

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

Form 10-Q

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Quarterly Period Ended July 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: 0-13351

NOVELL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0393339
(I.R.S. Employer
Identification No.)

1800 South Novell Place
Provo, Utah 84606
(Address of principal executive offices and zip code)

(801) 861-7000
(Registrant's telephone number, including area code)

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

YES NO

As of August 31, 2002, there were 364,412,913 shares of the Registrant's Common Stock outstanding.

Part I. Financial Information
Item 1. Financial Statements

NOVELL, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

<i>Amounts in thousands, except share and per share data</i>	<u>July 31, 2002</u> (Unaudited)	<u>October 31, 2001</u>
Assets		
Current assets:		
Cash and short-term investments	\$ 607,310	\$ 705,243
Receivables (less allowances of \$39,822 – July 31, 2002 and \$47,249 – October 31, 2001)	204,811	227,044
Inventories	231	947
Prepaid expenses	26,901	29,808
Deferred income taxes	22,098	34,595
Other current assets	<u>22,710</u>	<u>29,729</u>
Total current assets	884,061	1,027,366
Property, plant and equipment, net	459,687	496,620
Goodwill	167,310	187,795
Intangible assets	38,857	4,221
Long-term investments	94,657	114,971
Other assets	<u>73,223</u>	<u>73,033</u>
Total assets	<u>\$ 1,717,795</u>	<u>\$ 1,904,006</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 59,063	\$ 77,571
Accrued compensation	87,922	87,382
Accrued marketing liabilities	12,183	13,672
Other accrued liabilities	127,778	150,842
Income taxes payable	26,245	38,175
Deferred revenue	<u>239,929</u>	<u>243,261</u>
Total current liabilities	553,120	610,903
Minority interests	19,170	22,436
Stockholders' equity:		
Common stock, par value \$.10 per share: authorized – 600,000,000 shares:		
Issued --364,344,161 shares-July 31, 2002, 362,341,403 shares-October 31, 2001	36,434	36,234
Preferred stock, par value \$.10 per share: authorized – 500,000 shares, issued – 0 shares	--	--
Additional paid in capital	291,594	256,332
Retained earnings	830,335	985,486
Accumulated other comprehensive income (loss)	(3,389)	2,455
Other	<u>(9,469)</u>	<u>(9,840)</u>
Total stockholders' equity	<u>1,145,505</u>	<u>1,270,667</u>
Total liabilities and stockholders' equity	<u>\$ 1,717,795</u>	<u>\$ 1,904,006</u>

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended	
	July 31, 2002	July 31, 2001
<i>Amounts in thousands, except per share data</i>		
Net sales	\$ 282,273	\$ 249,084
Cost of sales	109,822	76,176
Gross profit	172,451	172,908
Operating expenses:		
Sales and marketing	90,125	100,013
Product development	41,492	47,976
General and administrative	29,566	28,101
Restructuring	--	30,392
Purchased in-process research and development	3,000	--
Total operating expenses	164,183	206,482
Income (loss) from operations	8,268	(33,574)
Other income, net		
Investment income	5,268	8,636
Other, net	1,962	1,870
Other income, net	7,230	10,506
Income (loss) before taxes	15,498	(23,068)
Income tax expense (benefit)	5,549	(3,794)
Net income (loss)	\$ 9,949	\$ (19,274)
Net income (loss) per share:		
Basic	\$ 0.03	\$ (0.06)
Diluted	\$ 0.03	\$ (0.06)
Weighted average shares outstanding:		
Basic	364,211	328,683
Diluted	364,247	328,683

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

	Nine Months Ended	
	July 31, 2002	July 31, 2001
<i>Amounts in thousands, except per share data</i>		
Net sales	\$ 833,985	\$ 734,874
Cost of sales	<u>340,219</u>	<u>210,255</u>
Gross profit	493,766	524,619
Operating expenses:		
Sales and marketing	261,660	338,335
Product development	122,976	147,388
General and administrative	90,946	77,347
Restructuring	19,100	30,392
Purchase in-process research and development	<u>3,000</u>	<u>--</u>
Total operating expenses	497,682	593,462
Loss from operations	(3,916)	(68,843)
Other income (loss), net		
Investment income (loss)	(9,323)	(104,710)
Other, net	<u>8,625</u>	<u>856</u>
Other income (loss), net	(698)	(103,854)
Loss before taxes	(4,614)	(172,697)
Income tax expense (benefit)	<u>6,835</u>	<u>(5,386)</u>
Net loss before cumulative effect of change in accounting principle	(11,449)	(167,311)
Cumulative effect of change in accounting principle	<u>(143,702)</u>	<u>(11,048)</u>
Net loss	<u>\$ (155,151)</u>	<u>\$ (178,359)</u>
Net loss per share - basic and diluted:		
Before cumulative effect of change in accounting principle	\$ (0.03)	\$ (0.52)
Cumulative effect of change in accounting principle	<u>(0.40)</u>	<u>(0.03)</u>
	<u>\$ (0.43)</u>	<u>\$ (0.55)</u>
Weighted average shares outstanding – basic and diluted:	363,131	322,913

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS

<i>Dollars in thousands</i>	Nine Months Ended	
	July 31, 2002	July 31, 2001
Cash flows from operating activities		
Net loss	\$ (155,151)	\$ (178,359)
Adjustments to reconcile net loss to net cash provided by operating activities		
Gain on sale of fixed assets	(8,762)	--
Depreciation and amortization	49,175	66,995
Loss on impaired goodwill	143,702	--
Loss on impaired investments and fixed assets	29,839	152,806
Non-cash restructuring charges	16,426	19,185
Purchased in-process research and development	3,000	--
Decrease in receivables	29,346	43,392
Decrease in inventories	716	1,554
Decrease (increase) in prepaid expenses	4,756	(5,085)
Decrease (increase) in deferred income taxes	963	(8,339)
Decrease in other current assets	7,656	9,013
Decrease in accounts payable	(21,564)	(23,905)
Decrease in current liabilities, net	(78,168)	(26,172)
(Decrease) increase in deferred revenue	<u>(3,332)</u>	<u>10,494</u>
Net cash provided by operating activities	18,602	61,579
Cash flows from financing activities		
Issuance of common stock, net	6,861	5,528
Repurchase of common stock	<u>--</u>	<u>(64,954)</u>
Net cash provided by (used in) financing activities	6,861	(59,426)
Cash flows from investing activities		
Expenditures for property, plant and equipment	(18,676)	(25,044)
Proceeds from the sale of property, plant and equipment	16,050	--
Purchases of short-term investments	(1,191,184)	(642,197)
Maturities of short-term investments	907,134	546,823
Sales of short-term investments	425,534	103,413
Proceeds from Volera minority shareholders	--	25,975
Cash acquired from acquisitions – SilverStream in 2002, Cambridge in 2001	108,286	72,358
Cash paid for acquisition of SilverStream	(210,847)	--
Expenditures for long-term investments	(7,882)	(36,523)
Other	<u>(2,955)</u>	<u>(14,006)</u>
Net cash provided by investing activities	25,460	30,799
Total increase in cash and cash equivalents	50,923	32,952
Cash and cash equivalents - beginning of period	<u>337,927</u>	<u>289,537</u>
Cash and cash equivalents - end of period	388,850	322,489
Short-term investments - end of period	<u>218,460</u>	<u>364,454</u>
Cash and short-term investments - end of period	<u>\$ 607,310</u>	<u>\$ 686,943</u>

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
NOTES TO CONSOLIDATED UNAUDITED CONDENSED FINANCIAL STATEMENTS

A. Quarterly Financial Statements

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 financial statements and accompanying notes. As discussed under the subheading "Critical Accounting Policies" in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," actual results could differ materially from those estimates. The accompanying consolidated unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q but do not include all of the information and footnotes required by generally accepted accounting principles and should, therefore, be read in conjunction with the Company's fiscal 2001 Annual Report on Form 10-K. These financial statements do include all normal recurring adjustments that the Company believes necessary for a fair presentation of the statements. The interim operating results are not necessarily indicative of the results for a full year. Certain reclassifications, none of which affected net loss, have been made to the prior years' amounts in order to conform to the current year's presentation.

