AETHER SYSTEMS INC
Form 10-Q/A
November 19, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q/A

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE PERIOD ENDED SEPTEMBER 30, 2001

OR

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

COMMISSION FILE NUMBER: 000-27707
AETHER SYSTEMS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	52-2186634
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
11460 CRONRIDGE DR. OWINGS MILLS, MD (Address of principal executive offices)	21117 (Zip Code)

(Registrant's telephone number, including area code): (410) 654-6400

Securities registered Pursuant to Section 12(b) of the Act: NONE.

Securities Registered Pursuant to Section 12(g) of the Act:
COMMON STOCK, PAR VALUE $.01
CONVERTIBLE SUBORDINATED NOTES DUE 2005

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of November 9, 2001, 40,978,743 shares of the Registrant's common stock, $.01 par value per share, were outstanding.

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1

AETHER SYSTEMS, INC.

QUARTERLY REPORT ON FORM 10-Q/A
FOR THE QUARTER ENDED SEPTEMBER 30, 2001

INDEX

[The purpose of this amendment is to move cash paid for interest from financing activities to operating activities in the Statement of Cash Flows in Part I, Item 1 and to make a conforming change in the Management's Discussion and Analysis in Part I, Item 2.]

PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2001- UNAUDITED AND DECEMBER 31, 2000

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE LOSS FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2001 AND 2000 - UNAUDITED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000 --UNAUDITED

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

2

PART I -- FINANCIAL INFORMATION
ITEM 1: FINANCIAL STATEMENTS

AETHER SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	SEPTEMBER 30, 2001	DECEMBER 31 2000
ASSETS	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 581,620	$ 856,391
Restricted cash	10,320	16,356
Short-term investments	2,532	2,648

Trade accounts receivable, net of allowance for doubtful accounts of $10,131 and $5,695 at September 30, 2001 and December 31, 2000, respectively	27,333	30,263
Inventory, net of allowance for obsolescence of $13,969 and $137 at September 30, 2001 and December 31, 2000, respectively	25,898	19,130
Prepaid expenses and other current assets	16,242	17,081
Total current assets	663,945	941,869
Property and equipment, net	66,875	53,223
Investments	35,210	182,444
Intangibles, net	269,987	1,478,485
Other assets, net	23,416	21,354
	$ 1,059,433	$ 2,677,375
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,151	$ 9,747
Accrued expenses	35,413	66,949
Restructuring reserve	14,388	
Accrued employee compensation and benefits	13,641	12,566
Deferred revenue	17,718	14,170
Accrued interest payable	681	5,072
Current portion of notes payable	15,219	13,741
Total current liabilities	101,211	122,245
Convertible subordinated notes payable and other notes payable, less current portion	300,842	321,201
Deferred tax liability	691	10,694
Restructuring reserve	12,492	
Deferred revenue	6,974	--
Minority interest in net assets of a subsidiary	--	55,537
Stockholders' equity:		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; 0 shares issued and outstanding at September 30, 2001 and December 31, 2000	--	--
Common stock, $0.01 par value; 1,000,000,000 shares authorized; 40,726,724 and 40,415,722 shares issued and outstanding at September 30, 2001 and December 31, 2000, respectively	407	404
Additional paid-in capital	2,571,606	2,552,016
Accumulated deficit	(1,932,634)	(385,314
Foreign currency translation adjustment	(710)	(113
Unrealized gain (loss) on investments available for sale	(1,446)	705
$ Total stockholders' equity	637,223	2,167,698
	$ 1,059,433	$ 2,677,375

AETHER SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE LOSS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS END SEPTEMBER 30,	
	2001	2
Subscriber revenue	$ 11,179	$
Engineering services revenue	642	
Software and related services revenue	8,205	
Device sales	4,922	
Total revenue	24,948	1
Cost of subscriber revenue	6,805	
Cost of engineering services revenue	314	
Cost of software and related services revenue	2,892	
Cost of device sales	17,560	
Total cost of revenue	27,571	
Gross profit (loss)	(2,623)	
Operating expenses:		
Research and development (exclusive of option and warrant expense)	16,170	
General and administrative (exclusive of option and warrant expense)	21,955	2
Selling and marketing (exclusive of option and warrant expense)	14,780	1
In-process research and development related to acquisitions	--	
Depreciation and amortization	32,068	7
Option and warrant expense:		
Research and development	691	
General and administrative	1,846	
Selling and marketing	976	
Impairment of intangibles	129,201	
Restructuring charge	18,230	
	(235,917)	11
Operating loss	(238,540)	(10
Other income (expense):		
Interest income (expense), net	1,061	1
Equity in losses of investments	(16,762)	(1
Investment gains (losses) including impairments, net	(45,661)	
Minority interest	47,394	
Loss before income taxes, extraordinary item and cumulative effect of change in accounting principle	(252,508)	(10
Income tax benefit	9,129	
Loss before extraordinary item and cumulative effect of change in accounting principle	(243,379)	(10
Extraordinary item relating to early extinguishment of debt	--	
Loss before cumulative effect of change in accounting principle	$(243,379)	$(10
Cumulative effect of change in accounting principle relating to adoption of SFAS 133, Accounting for Derivatives	--	
Net loss	$(243,379)	$(10

Other comprehensive loss:		
Unrealized holding gain (loss) on investments available for sale	18,015	(5
Foreign currency translation adjustment	(133)	
Comprehensive loss	$(225,497)	$(16
Loss per share - basic and diluted - before extraordinary item and cumulative effect of change in accounting principle	$ (5.98)	$
Extraordinary item relating to early extinguishment of debt	$ --	$
Cumulative effect of change in accounting principle related to adoption of SFAS 133, Accounting for Derivatives	$ --	$
Net loss per share-basic and diluted	$ (5.98)	$
Weighted average shares outstanding--basic and diluted	40,694	3

See accompanying notes to condensed consolidated financial statements.

AETHER SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30, 2001	2000
Cash flows from operating activities:		
Net loss	$(1,547,320)	$ (230,4
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	153,312	156,7
Provision for doubtful accounts	8,533	
Provision for inventory obsolescence	14,371	
Equity in losses of investments	48,285	31,4
Option and warrant expense	12,450	10,0
Minority interest	(55,541)	(5,9
Income tax benefit	(10,003)	(6
In process research and development related to acquisitions	--	6,0
Restructuring charge	34,089	
Extraordinary item	(7,684)	
Cumulative effect of change in accounting principle	(6,564)	
Impairment charges related to goodwill from acquisitions	1,090,781	
Realized loss on long-term investments, including impairments	141,553	
Changes in assets and liabilities, net of acquired assets and liabilities:		
Increase in trade accounts receivable	(5,603)	(8,2

Increase in inventory	(21,830)	(4,0
(Increase) decrease in prepaid expenses and other assets	312	(13,2
Increase (decrease) in accounts payable	(5,596)	2,4
Increase (decrease) in accrued expenses, accrued employee compensation and benefits, and interest payable	(10,637)	25,3
Increase in deferred revenue and other long term liabilities	10,523	3,1
Net cash used by operating activities	(156,569)	(27,3
Cash flows from investing activities:		
Sales and maturities of investments	7,864	6,7
Purchases of short-term investments	(3,411)	(4,8
Purchases of property and equipment	(34,954)	(30,2
Cost of investments	(36,973)	(114,0
Costs of acquisitions, net of cash acquired	(42,116)	(252,7
Increase in restricted cash	--	5,8
Increase in other intangible assets	311	
Increase in other assets	(3,017)	
Net cash used in investing activities	(112,296)	(389,3
Cash flows from financing activities:		
Proceeds from issuance of common stock	--	1,057,0
Proceeds from issuance of convertible debt	--	300,5
Repayment of notes payable including buyback of convertible debt	(12,899)	
Borrowings under notes payable	--	
Decrease in restricted cash	315	
Exercise of options and warrants	1,518	2,4
Contributions from a minority shareholder of a subsidiary	5,160	20,8
Net cash provided by (used in) financing activities	(5,906)	1,380,8
Net increase (decrease) in cash and cash equivalents	(274,771)	964,2
Cash and cash equivalents, at beginning of period	856,391	78,5
--Cash and cash equivalents, at end of period	$ 581,620	$ 1,042,7
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	$ 18,243	$ 9,3

Supplemental disclosure of non-cash investing and financing activities:

For the nine months ended September 30, 2001 and 2000, the Company incurred an unrealized net holding gain (loss) associated with its investments available for sale totaling ($2.2) million and $5.8 million, respectively. These amounts have been reported as changes in stockholders' equity.

For the nine months ended September 30, 2001 and 2000, the Company recorded additions to stockholders equity of $6.1 million and $73.3 million, respectively, from the issuance of stock by

Omnisky Inc. to third parties at per share amounts in excess of the book value per share of the Company's investment in Omnisky Inc.

In January 2000, approximately $600,000 of trade receivables owed to the Company by OmniSky, Inc. were offset by the Company's additional investment made in OmniSky, Inc.

In March 2000, the Company acquired Riverbed Technologies, Inc. for 4,537,281 shares of the Company's common stock and converted existing options held by Riverbed employees into options to acquire 862,480 shares of the Company's common stock. The value of the common stock and replacement options of $1.136 billion was allocated to the fair value of the assets purchased and liabilities assumed with a corresponding increase in stockholders' equity.

In connection with the acquisition of IFX and the formation of Sila, the Company established a deferred tax liability of $11.2 million. Such amount was offset by an equal increase in goodwill.

