

CYBERGUARD CORP
Form 10-Q/A
May 27, 2003
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended DECEMBER 31, 2002

OR

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

For the transition period from _____ to _____

Commission file number 0-24544

CYBERGUARD CORPORATION

(Exact name of Registrant as Specified in Its Charter)

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Florida (State or Other Jurisdiction of Incorporation or Organization)	65-0510339 (I.R.S. Employer Identification No.)
2000 West Commercial Blvd., Suite 200, Fort Lauderdale, Florida (Address of Principal Executive Offices)	33309 (Zip Code)

Registrant's Telephone Number, Including Area Code

954-958-3900

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports),

Yes No

and (2) has been subject to such filing requirements for the past 90 days.

Yes No

As of February 5, 2003, 19,975,951 shares of the Registrant's \$0.01 par value Common Stock were outstanding.

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	Dec. 31,	June 30,
	2002	2002
	<u> </u>	<u> </u>
ASSETS		
Cash and cash equivalents	\$ 8,931	\$ 6,166
Restricted cash	75	44
Accounts receivable, less allowance for uncollectible accounts of \$437 at Dec. 31, 2002 and \$109 at June 30, 2002	6,487	5,152
Inventories, net	147	442
Other current assets	1,174	801
	<u> </u>	<u> </u>
Total current assets	16,814	12,605
Property and equipment at cost, less accumulated depreciation of \$2,850 at Dec. 31, 2002 and \$2,335 at June 30, 2002	1,338	1,212
Capitalized software, net	246	219
Other assets	80	94
	<u> </u>	<u> </u>
Total assets	<u>\$ 18,478</u>	<u>\$ 14,130</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Note payable	\$ 96	\$ 140
Accounts payable	887	778
Deferred revenue	4,677	3,951
Accrued expenses and other liabilities	2,501	2,305
	<u> </u>	<u> </u>
Total liabilities	8,161	7,174
Commitments and Contingencies		
Shareholders' equity		
Preferred Stock par value \$0.01; authorized 5 shares; none issued		
Common stock par value \$0.01; authorized 50,000 shares issued and outstanding 19,734 at Dec. 31, 2002 and 19,100 at June 30, 2002	197	191
Additional paid-in capital	89,662	88,673
Accumulated deficit	(79,635)	(82,075)
Accumulated other comprehensive income	93	167
	<u> </u>	<u> </u>

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Total shareholders' equity	10,317	6,956
Total liabilities and shareholders' equity	\$ 18,478	\$ 14,130

See accompanying notes to condensed consolidated financial statements

Table of Contents**CYBERGUARD CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(Amounts in thousands, except per share data)**

	Three Months Ended		Six Months Ended	
	Dec. 31,	Dec. 31,	Dec. 31,	Dec. 31,
	2002	2001	2002	2001
Revenues:				
Products	5,795	3,968	10,668	6,969
Services	2,438	1,785	4,665	3,359
Total revenues	8,233	5,753	15,333	10,328
Cost of revenues:				
Products	1,398	1,130	2,622	1,866
Services	721	493	1,273	944
Total cost of revenues	2,119	1,623	3,895	2,810
Gross profit	6,114	4,130	11,438	7,518
Operating expenses:				
Research and development	1,207	1,003	2,254	2,359
Selling, general and administrative	3,543	2,986	6,865	5,955
Total operating expenses	4,750	3,989	9,119	8,314
Operating income (loss)	1,364	141	2,319	(796)
Other income/(expense):				
Interest income/(expense), net	25	5	54	27
Gain/(loss) on sale of assets	3	(14)	(33)	(17)
Other income/(expense):	116	(22)	100	(12)
Total other income/(expense)	144	(31)	121	(2)
Net income (loss)	1,508	110	2,440	(798)
Basic earnings (loss) per common share	\$ 0.08	\$ 0.01	\$ 0.13	\$ (0.04)
Weighted average number of common shares outstanding	19,475	18,667	19,328	18,610
Diluted earnings (loss) per common share	\$ 0.06	\$ 0.01	\$ 0.10	\$ (0.04)

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Diluted common shares outstanding	24,316	19,267	23,479	18,610
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See accompanying notes to condensed consolidated financial statements

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CYBERGUARD CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in thousands)

	<u>Six Months Ended</u>	
	<u>Dec. 31,</u>	<u>Dec.</u>
	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income/(loss)	\$ 2,440	\$ (798)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation	476	353
Amortization	152	380
Loss on disposal of property & equipment	33	16
Interest on convertible debt		3
Provision for uncollectible accounts receivable	328	38
Provision for inventory reserve		2
Compensation expense related to stock options	70	55
Non cash expense for company 401(k) match	123	117
Translation adjustment	(74)	20
Changes in assets and liabilities		
(Increase)/Decrease in restricted cash	(31)	707
(Increase) in accounts receivable	(1,663)	(66)
(Increase)/Decrease in other current assets	(374)	223
(Increase) in inventories	(320)	(237)
Increase/(Decrease) in accounts payable	110	(538)
Increase in accrued expenses and other liabilities	196	17
Increase in deferred revenue	726	977
Decrease/(Increase) in other, net	14	(1)
	<u>2,206</u>	<u>1,268</u>
Net cash provided by operating activities		
Cash flows used in investing activities:		
Capitalized software costs	(179)	(182)
Proceeds from the sale of property & equipment		10
Purchase of property & equipment	(20)	(148)
	<u>(199)</u>	<u>(320)</u>
Net cash (used in) investing activities		
Cash flows provided by/(used in) financing activities:		
Repayment on notes payable	(44)	(752)
Net repayments on line of credit		(113)
Proceeds from stock options exercised	766	168
Proceeds from issuance of common stock in stock purchase plan	36	217

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Net cash provided by/(used in) financing activities	758	(480)
Net increase in cash	2,765	468
Cash and cash equivalents at beginning of period	6,166	4,771
Cash and cash equivalents at end of period	\$ 8,931	\$ 5,239
Supplemental disclosure of cash flow information:		
Cash paid for interest	3	55
Cash paid for income taxes		

Supplemental disclosure of non-cash information:

During January 2001, approximately 310 options to purchase shares of the Company's common stock were issued at a below market price, which required the Company to record approximately \$11 and \$54 in compensation expense for the period ended December 2002 and 2001 respectively.

