluded that, as of the evaluation date, such controls and procedures were effective, in all material respects, to ensure that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

Subsequent to the date of the evaluation, there have been no significant changes to our internal controls or in other factors that could significantly affect our internal controls.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORMS 8-K

(a) The following documents are filed as part of this Form 10-K:

1. Financial Statements. The following financial statements of OPNET Technologies, Inc. are filed as part of this Form 10-K on the pages indicated:

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

2. Schedules are omitted as the required information is inapplicable or the information is presented in the financial statements or related notes.

3. Exhibits. The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this Annual Report on Form 10-K

(b) Reports on Forms 8-K

On April 28, 2003, the Registrant furnished a Current Report on Form 8-K to report under Item 9 (Regulation FD Disclosure) that, on April 28, 2003, the Registrant issued a press release announcing its financial results for the quarter ended March 31, 2003. A copy of the press release was attached as Exhibit 99.1 to the Current Report on Form 8-K.

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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 on the 3rd day of June, 2003.

OPNET TECHNOLOGIES, INC.

By: /s/ MARC A. COHEN

Marc A. Cohen

Chairman of the Board of Directors

and Chief Executive Officer

Pursuant to the requirements of the Securities 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 3rd day of June, 2003.

Signature	Title
/s/ MARC A. COHEN	Chairman of the Board of Directors and Chief Executive Officer
Marc A. Cohen	(Principal Executive Officer)
/s/ ALAIN J. COHEN	President, Chief Technology Officer and Director
Alain J. Cohen	
/s/ JOSEPH W. KUHN	Vice President and Chief Financial Officer
Joseph W. Kuhn	(Principal Financial and Accounting Officer)
/s/ STEVEN G. FINN, PhD	Director
Steven G. Finn, PhD	
/s/ WILLIAM F. STASIOR	Director
William F. Stasior	

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CERTIFICATIONS

I, Marc A. Cohen, certify that:

1. I have reviewed this annual report on Form 10-K of OPNET Technologies, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: June 3, 2003 By: /s/ MARC A. COHEN

Marc A. Cohen

Chairman and Chief Executive Officer
(Principal Executive Office)

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I, Joseph W. Kuhn, certify that:

1. I have reviewed this annual report on Form 10-K of OPNET Technologies, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: June 3, 2003

By: /s/ Joseph W. Kuhn

Joseph W. Kuhn

Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

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INDEPENDENT AUDITORS REPORT

To the Board of Directors and Stockholders of

OPNET Technologies, Inc.

Bethesda, Maryland

We have audited the accompanying consolidated balance sheets of OPNET Technologies, Inc. and its subsidiaries (the Company), as of March 31, 2003 and 2002, and the related consolidated statements of operations, cash flows and stockholders equity for each of the three years in the period ended March 31, 2003. 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of March 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP

McLean, Virginia

April 23, 2003

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OPNET TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

	March 31,	
	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 70,251	$ 62,240
Accounts receivable, net	6,420	7,403
Unbilled accounts receivable	933	1,331
Refundable income taxes		1,253
Deferred income taxes, prepaid expenses and other current assets	1,412	910
Total current assets	79,016	73,137
Property and equipment, net	7,008	7,670
Intangible assets, net	1,566	2,067
Goodwill	12,212	12,212
Deferred income taxes and other assets	626	70
Total assets	$ 100,428	$ 95,156
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 215	$ 544
Accrued liabilities	2,756	2,362
Deferred and accrued income taxes	172	156
Deferred revenue	9,127	8,019
Total current liabilities	12,270	11,081
Notes payable	300	150
Deferred rent	632	381
Deferred revenue	484	506
Deferred income taxes		43
Total liabilities	13,686	12,161
Commitments and contingencies (note 11)		
Stockholders equity:		
Preferred stock 5,000 shares authorized; no shares issued and outstanding at March 31, 2003 and 2002		
Common stock 100,000 shares authorized; 25,522 and 25,220 shares issued at March 31, 2003 and 2002, respectively; 19,388 and 19,086 shares outstanding at March 31, 2003 and 2002, respectively	26	25
Additional paid-in capital	73,600	72,655
Deferred compensation	(59)	(74)
Retained earnings	17,257	14,499

Accumulated other comprehensive income (loss)	18	(10)
Treasury stock 6,134 shares at March 31, 2003 and 2002	(4,100)	(4,100)
Total stockholders equity	86,742	82,995
Total liabilities and stockholders equity	$ 100,428	$ 95,156

See accompanying notes to consolidated financial statements.

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OPNET TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Year Ended March 31,		
	2003	2002	2001
Revenues:			
Software licenses	$ 31,223	$ 27,003	$ 18,939
Services	15,228	17,753	14,005
Total revenues	46,451	44,756	32,944
Cost of revenues:			
Software licenses	900	459	395
Services	6,276	5,863	4,750
Total cost of revenues	7,176	6,322	5,145
Gross profit	39,275	38,434	27,799
Operating expenses:			
Research and development	12,909	12,339	8,263
Sales and marketing	18,245	16,866	13,745
General and administrative	4,897	4,655	3,362
Amortization of acquired technology	504	434	
Purchased in-process research and development			770
Total operating expenses	36,555	34,294	26,140

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