In September of 2000, the Company acquired Cerulean for 462,412 shares of the Company's common stock and converted existing options held by Cerulean employees into options to acquire 94,275 shares of the Company's common stock plus $75.0 million in cash. The value of the common stock and vested replacement options of $69.9 million was allocated to the fair value of the assets purchased and the liabilities assumed with a corresponding increase in stockholders' equity.

In connection with the acquisitions of Cerulean and Sinope, the Company had accrued $47.3 million as of September 30, 2000 for purchase price and acquisition costs. Such amount has been allocated to the fair value of the assets purchased and the liabilities assumed.

See accompanying notes to condensed consolidated financial statements.

AETHER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION, DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

ORGANIZATION AND DESCRIPTION OF BUSINESS

Aether Systems, Inc. and its subsidiaries (the "Company") provide technologies that enable businesses to extend their data and commercial transactions to wireless and mobile handheld devices. From its inception until March 1997, the Company primarily provided wireless engineering services, including the development of wireless software applications for customers. In March 1997, the Company began offering services that provide the users of wireless handheld devices access to real-time financial information. During 1997, the Company made a strategic decision to focus a significant portion of its engineering resources on the development of these and other wireless data services and systems, including the Aether Intelligent Messaging(TM) ("AIM") package of wireless messaging software and software development tools.

In 1998 and 1999, the Company continued to develop financial information services--as well as financial transaction services--internally and through the acquisition of Mobeo, Inc. ("Mobeo"). In 1999, the Company also completed its initial public offering and began to expand its service offerings to areas other than financial information and transactions.

In 2000, the Company continued its expansion into other vertical markets through several acquisitions and through organic growth. Also in 2000, the Company moved into the European marketplace with the acquisition of IFX Group Plc ("IFX") and the related formation of Sila Communications Limited ("Sila"). During the current year, the Company has focused on the integration of it's acquisitions and the creation and deployment of Aether Fusion(TM), a comprehensive wireless technology foundation designed to provide customers and partners with a single-source solution for accessing essential data and applications wirelessly.

Recently the Company entered into a strategic alliance with AOL Time Warner whereby Aether Fusion(TM) technology would extend AOL's Netbusiness, email and instant messaging to wireless platforms for small and medium enterprises.

BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of Aether Systems, Inc. and its subsidiaries. The condensed consolidated balance sheet as of September 30, 2001, the condensed consolidated statements of operations and other comprehensive loss for the three and nine months ended September 30, 2001 and 2000, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2001 and 2000 have been prepared by the Company, without audit. In the opinion of management, all adjustments have been made, which

include normal recurring adjustments necessary to present fairly the condensed consolidated financial statements. Operating results for the three and nine months ended September 30, 2001 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report for the year ended December 31, 2000 on Form 10-K.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue Recognition

The Company derives subscriber revenue from the provision of real-time access to business information integrated into existing wireless communication platforms. Subscriber revenue consists of fixed charges for usage recognized as the service is provided, and one-time non-refundable activation fees recognized ratably over the expected life of the customer relationship. For certain of the Company's products, the subscribers' monthly fee includes the use of a wireless handheld device. Revenue for such devices is recognized as the related service is provided. Direct activation costs are expensed as incurred. Certain of the Company's customers are billed in advance with revenue deferred and recognized on a monthly basis over the term of the agreement. Also included in subscriber revenue are market exchange fees for access to financial information from the securities exchanges and markets, which are recognized as the service is provided. The Company also recognizes fees for managing data through its network operations center. Such fees are recognized ratably over the contract period.

Engineering services revenue is derived from the provision of wireless integration consulting under time-and-materials and fixed-fee contracts. Revenue on time-and-materials contracts is recognized as services are performed. Revenue on fixed-fee contracts is recognized on the percentage-of-completion method based on costs incurred in relation to total estimated costs. Anticipated contract losses are recognized as soon as they become known and estimable.

Software and related services revenues are generated from licensing software and providing services, including maintenance and technical support, training and consulting. Software revenue consists of fees for licenses of the Company's software products. The Company recognizes the revenue when the license agreement is signed, the license fee is fixed and determinable, delivery of the software has occurred, and collectibility of the fees is considered probable. Revenue from software licensing and related wireless engineering consulting services for which the software requires significant customization and modification is recognized using the percentage of completion method in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, based on the hours incurred in relation to the total estimated hours. Service revenues consists of maintenance and technical support, which consists of unspecified when-and-if available product updates and customer telephone support services and are recognized ratably over the term of the service period. Other service revenues are recognized as the related services are provided. In situations where the Company hosts the software and the customer has the option to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the Company to host the software, the software element is accounted for in accordance with SOP 97-2 as discussed above.

Device sales are derived from the sales of wireless handheld devices at or near our cost. Revenues on these device sales are either recognized upon shipment of the devices or recognized over the expected life of the customer relationship in accordance with SAB 101.

(b) Cost of Revenues

Cost of subscriber revenue consists primarily of airtime costs, financial data costs, and securities and market exchange fees. Cost of subscriber revenue excludes depreciation related to the Company's network operations centers and certain customer fulfillment costs. Cost of engineering services revenue consists of cash compensation and related costs for engineering personnel and materials. The cost of software license revenue consists primarily of third party royalties. The cost of maintenance, consulting and support revenue consists primarily of personnel-related costs. Cost of device sales consists of the cost of the hardware from the manufacturer or wholesaler. The cost of wireless handheld devices is recognized on delivery when sold or amortized over the expected life of the customer relationship. The cost of device sales also includes charges for inventory obsolesence.

(c) Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses and notes payable (excluding the convertible subordinated notes), approximate their fair values due to the relatively short duration of the instruments.

The fair value of the convertible subordinated notes at September 30, 2001

was $171.5 million based on their quoted market price.

(d) Credit Risk

Financial instruments which potentially subject the Company to credit risk consist primarily of cash, cash equivalents and trade receivables.

The Company invests cash not immediately needed for operations in money market securities of various financial institutions, commercial paper and certificates of deposit. The money market securities represent underlying investments in commercial paper issued by financial institutions and other companies with high credit ratings and securities issued by or backed by the U.S. Government. The amounts invested in some cases exceed the F.D.I.C. limits. The Company has not experienced any losses in its cash and cash equivalents and believes it is not exposed to any significant credit risk on these amounts.

Trade accounts receivable subject the Company to the potential for credit risk. The Company extends credit to customers on an unsecured basis in the normal course of business. Some of these customers have a limited operating history and have reported significant losses since inception. They are subject to many of the same risks and uncertainties as the Company, including rapid changes in technology, no established markets for their products, and intense competition, among others. In addition, some of these companies will require significant infusions of capital to continue operations. The availability of such capital has been curtailed and some of these companies may not be able to raise sufficient funds to continue to operate, which could limit the Company's ability to generate further revenues from these companies as well as to collect the outstanding receivables.

The Company's policy is to perform an analysis of the recoverability of its trade accounts receivable at the end of each reporting period and to establish allowances for those accounts considered uncollectible. If market conditions for these companies continue to deteriorate, the Company may be required to record additional allowances for doubtful accounts in the future.

(e) Inventory

Inventory, net of allowance for obsolete and slow-moving inventory, consists of finished goods such as handheld and laptop computers, pagers, wireless modems, and accessories and is stated at the lower of cost or market. Cost is determined using a standard costing method, which approximates the first-in, first-out method. The Company's inventory is subject to rapid technological changes that could have an adverse impact on its realization in future periods. In addition, there are a limited number of suppliers of the Company inventory. During the three and nine month periods ended September 30, 2001, the Company recorded an inventory reserve of approximately $12.5 and $14.4 million, respectively, due to obsolescence and excess inventory.

(f) Investments

The Company accounts for those investments in which the Company exercises significant influence or has an ownership interest greater than twenty percent under the equity method. For equity method investments, the Company records its proportionate share of the investee's net income or loss. Generally, the Company accounts for its investments in which the Company has an ownership interest of less than twenty percent under the cost method for its private investments.

Investments in marketable equity securities, if not considered equity method investments, are considered available-for-sale securities. Investments carried at cost are written down if circumstances indicate the carrying amount of the investment may not be recoverable, and such losses are considered other than temporary. Investments available for sale are carried at fair value based on quoted market prices. Net unrealized holding gains and losses are excluded from income and are reported as a separate component of stockholders' equity, unless such losses are considered other than temporary. Realized gains and losses are included in income.

(g) Intangibles and Recovery of Long-Lived Assets

Cost in excess of the fair value of tangible and identifiable intangible net assets acquired is amortized on a straight-line basis over three to seven years. Identifiable intangible net assets consist of completed technology, assembled workforce, trademarks, and acquired subscribers. Identifiable intangible net assets are amortized on a straight-line basis over two to seven years.

The Company's policy is to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company may recognize an impairment when the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset. The measurement of the impairment losses to be recognized is based upon the difference between the fair value and the carrying amount of the assets.

(h) Restructuring Charges

The Company records charges for costs associated with a restructuring plan only when

the exit plan is committed to by the Company, the costs associated with the plan are incremental to other costs incurred by the Company in the conduct of its activities prior to the commitment date and will be incurred as a direct result of the exit plan, the costs associated with the plan represent amounts to be incurred by the enterprise under a contractual obligation that existed prior to the commitment date and will either continue after the exit plan is completed with no economic benefit to the Company or be a penalty incurred by the Company to cancel the contractual obligation, and the cost of the component of the plan being accrued for can be reasonably estimated.