For the period ended December 31, 2002, approximately \$615 of inventory was reclassified to fixed assets.

See accompanying notes to condensed consolidated financial statements

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CYBERGUARD CORPORATION

Notes to Condensed Consolidated Financial Statements

December 31, 2002

Amounts in thousands, except per share data

(Unaudited)

1. Basis of Presentation

CyberGuard Corporation (the "Company") has prepared the condensed consolidated financial statements included herein, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission with respect to Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made are adequate so as to make the information contained not misleading. These interim financial statements and the notes should be read in conjunction with the financial statements and the notes included in the Company's 10-K for the year ended June 30, 2002 and the risk factors set forth in the Company's annual report on Form 10-K, including, without limitation, risk related to the factors listed below. In the Company's opinion, all adjustments (consisting only of normal recurring adjustments) necessary for fair presentation of the information shown have been included. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. On an on-going basis, we evaluate significant estimates used in preparing our financial statements, including revenue recognition, bad debt, software development cost, inventory valuation, and reserve for deferred taxes. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2. Summary of Significant Accounting Policies

Software Development Costs The Company capitalizes costs related to the development of certain software products in accordance with Statement of Financial Accounting Standards No. 86, "Accounting For the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed" (SFAS No. 86) which requires capitalization to begin when technological feasibility has been established and ends when the product is available for general release to customers. Software development costs incurred prior to technological feasibility, defined by implementation of a beta project, are considered research and development costs and are expensed as incurred. Capitalized costs are amortized on a straight-line method over two years. The Company capitalized \$76 in software development costs for the quarter ended December 31, 2002 and \$179 for the six months ended December 31, 2002.

Revenue Recognition Revenues from product sales are recognized only when a contract or agreement has been executed, delivery of the product has occurred, the fee is fixed and determinable and we believe collection is probable. While we generally recognize product revenue on product shipment, we defer revenues on product sales for value added resellers until the partners demonstrate consistency of payment within terms and no product returns for a three-month period. Service revenues are recognized ratably on a monthly basis over the service contract term. Service revenues primarily include the annual fee for maintenance, which is sold as part of our security solutions, and for subscription renewals from our existing customers and end users. These services provide our customers access to our worldwide support organization for product updates, general security information and technical support. For the quarter ended December 31, 2002, no resellers were reclassified from cash basis to accrual and one reseller was reclassified from accrual to cash basis because it did not demonstrate consistency of payment within terms. During the six months ended December 31, 2002, thirteen (13) resellers, net, were changed from cash basis to accrual, based on a reasonable assurance

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of collectibility from evaluating their payment histories and no product returns. The impact of the reclassification did not have a material effect on revenue.

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Revenue on post-contract customer support is deferred and amortized by the straight-line method over the term of the contracts. The Company also provides professional support services, which are available under service agreements and charged for separately. These services are generally provided under time and materials contracts and revenue is recognized as the service is provided.

Net Income Per Share Basic income/(loss) per share is computed by dividing net income/(loss) available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings/(loss) per share data is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options and warrants using the treasury method. When the effects of the outstanding stock options, warrants and/or convertible securities are anti-dilutive, they are not included in the calculation of diluted earnings/(loss) per share.

The table below illustrates the components of earnings per share:

	<u>Three Months Ended December 31, 2002</u>	<u>Three Months Ended December 31, 2001</u>	<u>Six Months Ended December 31, 2002</u>	<u>Six Months Ended December 31, 2001</u>
Net Income/(loss)	\$1,508	\$110	\$2,440	(\$798)
Weighted average number of common shares outstanding	19,475	18,667	19,328	18,610
Dilutive effect of:				
Employee stock options	3,559	536	3,104	0
Warrants	1,282	64	1,047	0
Weighted average number of common shares outstanding	24,316	19,267	23,479	18,610
Earnings/(loss) per share				
Basic	0.08	0.01	0.13	(0.04)
Diluted	0.06	0.01	0.10	(0.04)

The results of operations for the six months ended December 31, 2002 are not necessarily indicative of the results of operations that may be expected for the year ending June 30, 2003.

The Company's operating results and financial condition may be impacted by a number of factors including, but not limited to, the following, any of which could cause actual results to vary materially from current and historical results or the Company's anticipated future results. A portion of the Company's revenue is derived from its international operations and sources. As a result, the Company's operations and financial results could be affected by international factors such as; changes in foreign currency exchange rates, weak economic conditions in the international markets in which the Company distributes its products and the potential conflict in the Middle East. The network security industry is highly competitive and competition is expected to intensify. There are numerous companies competing in segments of the market in which the Company does business. Competitors include organizations significantly larger and with more development, marketing and financial resources than the Company. In addition, the Company is subject to risks and uncertainties which include, but are not limited to, the

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CYBERGUARD CORPORATION

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Amounts in thousands, except per share data

(Unaudited)

timely development of and acceptance of new products, impact of competitive products, competition for and retention of key management and technology employees, possible attacks on our networks causing changes to the public's perception of the Company, the ability to secure additional financing, government regulation, inventory obsolescence, the ultimate outcome of certain litigation matters, and cash balances in excess of federally insured limits.

3. Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*, as liabilities for these costs are now recognized when incurred rather than at the date an entity commits to an exit plan. The provisions of SFAS 146 are effective, on a prospective basis, for exit or disposal activities initiated by the Company after December 31, 2002. The Company believes SFAS 146 will not have any impact on the Company at this time.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* an amendment of FASB Statement No. 123. SFAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS 123 to require prominent disclosures about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS 148 also amends APB Opinion No. 28,

Interim Financial Reporting, to require disclosures about those effects in interim financial information. The amendments to SFAS 123 in paragraphs 2(a)-2(e) of the statement shall be effective for financial statements for fiscal years ending after December 15, 2002. The amendment to SFAS 123 in paragraph 2(f) of this statement and the amendment to Opinion 28 in paragraph 3 shall be effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. The Company currently accounts for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS No. 123. The Company believes that it will continue to account for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and will adopt the additional disclosure provisions of SFAS 148 during the first quarter of its year ending December 31, 2003.

4. Contingencies

On August 24, 1998, the Company announced, among other things, that due to a review of its revenue recognition practices relating to distributors and resellers, it would restate prior financial results. After the August 24, 1998 announcement, twenty-five purported class action lawsuits were filed by alleged shareholders against the Company and certain former officers and directors. Pursuant to an order issued by the Court, these actions have been consolidated into one action, styled Stephen Cheney, et al. v. CyberGuard Corporation, et al., Case No. 98-6879-CIV-Gold, in the United States District Court, Southern District of Florida. On August 23, 1999, the plaintiffs filed a Consolidated and Amended Class Action Complaint. This action seeks damages purportedly on behalf of all persons who purchased or

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(Unaudited)

otherwise acquired the Company's common stock during various periods from November 7, 1996 through August 24, 1998. The complaint alleges, among other things, that as a result of accounting irregularities relating to the Company's revenue recognition policies, the Company's previously issued financial statements were materially false and misleading and that the defendants knowingly or recklessly published these financial statements which caused the Company's common stock prices to rise artificially. The action alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and SEC Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act. Subsequently, the defendants, including the Company, filed their respective motions to dismiss the Consolidated and Amended Class Action Complaint. On July 31, 2000, the Court issued a ruling denying the Company's and Robert L. Carberry's (the Company's CEO from June 1996 through August 1998) motions to dismiss. The court granted the motions to dismiss with prejudice for defendants William D. Murray (the Company's CFO from November 1997 through August 1998), Patrick O. Wheeler (the Company's CFO from April 1996 through October 1997), C. Shelton James (the Company's former Audit Committee Chairman), and KPMG Peat Marwick LLP (KPMG). On August 14, 2000, the plaintiffs filed a motion for reconsideration of that order. The Company filed an answer to the plaintiffs' Consolidated and Amended Class Action Complaint on August 24, 2000. On March 20, 2001, the Court ruled on the plaintiffs' motion for reconsideration that the previously dismissed defendants William D. Murray, Patrick O. Wheeler and C. Shelton James should not have been dismissed from the action and shall be defendants in this action under the control person liability claims under Section 20(a) of the Exchange Act, and that the plaintiffs may amend the Consolidated and Amended Class Action Complaint to bring claims against C. Shelton James under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. On April 5, 2001, the plaintiffs filed their Second Consolidated and Amended Class Action Complaint to include amended claims against C. Shelton James. On May 10, 2001, the Company filed an answer and affirmative defenses to plaintiffs' Second Consolidated and Amended Class Action Complaint. On August 14, 2002, the Court granted the plaintiffs' Motion for Class Certification and certified the class to include all investors who acquired the Company's common stock between November 7, 1996 and August 24, 1998 and were damaged by the purchase of such stock. The trial is scheduled for March 2004. The parties are currently conducting discovery.

The Company's obligation to indemnify its officers and directors under the aforementioned lawsuit is insured to the extent of the limits of the applicable insurance policies. The Company has notified its insurance carrier of the existence of the lawsuit, and the carrier has sent the Company a reservation of rights letter. The Company intends to vigorously defend this action, and believes that in the event that it is unsuccessful, insurance coverage will be available to defray a portion, or substantially all, of the expense of defending and settling the lawsuit or paying a judgment. However, the Company is unable to predict the ultimate outcome of the litigation. There can be no assurance that the Company will be successful in defending the lawsuit or, if unsuccessful, that insurance will be available to pay all or any portion of the expense of the lawsuit. If the Company is unsuccessful in defending the lawsuit and the insurance coverage is unavailable or insufficient, the resolution of the lawsuit could have a material adverse effect on the Company's consolidated financial position, results of operations, and cash flows. The Company's consolidated financial statements do not include any adjustments related to these matters. We are unable at this time to estimate the loss, if any, that the Company may incur if we are unsuccessful in defending this suit.

On September 16, 1999, the Company filed a lawsuit against KPMG and August A. Smith, the KPMG engagement partner. The lawsuit is pending in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Case No. 00-004102-CACE-14. On May 1, 2000, the Company filed the First Amended Complaint, alleging that KPMG failed to properly audit the Company's financial statements and provided inaccurate advice on accounting matters for fiscal years 1996, 1997 and 1998. The action

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(Unaudited)

alleges professional malpractice, breach of fiduciary duty, breach of contract and breach of implied duty of good faith, and seeks damages in excess of \$10 million. KPMG and Mr. Smith filed motions to dismiss, which were denied. In August 2000, KPMG and Mr. Smith filed their answers and KPMG filed counterclaims against the Company, alleging the Company's breach of contract, negligent misrepresentation and abuse of process, and seeking an unspecified amount of damages consisting of unpaid service fees and legal fees and costs. The Company filed an answer to KPMG's counterclaims and moved to dismiss KPMG's abuse of process counterclaim. On April 9, 2001, the Court dismissed the abuse of process counterclaim with prejudice. The parties are currently conducting discovery.