B. Acquisitions

Pursuant to the terms of an Agreement and Plan of Merger, dated as of June 9, 2002 by and among Novell, Delaware Planet, Inc., a wholly owned subsidiary of Novell, and SilverStream Software, Inc., a Delaware corporation ("SilverStream"), Delaware Planet commenced a cash tender offer on June 18, 2002 to acquire all of the outstanding shares of SilverStream common stock at a price of \$9.00 per share. On July 17, 2002, Delaware Planet announced the completion of its cash tender offer, pursuant to which it purchased almost all outstanding shares of SilverStream common stock at a price of \$9.00 per share. On July 19, 2002, Novell completed its acquisition of SilverStream by merging Delaware Planet into SilverStream. As a result of the merger, each share of SilverStream common stock that was not tendered in the tender offer now represents the right to receive \$9.00 in cash, without interest.

SilverStream provides software products and services that enable organizations to more effectively conduct business using the Web. SilverStream's products and services leverage the power of standards such as Java and XML to unify relevant information and services while enabling businesses to leverage prior technology investments. They also help customers rapidly deliver Web-based applications that are scalable, reliable and secure. The Company acquired SilverStream to further its development of Web services products and services and to enhance its current Web services and product offerings.

At the closing date of the merger, there were 23,427,448 shares of SilverStream outstanding resulting in a total cash acquisition price of \$210.8 million. Direct transaction costs are estimated to be \$4.0 million and SilverStream stock options assumed, both vested and unvested, totaled \$28.6 million.

With respect to stock options assumed as a part of the merger, all SilverStream options, vested and unvested, were exchanged for Novell options with the same terms and vesting characteristics. The fair value of these options was included in the acquisition purchase price. The portion of the intrinsic value of unvested options that will be earned over the remaining vesting period of those options has been deducted from the fair value of the unvested options. This deferred compensation will be amortized over the remaining vesting period of approximately two years, in accordance with Financial Accounting Standards Board Interpretation Number 44 ("FIN 44"). In total, options to purchase 4.9 million shares of SilverStream common stock were converted into options to purchase 15.0 million shares of Novell stock using a conversion ratio of 3.0518.

The fair value of the options was determined using the Black-Scholes model using the following assumptions:

- Fair market value of the underlying shares was based on the average closing price of Novell’s common stock on June 10, 2002 and the three days prior and subsequent to that date.
- Expected life of 2-5 years
- Expected volatility of 80%
- Risk free interest rate of 5%
- Expected dividend rate of 0%

The value of the acquisition was preliminarily allocated as follows:

<i>(in thousands)</i>	<u>Estimated Acquisition Cost</u>	<u>Asset Life (in years)</u>
Adjusted net tangible assets acquired	\$ 97,833	N/A
Deferred compensation	4,826	2 years
Intangible assets		
Purchased in-process research and development	3,000	expensed in the third quarter of fiscal 2002
Developed technology	19,800	3 years
Trademarks / trade names	2,200	indefinite life
Goodwill	<u>115,771</u>	N/A
	<u>\$ 243,430</u>	

The allocation will be adjusted over the next twelve months as integration plans are finalized, as allowed by Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combinations,” issued by the Financial Accounting Standards Board (“FASB”) in June 2001. There are no other outstanding contingencies that could affect the allocation.

Goodwill from the acquisition resulted from the Company’s belief that the technology SilverStream had developed is valuable to its Web services strategy. The Company also believes it was more beneficial to acquire such technology rather than develop it in-house. The goodwill from the SilverStream acquisition has been allocated to the Company’s product segment because the eXtend™ product suite will be included with the Net Directory Services group of products. In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” also issued by the FASB in June 2001, the Company will not amortize the goodwill or intangibles with indefinite lives associated with this acquisition. The Company will review these assets periodically for potential impairment issues. Goodwill is not deductible for tax purposes.

Net tangible assets of SilverStream consisted mainly of cash and cash equivalents, accounts receivable, fixed assets, accounts payable, and other liabilities.

The value of deferred compensation of approximately \$4.8 million represents the intrinsic value of the unvested options assumed by Novell and was determined under the guidance of FIN 44.

The \$3.0 million of in-process research and development pertains to acquired research and development on the eXtend line of products that are not currently technologically feasible, meaning they have not reached the working model stage and do not contain all of the major functions planned for the product nor are they ready for initial customer testing. The estimated amount of the in-process research and development charge represents a preliminary estimate and represents technology related to replacement and enhancement to be included in the next versions of the SilverStream’s eXtend product line. Shortly before the acquisition, SilverStream released its latest version of each of its products in the eXtend line: Application Server, Composer, Workbench, and Director. Therefore, there was minimal research and development in process. In-process research and development was valued based on discounting forecasted cash flows directly from the related products. Completion of development on the future upgrades of these products is dependant upon the Company delivering on its web services strategy and successfully integrating SilverStream. The in-process research and development does not have any alternative future use and did not otherwise qualify for capitalization.

To determine the value of the developed technology, the expected future cash flow attributable to the existing product technology, the family of eXtend products, which are currently shipping and can be combined with Novell products or services, was discounted taking into account risk associated with these assets relative to the in-process research and development. The analysis resulted in a valuation of approximately \$19.8 million for developed technology, which has reached technological feasibility.

The value of trademarks and trade names was determined based on assigning a royalty rate to the revenue streams that were expected from the products using the eXtend trade names. The royalty rate was determined based on trade name recognition, marketing support and contribution of the trade name's value relative to the revenue drivers. The pre-tax royalty rates of 0.5 percent to the product revenues were then discounted to a present value, resulting in a valuation of approximately \$2.2 million.

The Company's statement of operations includes SilverStream results for the period July 20, 2002 through July 31, 2002. The unaudited pro forma consolidated statement of operations data for the nine months ended July 31, 2002 and 2001 set forth below gives effect to the acquisition of SilverStream as if it had occurred on November 1, 2000. The unaudited pro forma results for these periods include an adjustment to reflect amortization of intangibles recorded in conjunction with the acquisition and the adoption of FAS 142 at the beginning of each of these periods.

<i>Amounts in thousands, except per share data</i>	<u>Nine months ended July 31, 2002</u>	<u>Nine months ended July 31, 2001</u>
Revenue	\$ 861,841	\$ 791,957
Net income (loss) before accounting change	(95,584)	(176,811)
Net income (loss)	(239,286)	(190,859)
Earnings (loss) per share – Basic and Diluted	\$ (0.66)	\$ (0.59)

C. Cash and Short-term Investments

The Company considers all highly liquid debt instruments purchased with a term to maturity of three months or less to be cash equivalents. Short-term investments are widely diversified, consisting primarily of investment grade securities that either mature within the next 12 months or have other characteristics of short-term investments such as the following. Fixed income securities are included in short-term investments and have contractual maturities ranging from zero to seven years. Securities that are anticipated to be used for current operations are classified as short-term investments, even though some maturities may extend beyond one year. Money market preferreds, included in short-term investments, have contractual maturities of less than 180 days. No other short-term investments have contractual maturities. All marketable debt and equity securities that are included in cash and short-term investments are considered available-for-sale and are carried at fair market value. The unrealized gains and losses related to these securities are included in Other Comprehensive Income (Loss), net of tax, after any applicable tax valuation allowances. Fair market values are based on quoted market prices where available; if quoted market prices are not available, the fair market values are based on quoted market prices of similar instruments of companies that are comparable in size, product offerings, and market sector. When securities are sold, their cost is determined based on the specific identification method. As of July 31, 2002, the Company had \$3.3 million of cash restricted in support of outstanding letters of credit.

The following is a summary of cash and short-term investments, all of which are considered available-for-sale.

<i>(Amounts in thousands)</i>	Cost at <u>July 31, 2002</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair Market Value at <u>July 31, 2002</u>
Cash and cash equivalents:				
Cash	\$ 159,940	\$ --	\$ --	\$ 159,940
U.S. government and agency securities	42,821	--	--	42,821
Corporate debt	50,795	--	--	50,795
Money market funds	<u>135,294</u>	<u>--</u>	<u>--</u>	<u>135,294</u>
Total cash and cash equivalents	388,850	--	--	388,850
Short-term investments:				
U.S. government and agency securities	62,105	519	--	62,624
Corporate debt	148,125	2,322	(272)	150,175
Money market preferreds	--	--	--	--
Equity securities	<u>8,835</u>	<u>313</u>	<u>(3,487)</u>	<u>5,661</u>
Total short-term investments	219,065	3,154	(3,759)	218,460
 Total cash and short-term investments	 <u>\$ 607,915</u>	 <u>\$ 3,154</u>	 <u>\$ (3,759)</u>	 <u>\$ 607,310</u>
<i>(Amounts in thousands)</i>	Cost at <u>October 31, 2001</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair Market Value at <u>October 31, 2001</u>
Cash and cash equivalents:				
Cash	\$ 156,088	\$ --	\$ --	\$ 156,088
Corporate debt	3,995	--	--	3,995
Money market funds	<u>177,844</u>	<u>--</u>	<u>--</u>	<u>177,844</u>
Total cash and cash equivalents	337,927	--	--	337,927
Short-term investments:				
State and local government debt	151,459	5,074	--	156,533
Corporate debt	138,679	2,255	(9)	140,925
Money market preferreds	17,034	--	(34)	17,000
Mutual funds	41,014	--	--	41,014
Equity securities	<u>12,336</u>	<u>538</u>	<u>(1,030)</u>	<u>11,844</u>
Total short-term investments	360,522	7,867	(1,073)	367,316
 Total cash and short-term investments	 <u>\$ 698,449</u>	 <u>\$ 7,867</u>	 <u>\$ (1,073)</u>	 <u>\$ 705,243</u>

During the first nine months of fiscal 2002, the Company realized gains of \$7.4 million and realized losses of \$1.0 million on the sale of short-term securities. During the first nine months of fiscal 2001, the Company realized gains of \$10.7 million and realized losses of \$0.8 million from the sale of short-term securities.