(i) Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, long-term contracts, allowances for uncollectible receivables, inventory obsolescence, recoverability of long-lived assets and investments, depreciation and amortization, employee benefits, taxes and contingencies. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the condensed consolidated financial

statements in the period they are determined to be necessary.

(j) Recent Accounting Pronouncements

On January 1, 2001, the Company adopted Statement of Financial Accounting Standards (SFAS), Accounting for Derivative Instruments and Hedging Activities. SFAS 133, as amended by SFAS 137 and further amended by SFAS 138, established accounting and reporting standards for derivative financial instruments and associated hedging activities as well as hedging activities in general. The adoption of SFAS 133, as amended, created a benefit of $6.6 million on the adoption date of January 1, 2001, as reflected in the condensed consolidated statement of operations. The benefit was derived from the valuation, as of January 1, 2001, of certain warrants to purchase stock of two of our investee companies. The warrants include net settlement provisions and are, therefore, considered derivatives. These warrants are revalued at the end of each quarter, which caused reductions of approximately $406,000 and $6.4 million in the investment balance which is included in realized loss on investment in the condensed consolidated statement of operations for the three and nine months ended September 30, 2001, respectively.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, Business Combinations, and SFAS 142, Goodwill and Other Intangible Assets. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. SFAS 141 also specifies criteria intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS 142 requires

that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.

The Company is required to adopt the provisions of SFAS 141 immediately, except with regard to business combinations initiated prior to July 1, 2001, which it expects to account for using the purchase method, and SFAS 142 effective January 1, 2002. Furthermore, any goodwill and any intangible asset determined to have an indefinite useful life that are acquired in a purchase business combination completed after June 30, 2001 will not be amortized, but will continue to be evaluated for impairment in accordance with the appropriate pre-SFAS 142 accounting literature. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 will continue to be amortized prior to the adoption of SFAS 142.

SFAS 141 requires upon adoption of SFAS 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in SFAS 141 for recognition apart from goodwill. Upon adoption of SFAS 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired in purchase business combinations, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an

intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of SFAS 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

In connection with the transitional goodwill impairment evaluation, SFAS 142 will require the Company to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To accomplish this the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company will then have up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit's carrying amount. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired and the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of it's assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation in accordance with SFAS 141, to its carrying amount, both of which would be measured as of the date of adoption. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's statement of operations.

As of the date of adoption, the Company expects to have unamortized identifiable intangible assets in the amount of approximately $79.7 million which will be subject to the transition provisions of SFAS 141 and 142. Because of the extensive effort needed to comply with adopting SFAS 141 and 142, it is not practicable to reasonably estimate the impact of adopting

these Statements on the Company's financial statements at the date of this report, including whether any transitional impairment losses will be required to be recognized as the cumulative effect of a change in accounting principle.

In August 2001, the Financial Accounting Standards Board issued FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Statement 144), which supersedes both FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (Statement 121) and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (Opinion 30), for the disposal of a segment of a business (as previously defined in that Opinion). Statement 144 retains the fundamental provisions in Statement 121 for recognizing and measuring impairments losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with Statement 121. For example, Statement 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. Statement 144 retains the basic provisions of Opinion 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of

a business). Unlike Statement 121, an impairment assessment under Statement 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under Statement No. 142, Goodwill and Other Intangible Assets.

The Company is required to adopt Statement 144 no later than the year beginning after December 15, 2001, and plans to adopt its provisions for the quarter ending March 31, 2002. Management does not expect the adoption of Statement 144 for long-lived assets held for use to have a material impact on the Company's financial statements because the impairment assessment under Statement 144 is largely unchanged from Statement 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities. Therefore, management cannot determine the potential effects that adoption of Statement 144 will have on the Company's financial statements.

(3) ACQUISITIONS

The Company has made the following acquisitions:

			PURCHASE PR	
NAME	ACQUISITION DATE	CASH INCLUDING RELATED EXPENSES		EQUI
Mobeo, Inc.	August 19, 1999	$11.5 million	$ 374,000	consist
LocusOne Communications, Inc.	February 3, 2000	$40.2 million		--
Riverbed Technologies, Inc.	March 6, 2000	$16.9 million	$ 1.136 billion,	consist stock a
IFX Group Plc	April 6, 2000	$85.0 million		--
NetSearch, LLC	April 20, 2000	$35.4 million		--
Cerulean Technology, Inc.	September 14, 2000	$79.8 million	$ 69.9 million	consist stock a
SunPro, Inc.	September 18, 2000	$10.8 million		--
Sinope, Inc.	September 25, 2000	$2.8 million		--
Portion of Motient Corp.	November 30, 2000	$49.2 million		--
RTS Wireless, Inc.	December 20, 2000	$34.2 million	$ 78.0 million	consist stock a
Total		$365.8 million	$ 1.284 billion	consist stock a

The following summary, prepared on a pro forma basis, presents the results of the Company's operations (unaudited) as if all of the acquisitions occurring after January 1, 2000 had been completed as of January 1, 2000:

(UNAUDITED)
NINE MONTHS ENDED SEPTEMBER 30, 2000
(IN THOUSANDS, EXCEPT PER SHARE DATA)

Revenue	$70,981
Net loss	$(364,471)
Net loss per share -- basic and diluted	$(9.67)

The unaudited pro forma results of operations are not necessarily indicative of what actually would have occurred if the acquisitions had taken place as of January 1, 2000, nor are they a projection of the Company's results of operations for any future period. Additionally, the unaudited proforma results of operations exclude the impairment charges related to goodwill and investments which were incurred in 2001.

During 2000 and 1999, the Company recorded approximately $1.7 billion in goodwill and other intangibles related to its acquisitions.

A number of factors indicated that impairments may have occurred in the three months ended March 31, 2001. Consideration for some of the Company's acquisitions was partially or fully funded through the issuance of shares of the Company's common stock at a time when its stock price was at historically high prices. The Company's stock price ranged from $40.81 to $266.00 at the time of these acquisitions. At March 31, 2001, the Company's stock price was $13.00. Most of the companies that the Company acquired or invested in were start-up or newly formed entities. Most of these companies were privately-held and their fair values are highly subjective and not readily determinable. At the time of these acquisitions and investments, market valuations and the availability of capital for such companies were at historically high levels. From the end of 2000 through March 31, 2001, stock prices and market valuations in the Company's industry and similar industries fell substantially in response to a variety of factors, including a general downturn in the economy, a curtailment in the availability of capital and a general reduction in technology expenditures.

Based on the factors described above, the Company determined that the goodwill in its acquisitions and investments may have become impaired as of March 31,2001. In accordance with SFAS No. 121, the Company performed an undiscounted cash flow analysis of its acquisitions to determine whether an impairment existed. When the undiscounted cash flows for an acquired company was less than the carrying value of the net assets, management determined a range of fair values using a combination of valuation methodologies. The methodologies included:

- Discounted cash flow analysis, which is based upon converting expected future cash flows to present value.
- Changes in market value since the date of acquisition relative to the following:
  - the Company's stock price;

  - comparable companies;
  - the NASDAQ composite index; and
  - a composite of companies that operate with in the Company's industry.

- Market price multiples of comparable companies.

- Contribution to the Company's market valuation.

The methodologies used were consistent with the specific valuation methods used when the original purchase price was determined. The Company's best estimate of the fair value was determined from the range of possible values after considering the relative performance, future prospects and risk profile of the acquired company.

In connection with the valuation of the Riverbed Technologies, Inc. acquisition, the Company engaged an independent third party to determine the fair value of the acquired business because of the magnitude of the acquisition and the associated potential impairment.

As a result of its review, management determined that the carrying value of goodwill and certain other intangible assets related to its acquisitions were not fully recoverable. Accordingly, at March 31, 2001, the Company recorded an impairment charge of approximately $959 million, which represents the difference between the carrying value and fair value of its goodwill and other intangible assets. The impairment of goodwill and other intangible assets from the acquisition of Riverbed Technologies, Inc. amounted to approximately $775 million, or 81% of the total impairment charge recorded. The Company also recorded impairment charges to goodwill and other intangibles related to the acquisitions of LocusOne Communications, Inc., NetSearch, LLC, Cerulean Technology, Inc., Sunpro and RTS Wireless, Inc. of approximately $184 million.

At June 30, 2001, the Company performed a review of each of its acquisitions similar to the review performed at March 31, 2001. The results of its review indicated that of the aggregate carrying value of goodwill and certain other intangible assets related to our acquisitions, the value of the work force-in-place resulting from certain acquisitions had become further impaired in the quarter ended June 30, 2001. Accordingly, the Company reduced the carrying value of this asset by $2.2 million.

At September 30, 2001 the Company again performed a review of each of its acquisitions similar to the review performed at March 31, 2001 and June 30, 2001. The results of its review indicated that several intangible assets had become impaired in the quarter ended September 30, 2001. Accordingly, the Company reduced the carrying value of these assets by $129.2 million, most of which related to certain intangible assets obtained in connection with our acquisition of IFX and the subsequent formation of Sila. As a result, as of September 30, 2001, the adjusted book value of goodwill and other intangibles was approximately $270.0 million.

Because the conditions underlying the factors the Company uses to evaluate its acquisitions change from time to time, the Company could determine that it is necessary to take additional material impairment charges in future periods.