On November 14, 2002, the Company filed a lawsuit against Data Return Corporation in the United States District Court of the Northern District of Texas, alleging breach of contract, and seeking, among other remedies, damages of approximately \$4 million. On December 9, 2002, Data Return Corporation filed an answer and affirmative defenses, and also counterclaims against the Company, alleging breach of contract, breach of warranty, fraud, negligent misrepresentation and deceptive trade practices, and seeking unspecified damages. On December 30, 2002, CyberGuard filed its answer and affirmative defenses to the counterclaim and a motion to dismiss the fraud, negligent misrepresentation and deceptive trade practices counterclaims.

The Company is involved from time to time, in the ordinary course of its business, in various litigation relating to the conduct of its business. The Company believes that these other litigation matters will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

5. Subsequent Events

On January 23, 2003, the Company signed an Asset Purchase Agreement to acquire certain assets of NetOctave Inc. for approximately \$1.5 million in cash and stock. Subject to certain conditions, the transaction is expected to close by March 31, 2003.

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(Dollars in thousands, except per share data)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q contains forward-looking statements about future results, which are subject to risks, and uncertainties, including those discussed below. These statements relate to future events or our future financial performance. In many cases you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential, intend, or combinations of such terms and other comparable terminology. However, the absence of these words does not mean that the statements are not forward-looking. Forward-looking statements include statements about our plans, objectives, expectations, intentions and other statements that are not historical facts. They are subject to known and unknown risks and uncertainties and assumptions that could cause our actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including, but not limited to, the risks described in Part II, Item 7, of the Company's 10-K for the year ended June 30, 2002. You should not unduly rely on these forward-looking statements, which apply only as of the date of this quarterly report. We undertake no obligation to update any forward-looking statements to reflect new information, circumstances or events after the date of this report. These forward-looking statements are only predictions.

The Company provides a full suite of products and services for the network security industry. The products offered by the Company include the CyberGuard® Firewall and VPN, proprietary and third party technology and consulting, support, and installation services.

Results of Operations

The quarter ended December 31, 2002 compared to the quarter ended December 31, 2001

Net Revenues

Net revenues consist primarily of the network security products and maintenance contracts related to these products. For the quarter ended December 31, 2002, net revenues increased by \$2,480 to \$8,233 compared to \$5,753 for the quarter ended December 31, 2001. The increase was comprised of an increase in product sales of \$1,827 and services of \$653. Total international revenue represented approximately 44% of total revenues for the three months ended December 31, 2002 compared to approximately 55% for the three months ended December 31, 2001. The growth in revenues resulted from strong growth in the US market, particularly in the government sector when compared to the quarter ended December 31, 2001.

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n All three worldwide regions experienced significant product revenue growth during the quarter ended December 31, 2002. Network security product revenue accounted for 70% of revenue during the quarter ended December 31, 2002 compared to 69% of revenues during the quarter ended December 31, 2001.

Service revenue includes maintenance contracts related to new product sales, renewal maintenance contracts for products previously deployed, training, installation and consulting services. The increase in service revenue corresponds to the growth in the Company's customer base and its timing of renewal maintenance. Support services for network security products accounted for 30% of revenues during the quarter ended December 31, 2002 as compared to 31% of revenues during the quarter ended December 31, 2001.

Gross Profit

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(Dollars in thousands, except per share data)

Gross profit as a percentage of revenues increased to 74.3% for the quarter ended December 31, 2002 compared to 71.8% for the quarter ended December 31, 2001. This increase reflects lower components cost. In addition, service revenue increased because of a growing customer base while service costs grew at a slower rate than revenue.

The Company's gross margin has been, and will continue to be, affected by a variety of factors including, competition, the mix and average selling prices of products, new product introductions and enhancements, and the fluctuations in manufacturing volumes. We must continue to manage each of these factors effectively for our gross margins to remain at their current level.

Operating Expenses, Other Income and Expense and Net Income

Research and development expense includes salaries, non-capitalized equipment, software tools, and depreciation from capital equipment and software. Research and development expense increased by \$204 to \$1,207 for the quarter ended December 31, 2002 compared to \$1,003 for the quarter ended December 31, 2001. The increase is the result of additional headcount and the return to full salary following the completion of the special option program discussed in Part I, Item 1, Footnote 7 of the 10Q filed with the SEC for quarter ending December 31, 2001.

Additionally, approximately \$76 of research and development cost was capitalized during the quarter ended December 31, 2002 compared to \$182 for the quarter ended December 31, 2001. As a percentage of total revenue, research and development expense decreased to 14.6% for the quarter ended December 31, 2002 from 17.4% for the quarter ended December 31, 2001. The lower percentage is primarily the result of an increase in revenues.

We expect to increase our research and development costs in total dollars to enhance and expand our current product offerings and develop new products. We plan to continue to make the necessary investment in research and development to keep our products at a competitive advantage.

Selling, general and administrative expense includes salaries, commissions, costs associated with the executive, human resource, finance and administrative support functions, and legal and accounting professional services. Selling, general and administrative expense increased by \$557 to \$3,543 for the quarter ended December 31, 2002 from \$2,986 for the quarter ended December 31, 2001.

The increase in selling, general and administrative expenses for the quarter ended December 31, 2002, of \$557 is primarily attributable to increases in the sales and marketing area related to increased headcount for training, marketing, inside sales staff and expansion of personnel within our US Government sales force. Additionally, the return to full salary following the special option program as described above in the discussion on research and development expense also contributed to the increase. Other cost increases included higher expenditures related to advertising and trade show activity.