The Company did not record any impairment losses on short-term investments during the first nine months of fiscal 2002. During the first nine months of fiscal 2001 the Company recorded \$16.5 million of impairment losses related to short-term investments whose decline in market value was determined to be other than temporary. The Company reviews all of its investments for impairment and recognizes impairment losses as appropriate.

D. Long-term Investments

The primary components of long-term investments are investments made through the Novell Venture account, Cambridge Technology Capital Fund I L.P. ("CTC I"), and direct strategic long-term equity investments. Long-term investments are initially recorded at cost and are written down when they become impaired.

Investments made through the Novell Venture account generally are in private companies, primarily small capitalization stocks in the high-technology industry sector, and funds managed by venture capitalists. Investments made through CTC I generally are in expansion-stage, private companies providing products and

services within the technology industry. The value of the investments made through the Novell Venture account and CTC I is dependent on the performance, successful acquisition, and/or initial public offering of the investees.

The Company routinely reviews its investments in private securities and venture funds for impairment. The Company analyzes each investment based on factors such as the investee’s financial statements, the business environment in which the investee operates, as well as information obtained from the investee regarding its operations. During the first nine months of fiscal 2002 and 2001, the Company recognized impairment losses on long-term investments totaling \$29.8 million and \$133.2 million, respectively.

E. Goodwill and Intangible Assets

The following is a summary of goodwill:

<i>(Amounts in thousands)</i>	<u>July 31, 2002</u>	<u>October 31, 2001</u>
IT consulting related goodwill	\$ --	\$ 138,211
Celerant related goodwill	42,500	42,500
Product related goodwill	<u>124,810</u>	<u>7,084</u>
Total goodwill	<u>\$ 167,310</u>	<u>\$ 187,795</u>

Total goodwill at July 31, 2002 included goodwill \$115.8 million from the SilverStream acquisition, which is included in the product segment.

In June 2001, the FASB issued SFAS No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 142 supersedes APB Opinion No. 17, “Intangible Assets,” and states that goodwill and other intangible assets with indefinite lives are no longer amortized but are reviewed for impairment annually, or more frequently if impairment indicators arise. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. The provisions under SFAS No. 142 relating to the discontinuance of amortization of goodwill and indefinite lived intangible assets are effective for assets acquired after June 30, 2001, and for assets acquired prior to June 30, 2001, upon adoption of the statement. Novell elected to adopt this statement beginning in the first quarter of fiscal 2002, and discontinued amortization of goodwill acquired prior to July 1, 2001. The Company will review goodwill and intangibles for impairment on a periodic basis. The following table shows what net income would have been had the provision been applied at the beginning of fiscal 2001:

<i>(Amounts in thousands)</i>	<u>Quarter ended July 31, 2002</u>	<u>Quarter ended July 31, 2001</u>	<u>Year-to-date July 31, 2002</u>	<u>Year-to-date July 31, 2001</u>
Income (loss) before extraordinary item				
As reported	\$ 9,949	\$ (19,274)	\$ (11,449)	\$(167,311)
Pro forma		\$ (18,308)		\$(165,349)
Net income (loss)				
As reported	\$ 9,949	\$ (19,274)	\$(155,151)	\$(178,359)
Pro forma		\$ (18,308)		\$(176,397)
Basic and diluted income (loss) per share				
As reported	\$ 0.03	\$ (0.06)	\$ (0.43)	\$ (0.55)
Pro forma		\$ (0.06)		\$ (0.55)

SFAS No. 142 also requires companies to perform an impairment test within six months of adopting the statement. Steps required in the impairment test include: Step 1 - identifying reporting units, assigning assets and liabilities to the reporting units, assigning goodwill to reporting units, and determining if the fair value of each reporting unit is less than its carrying amount. If the fair value is below carrying value, Step 2 – determining the impairment amount – is performed. The Company completed this test during the second quarter of fiscal 2002. Through Step 1, the Company reviewed its three operating segments to identify its four reporting units; Product, Volera, Inc., Information Technology (IT) Consulting, and Management Consulting. The Company’s consulting segment was broken down into two reporting units, IT Consulting and Management Consulting, because they are managed and reported separately within the Company and they do not share the

same customer base or offer similar services. Based on the present value of expected future cash flows and analysis of qualitative factors, the Company determined that the IT Consulting unit had a fair value that was less than its carrying amount. Step 2 was then performed for this unit to determine the impairment amount, resulting in a transitional goodwill impairment loss of \$143.7 million as of November 1, 2001, which was recorded as the cumulative effect of an accounting change in the Company's Consolidated Statements of Operations. The decline in fair value of the IT consulting unit was primarily due to a softening in the consulting and technology markets as well as the global economy causing a sharp decline in IT consulting revenue and profitability.

The changes in the carrying amount of goodwill for the nine months ended July 31, 2002 are as follows:

<i>(Amounts in thousands)</i>	<u>Product</u>	<u>Volera</u>	<u>IT Consulting</u>	<u>Management Consulting</u>	<u>Total</u>
Balance as of November 1, 2001	\$ 7,084	\$ --	\$ 143,702	\$ 42,500	\$ 193,286
Acquisitions during the year	117,726	--	--	--	117,726
Impairment of goodwill	<u>--</u>	<u>--</u>	<u>(143,702)</u>	<u>--</u>	<u>(143,702)</u>
Balance as of July 31, 2002	<u>\$ 124,810</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 42,500</u>	<u>\$ 167,310</u>

The following is a summary of intangible assets:

<i>(Amounts in thousands)</i>	<u>July 31, 2002</u>	<u>October 31, 2001</u>
Developed technology	\$ 35,275	\$ 4,221
Trade names	<u>3,582</u>	<u>--</u>
Total intangible assets	<u>\$ 38,857</u>	<u>\$ 4,221</u>

Developed technology relates primarily to technology acquired as a part of the acquisition of SilverStream's eXtend product line of shipping products. Also included are several other small product-related acquisitions. Developed technology is amortized over three years. Trade names relate to the SilverStream individual product names, which Novell continues to use. This asset has an indefinite life and therefore is not amortized but will be reviewed for impairment at least annually. Financial Accounting Standards No. 109 ("FAS 109"), "Accounting for Income Taxes," requires that a deferred tax liability be established for identifiable intangible assets. FAS 109 also prohibits the recognition of a deferred tax liability for non-deductible goodwill.

F. Income Taxes

The Company's estimated effective tax rate for the first nine months of fiscal 2002 is 30% on income before the write-off of purchased in-process research and development, investment impairment, and the effect of the cumulative change in accounting principle. The rate differs from the effective tax rate of 21% for fiscal 2001 primarily as a result of changes in the forecasted income before taxes for fiscal 2002. There is no tax benefit for the investment impairment because corporations can only use capital losses to offset capital gains. The Company cannot be assured at this time that it can generate sufficient capital gains during the five-year carry-over period to recognize the tax benefit of this capital loss. Accordingly, a valuation allowance has been established for the investment impairments taken in the second quarter of fiscal 2002. There is no tax benefit for the change in accounting method since goodwill is not deductible for tax purposes in this situation. The write-off of purchased in-process research and development is not deductible for tax purposes.

The Company paid cash amounts for income taxes of \$14.7 million in the first nine months of fiscal 2002 and \$9.2 million during the same period of fiscal 2001.