(4) INVESTMENTS

(a) Investments Under the Equity Method of Accounting

The Company has six investments that are recorded using the equity method of accounting: Omnisky (22.6% interest as of September 30, 2001), Inciscent (27.5% interest as of September 30, 2001), VeriStar (25.3% interest as of

September 30, 2001), MindSurf (49.8% interest as of September 30, 2001), Spring Wireless (28.6% interest as of September 30, 2001) and Mobiya (40.0% interest as of September 30, 2001). The Company recorded approximately $16.8 million and $48.3 million in expenses for the three and nine months ended September 30, 2001, respectively, to reflect its proportionate share of the losses in these companies based upon preliminary unaudited financial information. The Company recorded approximately $17.6 million and $31.4 million in expenses for the three and nine month periods ended September 30, 2000, respectively, to reflect its proportionate share of the losses in these companies based on unaudited financial information. At September 30, 2001, the carrying value of these investments was $15.7 million, net of proportionate share of losses and impairment charges. For the three and nine months ended September 30, 2001, the Company generated $0.8 and $7.0 million in revenue, respectively, from products or services provided to these companies. For the three and nine month periods ended September 30, 2000, the Company generated $3.0 million and $5.3 million in revenue, respectively, from products or services provided to these companies. In addition, the Company had $0.5 million and approximately $2.7 million in accounts receivable at September 30, 2001 and December 31, 2000, respectively, due from these companies.

On June 5, 2001 the Company entered into a forward purchase contract with Credit Suisse First Boston (CSFB) which provides for the Company to deliver no more than 2,439,100 shares of Omnisky stock to CSFB on June 5, 2002. In return CSFB has paid the Company $5.2 million in the second quarter of 2001 which has been recorded as a note payable in the accompanying balance sheet as of September 30, 2001. The Company has recorded a gain on the forward purchase contract of $4.8 million during the three months ended September 30, 2001 due to the decline in the fair value of OmniSky stock.

(b) Other Investments

The Company has investments in five publicly traded companies.

Prior to September 20, 2001, the Company had an interest in Data Critical Corp. ("Data Critical"). Effective September 20, 2001 Data Critical was sold to General Electric. The Company received proceeds of $4.6 million from the sale and realized a gain on the sale totaling $2.8 million.

The Company also has investments in eleven private companies. The Company accounts for these investments at cost unless circumstances indicate the carrying amount of the investment may not be recoverable, at which time the carrying value of the investment is adjusted to fair value.

Prior to August 28, 2001, the Company had an interest in Strategy.com, Inc. ("Straegy.com"). Effective August 28, 2001 Strategy.com was sold to MicroStrategy Incorporated. In return for its interest in Strategy.com, the Company received 500,000 shares of MicroStrategy. The Company recorded a realized loss of $8.8 million as a result of this transaction.

For the three and nine months ended September 30, 2001, the Company generated approximately $78,000 and $1.3 million, respectively in revenue from products or services provided to these investees. In addition, the Company has approximately $79,000 in accounts receivable, net of reserves, at September 30, 2001 due from these investees.

(c) Impairment Charges

The Company adjusts the carrying value of its available-for-sale investments in public companies to market and records the change in market value to other comprehensive income. In accordance with SAB 59, Accounting for Noncurrent Marketable Equity Securities, the Company assessed the decline in market value in certain of its public company investments as other than temporary after reviewing the following factors: length of time and extent to which the market value of the investment has been below cost, the financial position and the near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the investee for a period of time sufficient to allow for any anticipated recovery in market value. As of March 31, 2001, in accordance with SAB 59, the Company recorded a realized loss of $27.0 million related to these other than temporary declines.

At June 30, 2001, the Company performed a review of each of its available-for-sale investments in public companies. Based on this review, the company determined that no additional adjustments were required to its available-for-sale investments as a result of other than temporary declines.

At September 30, 2001, the Company performed a review of each of its available-for-sale investments in public companies. Based on this review, the Company determined that adjustments to its available-for-sale investments of $28.0 million were required as a result of declines that the Company deemed to be other than temporary.

With respect to investments in non-public companies, the Company's management performs on-going reviews based on quantitative and qualitative measures. In evaluating its non-public company investments, management determined a range of market values based on a combination of the following valuation methods where applicable:

- Recent funding rounds.

- Changes in market value since the date of investment relative to the following:

    - the Company's stock price;

    - comparable companies;

    - the NASDAQ composite index

    - a composite of companies that operate with in the Company's industry; and

    - market price multiples of comparable companies.

The fair value was determined from the range of possible values, after considering the strength of the investee's financial position, future prospects and risk profile of the invested company. During the first quarter of fiscal 2001, the Company recorded an impairment charge of approximately $61.8 million related to these non-public company investments.

At June 30, 2001, the Company performed a review of its investments in non-public companies similar to the review performed at March 31, 2001. As a result of the review, the Company reduced the carrying value of one of its investments by $1.1 million.

At September 30, 2001 the Company performed a review of its investment in non-public companies similar to the review performed at March 31, 2001. As a result of the review, the Company reduced the carrying value of its investments by $16.1 million.

Because the conditions underlying the factors the Company uses to evaluate its investments change from time to time, the Company could determine that it is necessary to take additional material impairment charges in future periods.

(5) RESTRUCTURING CHARGES

(a) During the second quarter, Aether implemented an expense reduction plan as part of its integration strategy focused on improving operational efficiencies and the implementation of other measures in order to reduce planned expenses. These efforts have resulted in the consolidation of excess facilities and elimination of redundant positions from acquired companies. As a result of this restructuring plan, the Company recorded a charge to earnings in the second quarter of $15.9 million. The charge related mainly to a workforce reduction of over 250 positions and the closing of six facilities. Employee separation benefits of $4.9 million under the restructuring plan include severance, medical, and other benefits. Facility closure costs of $11.0 million include expected losses on subleases, brokerage commissions, asset impairment charges, and other costs. As of June 30, 2001, the accrued liability related to the restructuring had been reduced to $13.7 million as a result of payments of approximately $2.2 million during the second quarter.

(b) During the third quarter, Aether continued its expense reduction plan as part of its integration strategy focused on improving operational efficiencies and the implementation of other measures in order to reduce planned expenses. These efforts have resulted in the further consolidation of excess facilities and elimination of positions. As a result of this restructuring plan, the Company recorded a charge to earnings in the third quarter of $18.2 million (net of adjustments of approximately $367,000). The charge related mainly to a workforce reduction of over 230 positions and the closing or consolidation of six facilities. Employee separation benefits of $4.1 million under the restructuring plan include severance, medical, and other benefits. Facility closure and other costs of $14.5 million include expected losses on subleases, brokerage commissions, asset impairment charges, contract termination costs and other costs.

A rollforward of the restructuring accrual is as follows:

	Beginning Accrual June 30, 2001	Additional Accrual	Cash Payments	Adj
Employee Separation Benefits	$ 4,268	4,070	$ (3,463)	$
Facility Closure Costs & Other	9,394	14,528	(1,550)	
	13,662	18,598	$ (5,013)	$

(6) STOCK OPTIONS AND WARRANTS

(a) Options

In January 2001, the Company's employees were given the right to exchange

existing options for shares of restricted stock. 567 employees agreed to have their options canceled in exchange for approximately 756,000 shares of restricted stock. The Company expects to record $26.6 million of expense over the next four years associated with the issuance of the restricted stock. The Company recorded approximately $1.6 million and $3.3 million of expense associated with the issuance of the restricted stock for the three and nine months ended September 30, 2001, respectively.

(b) 3COM Warrants

In connection with the sale of an equity interest in the Company to 3Com, the Company granted a conditional warrant to 3Com to purchase 893,665 shares at an exercise price of $0.01

per share. On September 23, 2001, 3Com exercised 143,665 warrants which had vested during 1999. 3Com vests in the remainder of the warrants upon performance of certain services and achievement of specific criteria. As of September 30, 2001, warrants to purchase 750,000 shares had not been earned by 3Com. On October 29, 2001, the exercise term elapsed without 3Com having attained the aforementioned milestones, accordingly, no expense relating to the remaining warrants has been recorded, or will ever be recorded.

1. Class Action Complaint for Violations of Federal Securities Laws, Jury Trial Demanded, Civil Action No. 01 CV-7712, filed August 17, 2001. In the United States District Court for the Southern District of New York, George Murphy v. Aether Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., FleetBoston Robertson Stephens, Inc., Credit Suisse First Boston Corp., US Bancorp Piper Jaffray Inc., Bank of America Securities LLC, Morgan Stanley & Co. Inc., and inds., defendants.

2. Class Action Complaint for Violations of Federal Securities Laws, Jury Trial Demanded, Civil Action No. 01 CV-7634, filed August 16, 2001. In the United States District Court for the Southern District of New York, Jerry Krim v. Aether Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., BancBoston Robertson Stephens Inc., Donaldson Lufkin & Jenrette Securities Corp., US Bancorp Piper Jaffray Inc., Deutsche Bank Securities Inc., Friedman, Billing, Ramsey & Co. Inc., and inds., defendants. NOTE: THIS CASE HAS BEEN CONSOLIDATED WITH CV-5570 AND CLOSED ON SEPTEMBER 4, 2001.

(7) COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

Legal Proceedings

Aether and certain of its officers and directors are among the defendants named in eight purported class action lawsuits. These actions were filed on behalf of persons and entities who acquired Aether's common stock after its initial public offering in October 21, 1999. The suits seek damages on account of alleged violations of securities laws. Among other things, the complaints claim that prospectuses, dated October 21, 1999 and September 27, 2000 and issued by Aether in connection with the public offerings of its common stock, allegedly contained untrue statements of material fact or omissions of material fact in violation of securities laws because the prospectuses allegedly failed to disclose that the offerings' underwriters had solicited and received additional and excessive fees, commissions and benefits beyond those listed in the arrangements with certain of their customers which were designed to

maintain, distort and/or inflate the market price of Aether's common stock in the aftermarket. The actions seek unspecified monetary damages and rescission. The Company believes the claims are without merit and plans to vigorously contest these actions. Two of the eight actions were filed since the 10-Q for the period ended June 30, 2001.