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Total other income increased \$175 for the quarter ended December 31, 2002 to \$144 compared to an expense of \$31 for the quarter ended December 31, 2001. The increase in other income is due primarily to a foreign currency gain of \$116 for the quarter ended December 31, 2002, compared to a foreign currency loss of \$22 and a loss on the sale of fixed assets of \$14 in the quarter ended December 31, 2001.

Net income for the quarter ended December 31, 2002 was \$1,508 compared to net income of \$110 for the quarter ended December 31, 2001. The Company did not provide for income taxes due to its estimate of the effective tax rate expected to be applicable for the full fiscal year and the significant net operating loss carryforwards available.

The company is currently evaluating the valuation allowance recorded for the Company's deferred tax asset. Management anticipates that during the quarter ending March 31, 2003, a significant amount of the valuation allowance related to the deferred tax asset will be reversed. This reversal will be based on management's estimate and conclusions regarding the ultimate realization of the deferred tax asset,

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CYBERGUARD CORPORATION

December 31, 2002

(Dollars in thousands, except per share data)

including but not limited to, the company's recent positive financial results as well as projected earnings through June 30, 2005. The company will continue to evaluate each quarter the amount, if any, of additional reduction of the valuation allowance that should be made. The impact of the reduction of the valuation allowance will be to increase net income in the period the determination is made which is currently anticipated to be March 31, 2003.

The six-month period ended December 31, 2002 compared to the six-month period ended December 31, 2001

Net Revenues

Net revenues consist primarily of the network security products and maintenance contracts related to these products. For the six-month period ended December 31, 2002, net revenues increased by \$5,005 to \$15,333 compared to \$10,328 for the six-month period ended December 31, 2001. The increase was comprised of an increase in product sales of \$3,699 and services of \$1,306. Total international revenue represented approximately 48% of total revenues for the six-month period ended December 31, 2002 compared to approximately 54% for the six-month period ended December 31, 2001.

The increase in revenues for the six-month period ended December 31, 2002 is attributable to several key factors:

- n New channel partner revenue contribution
- n Strong government purchases, particularly in the US market
- n Continued development and contribution from the Europe, Middle East and Africa region
- n More seasoned sales force

All three worldwide regions experienced significant product revenue growth during the six-month period ended December 31, 2002. Network security product revenue accounted for 70% of revenue during the six-month period ended December 31, 2002 compared to 67% of revenues during the six-month period ended December 31, 2001.

Service revenue includes maintenance contracts related to new product sales, renewal maintenance contracts for products previously deployed, training, installation and consulting services. The increase in service revenue corresponds to the growth in the Company's customer base and its

timing of renewal maintenance. Support services for network security products accounted for 30% of revenues during the six-month period ended December 31, 2002 compared to 33% of revenues during the quarter ended December 31, 2001.

Gross Profit

Gross profit as a percentage of revenues increased to 74.6% for the six-month period ended December 31, 2002 compared to 72.8% for the six-month period ended December 31, 2001. This increase reflects lower components cost. In addition, service revenue increased because of a growing customer base while service costs grew at a slower rate than revenue.

The Company's gross margin has been, and will continue to be, affected by a variety of factors including, competition, the mix and average selling prices of products, new product introductions and enhancements, and the fluctuations in manufacturing volumes. We must continue to manage each of these factors effectively for our gross margins to remain at their current level.

Operating Expenses, Other Income and Expense and Net Income

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Research and development expense includes salaries, non-capitalized equipment, software tools, and depreciation from capital equipment and software. Research and development expense decreased by \$105 to \$2,254 for the six-month period ended December 31, 2002 compared to \$2,359 for the six-month period ended December 31, 2001. The decrease is the result of the reduction in salary expense related to the special option program discussed in Part I, Item 1, Footnote 7 of the 10Q filed with the SEC for quarter ending December 31, 2001. Capitalized software costs for the six-month period ended December 31, 2002 were \$179 compared to \$182 for the six-month period ended December 31, 2001. As a percentage of total revenue, research and development expense decreased to 14.7% for the six-month period ended December 31, 2002 from 22.8% for the six-month period ended December 31, 2001. The lower percentage is primarily the result of an increase in revenues.

We expect to increase our research and development costs in total dollars to enhance and expand our current product offerings and develop new products. We also expect research and development costs to increase at a slower rate than revenues. We plan to continue to make the necessary investment in research and development to keep our products at a competitive advantage.

Selling, general and administrative expense includes salaries, commissions, costs associated with the executive, human resource, finance and administrative support functions, and legal and accounting professional services. Selling, general and administrative expense increased by \$910 to \$6,865 for the six-month period ended December 31, 2002 from \$5,955 for the six-month period ended December 31, 2001.

The increase in selling, general and administrative expenses for the six-month period ended December 31, 2002, of \$910 is attributable to increased headcount for training, marketing and inside sales staff, expansion of personnel within our US Government sales force and severance costs related to employee termination in the Europe, Middle East and Africa region. Other cost increases included higher expenditures related to advertising and trade shows.

Total other income increased \$123 for the six-month period ended December 31, 2002 to \$121 compared to an expense of \$2 for the six-month period ended December 31, 2001. The increase in other income is due primarily to a foreign currency gain of \$100 for the six month period ended December 31, 2002, compared to a foreign currency loss of \$12 for the six-month period ended December 31, 2001.

Net income for the six-month period ended December 31, 2002 was \$2,440 compared to a net loss of \$798 for the six-month period ended December 31, 2001. The Company did not provide for income taxes due to its estimate of the effective tax rate expected to be applicable for the full fiscal year and the significant net operating loss carryforwards available.