G. Line of Credit

The Company currently has a \$10 million unsecured revolving bank line of credit. The line of credit expires on March 1, 2003. The line can be used for either letter of credit or working capital purposes and is subject to the terms of a credit agreement containing financial covenants and restrictions, none of which are expected to significantly affect the Company's operations. At July 31, 2002, there were standby letters of credit of \$6.6 million outstanding under this agreement. The Company has an additional \$3.4 million in outstanding letters of credit at other banks collateralized by \$3.3 million cash.

H. Restructuring

During the second quarter of fiscal 2002, the Company recorded a pre-tax restructuring charge of approximately \$20.4 million. The charge was a result of the Company's continued move towards its business strategy of becoming a solutions provider, addressing changes in the market due to technology changes, and becoming more customer focused. Specific actions taken included reducing the Company's workforce worldwide by approximately 50 employees (less than 1%), consolidating facilities, closing offices in unprofitable locations, and disposing of excess property and equipment. The following table summarizes the activity during fiscal 2002 related to the second quarter fiscal 2002 restructuring.

	<u>Total</u> <u>Restructuring Charge</u>	<u>Cash</u> <u>Payments</u>	<u>Non-Cash</u> <u>Charges</u>	<u>Balance at</u> <u>July 31, 2002</u>
(Amounts in thousands)				
Severance and benefits	\$ 14,748	\$ (7,743)	\$ (1,318)	\$ 5,687
Excess facilities and property and equipment	5,146	(556)	--	4,590
Other restructuring-related costs	<u>492</u>	<u>(3)</u>	<u>(150)</u>	<u>339</u>
	<u>\$ 20,386</u>	<u>\$ (8,302)</u>	<u>\$ (1,468)</u>	<u>\$ 10,616</u>

As of July 31, 2002, the remaining balance of the second quarter 2002 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the next four quarters, and redundant facilities and other fixed contracts, which will be paid over the respective remaining contract terms.

At the end of the fourth quarter of fiscal 2001, the Company recorded \$50.7 million of pre-tax, restructuring charges resulting from changes in general market conditions, changing customer demands, and the Company's evolution of its business strategy, all of which required the Company to restructure its operations. This business strategy focuses on Net business solutions along with Net services software designed to secure and power the networked world across leading operating systems. The execution of this strategy included refining the Company's consulting initiatives, refocusing research and development efforts, defining sales and marketing efforts to be more customer and solutions oriented, and adjusting the overall cost structure given current revenue levels and the Company's direction.

Specific actions included reducing the Company's workforce worldwide by approximately 1,100 employees (approximately 16%), consolidating excess facilities and disposing of excess property and equipment, terminating a management consulting contract that no longer fit with the Company's strategic focus, and abandoning and writing off technologies that no longer fit within the Company's new strategy. The Company also realigned its remaining resources to better manage and control its business.

The following table summarizes the costs and activities during the first nine months of fiscal 2002, related to the fourth quarter 2001 restructuring.

	<u>Balance at October 31, 2001</u>	<u>Cash Payments</u>	<u>Non-Cash Charges / Adjustments</u>	<u>Balance at July 31, 2002</u>
<i>(Amounts in thousands)</i>				
Severance and benefits	\$ 32,793	\$ (26,646)	\$ (4,000)	\$ 2,147
Excess facilities and property and equipment	10,896	(5,271)	1,970	7,595
Other restructuring-related costs	<u>911</u>	<u>(226)</u>	<u>—</u>	<u>685</u>
	<u>\$ 44,600</u>	<u>\$ (32,143)</u>	<u>\$ (2,030)</u>	<u>\$ 10,427</u>

As of July 31, 2002, the remaining balance of the fourth quarter 2001 restructuring charge included accrued liabilities largely related to severance and benefits, which will be paid out during fiscal 2002, and redundant facilities costs, which will be paid over the respective remaining lease terms.

During the third quarter of fiscal 2001, the Company recorded a restructuring charge of approximately \$30.4 million, pre-tax, as a result of the Company's acquisition of Cambridge Technology Partners ("Cambridge") and changes in the Company's business to move towards a Net business solutions strategy.

Specific actions included reducing the Company's workforce worldwide by approximately 280 employees (approximately 5% before the addition of Cambridge) across all functional areas, consolidating facilities and disposing of excess property and equipment, abandoning and writing off technologies that no longer fit within the integrated Company's new strategy, and discontinuing unprofitable product lines. The following table summarizes the activity during the first nine months of 2002, related to the third quarter 2001 restructuring costs.

	<u>Balance at October 31, 2001</u>	<u>Cash Payments</u>	<u>Non-Cash Charges</u>	<u>Balance at July 31, 2002</u>
<i>(Amounts in thousands)</i>				
Severance and benefits	\$ 3,377	\$ (2,128)	\$ —	\$ 1,249
Abandoned technology	211	(211)	—	—
Excess facilities and property and equipment	9,736	(5,191)	—	4,545
Exit unprofitable product lines	486	(486)	—	—
Other restructuring-related costs	<u>527</u>	<u>(340)</u>	<u>—</u>	<u>187</u>
	<u>\$ 14,337</u>	<u>\$ (8,356)</u>	<u>\$ —</u>	<u>\$ 5,981</u>

As of July 31, 2002, the remaining balance of the third quarter 2001 restructuring charge included accrued liabilities largely related to severance benefits and excess facilities costs, which will be paid over the respective remaining lease terms.

During the second quarter of fiscal 2002, the Company also released approximately \$1.3 million of excess accruals related to a fiscal 2000 restructuring, which reduced the restructuring costs reflected on the statement of operations for the nine months ended July 31, 2002. These excess accruals relate to facilities and legal costs that were not required.

I. Commitments and Contingencies

On December 21, 2001, Novell formed a venture capital fund, Novell Technology Capital Fund I, L.P. (the "Fund"), and related entities that include Novell Technology GPLP I, L.P. ("GPLP"), the general partner of the Fund. Subsequent to the end of the third quarter of fiscal 2002, due to the difficulty of raising funds in the current market conditions, Novell decided not to go forward with this initiative and is in the process of dissolving the Fund. Novell had committed to an aggregate investment of \$15 million in the Fund and in GPLP, from which it will be released. Mr. Messman, a director of Novell and Novell's Chief Executive Officer and

President, had committed to an investment in the Fund as a limited partner. Mr. Linsalata, Novell's Senior Vice President, Venture Investments, had committed to an investment in the Fund as a limited partner, and to a limited partnership investment in GPLP. Additionally, Mr. Linsalata would have been entitled to a portion of the amounts allocable to GPLP by the Fund. No amounts have been distributed by the Fund or GPLP. The financial and operating results of the Fund, GPLP and other related entities have been consolidated in Novell's financial statements for the third quarter of fiscal 2002.

The Board of Directors also established the Novell Venture account within Novell's investment portfolio for the purpose of making investments in private companies, mainly small capitalization stocks in the high-technology industry sector, and in funds managed by venture capitalists for the promotion of the Company's business and strategic objectives. As of July 31, 2002, the Company had investments of \$35.7 million in private companies and \$56.5 million in externally managed venture capital funds, and had commitments to the externally managed venture capital funds to contribute an additional \$77.5 million over the next two to five years, as requested by the fund managers. Novell, through its acquisition of Cambridge, also owns both limited and general partnership interests in the Cambridge Technology Capital Fund I ("CTC I") entitling it to approximately 24% of CTC I's income and expenses. As of July 31, 2002, the Company had an investment balance of \$1.4 million in CTC I and had commitments to contribute an additional \$300,000 through 2007.

In May 2002, France Telecom SA and U.S. Philips Corporation, alleged co-owners of a U.S. patent, filed suit in the U.S. District Court, District of Delaware, against Novell. The plaintiffs allege that Novell's NetWare client software infringes the patent. In the suit, the plaintiffs seek unspecified monetary damages and an injunction prohibiting infringement of the patent. Novell intends to vigorously defend itself. This litigation is in its early stages. Although there can be no assurance as to the ultimate disposition of the suit, Novell does not believe that the resolution of this litigation will have a material adverse effect on its financial position, results of operations, or cash flows.

SilverStream and several of its former officers and directors, as well as the underwriters who handled SilverStream's public offerings, are named as defendants in several class action complaints that have been filed on behalf of certain of former stockholders of SilverStream who purchased securities between August 16, 1999 and December 6, 2000. These complaints allege violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. In particular, they allege, among other things, that there was undisclosed compensation received by the underwriters of SilverStream's initial and secondary public offerings. The plaintiffs are seeking monetary damages, statutory compensation and other relief that may be deemed appropriate by the court. The plaintiffs have brought similar actions against a large number of other issuers and underwriters, making similar allegations. A Consolidated Amended Complaint was filed, in the U.S. District Court, Southern District of New York, on April 19, 2002. All issuers, including SilverStream, filed a Motion to Dismiss on July 15, 2002. Novell believes that SilverStream and the individual defendants have meritorious defenses to the claims made in the complaints and intends to contest the lawsuits vigorously.