1. Class Action Complaint for Violations of Federal Securities Laws, Jury Trial Demanded, Civil Action No. 01 CV-7712, filed August 17, 2001. In the United States District Court for the Southern District of New York, George Murphy v. Aether Systems, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., FleetBoston Robertson Stephens, Inc., Credit Suisse First Boston Corp., US Bancorp Piper Jaffray Inc., Bank of America Securities LLC, Morgan Stanley & Co. Inc., and inds., defendants.

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The Company is also a party to other legal proceedings in the normal course of business. Based on evaluation of these matters and discussions with counsel, management believes that liabilities arising from these matters will not have a material adverse effect on the consolidated results of operations or financial position of the Company.

Purchase Commitments

a) On April 11, 2000, the Company entered into a marketing agreement with Research in Motion Limited (RIM). This agreement includes joint commitments between Aether and RIM concerning sales and marketing and development efforts and allows Aether to license the Blackberry wireless messaging software for use in the Aether network operating center. The agreement includes a commitment to purchase up to 140,000 RIM handheld devices over the following three years. The total commitment is dependent upon certain conditions being met by RIM over the period of the agreement. As of September 30, 2001, the Company has met its obligation for purchases over the next three quarters.

b) The Company is committed to take delivery of 10,420 Novatel wireless modems. 5,420 of these modems have already been paid for.

c) In connection with the acquisition of Motient's retail transportation segment, the Company signed airtime purchase commitments with Motient in the amount of $15 million over three years.

Acquisitions and Investments

The Company is committed to make the following payments during the remainder of 2001 relating to its acquisitions and investments:

(a) Motient--In connection with the acquisition of Motient's retail transportation business, the Company is committed to pay up to an additional $22.5 million if certain revenue and other incentive targets are met in 2001. As of September 30, 2001, these targets have not been met, and as such the Company has not made any payments pursuant to this commitment.

(b) Sila Communications--The Company has committed to provide additional funding of up to $3.4 million in 2001 to its majority-owned subsidiary, Sila Communications, Limited.

(c) In July 2001, the Company entered into a joint venture, which would commit the Company to $20 million in funding, assuming the joint venture meets certain operational milestones. As of September 30, 2001, the Company funded approximately $5 million of these commitments. For the three and nine months ended September 30, 2001, the Company recorded revenue of approximately $49,000 and $1.4 million, respectively, from the sale of products and services to the joint venture partner and held a receivable of approximately $1.2 million as of September 30, 2001. As of the date of this filing, none of the operational milestones had been met.

Subsequent Events

Subsequent to September 30, 2001, the Company and America Online, Inc. entered into a strategic alliance to develop and market wireless solutions to small and medium sized businesses. Aether Fusion technology will extend AOL's Netbusiness email and instant messaging to wireless platforms for the small and medium enterprise. Aether will promote these new products, as well as Aether's current and future wireless data products and services, across the family of America Online interactive brands as well as AOL Time Warner's broad range of media properties. In addition, America Online will make a minority investment in Aether Systems.

(8) SEGMENT INFORMATION

The Company's operating segments include Vertical Markets, European Operations and Corporate and Other. Each of these segments has distinct management teams. The Vertical Markets segment provides similar integrated wireless products and services to a variety of markets including but not limited to transportation, logistics, government, health care and financial services. Our European Operations segment consists of Sila, the Company's European joint venture with Reuters, which has the majority of its customers in the European financial services industry. Corporate and Other consists mainly of special programs revenue and cost of sales, SG&A expenses and corporate assets.

During 2000 and again in 2001, the Company's reportable segments changed--and the Company expects them to continue to change--as its operating structure, business and the markets in which it operates evolve.

Segment detail is summarized as follows:

	Vertical Markets	European Operations	Corporate and other	Total
THREE MONTHS ENDED SEPTEMBER 30, 2001				
Revenue	$ 20,709	$ 3,008	$ 1,231	$ 24,948
Gross Profit (loss)	$ 8,436	$ 1,713	$ (12,772)	$ (2,623)
Total Assets	$ 319,024	$ 35,415	$ 704,994	$1,059,433
THREE MONTHS ENDED SEPTEMBER 30, 2000				
Revenue	$ 10,941	$ 5,281	$ 0	$ 16,222
Gross Profit	$ 5,528	$ 2,734	$ 0	$ 8,262
Total Assets	$1,235,013	$183,645	$1,307,652	$2,727,310
NINE MONTHS ENDED SEPTEMBER 30, 2001				
Revenue	$ 74,222	$ 10,227	$ 3,243	$ 87,692
Gross Profit (loss)	$ 32,570	$ 4,214	$ (15,096)	$ 21,688
NINE MONTHS ENDED SEPTEMBER 30, 2000				
Revenue	$ 23,760	$ 8,618	$ 0	$ 32,378
Gross Profit	$ 11,433	$ 4,334	$ 0	$ 15,767

The Company derives revenue primarily from the U.S. and Europe. Information regarding our revenues and long lived assets in different geographic regions is as follows (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,		
	2001	2000	
Revenue:			
U.S.	$ 21,484	$ 10,726	$

Aggregate Foreign	3,464	5,496	13,742	8,887
	$ 24,948	$ 16,222	$ 87,692	$ 32,378
Long-Lived Assets				
U.S.	$ 322,855	$ 1,271,024		
Aggregate Foreign	14,008	162,526		
	$ 336,863	$ 1,433,550		

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following description of our financial condition and results of operations in conjunction with our Condensed Consolidated Financial Statements and Notes thereto and other financial data appearing elsewhere in this Form 10-Q.

This report includes forward-looking statements that involve risks and uncertainties. When used herein, the words "anticipate," "believe," "estimate," "intend," "may," "will," and "expect" and similar expressions as they relate to Aether Systems, Inc. ("Aether" or "Company") or its management are intended to identify such forward-looking statements. The Company's actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences include those discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations and Business." in the section entitled "Factors Affecting Operating Results" in Item 7 of our annual report on Form 10-K filed with the SEC on April 2, 2001 plus the effects of past or future terrorist attacks. Aether undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

OVERVIEW

Aether Systems, Inc. was originally formed as Aeros, L.L.C. in January 1996. We changed our name to Aether Technologies International, L.L.C. effective August 1996 and to Aether Systems L.L.C. effective September 1999. Immediately prior to the completion of our initial public offering of common stock on October 26, 1999, the limited liability company was converted into a Delaware corporation and our name was changed to Aether Systems, Inc.

From our inception until March 1997, we primarily provided wireless engineering services, including the development of wireless software applications for customers. In March 1997, we began offering services that provide the users of wireless handheld devices access to real-time financial information. During 1997, we made a strategic decision to focus a significant portion of our engineering resources on the development of these and other wireless data services and systems, including our Aether Intelligent Messaging(TM) (AIM) package of wireless messaging software and software development tools.

In 1998 and 1999, we continued to develop financial information services--as well as financial transaction services--internally and through our acquisition of Mobeo, Inc. In 1999, we also completed our initial public

offering and began to expand our service offerings to areas other than financial information and transactions.

In 2000, the Company continued its expansion into other vertical markets through several acquisitions and through organic growth. Also in 2000, the Company moved into the European marketplace with the acquisition of IFX Group Plc ("IFX") and the related formation of Sila Communications Limited ("Sila"). During the current year, the Company has focused on the integration of its acquisitions and the creation and deployment of Aether Fusion(TM), a comprehensive wireless technology foundation designed to provide customers and partners with a single-source solution for accessing essential data and applications wirelessly.

Recently the Company entered into a strategic alliance with AOL Time Warner whereby Aether Fusion(TM) technology would extend AOL's Netbusiness, email and instant messaging to wireless platforms for small and medium enterprises.

The Company's current operating segments include Vertical Markets, European Operations and Corporate and Other. During 2000, and again in 2001, our reportable segments changed--and we expect them to continue to change--as our operating structure, business and the market in which we operate evolve. Each of our segments has distinct management teams.

FACTORS AFFECTING COMPARABILITY

Our results of operations in 2001 and 2000 have been affected by acquisitions, investments, impairment charges and the formation of Sila. In addition, a combination of factors has resulted in operating losses that we expect will continue for some time. The factors identified below have had a significant impact on our operations and should be considered in comparing our results of operations in 2001 to those in 2000.

Acquisitions

We have acquired companies to expand our product offerings and geographic markets and to acquire additional engineering resources to develop products. From September 1999 through December 31, 2000, we acquired 10 businesses (or parts of businesses) for an aggregate consideration (not including contingent payments that had not yet been earned) of $365.8 million and equity valued at the time of acquisition of $1.284 billion, consisting of 6,259,445 shares of our common stock and 1,093,785 replacement options. These acquisitions included the following:

- During 1999, we acquired Mobeo for a purchase price and related expenses of $11.5 million in cash and 46,105 options valued at $374,000.

- In early 2000, we acquired LocusOne, NetSearch, and IFX for purchase prices aggregating approximately $160.6 million.