The company is currently evaluating the valuation allowance recorded for the Company's deferred tax asset. Management anticipates that during the quarter ending March 31, 2003, a significant amount of the valuation allowance related to the deferred tax asset will be reversed. This reversal will be based on management's estimate and conclusions regarding the ultimate realization of the deferred tax asset, including but not limited to, the company's recent positive financial results as well as projected earnings through June 30, 2005. The company will continue to evaluate each quarter the amount, if any, of additional reduction of the valuation allowance that should be made. The impact of the reduction of

the valuation allowance will be to increase net income in the period the determination is made which is currently anticipated to be March 31, 2003.

Liquidity and Capital Resources

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At December 31, 2002, the Company had cash and cash equivalents on hand of \$8,931 representing an increase of \$2,765 from \$6,166 as of June 30, 2002. Net cash provided by operating activities during the six-month period ended December 31, 2002 of \$2,206 was primarily attributable to net income from operations of \$2,440 combined with increases in accounts payable, accrued expenses and deferred revenue, offset by an increase in accounts receivable, other current assets and inventory. Net cash used in investing activities during the six-month period ended December 31, 2002 of \$199 related to the capitalization of software costs and the purchase of property and equipment. Cash provided by financing activities during the six-month period ended December 31, 2002 reflects the proceeds from stock options exercised and purchases made through the Company's Employee Stock Purchase Plan, net of repayments on a note payable.

The Company's principal sources of liquidity at December 31, 2002, consisted of cash, accounts receivable, and vendor trade credit.

We believe our existing cash; cash equivalents and short-term investments will be sufficient to meet our cash requirements at least through the next twelve months. However, we may be required or could elect to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including our rate of revenue growth, the timing and extent of spending on support, product development efforts and expansion of sales and marketing, the timing of introductions of new products and enhancement to existing products, and market acceptance of our products. Other recent and possible future events that could also materially impact the Company's ability to successfully execute on its business plans are described in Information Relating to Forward Looking Statements of this Item on Form 10-Q.

We have no other agreements or arrangements for third parties to provide us with sources of liquidity and capital resources, including off balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial conditions and results of operations is based on our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. On an on-going basis, we evaluate significant estimates used in preparing our financial statements, including revenue recognition, bad debt, software development cost, inventory valuation, and reserve for deferred taxes. We based our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in preparing our consolidated financial statements:

Revenue Recognition

Revenue recognition rules for software companies are very complex. CyberGuard follows very specific and detailed guidelines in measuring revenue; however, certain judgments affect the application of our revenue policy. The discretion involved in this process makes revenue results difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in future operating losses.

We generate revenues through:

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- n Sales of product and services subscriptions indirectly through our reseller network at a discount from list price;

- n Sales of products and services subscriptions directly to our end users.

Service revenues primarily include the annual fee for maintenance, which is sold as part of our security solutions, and for subscription renewals from our existing customers and end users. These services provide our customers access to our worldwide support organization for product updates, general security information and technical support.

We recognize revenues for product sales only when a contract or agreement has been executed, delivery of the product has occurred, the fee is fixed and determinable and we believe collection is probable. While we generally recognize product revenue on product shipment, we defer revenues on product sales for value added resellers until the partners demonstrate consistency of payment within terms and no product returns for a three-month period. Service revenues are recognized ratably on a monthly basis over the service contract term.

Bad Debts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Significant judgment is required when we assess the ultimate realization of receivables, including the probability of collection and the credit-worthiness of each customer. In estimating the allowance for doubtful accounts, we analyze our accounts receivable aging, historical bad debts, customer credit-worthiness, current economic trends and other factors. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowance might be required.

Software Development Costs

The Company capitalizes costs related to the development of certain software products in accordance with Statement of Financial Accounting Standards No. 86, Accounting For the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed (SFAS No. 86) which requires capitalization to begin when technological feasibility has been established and ends when the product is available for general release to customers. Software development costs incurred prior to technological feasibility, defined by implementation of a beta project, are considered research and development costs and are expensed as incurred. Capitalized costs are amortized on a straight-line method over two years.

Inventory Valuation

Inventories consist primarily of component parts and computer hardware and are carried at the lower of cost, determined by the First-In-First-Out (FIFO) method, or market. We write our inventories down to estimated market value based on assumptions of our future demand, based on projected product releases and market conditions. Variation in market trends, customer preferences, introduction of new products (replacing existing products) or technological advances could, however, significantly affect these estimates and result in additional inventory write-downs.

Deferred Taxes

We have provided a valuation allowance for deferred tax assets, that cannot be currently recognized due to our cumulative losses. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize the deferred tax

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asset, in the future, an adjustment to the deferred tax asset would increase income in the period the determination was made.

Information Relating to Forward Looking Statements

Statements regarding future products, prospects, profitability, business plans and strategies, future revenues and revenue sources, future liquidity and capital resources, future computer network security market directions, future acceptance of the Company's products and possible growth in markets, as well as all other statements contained in this Report on Form 10-Q that are not purely historical are forward-looking statements.