In February 1998, a suit was filed in the U.S. District Court, District of Utah, against Novell and certain of its officers and directors, alleging violation of federal securities laws by concealing the true nature of Novell's financial condition and seeking unspecified damages. The lawsuit was brought as a purported class action on behalf of purchasers of Novell common stock from November 1, 1996 through April 22, 1997. After a first dismissal and a subsequent amendment to the complaint, the Federal District Judge dismissed the amended complaint with prejudice for failure to state a claim. The plaintiffs have filed a Notice of Appeal to the Tenth Circuit Court of Appeals and Novell intends to vigorously defend to uphold the Federal District Court's ruling. While there can be no assurance as to the ultimate disposition of the lawsuit, Novell does not believe that the resolution of this litigation will have a material adverse effect on its financial position, results of operations, or cash flows.

In January 1995, Lantec, Inc. filed suit against Novell in the U.S. District Court, the District of Utah, for alleged anti-trust violations arising from Novell's acquisition of the GroupWise technology. The plaintiffs were seeking to demonstrate damages of \$300 million. On April 19, 2001, the judge ruled in favor of Novell and dismissed the entire complaint. The plaintiff filed a Notice of Appeal to the Tenth Circuit Court of Appeals and Novell intends to vigorously defend to uphold the Federal District Court's ruling. While there can be no assurance as to

the ultimate disposition of the lawsuit, Novell does not believe that the resolution of this litigation will have a material adverse effect on its financial position, results of operations, or cash flows.

The Company is a party to a number of legal claims arising in the ordinary course of business. The Company believes the ultimate resolution of these claims will not have a material adverse effect on its financial position, results of operations, or cash flows.

J. Segment Information

The Company is organized and operates as three business segments: product, consulting, and Volera, Inc. The Company's products and services are sold throughout the world. The Company's offerings within the product segment are sold domestically via direct, OEM, reseller, and distributor channels, and internationally are sold directly and through distributors who sell to dealers and end users. The following is a description of each of the three segments:

- Product – includes Net Management Services products (Directory-Enabled OS, Management and Collaboration products, and UNIX royalties), Net Directory Services and other directory products, and product-related customer service, support, and education. Products in this segment are packaged under the names NetWare, ZEN, GroupWare, eDirectory, DirXML, iChain, Single Sign On, eXtend (SilverStream product suite).
- Consulting – includes Novell and Cambridge IT services consulting and Celerant management consulting.
- Volera, Inc. – Novell's majority-owned subsidiary, which provides Content Distribution Network software.

Beginning November 1, 2001, the performance of the Company is evaluated by the Chief Executive Officer and the Worldwide Management Committee, the Company's chief decision makers, based on the review of revenue, segment gross margin, and segment income (loss) from operations for each of the segments above. Performance is also evaluated based on revenue results by geographic region. Separate financial information is not evaluated by business segment in regards to asset allocation. Except for net sales, operating results by segment are not available for the third quarter and year-to-date fiscal 2001. Prior to the acquisition of Cambridge, the Company operated in one segment and did not maintain operating results for the current segments. Operating results, other than net sales, were available on a total company basis only. As the Company continues to consolidate its operations, it will evaluate how it should most appropriately manage its business and may make changes to its operating segments accordingly.

Operating Results by Segment

Quarter ended July 31, 2002 <i>(Amounts in thousands)</i>	<u>Product</u>	<u>Consulting</u>	<u>Volera</u>	<u>Total Novell</u>
Net sales	\$ 206,153	\$ 74,155	\$ 1,965	\$ 282,273
Direct consulting cost of sales		<u>58,315</u>		58,315
Consulting contribution margin		15,840		
Other cost of sales	<u>39,530</u>	<u>11,002</u>	<u>975</u>	<u>51,507</u>
Gross profit	166,623	4,838	990	172,451
Segment operating expenses	<u>130,157</u>	<u>24,843</u>	<u>6,183</u>	<u>161,183</u>
Segment income (loss) from operations	<u>\$ 36,466</u>	<u>\$ (20,005)</u>	<u>\$ (5,193)</u>	11,268
Unallocated operating expenses				<u>3,000</u>
Income from operations				<u>\$ 8,268</u>

Quarter ended July 31, 2001 <i>(Amounts in thousands)</i>	<u>Product</u>	<u>Consulting</u>	<u>Volera</u>	<u>Total Novell</u>
Net sales	\$ 209,750	\$ 37,109	\$ 2,225	\$ 249,084
Year-to-date July 31, 2002 <i>(Amounts in thousands)</i>	<u>Product</u>	<u>Consulting</u>	<u>Volera</u>	<u>Total Novell</u>
Net sales	\$ 602,519	\$ 225,968	\$ 5,498	\$ 833,985
Direct consulting cost of sales		<u>186,413</u>		186,413
Consulting contribution margin		39,555		
Other cost of sales	<u>115,086</u>	<u>35,956</u>	<u>2,764</u>	<u>153,806</u>
Gross profit (loss)	487,433	3,599	2,734	493,766
Segment operating expenses	<u>377,575</u>	<u>75,426</u>	<u>19,925</u>	<u>472,926</u>
Segment income (loss) from operations	<u>\$ 109,858</u>	<u>\$ (71,827)</u>	<u>\$ (17,191)</u>	20,840
Unallocated operating expenses				<u>24,756</u>
Loss from operations				<u>\$ (3,916)</u>
	<u>Product</u>	<u>Consulting</u>	<u>Volera</u>	<u>Total Novell</u>
Year-to-date July 31, 2001 <i>(Amounts in thousands)</i>				
Net sales	\$ 664,067	\$ 64,874	\$ 5,933	\$ 734,874

Direct consulting cost of sales includes salaries, benefits, and project related travel expenses for consultants (reimbursable and non-reimbursable), fees paid to subcontractors for work performed on projects, and other expenses incurred specifically for consulting projects. Other cost of sales for consulting includes consulting costs not directly attributable to a project, including allocations for facilities and information systems and technology. Segment operating expenses include direct segment costs along with management's allocation of certain common sales, marketing, and general and administrative costs to each business unit. Unallocated operating expenses include purchased in-process research and development, restructuring, and integration expenses.

Prior to fiscal 2002, the Company operated in one segment. The Company's decision makers evaluated the Company based on total Company results. Revenue was evaluated based on geographic location and product category. Other than net sales, separate financial information was not available by product category and geographic location. The following table shows third quarter and year-to-date fiscal 2002 and 2001 revenue under the previous segment categories.

Revenue by product category <i>(Amounts in thousands)</i>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>July 31, 2002</u>	<u>July 31, 2001</u>	<u>July 31, 2002</u>	<u>July 31, 2001</u>
Net management services	\$ 158,226	\$ 170,226	\$ 463,774	\$ 537,977
Net directory services	12,995	4,854	35,004	20,469
Net content services	1,965	2,225	5,498	5,933
Consulting, support services and education	<u>109,087</u>	<u>71,779</u>	<u>329,709</u>	<u>170,495</u>
Total net sales	<u>\$ 282,273</u>	<u>\$ 249,084</u>	<u>\$ 833,985</u>	<u>\$ 734,874</u>

Sales outside the U.S. are comprised of sales to international customers in Europe, the Middle East, Africa, Canada, South America, and the Asia Pacific region. International sales in any single international location were not material to the Company as a whole.

For the first nine months of fiscal 2002 and fiscal 2001, sales to international customers were approximately \$400.2 million and \$322.6 million, respectively. In the first nine months of fiscal 2002 and fiscal 2001, 73% and 67%, respectively, of international sales were to European countries. No one foreign country accounted for 10% or more of total net sales in either period.

There were no customers accounting for more than 10% of total revenue during the first nine months of fiscal 2002 or fiscal 2001.