- On March 6, 2000, we acquired Riverbed for 4,537,281 shares of our common stock and 862,480 options with an aggregate value of $1.136 billion. In connection with our

acquisition of Riverbed, we incurred costs totaling approximately $16.9 million.

- In September 2000, we acquired Cerulean, SunPro and Sinope for purchase prices and related expenses aggregating approximately $93.4 million and 462,412 shares of our common stock and 94,952 options with an aggregate value of $69.9 million.

- On November 30, 2000, we acquired Motient's retail transportation business unit for $49.2 million in cash and related expenses plus an additional sum of up to $22.5 million depending on whether certain revenue and other incentive targets are met in 2001.

- On December 22, 2000, we acquired RTS for a purchase price of $34.2 million in cash and related expenses plus 1,259,752 shares of our common stock and 90,248 options with an aggregate value of $78.0 million.

Our acquisitions increase our operating revenues and expenses from the date of acquisition. In the discussion of results below, we quantify the effects of acquisitions on our revenues and expenses. Acquisitions also increase depreciation and amortization significantly as we amortize the value of acquisition intangibles. Amortization related to acquisition intangibles was $26.8 million and $138.1 million for the three and nine months ended September 30, 2001, respectively, and $70.1 million and $152.8 million for the three and nine months ended September 30, 2000, respectively. The decrease in the third quarter 2001 compared to third quarter of 2000 was primarily due to the write-down of Riverbed goodwill at March 31, 2001. Finally, acquisitions affect non-cash compensation when we issue options to employees at the time of an acquisition.

Formation of Sila

On May 4, 2000, we formed Sila with Reuters to extend our operations to the European market. We contributed our IFX subsidiary (which we purchased for $85.0 million shortly before forming Sila), plus $13.5 million in cash to acquire a 60.0% interest in Sila. Reuters contributed cash of approximately $20.8 million and Futures Pager Limited, a European paging company, for the remaining 40.0% interest. The results of Sila are consolidated in our financial statements.

Investments

We have made investments through Aether Capital, L.L.C., our wholly-owned subsidiary, to promote the development of new technologies that are compatible with the services we offer or that we may wish to integrate into our services. These investments include:

- In August 1999, we formed a new company called OpenSky, which was renamed OmniSky in October 1999. We have invested a total of $9.2 million in OmniSky. We formed OmniSky with 3Com to pursue opportunities in the emerging consumer and business mass markets for wireless e-mail, Internet access and other electronic transactions applications. As of September 30, 2001, we owned approximately 22.6% of OmniSky after completion of OmniSky's initial public offering. We account for our investment in OmniSky under the equity method of accounting.

- In March 2000, we acquired a 27.5% interest in Inciscent in the form of preferred stock for a purchase price of $9.9 million. We formed Inciscent with Metrocall, PSINet, and Hicks, Muse, Tate & Furst and other investors to develop wireless e-mail, Internet access

and other applications for the small office and home office markets. We account for our investment in Inciscent under the equity method of accounting.

- In July 2000, we entered into an agreement with Sylvan to establish Mindsurf, a new company focused on educational services. We have committed to acquire a 47% interest in Mindsurf for $32.9 million in cash. Sylvan has also committed to acquire a 47% interest for $32.9 million in cash while the remaining 6% will be owned by other minority investors. As of September 30, 2001, we have funded $16.3 million of our commitment to Mindsurf. We can agree with Sylvan at any time to cease funding for Mindsurf. We account for our investment in Mindsurf under the equity method of accounting.

Investments also include five publicly-traded companies. We account for these five investments at fair value based on quoted market prices. Net unrealized holding gains and losses on these available-for-sale securities are excluded from income and recorded as a separate component of stockholders' equity unless the decline is deemed to be other than temporary. Subsequent to our investment, the market values of these investments have decreased significantly. In some cases we have determined the decline in market value of our investments in publicly-traded companies to be other than temporary, and as such have recorded realized losses on these investments, which are included in net income.

Investments also include eleven private companies. The Company accounts for these investments at cost unless circumstances indicate the carrying amount of the investment may not be recoverable, at which time the carrying value of the investment is adjusted to fair value.

IMPAIRMENT CHARGES

From 1999 through September 30, 2001, the Company recorded approximately $1.7 billion in goodwill and other intangibles related to its acquisitions. In addition, the Company has made investments in other businesses totaling approximately $192.9 million during this period. The Company's management performs an on-going analysis of the recoverability of its goodwill and other intangibles and the value of its investments in accordance with SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and For Long-Lived Assets to be Disposed Of. Based on quantitative and qualitative measures, the Company assesses the need to record impairment losses on long-lived assets used in operations when impairment indicators are present. The impairment conditions evaluated by management may change from period to period, given that the Company operates in a volatile business environment.

A number of factors indicated that impairments may have occured in the period ended March 31, 2001. Consideration for some of the Company's acquisitions was partially or fully funded through the issuance of shares of the Company's common stock at a time when its stock price was at historically high prices. The Company's stock price ranged from $40.81 to $266.00 at the time of these acquisitions. At March 31, 2001, the Company's stock price was $13.00. Most of the companies the Company acquired or invested in are start-up or newly formed entities. Most of these companies were privately-held and their fair values are highly subjective and not readily determinable. At the time of these acquisitions and investments, market valuations and the availability of capital for such companies was at historically high levels. Between the end of 2000 and March 31, 2001, stock prices and market valuations in the

Company's industry and similar industries had fallen substantially in response to a variety of factors, including a general downturn in the economy, a curtailment in the availability of capital and a general reduction in technology expenditures.

Based on the factors described above, the Company determined at March 31, 2001 that the goodwill in its acquisitions and investments may have become impaired. In accordance with SFAS No. 121, the Company performed an undiscounted cash flow analysis of its acquisitions to determine whether an impairment existed. When the undiscounted cash flows for an acquired company was less than the carrying value of the net assets, management determined a range of fair values using a combination of valuation methodologies. The methodologies included:

- Discounted cash flow analysis, which is based upon converting expected future cash flows to present value.

- Changes in market value since the date of acquisition relative to the following:

  - the Company's stock price;

  - comparable companies;

  - the NASDAQ composite index; and

  - a composite of companies that operate with in the Company's industry.

- Market price multiples of comparable companies.

- Contribution to the Company's market valuation.

The methodologies used were consistent with the specific valuation methods used when the original purchase price was determined. The Company's best estimate of the fair value was determined from the range of possible values after considering the relative performance, future prospects and risk profile of the acquired company.

In connection with the valuation of the Riverbed Technologies, Inc. acquisition, the Company engaged an independent third party to determine the fair value of the acquired business, because of the magnitude of the acquisition and the associated potential impairment.

As a result of its review, management determined that the carrying value of goodwill and certain other intangible assets related to its acquisitions were not fully recoverable. Accordingly, at March 31, 2001, we recorded an impairment charge of approximately $959 million, which represents the difference between the carrying value and fair value of its goodwill and other intangible assets. The impairment of goodwill and other intangible assets from the acquisition of Riverbed Technologies, Inc. amounted to approximately $775 million, or 81% of the total impairment charge. We also recorded impairment charges to goodwill and other intangibles related to the acquisitions of LocusOne Communications, Inc., NetSearch, LLC, Cerulean Technology, Inc., Sunpro and RTS Wireless, Inc. of approximately $184 million.

At June 30, 2001, we performed a review of each of our acquisitions similar to the review performed at March 31, 2001. The results of our review indicated that of the aggregate carrying value of goodwill and certain other intangible assets related to our acquisitions, only the value of the

work-force-in-place resulting from certain acquisitions had become further impaired in the

quarter ended June 30, 2001. Accordingly, the Company reduced the carrying value of this asset by $2.2 million.

At September 30, 2001 the Company again performed a review of each of its acquisitions similar to the review performed at March 31, 2001 and June 30, 2001. The results of its review indicated that several intangible assets had become impaired or further impaired in the quarter ended September 30, 2001. Accordingly, the Company reduced the carrying value of these assets by $129.2 million, most of which related to certain intangible assets obtained in connection with our acquisition of IFX and the subsequent formation of Sila. As a result, as of September 30, 2001, the adjusted book value of goodwill and other intangibles was approximately $270.0 million.

The Company adjusts the carrying value of its available-for-sale investments in public companies to market and records the change in market value to other comprehensive income. In accordance with SAB 59, Accounting for Noncurrent Marketable Equity Securities, the Company assessed the decline in market value in certain of its public company investments as other than temporary after reviewing the following factors: length of time and extent to which the market value of the investment has been below cost, the financial position and the near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the investee for a period of time sufficient to allow for any anticipated recovery in market value. As of March 31, 2001, in accordance with SAB 59, the Company recorded a realized loss of $27.0 million related to these other than temporary declines.

At June 30, 2001, the Company performed a review of each of its available-for-sale investments in public companies. Based on this review, the Company determined that no additional adjustments were required to its available-for-sale investments as a result of other than temporary declines.

At September 30, 2001, the Company performed a review of each of its available-for-sale investments in public companies. Based on this review, the Company determined that adjustments to its available-for-sale investments of $28.0 million were required as a result of declines that the Company deemed to be other than temporary.

With respect to investments in non-public companies, the Company's management performs on-going reviews based on quantitative and qualitative measures. In evaluating its non-public company investments, management determined a range of market values based on a combination of the following valuation methods where applicable:

- Recent funding rounds.
- Changes in market value since the date of investment relative to the following:
  - the Company's stock price;
  - comparable companies;
  - the NASDAQ composite index
  - a composite of companies that operate with in the Company's

industry.

- market price multiples of comparable companies.