Forward-looking statements are based upon assumptions and analyses made by the Company in light of current conditions, future developments and other factors the Company believes are appropriate in the circumstances, or information obtained from third parties and are subject to a number of assumptions, risks and uncertainties. Readers are cautioned that forward-looking statements are not guarantees of future performance and that the actual results might differ materially from those suggested or projected in the forward-looking statements. Accordingly, there can be no assurance that the forward-looking statements will occur or that results will not vary significantly from those described in the forward-looking statements. Some of the factors that might cause future actual events to differ from those predicted or assumed include: future advances in technologies and computer security; the Company's history of annual net operating losses and the financing of these losses through the sale of assets and newly issued Company securities; the Company's ability to execute on its business plans; the Company's dependence on outside parties such as its key customers and alliance partners; competition from major computer hardware, software, and networking companies; risk and expense of government regulation and effects on changes in regulation; the limited experience of the Company in marketing its products; uncertainties associated with product performance liability; risks associated with growth and expansion; global economic conditions, overall network security spending, risks associated with obtaining and maintaining patent and intellectual property right protection, uncertainties in availability of expansion capital in the future and other risks associated with capital markets, including the events of September 11, 2001 and its repercussions. In addition, certain events that have occurred also are factors that might cause future actual events to differ from those predicted or assumed, including: the impact of the restatement of financial results for the Company's fiscal year ended June 30, 1997 and quarters ended September 30, 1997, December 31, 1997 and March 31, 1998; the completion of the numerous organizational changes and the assembly of a new management team for CyberGuard; the outcome of a class action lawsuit against the Company relating to the restatement of financial results for the fiscal periods noted above. In addition, the forward-looking statements herein involve assumptions, risks and uncertainties, including, but not limited to economic, competitive, operational, management, governmental, regulatory, litigation and technological factors affecting the Company's operations, liquidity, capital resources, markets, strategies, products, prices and other factors discussed elsewhere herein and in the other documents filed by the Company with the Securities and Exchange Commission. Many of the foregoing factors are beyond the Company's control.

The Company's future success is based largely on its ability to develop and sell increasingly technologically advanced network security solutions in sufficient volume and at sufficient prices to become profitable on a consistent basis. In addition, the network security market is characterized by extremely rapid technological change, requiring rapid product development. The velocity of technological change has accelerated, and the Company believes that it is important to its future that it keeps pace with these changes. The Company believes that competition will continue to intensify in the rapidly evolving markets in which the Company is involved, and that the continued development of

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technologically advanced products will be necessary to keep our products current. The Company believes that its ability to generate adequate cash flow from operations will be critical to its future.

Item 3. Quantitative and Qualitative Disclosures Concerning Market Risk

We have limited exposure to financial market risks, including changes in interest rates. The fair value of our investments or related income would not be significantly impacted by a 100 basis point increase or decrease in interest rates due mainly to the short-term nature of the major portion of our investments. A fluctuation in interest rates would not significantly affect interest expense on debt obligations since a significant portion of the debt obligation is at a fixed rate of interest.

The Company uses the U.S. Dollar as its reporting currency for financial statement purposes. The Company conducts business in numerous countries around the world through its European subsidiary that uses the local currency to denominate its transactions. Therefore, the Company is subject to certain risks associated with fluctuating foreign currencies.

Due to the long-term nature of the Company's investment in this subsidiary, the translation adjustments resulting from these exchange rate fluctuations are excluded from the results of operations and recorded in a separate component of consolidated stockholders' equity. The Company monitors its currency exposure but does not hedge its translation exposure due to the high economic costs of such a program and the long-term nature of its investment in its European subsidiary.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Within the 90 days prior to the date of filing this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the assistance of the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), the Company's Disclosure Control Procedures Committee, and Company management, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. This evaluation also considered the proposed amendments to Rule 13a-14 described in Securities and Exchange Commission Release Nos. 33-8183 and 34-46701. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of the evaluation.

Limitations on the Effectiveness of Controls

The Company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. We have designed our disclosure controls procedures to provide a reasonable level of assurance of reaching our desired disclosure control objectives. We believe our disclosure controls and procedures are effective in reaching that level of reasonable assurance. However, the Company's management, including the CEO and CFO, does not expect that the Company's disclosure controls or internal controls will prevent all errors and all potential fraud. A control system, no matter

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how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II: OTHER INFORMATION**Item 1. Legal Proceedings****Litigation**

On August 24, 1998, the Company announced, among other things, that due to a review of its revenue recognition practices relating to distributors and resellers, it would restate prior financial results. After the August 24, 1998 announcement, twenty-five purported class action lawsuits were filed by alleged shareholders against the Company and certain former officers and directors. Pursuant to an order issued by the Court, these actions have been consolidated into one action, styled Stephen Cheney, et al. v. CyberGuard Corporation, et al., Case No. 98-6879-CIV-Gold, in the United States District Court, Southern District of Florida. On August 23, 1999, the plaintiffs filed a Consolidated and Amended Class Action Complaint. This action seeks damages purportedly on behalf of all persons who purchased or otherwise acquired the Company's common stock during various periods from November 7, 1996 through August 24, 1998. The complaint alleges, among other things, that as a result of accounting irregularities relating to the Company's revenue recognition policies, the Company's previously issued financial statements were materially false and misleading and that the defendants knowingly or recklessly published these financial statements which caused the Company's common stock prices to rise artificially. The action alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and SEC Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act. Subsequently, the defendants, including the Company, filed their respective motions to dismiss the Consolidated and Amended Class Action Complaint. On July 31, 2000, the Court issued a ruling denying the Company's and Robert L. Carberry's (the Company's CEO from June 1996 through August 1998) motions to dismiss. The court granted the motions to dismiss with prejudice for defendants William D. Murray (the Company's CFO from November 1997 through August 1998), Patrick O. Wheeler (the Company's CFO from April 1996 through October 1997), C. Shelton James (the Company's former Audit Committee Chairman), and KPMG Peat Marwick LLP (KPMG). On August 14, 2000, the plaintiffs filed a motion for reconsideration of that order. The Company filed an answer to the plaintiffs' Consolidated and Amended Class Action Complaint on August 24, 2000. On March 20, 2001, the Court ruled on the plaintiffs' motion for reconsideration that the previously dismissed defendants William D. Murray, Patrick O. Wheeler and C. Shelton James should not have been dismissed from the action and shall be defendants in this action under the control person liability claims under Section 20(a) of the Exchange Act, and that the plaintiffs may amend the Consolidated and Amended Class Action Complaint to bring claims against C. Shelton James under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. On April 5, 2001, the plaintiffs filed their Second Consolidated and Amended Class Action Complaint to include amended claims against C. Shelton James. On May 10, 2001, the Company filed an