K. Net Income (Loss) Per Share

<i>(Amounts in thousands, except per share data)</i>	Three Months Ended		Nine Months Ended	
	<u>July 31, 2002</u>	<u>July 31, 2001</u>	<u>July 31, 2002</u>	<u>July 31, 2001</u>
Basic net income per share computation				
Net income (loss)	\$ 9,949	\$ (19,274)	\$ (155,151)	\$ (178,359)
Weighted average shares outstanding	364,211	328,683	363,131	322,913
Basic net income (loss) per share	\$ 0.03	\$ (0.06)	\$ (0.43)	\$ (0.55)
Diluted net income per share computation				
Net income (loss)	\$ 9,949	\$ (19,274)	\$ (155,151)	\$ (178,359)
Weighted average shares outstanding	364,211	328,683	363,131	322,913
Incremental shares attributable to exercise of outstanding options (treasury stock method)	36	--	--	--
Total	364,247	328,683	363,131	322,913
Diluted net income (loss) per share	\$ 0.03	\$ (0.06)	\$ (0.43)	\$ (0.55)

L. Comprehensive Income (Loss)

The components of comprehensive income (loss), net of tax, for the three-month and year-to-date periods ended July 31, 2002 and 2001, were as follows:

<i>(Amounts in thousands)</i>	Three Months Ended		Nine Months Ended	
	<u>July 31, 2002</u>	<u>July 31, 2001</u>	<u>July 31, 2002</u>	<u>July 31, 2001</u>
Net income (loss)	\$ 9,949	\$ (19,274)	\$ (155,151)	\$ (178,359)
Change in net unrealized gain/loss on investments	(672)	(4,630)	(4,687)	71,225
Change in cumulative translation adjustment	(843)	197	(1,157)	722
Comprehensive loss	\$ 8,434	\$ (23,707)	\$ (160,995)	\$ (106,412)

The components of accumulated other comprehensive income, net of related tax, at July 31, 2002 and October 31, 2001, are as follows:

<i>(Amounts in thousands)</i>	<u>July 31, 2002</u>	<u>October 31, 2001</u>
Net unrealized gain on investment:	\$ 345	\$ 5,032
Cumulative translation adjustment	(3,734)	(2,577)
Accumulated other comprehensive income (loss)	\$ (3,389)	\$ 2,455

M. Derivative Instruments

A large portion of Novell's sales, expense and capital purchasing activities are transacted in U.S. dollars. However, Novell does enter into transactions in other currencies, primarily European, Japanese yen and certain other Latin American and Asian currencies. To protect against reductions in value caused by changes in foreign exchange rates, Novell has established balance sheet hedging programs. The Company hedges currency risks of some assets and liabilities denominated in foreign currencies through the use of one-month forward contracts. Due to the short period of time between entering into the forward contracts and the quarter end, the fair value of the derivatives as of July 31, 2002 is insignificant and, accordingly, did not have a material impact on our financial position or results of operations. The Company does not currently hedge currency risks related to revenue or expenses denominated in foreign currencies.

N. Recent Accounting Pronouncements

In August 2001, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed. The provisions of SFAS No. 144 are effective for fiscal year 2002 and will be applied prospectively. The Company adopted SFAS No. 144 during fiscal 2002 and it did not have a material impact on the Company’s consolidated financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities.” The Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This statement eliminates the definition and requirements for recognition of exit costs in the Emerging Issues Task Force (“EITF”) Issues 94-3, which defined the requirements for recognition of a liability at the date an entity commits to a restructuring plan. This statement also established the fair value is the objective for initial measurement of the liability. The provisions of the Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company will adopt this statement in the fourth quarter of fiscal 2002.

At the beginning of the second quarter of fiscal 2002, the Company adopted FASB Emerging Issues Task Force No. 01-14, “Income Statement Characterization of Reimbursements Received for ‘Out-of-Pocket’ Expenses Incurred” (“EITF 01-14”). EITF 01-14 requires companies to account for reimbursements received for incurred out-of-pocket expenses as revenue and the related expenses as cost of sales. EITF 01-14 also requires companies to reclassify prior period financial statements to conform to current year presentation for comparative purposes. Previously these expenses were not included in the statement of operations. The adoption of EITF 01-14 did not have an impact on net earnings in any reported period. The Company restated the third quarter of fiscal 2001 through the first quarter of fiscal 2002 increasing revenue and cost of goods sold between \$2.5 million and \$8.2 million in each quarter depending on the amount of reimbursable revenue incurred.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") and other parts of this Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. In some cases, such forward-looking statements may be identified by the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue" or the negative thereof or other comparable terminology. Such forward-looking statements include statements regarding, among other things, our revenue expectations, future business strategies, market conditions and opportunities, and liquidity. All forward-looking statements are based on management's expectations and information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. The Company's actual results may differ materially from management's expectations and the results discussed in such forward-looking statements as a result of a number of factors, which include, but are not limited to, those set forth below in the section titled "Risk Factors Affecting Future Results of Operations."

Introduction

Novell, Inc., ("Novell" or the "Company") provides Net business solutions and Net services software designed to secure and power the networked world. Novell and its services division, Cambridge Technology Partners ("Cambridge"), help organizations solve complex business challenges, simplify their systems and processes, and capture new opportunities. Novell provides worldwide channel, consulting, education, and developer programs to support its offerings.

Critical Accounting Policies

The Company considers certain accounting policies related to revenue recognition and impairment of long-lived assets and valuation of deferred tax assets to be critical policies due to the estimation processes involved in each.

Revenue recognition. The Company's IT consulting services business derives a portion of its revenue from fixed-price, fixed-time contracts, which require the accurate estimation of the cost, scope and duration of each engagement. Revenue and the related costs for these projects are recognized based on percentage of completion, using time-to-completion to measure the percent complete with revisions to estimates reflected in the period in which changes become known. If the Company does not accurately estimate the resources required or the scope of work to be performed, or does not manage its projects properly within the planned periods of time or satisfy its obligations under the contracts, future consulting margins may be significantly and negatively affected or losses on existing contracts may need to be recognized. Any such resulting reductions in margins or contract losses could be material to the Company's results of operations.

The Company recognizes revenue from product sales, including license fees, when persuasive evidence of an agreement exists, delivery of the product has occurred, and the fee is fixed or determinable and collection is probable. If the total fee due from the customer is not fixed or determinable at the sale date, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. Revenue from services, including maintenance contracts and consulting, is recognized as services are performed, a signed contract exists, the fee is fixed or determinable, and collection of the resulting receivable is reasonably assured. The Company records a provision against revenue for estimated sales returns and allowances on product and service related sales in the same period as the related revenues are recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. If the historical data the Company uses to calculate these estimates does not properly reflect future returns, revenue could be overstated.

Impairment of long-lived assets and valuation of deferred tax assets. The Company's long-lived assets include fixed assets, long-term investments, goodwill and other intangible assets. At July 31, 2002, the Company had \$ 459.7 million of fixed assets, \$94.7 million of long-term investments, \$167.3 million of goodwill, \$38.9 million of intangible assets, and \$81.9 million of net deferred tax assets, current and non-current, accounting for approximately 44% of the Company's total assets.

The Company periodically reviews its fixed assets for impairment in accordance with FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In determining whether a fixed asset is impaired, the Company must make assumptions regarding recoverability of costs, estimated future cash flows from the asset, intended use of the asset and other related factors. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for these assets not previously recorded.

The fair value of the long-term investments is dependant on the performance of the companies or venture funds in which the Company has invested, as well as volatility inherent in the external markets for these investments. In assessing potential impairment for these investments, the Company will consider these factors as well as the forecasted financial performance of its investees. If these forecasts are not met, the Company may have to record additional impairment charges not previously recognized. During the nine months ended July 31, 2002, the Company recognized \$29.8 million of impairment losses related to its long-term investments.

In assessing the recoverability of the Company's goodwill and other intangibles, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for these assets not previously recorded. On November 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," and was, therefore, required to analyze its goodwill and other intangibles with indefinite lives for impairment issues during the first six months of fiscal 2002, and then on a periodic basis thereafter. The Company's first goodwill impairment analysis under SFAS 142 was completed during the second quarter of fiscal 2002 and resulted in an impairment charge of \$143.7 million related to goodwill in its IT Consulting group.

The carrying value of the Company's net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income in certain tax jurisdictions, based on estimates and assumptions. If these estimates and related assumptions change in the future, the Company may be required to record additional valuation allowances against its deferred tax assets resulting in additional income tax expense in the Company's consolidated statement of operations. Management evaluates the realizability of the deferred tax assets and assesses the need for additional valuation allowances on a quarterly basis.

Acquisitions

Pursuant to the terms of an Agreement and Plan of Merger, dated as of June 9, 2002 by and among Novell, Delaware Planet, Inc., a wholly owned subsidiary of Novell, and SilverStream Software, Inc., a Delaware corporation ("SilverStream"), Delaware Planet commenced a cash tender offer on June 18, 2002 to acquire all of the outstanding shares of SilverStream common stock at a price of \$9.00 per share. On July 17, 2002, Delaware Planet announced the completion of its cash tender offer, pursuant to which it purchased almost all outstanding shares of SilverStream common stock at a price of \$9.00 per share. On July 19, 2002, Novell completed its acquisition of SilverStream by merging Delaware Planet into SilverStream. As a result of the merger, each share of SilverStream common stock that was not tendered in the tender offer now represents the right to receive \$9.00 in cash, without interest.