The fair value was determined from the range of possible values, after considering the strength of the investee's financial position, future prospects and risk profile of the invested company. During the first quarter of fiscal 2001, the Company recorded an impairment charge of approximately $61.8 million related to these non-public company investments.

At June 30, 2001, we performed a review of our investments in non-public companies similar to the review performed at March 31, 2001. As a result of our review, we reduced the carrying value of one of our investments by $1.1 million.

At September 30, 2001 the Company performed a review of our investment in non-public companies similar to the review performed at March 31, 2001. As a result of the review, we reduced the carrying value of our investments by $16.1 million.

Because the conditions underlying the factors the Company uses to evaluate its acquisitions and investments changes from time to time, the Company could determine that it is necessary to take additional material impairment charges in future periods.

OPERATING REVENUES AND EXPENSES

We describe below the components of our operating revenues and expenses.

Subscriber revenue and expenses

We derive recurring revenue from subscribers in the Vertical Markets and European Operations segments.

Subscriber revenue may consist of:

- a one-time non-refundable activation fee, which we recognize ratably over the expected life of the customer relationship;

- monthly per-subscriber service fees, which we recognize as services are provided;

- monthly per-subscriber exchange fees for access to financial information from the securities exchanges and markets, which we recognize as services are provided; and

- monthly fees for providing access to our network operations center, which we recognize as services are provided, ratably over the contract period.

For certain of our products, our subscribers' monthly fee includes the use of a wireless handheld device. Revenue for such devices is recognized as the related service is provided. Contracts with our wireless data subscribers are generally for a one-year period and include a termination penalty if cancelled by the subscriber before the one-year period expires. These contracts are generally renewable at the option of the subscriber for additional one-year periods or otherwise continue on a monthly basis until cancelled by the subscriber.

Cost of subscriber revenue consists primarily of airtime costs, financial data costs, and securities exchange and market fees. Our airtime costs are determined by agreements we have with several wireless carriers. Typically, we have one-year contracts to buy data network capacity either for an agreed amount of kilobytes at a flat fee or on a cents-per-kilobyte basis.

Cost of subscriber revenue excludes depreciation on our network operations center and certain costs of customer fulfillment, which is included in sales and marketing expense.

Engineering services revenue and expenses

Revenue from wireless engineering services consists of amounts billed to our customers for engineering time on an hourly basis or fixed fees on a per project basis. This revenue is recognized as the work is performed. Cost of engineering services revenue consists of cash compensation and related costs for engineers and other project-related costs.

Software and related services revenue and expenses

We derive revenue from the licensing of software products, including the AIM platform, the ScoutWare software suite, the e-Mobile software suite, the PacketCluster software suite, the FireRMS software suite and the Advantage software suite. In future quarters we expect to generate revenue from the licensing of our new software foundation Aether Fusion(TM). Cost of software and related services revenue consists of costs of licensing, including royalty payments and personnel costs.

Device sales and expenses

We generate revenue by providing our subscribers the option to purchase wireless handheld devices from us at or near cost, which we recognize as revenue upon shipment of the devices, or over the expected term of the customer relationship. Cost of device sales consists of the cost of the hardware from the hardware manufacturer or wholesaler.

Research and development expenses

Research and development expenses consist primarily of cash compensation and related costs for engineers engaged in research and development activities and, to a lesser extent, costs of materials relating to these activities. We expense research and development costs as we incur them.

General and administrative and selling and marketing expenses

General and administrative expenses consist primarily of cash compensation and related costs for general corporate and business development personnel, along with rent and other costs. Selling and marketing expenses consist primarily of advertising and promotions, sales and marketing personnel, travel and entertainment, certain customer fulfillment and other costs.

Depreciation and amortization expenses

Depreciation and amortization expenses consist primarily of the amortization of intangible assets obtained in connection with our acquisitions. Depreciation and amortization expenses also include depreciation expenses arising from equipment purchased for our network operations centers and other property and equipment purchases.

Option and warrant expenses

Option and warrant expense consists of expenses recorded to account for the difference, on the date of grant, between the fair market value and the exercise price of stock options issued to employees, restricted stock granted to employees and the fair value of equity-based awards to non-employees. We commonly issue options and/or warrants at prices below market value in

connection with our acquisitions. Given our numerous acquisitions since our inception and our restricted stock plan, we expect to continue to have substantial option and warrant expense.

Impairment of intangibles

Impairment of intangibles expense consists of the amount of goodwill and other intangibles, written down in accordance with SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Assets to Be Disposed Of. The impaired goodwill related to our acquisitions of Riverbed Technologies, Inc., LocusOne Communications, Inc., NetSearch, Inc. Cerulean Technology, Inc. SunPro, Inc., IFX and the related formation of Sila and RTS Wireless, Inc.

Restructuring Charge

The restructuring charge consists primarily of the costs that we estimate we will incur associated with the plan we have begun to implement to consolidate excess facilities and eliminate redundant positions from acquired companies.

Interest income (expense), net

Interest income (expense), net consists primarily of interest income from cash equivalents and short-term investments, interest expense and realized gains (losses) on sale of our investments.

Equity in losses of investments

Equity in losses of investments consists of our proportionate share of the net losses of OmniSky, Inciscent, MindSurf, VeriStar Corporation, Mobiya, and Spring Wireless, which are recorded under the equity method of accounting.

Minority interest

Minority interest consists wholly of Reuters' ownership interest in Sila.

Investment gains (losses), including impairments, net.

Investment gains (losses), including impairments, net, consists of the loss taken on investments where the decline in market value was deemed to be other than temporary. Investment losses also include amounts related to the decline in the fair value of derivative instruments, offset by gains on the sales of investments.

Income tax benefit

Income tax benefit consists of a foreign deferred tax benefit associated with the losses generated by Sila.

Cumulative effect of change in accounting principle

Cumulative effect of change in accounting principle consists entirely of the cumulative benefit of the implementation of SFAS 133, Accounting for Derivative Instruments and Hedging Activities.

Extraordinary Item

The extraordinary item consists entirely of the gain realized from the early extinguishment of $20.0 million in convertible subordinated notes payable.

COMPARISON OF RESULTS FOR THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

Subscriber revenue. Subscriber revenue increased to $11.2 million for the three months ended September 30, 2001 from $7.6 million for the three months ended September 30, 2000, while subscribers increased to 60,033 at September 30, 2001 from 22,919 at September 30, 2000. The increase between periods was primarily due to $2.6 million in sales of our Mobile Max product line and about $1.0 million increase in sales to our financial services customers. Subscriber revenue increased to $33.0 million for the nine months ended September 30, 2001 from $16.5 million for the nine months ended September 30, 2000. The increase between periods was due to $7.9 million in sales of our Mobile Max product line and a $2.1 million increase in sales to our financial services customers. The remaining increase was primarily due to the revenue resulting from the increased number of subscribers offerings to large enterprise customers. The Mobile Max product line was obtained in connection with an acquisition made after September 30 of last year.

Cost of subscriber revenue. Cost of subscriber revenue increased to $6.8 million for the three months ended September 30, 2001 from $3.2 million for the three months ended September 30, 2000. We generally expect the cost of subscriber revenue to increase proportionately with any increase in subscriber revenue. The increase between periods was due to costs of sales of our Mobile Max product line of $1.9 million and a increase of approximately $1.5 million in cost of sales to our financial services customers. The remaining increase was due to the cost of revenue resulting from the increased number of subscribers that signed on to our offerings to large enterprise customers. Cost of subscriber revenue increased to $19.7 million for the nine months ended September 30, 2001 from $7.4 million for the nine months ended September 30, 2000. The increase between periods was due to costs of sales of our Mobile Max product line of $5.5 million and an increase of approximately $2.2 million in cost of sales to our financial services customers. The remaining increase was primarily due to the cost of revenue resulting from the increased number of subscribers that signed on to our offerings to large enterprise customers.

Engineering services revenue. Engineering services revenue decreased to $642,000 for three months ended September 30, 2001 from $2.5 million for the three months ended September 30, 2000. Engineering services revenue decreased as several large engineering projects were completed in early 2001. Engineering services revenue increased to $5.8 million for nine months ended September 30, 2001 from $5.6 million for the nine months ended September 30, 2000. Approximately $1.0 million of the change between periods was due to our engineering services contracts with Sun Microsystems, partially offset by the completion of several large projects in early 2001.

Cost of engineering services revenue. Cost of engineering services revenue decreased to $314,000 for three months ended September 30, 2001 from $1.9

million for the three months

ended September 30, 2000. This decrease was due primarily to the decrease in engineering services performed as discussed above. Cost of engineering services revenue decreased to $3.1 million for nine months ended September 30, 2001 from $3.5 million for the nine months ended September 30, 2000. This decrease was due primarily to the decrease in engineering services performed as discussed above.

Software and related services revenue. Software and related services revenue was $8.2 million for the three months ended September 30, 2001 and $5.3 million for the three months ended September 30, 2000. The increase between periods was primarily due to sales of licenses of the PacketCluster software suite and the FireRMS suite which we obtained in conjunction with acquisitions ocurring in or after the three months ended September 30, 2001. Software and related services revenue was $29.9 million for the nine months ended September 30, 2001 and $8.7 million for the nine months ended September 30, 2000. The increase between years was primarily due to sales of licenses and services of the PacketCluster software suite, FireRMS software suite AIM and the ScoutWare software platform, all of which were obtained in conjunction with acquisitions occurring in 2000.