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answer and affirmative defenses to plaintiffs' Second Consolidated and Amended Class Action Complaint. On August 14, 2002, the Court granted the plaintiffs' Motion for Class Certification and certified the class to include all investors who acquired the Company's common stock between November 7, 1996 and August 24, 1998 and were damaged by the purchase of such stock. The trial is scheduled for March 2004. The parties are currently conducting discovery.

The Company's obligation to indemnify its officers and directors under the aforementioned lawsuit is insured to the extent of the limits of the applicable insurance policies. The Company has notified its insurance carrier of the existence of the lawsuit, and the carrier has sent the Company a reservation of rights letter. The Company intends to vigorously defend this action, and believes that in the event that it is unsuccessful, insurance coverage will be available to defray a portion, or substantially all, of the expense of defending and settling the lawsuit or paying a judgment. However, the Company is unable to predict the ultimate outcome of the litigation. There can be no assurance that the Company will be successful in defending the lawsuit or, if unsuccessful, that insurance will be available to pay all or any portion of the expense of the lawsuit. If the Company is unsuccessful in defending the lawsuit and the insurance coverage is unavailable or insufficient, the resolution of the lawsuit could have a material adverse effect on the Company's consolidated financial position, results of operations, and cash flows. The Company's consolidated financial statements do not include any adjustments related to these matters. We are unable at this time to estimate the loss, if any, that the Company may incur if we are unsuccessful in defending this suit.

On September 16, 1999, the Company filed a lawsuit against KPMG and August A. Smith, the KPMG engagement partner. The lawsuit is pending in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Case No. 00-004102-CACE-14. On May 1, 2000, the Company filed the First Amended Complaint, alleging that KPMG failed to properly audit the Company's financial statements and provided inaccurate advice on accounting matters for fiscal years 1996, 1997 and 1998. The action alleges professional malpractice, breach of fiduciary duty, breach of contract and breach of implied duty of good faith, and seeks damages in excess of \$10 million. KPMG and Mr. Smith filed motions to dismiss, which were denied. In August 2000, KPMG and Mr. Smith filed their answers and KPMG filed counterclaims against the Company, alleging the Company's breach of contract, negligent misrepresentation and abuse of process, and seeking an unspecified amount of damages consisting of unpaid service fees and legal fees and costs. The Company filed an answer to KPMG's counterclaims and moved to dismiss KPMG's abuse of process counterclaim. On April 9, 2001, the Court dismissed the abuse of process counterclaim with prejudice. The parties are currently conducting discovery.

On November 14, 2002, the Company filed a lawsuit against Data Return Corporation in the United States District Court of the Northern District of Texas, alleging breach of contract, and seeking, among other remedies, damages of approximately \$4 million. On December 9, 2002, Data Return Corporation filed an answer and affirmative defenses, and also counterclaims against the Company, alleging breach of contract, breach of warranty, fraud, negligent misrepresentation and deceptive trade practices, and seeking unspecified damages. On December 30, 2002, CyberGuard filed its answer and affirmative defenses to the counterclaim and a motion to dismiss the fraud, negligent misrepresentation and deceptive trade practices counterclaims.

The Company is involved from time to time, in the ordinary course of its business, in various litigation relating to the conduct of its business. The Company believes that these other litigation matters will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Item 2. Changes in Securities and Use of Proceeds

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None

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

On December 5, 2002, the Company held its Annual Meeting of Shareholders at The Westin in Fort Lauderdale, Florida. William G. Scott and Daniel J. Moen were nominated as members to the Board of Directors for a period of three years and William D. Rubin was nominated as a member to the Board of Directors for a period of one year. Mr. Scott received 17,972,079 votes in favor of his appointment, while 52,207 shares were withheld, Mr. Moen received 17,972,025 votes in favor of his appointment, while 52,261 shares were withheld and Mr. Rubin received 17,971,803 votes in favor of his appointment, while 52,483 shares were withheld.

One other matter was brought for vote during the Annual Meeting: the ratification of Grant Thornton LLP as the Company's independent public accountants for the fiscal year ending June 30, 2003. The ratification of Grant Thornton LLP was passed with 17,923,591 votes in favor, 65,026 votes against, and 35,609 votes abstaining.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

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<u>Exhibit No.</u>	<u>Exhibit Description</u>
99.01	Certification by Scott J. Hammack, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.02	Certification by Michael D. Matte, Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- (b) Reports filed on Form 8-K during the quarter ended December 31, 2002: The Company filed no reports on Form 8-K during the quarter ended December 31, 2002.

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CERTIFICATIONS

I, Scott J. Hammack, certify that:

1. I have reviewed this quarterly report on Form 10-Q for CyberGuard Corporation;

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

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

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

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

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

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

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

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

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

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

Date: May 27, 2003

/S/ SCOTT J. HAMMACK

Scott J. Hammack

Chief Executive Officer

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I, Michael D. Matte, certify that:

1. I have reviewed this quarterly report on Form 10-Q for CyberGuard Corporation;

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

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

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

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

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

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

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

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

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

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

Date: May 27, 2003

/S/ MICHAEL D. MATTE

Michael D. Matte

Chief Financial Officer

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Index to Exhibits

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