SilverStream provides software products and services that enable organizations to more effectively conduct business using the Web. SilverStream's products and services leverage the power of standards such as Java and XML to unify relevant information and services while enabling businesses to leverage prior technology investments. They also help customers rapidly deliver Web-based applications that are scalable, reliable and secure. The Company acquired SilverStream to further its development of Web services products and services and to enhance its current Web services and product offerings.

At the closing date of the merger, there were 23,427,448 shares of SilverStream outstanding resulting in a total cash acquisition price of \$210.8 million. Direct transaction costs are estimated to be \$4.0 million and SilverStream stock options assumed, both vested and unvested, totaled \$28.6 million.

With respect to stock options assumed as a part of the merger, all SilverStream options, vested and unvested, were exchanged for Novell options with the same terms and vesting characteristics. The fair value of these options was included in the acquisition purchase price. The portion of the intrinsic value of unvested options that will be earned

over the remaining vesting period of those options has been deducted from the fair value of the unvested options. This deferred compensation will be amortized over the remaining vesting period of approximately two years, in accordance with Financial Accounting Standards Board Interpretation Number 44 (“FIN 44”). In total, options to purchase 4.9 million shares of SilverStream common stock were converted into options to purchase 15.0 million shares of Novell stock using a conversion ratio of 3.0518. The fair value of the options was determined using the Black-Scholes model using the following assumptions:

- Fair market value of the underlying shares was based on the average closing price of Novell’s common stock on June 10, 2002 and the three days prior and subsequent to that date.
- Expected life of 2-5 years
- Expected volatility of 80%
- Risk free interest rate of 5%
- Expected dividend rate of 0%

The value of the acquisition was preliminarily allocated as follows:

<i>(in thousands)</i>	Estimated <u>Acquisition Cost</u>	<u>Asset Life (in years)</u>
Adjusted net tangible assets acquired	\$ 97,833	N/A
Deferred compensation	4,826	2 years
Intangible assets		
Purchased in-process research and development	3,000	expensed in the third quarter fiscal 2002
Developed technology	19,800	3 years
Trademarks / trade names	2,200	indefinite life
Goodwill	<u>115,771</u>	N/A
	<u>\$ 243,430</u>	

The allocation will be adjusted over the next twelve months as integration plans are finalized, as allowed by Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combinations” issued by the Financial Accounting Standards Board (“FASB”) in June 2001. There are no other outstanding contingencies that could affect the allocation.

Goodwill from the acquisition resulted from the Company’s belief that the technology SilverStream had developed is valuable to its Web services strategy. The Company also believes it was more beneficial to acquire such technology rather than develop it in-house. The goodwill from the SilverStream acquisition has been allocated to the Company’s product segment because the eXtend product suite will be included with the Net Directory Services group of products. In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” also issued by the FASB in June 2001, the Company will not amortize the goodwill or intangibles with indefinite lives associated with this acquisition. The Company will review these assets periodically for potential impairment issues. Goodwill is not deductible for tax purposes.

Net tangible assets of SilverStream consisted mainly of cash and cash equivalents, accounts receivable, fixed assets, accounts payable, and other liabilities.

The value of the deferred compensation of approximately \$4.8 million represents the intrinsic value of the unvested options assumed by Novell and was determined under the guidance of FIN 44.

The \$3.0 million of in-process research and development pertains to acquired research and development on the eXtend line of products that are not currently technologically feasible, meaning they have not reached the working model stage and do not contain all of the major functions planned for the product nor are they ready for initial customer testing. The estimated amount of the in-process research and development charge represents a preliminary estimate and represents technology related to replacement and enhancement to be included in the next versions of the SilverStream's eXtend product line. Shortly before the acquisition, SilverStream released its latest version of each of its products in the eXtend line, Application Server, Composer, Workbench, and Director. Therefore, there was minimal research and development in process. Completion of development on the future upgrades of these products is dependant upon the Company delivering on its web services strategy and successfully integrating SilverStream. The in-process research and development does not have any alternative future use and did not otherwise qualify for capitalization.

To determine the value of the developed technology, the expected future cash flow attributable to the existing product technology, the family of eXtend products, which are currently shipping and can be combined with Novell products or services, was discounted, taking into account risks associated with these assets relative to the in-process research and development. The analysis resulted in a valuation of approximately \$19.8 million for developed technology, which has reached technological feasibility.

The value of trademarks and trade names was determined based on assigning a royalty rate to the revenue streams that were expected from the products using the eXtend trade names. The royalty rate was determined based on trade name recognition, marketing support and contribution of the trade name's value relative to the revenue drivers. The pre-tax royalty rates of 0.5 percent to the product revenues were then discounted to a present value, resulting in a valuation of approximately \$2.2 million.

The Company's statement of operations includes SilverStream results for the period July 20, 2002 through July 31, 2002.

Results of Operations

Net Sales

	<u>Quarter ended July 31,</u>			<u>Year-to-date July 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>Change</u>	<u>2002</u>	<u>2001</u>	<u>Change</u>
Net sales (thousands)	\$ 282,273	\$ 249,084	13.3%	\$ 833,985	\$ 734,874	13.5%

Beginning in fiscal 2002, Novell's operations are organized by operating segment - product, consulting, and Volera, Inc.

- Product – includes Net Management Services products (Directory-Enabled OS, Management and Collaboration products, and UNIX royalties), Net Directory Services and other directory products, and product-related customer service, support, and education. Products in this segment are packaged under the names NetWare, ZEN, GroupWare, eDirectory, DirXML, iChain, Single Sign On, eXtend (SilverStream product suite).
- Consulting – includes Novell and Cambridge IT services consulting and Celerant management consulting.
- Volera, Inc. – Novell's majority-owned subsidiary, which provides Content Distribution Network software.

Product sales decreased \$3.6 million or 2% in the third quarter of fiscal 2002 and \$61.5 million or 9% year-to-date 2002 compared to the same periods of fiscal 2001. Within the product segment, sales from Net Management Services products decreased \$12.0 million or 7% in the third quarter of fiscal 2002 and \$74.2 million or 14% year-to-date 2002 compared to the same periods of fiscal 2001. These decreases were primarily due to decreased sales of NetWare, which decreased 14% in the quarter and 17% year-to-date, and lower Unix royalty revenue from expiring royalty contracts, which decreased 11% for the quarter and 13% year-to-date. Also, year-to-date sales from Net Management Services were affected by decreased sales of Management and Collaboration products. Sales from Net Directory Services products increased \$8.1 million or 168% in the third quarter of fiscal 2002 and \$14.5 million or 71% year-to-date 2002 compared to the same periods of fiscal 2001 primarily due to increased sales from DirXML and Single Sign On, which have both grown over 300% year over year, and the addition of SilverStream revenue for the period July 20, 2002 through July 31, 2002. Product related service, education, and support remained relatively

flat during the third quarter of fiscal 2002 and decreased \$1.9 million year-to-date 2002 compared to the same periods of fiscal 2001. The Company believes product sales for the fourth quarter of fiscal 2002 will increase approximately \$10 million above third quarter fiscal 2002 levels, with approximately \$8 million coming from the addition of eXtend product sales and the balance resulting from seasonality.

Consulting sales were \$37.0 million or 99.8% higher in the third quarter of fiscal 2002 and \$161.1 million or 248% higher year-to-date 2002 compared to the same periods of fiscal 2001, due to the acquisition of Cambridge at the end of the third quarter of fiscal 2001. Cambridge operations were included in the Company's operating results for only 21 days in fiscal 2001 compared to the entire quarter in fiscal 2002. Consulting sales decreased \$1.2 million in the third quarter of fiscal 2002 compared to the second quarter of fiscal 2002, as sales from both the IT services and Celerant consulting units decreased approximately \$0.6 million quarter over quarter. This decrease was primarily due to a weakened services market and decreased demand for the Company's systems integration and Net solutions. The Company expects to see a leveling off of the decrease in the demand for consulting sales over the next few quarters as the economy stabilizes and companies increase investments in technology solutions.