Cost of software and related services revenue. Cost of software and related services revenue was $2.9 million for the three months ended September 30, 2001 and approximately $1.9 million for the three months ended September 30, 2000. Cost of software and related services revenue was $9.5 million for the nine months ended September 30, 2001 and $3.4 million for the nine months ended September 30, 2000. The increase between periods was due to the increase in software sales and services as discussed above.

Device sales. Revenue from device sales was $4.9 million for the three months ended September 30, 2001 and approximately $886,000 for the three months ended September 30, 2000. Revenue from device sales was $19.0 million for the nine months ended September 30, 2001 and approximately $1.6 million for the nine months ended September 30, 2000. The increase in device sales between periods relates primarily to the increase of subscribers between periods and the sales of devices to resellers.

Cost of device sales. Cost of device sales was $17.6 million for the three months ended September 30, 2001 and approximately $1.0 million for the three months ended September 30, 2000. Cost of device sales was $33.7 million for the nine months ended September 30, 2001 and $2.3 million for the nine months ended September 30, 2000. The increase in the cost of device sales between periods relates to the increase in device sales between periods. Included in our results are bulk sales of hardware at or below cost made primarily to reduce inventory. Additionally, the cost of device sales increased for the nine months ended September 30, 2001 due to an inventory write-down due to obsolesence and excess inventory of $1.9 million and $12.5 million taken in the first and third quarters of 2001, respectively.

Research and development expenses. Research and development expenses, including in-process research and development related to acquisitions, increased to $16.2 million for the three months ended September 30, 2001 from $10.1 million for the three months ended September 30, 2000. The increase between periods was due to increased expenses of $3.7 million associated with acquisitions made late in the third quarter and in the fourth quarter of last year. The remaining increase was due to the hiring of additional engineers and consultants for increased research and development activities associated with

the development of our software products, mobile computing platforms, including Aether Fusion (TM), and wireless data services. Research and development expenses, including in-process research and development related to acquisitions, increased to $52.0 million for the nine months ended September 30, 2001 from $18.0 million for the nine months ended September 30, 2000. The increase between periods was due to increased expenses of $17.8 million associated with acquisitions made late in the third

quarter and in the fourth quarter of last year. The remaining increase was due to the hiring of additional engineers and consultants for increased research and development activities associated with the development of our software products, mobile computing platforms, including Aether Fusion (TM), and wireless data services. Research and development expenses have begun to decline as our restructuring plans have been executed. We anticipate additional declines in future periods as we continue to execute on our restructuring plans and cost saving initiatives.

General and administrative expenses. General and administrative expenses increased to $22.0 million for the three months ended September 30, 2001 from $20.4 million for the three months ended September 30, 2000. The increase between periods was primarily due to additional personnel and consultants performing general corporate activities and due to increased general and administrative costs associated with our acquisitions since the prior year, partially offset by reductions in cost as we have implemented our restructuring plans. General and administrative expenses increased to $71.4 million for the nine months ended September 30, 2001 from $35.7 million for the nine months ended September 30, 2000. The increase between periods was primarily due to additional personnel and consultants performing general corporate activities, additional facilities and our acquisitions since the prior year. The increased scope of our business has required additional personnel and other expenses, such as consulting and facilities, in all areas including: customer service, network operations, project management, legal and accounting. General and administrative expenses have begun to decline as our restructuring plans have been executed. We anticipate additional declines in future periods as we continue to execute on our restructuring plans and cost saving initiatives.

Selling and marketing expenses. Selling and marketing expenses increased to $14.8 million for the three months ended September 30, 2001 from $10.5 million for the three months ended September 30, 2000. The increase between periods was due primarily to expenses for the quarter of $4.7 million associated with acquisitions made late in the third quarter and in the fourth quarter of last year, partially offset by reduced spending for our branding and advertising campaign. Selling and marketing expenses increased to $55.5 million for the nine months ended September 30, 2001 from $32.3 million for the nine months ended September 30, 2000. The increase in 2001 was primarily due to expenses for the nine months of $18.7 million associated with acquisitions made late in the third quarter and in the fourth quarter of last year. The remaining increase between periods was due to the increased first quarter expenses for the Aether Fusion(TM) branding campaign. Selling and marketing expenses have begun to decline as our restructuring plans have been executed. We anticipate additional declines in future periods as we continue to execute on our restructuring plans and cost saving initiatives.

Depreciation and amortization. Depreciation and amortization decreased to $32.1 million for the three months ended September 30, 2001 from $72.3 million for the three months ended September 30, 2000. Depreciation and amortization decreased to $153.3 million for the nine months ended September 30, 2001 from $156.8 million for the nine months ended September 30, 2000. This decrease was

primarily a result of the impairment charge recorded in the first quarter of 2001 which significantly reduced the carrying value of the goodwill and other intangibles.

Option and warrant expense. Option and warrant expense decreased to $3.5 million for the three months ended September 30, 2001 from $4.0 million for the three months ended September 30, 2000. Option and warrant expense increased to $12.5 million for the nine months ended September 30, 2001 from $10.1 million for the nine months ended September 30, 2000. The increase between the periods was due primarily to amortized option and warrant expense related to options with strike prices below market value on the date of grant, granted in conjunction with acquisitions made late in the third quarter and in the fourth quarter of last year, and the amortization of expense related to restricted stock granted in January 2001.

Restructuring charge. During the second quarter, Aether implemented an expense reduction plan as part of its integration strategy focused on improving operational efficiencies and the implementation of other measures in order to reduce planned expenses. These efforts have resulted in the consolidation of excess facilities and elimination of redundant positions from acquired companies. As a result of this restructuring plan, the Company recorded a charge to

earnings in the second quarter of $15.9 million. The charge related mainly to a workforce reduction of over 250 positions and the closing of six facilities. Employee separation benefits of $4.9 million under the restructuring plan include severance, medical, and other benefits. Facility closure costs of $11.0 million include expected losses on subleases, brokerage commissions, asset impairment charges, and other costs including expected contract termination costs.

During the third quarter, Aether continued its expense reduction plan as part of its integration strategy focused on improving operational efficiencies and the implementation of other measures in order to reduce planned expenses. These efforts have resulted in the further consolidation of excess facilities and elimination of positions. As a result of this restructuring plan, the Company recorded a charge to earnings in the third quarter of $18.2 million (net of adjustments of approximately $367,000). The charge related mainly to a workforce reduction of over 230 positions and the closing or consolidation of six facilities. Employee separation benefits of $4.1 million under the restructuring plan include severance, medical, and other benefits. Facility closure costs and other costs of $14.5 million include expected losses on subleases, brokerage commissions, asset impairment charges, contract termination, and other costs.

Interest income, net. Net interest income decreased to $1.1 million for the three months ended September 30, 2001 from $14.6 million for the three months ended September 30, 2000. Net interest income decreased to $10.7 million for the nine months ended September 30, 2001 from $31.5 million for the nine months ended September 30, 2000. The decrease between 2001 and 2000 was primarily due to a decrease in interest earned on cash and cash equivalents as our cash on hand decreased between periods related to investing and operating activities. The remaining decrease was due to the lowering of interest rates in 2001.

Equity in losses of investments. Equity in losses of investments was $16.8 million for the three months ended September 30, 2001 and $17.6 million for the three months ended September 30, 2000. Equity in losses of investments was $48.3

million for the nine months ended September 30, 2001 and $31.4 million for the nine months ended September 30, 2000. The increase related to our proportionate share of losses from OmniSky, Inciscent, MindSurf, VeriStar, Spring Wireless, and Mobiya, which are all accounted for under the equity method of accounting. We expect to continue to record equity losses in investments as these companies continue to develop their operations.

Investment gains (losses), including impairments, net. Investment gain (losses), including impairments, net was $45.7 million for the three months ended September 30, 2001. There was no such loss for the three months ended September 30, 2000. Investment loss, including impairments was $141.6 million for the nine months ended September 30, 2001. There was no such loss for the nine months ended September 30, 2000. The increase for the three and nine months ended September 30, 2001 was due primarily to the loss taken on investments where the decline in market value was deemed to be other than temporary. The Company also recorded a loss of approximately $406,000 and $6.4 million for the three and nine months ended September 30, 2001, respectively, relating to the decline in the fair value of derivative instruments, offset by gains on the sales of investments.

Minority interest. Minority interest was $47.4 million for the three months ended September 30, 2001 and $4.3 million for the three months ended September 30, 2000. Minority interest was $55.5 million for the nine months ended September 30, 2001 and $6.0 million for the nine months ended September 30, 2000. Minority interest relates to Reuters' proportional share of losses in Sila, which was formed in May 2000 and is consolidated into our financial statements. We expect that Sila will continue to incur losses as it develops its operations.

Income tax benefit. Income tax benefit was approximately $9.1 and $574,000 for the three months ended September 30, 2001 and 2000 and approximately $10.0 million and $574,000 for the nine months ended September 30, 2001 and 2000. This increase was due to a foreign deferred tax benefit associated with the losses generated by Sila, which was formed in May 2000.

Extraordinary Item. The extraordinary item consists entirely of the gain realized from the early extinguishment of $20.0 million in convertible subordinated notes payable.

Cumulative effect of change in accounting principle. Cumulative effect of change in accounting principle was $0 for the three months ended September 30, 2001 and $6.6 million for the nine months ended September 30, 2001 and was due entirely to the adoption of SFAS 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 133 provides that derivatives should be carried as an asset on the balance sheet at fair value, and that changes in fair value between periods should be included in net income. Our derivatives include warrants obtai