At the beginning of the second quarter of fiscal 2002, the Company adopted FASB Emerging Issues Task Force No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred," ("EITF 01-14"). EITF 01-14 requires companies to account for reimbursements received for incurred out-of-pocket expenses as revenue and the related expenses as cost of sales. Previously they were not included in the statement of operations. Reimbursable expense revenue is now included in consulting revenue in all periods presented. The Company restated the third quarter of fiscal 2001 through the first quarter of fiscal 2002 increasing revenue and cost of goods sold between \$2.5 million and \$8.2 million in each quarter, depending on the amount of reimbursable revenue incurred.

Net sales from Volera, Inc. were relatively flat in the third quarter of fiscal 2002 and year-to-date 2002 compared to the same periods of fiscal 2001 and are expected to remain relatively flat for the remainder of fiscal 2002. Volera's performance has not met the growth expectations of the Company and thus the Company is re-evaluating its strategy for Volera.

International sales represented 49% of total net sales in the third quarter of fiscal 2002 and 48% year-to-date 2002 compared to 43% in the third quarter of fiscal 2001 and 44% for the first nine months of fiscal 2001. During the third quarter of fiscal 2002, international sales increased 28% while domestic sales increased 2% compared to the same period of fiscal 2001. Year-to-date, international sales increased 24% and domestic sales increased 5% compared to the same period of fiscal 2001. Internationally, sales increases during the quarter were due to the addition of Cambridge, favorable foreign exchange rates, which accounted for approximately \$4.8 million, and recovering European market conditions. The increase in domestic sales during the third quarter and first nine months of fiscal 2002 was largely due to the addition of Cambridge revenue beginning July 10, 2001, the end of the third quarter of fiscal 2001.

Total net sales increased 3% in the third quarter of fiscal 2002 compared to the second quarter of fiscal 2002. Product sales were up 5%, consulting sales were down 2% and Volera sales were up 41% in the third quarter of fiscal 2002 compared to the second quarter of fiscal 2002. International sales benefited approximately \$4.8 million from favorable exchange rates. The Company expects total net sales for the fourth quarter of fiscal 2002 to increase approximately \$10 million compared to third quarter 2002 levels, with approximately \$8 million coming from the addition of SilverStream and the balance due to seasonality. Although NetWare sales improved in the third quarter of fiscal 2002 compared to the second quarter of fiscal 2002, the Company is working to address the long-term growth potential of the NetWare product line. In addition, the Company is also addressing declining sales in the consulting segment in an effort to improve results in future periods. The Company completed its integration of Cambridge during the first half of fiscal 2002. It has reorganized its sales force to provide better coverage and resources for its customers and partners, focusing on solving business issues with Novell solutions and services. In addition, the Company is integrating the SilverStream products into its offerings and integrating SilverStream's operations as deemed appropriate. The Company anticipates that it will take several quarters to fully realize the benefits from these actions.

At July 31, 2002, the Company had \$239.9 million of deferred revenue on its Balance Sheet representing revenue that will be recognized in future periods. The majority of this deferred revenue relates to one-year maintenance contracts, which are recognized ratably over a 12-month period. The Company has either received payment or recorded a receivable for the deferred revenue, and believes the risk of collectability is low. Direct costs to be incurred to fulfill these maintenance obligations are relatively small and are recognized as work is performed.

Gross Profit

	<u>Quarter ended July 31,</u>		<u>Change</u>	<u>Year-to-date July 31,</u>		<u>Change</u>
	<u>2002</u>	<u>2001</u>		<u>2002</u>	<u>2001</u>	
Gross profit (thousands)	\$ 172,451	\$ 172,908	(0.3)%	\$ 493,766	\$ 524,619	(5.9)%
Percentage of net sales	61.1%	69.4%		59.2%	71.4%	

Gross profit as a percentage of net sales decreased in the third quarter and year-to-date 2002 compared to the same periods of fiscal 2001, primarily due to the effects of a higher mix of lower-margin consulting business along with decreased product sales levels. The mix between product sales and consulting sales has shifted due to the acquisition of Cambridge, causing product sales to become a smaller percentage of total sales. During the third quarter and year-to-date fiscal 2002, gross margin for the consulting segment was \$4.8 million or 7% and \$3.6 million or 2%, respectively. The low consulting margins are primarily due to decreased consulting sales, reduced prices, and increased costs related to excess consultants who were not fully utilized on consulting engagements. The Company does not expect overall gross profit margins to reach fiscal 2001 levels in the future due to the increase in the consulting business as a percentage of total sales. However, the Company believes the current gross profit margin of 61% can be improved and is currently addressing ways to improve its gross margin in future periods, such as improved utilization and increased consulting billing rates.

As described above, the Company adopted EITF 01-14, which requires companies to account for reimbursements received for out-of-pocket expenses incurred as revenue and the related expenses as cost of sales. This change did not have a significant effect on gross margin.

Operating Expenses

<i>(Amounts in thousands)</i>	<u>Quarter ended July 31,</u>		<u>Change</u>	<u>Year-to-date July 31,</u>		<u>Change</u>
	<u>2002</u>	<u>2001</u>		<u>2002</u>	<u>2001</u>	
Sales and marketing	\$ 90,125	\$ 100,013	(9.9)%	\$ 261,660	\$ 338,335	(22.7)%
Percentage of net sales	31.9%	40.2%		31.4%	46.0%	
Product development	41,492	47,976	(13.5)%	122,976	147,388	(16.6)%
Percentage of net sales	14.7%	19.3%		14.7%	20.1%	
General and administrative	29,566	28,101	5.2%	90,946	77,347	17.6%
Percentage of net sales	10.5%	11.3%		10.9%	10.5%	
Restructuring	--	30,392	--	19,100	30,392	(37.2)%
Percentage of net sales	--	12.2%		2.3%	4.1%	
Purchased in-process R&D	3,000	--	--	3,000	--	--
Percentage of net sales	1.1%	--		0.4%	--	
Total operating expenses	\$ 164,183	\$ 206,482	(20.5)%	497,682	593,462	(16.1)%
Percentage of net sales	58.2%	82.9%		59.7%	80.8%	

Sales and marketing expenses decreased \$9.9 million and \$76.7 million in the third quarter and year-to-date of fiscal 2002, respectively, compared to the same periods of fiscal 2001. These declines are primarily due to decreased spending on marketing campaigns and lower headcount due to the restructurings in the third and fourth quarters of fiscal 2001 and second quarter of fiscal 2002. Sales and marketing headcount decreased by 241 year-over-year, excluding the addition of 151 SilverStream employees who became Novell employees on July 20, 2002. In addition, sales and marketing expenses fluctuate in any given period due to the timing of product promotions, advertising or

other discretionary expenses.

Product development expenses decreased \$6.5 million in the third quarter of fiscal 2002 and \$24.4 million year-to-date 2002 compared to the same periods in fiscal 2001. These declines are due primarily to decreased headcount as a result of the restructurings that took place in the third and fourth quarters of fiscal 2001 and second quarter of fiscal 2002. Product development headcount decreased by 75 year-over-year, excluding the addition of 121 SilverStream employees who became Novell employees on July 20, 2002. Product development expense as a percentage of sales decreased due to the addition of Cambridge consulting sales, which does not have any associated product development costs.

General and administrative expenses increased \$1.5 million during the third quarter of fiscal 2002 and \$13.6 million year-to-date 2002 compared to the same periods of fiscal 2001. The increase in general and administrative expense dollars in the third quarter of fiscal 2002 was primarily due to the impact of a full quarter of Cambridge general and administrative costs, net of integration or restructuring reductions, compared to only 21 days of these expenses in the third quarter of fiscal 2001. In addition, the Company incurred higher costs related to the addition of SilverStream at the end of the third quarter of fiscal 2002, and higher costs for outside advisors, offset somewhat by lower bad debt write-offs related to uncollectible accounts receivable. General and administrative costs decreased as a percentage of sales in the third quarter of fiscal 2002 compared to the same period of fiscal 2001 primarily due to increased sales in the third quarter of fiscal 2002. The year-to-date general and administrative expense increases, both dollars and as a percentage of sales, were primarily due to the addition of Cambridge general and administrative costs and integration costs related to the acquisition of Cambridge, offset somewhat by headcount reductions resulting from the restructurings that took place in the third and fourth quarters of fiscal 2001.

The purchased in-process research and development charge in the third quarter of fiscal 2002 resulted from the acquisition of SilverStream and pertains mainly to research and development work for the next version of the current SilverStream products.

Restructuring

During the second quarter of fiscal 2002, the Company recorded a pre-tax restructuring charge of approximately \$20.4 million. The charge was a result of the Company's continued move towards its business strategy of becoming a solutions provider, addressing changes in the market due to technology changes, and becoming more customer-focused. Specific actions taken included reducing the Company's workforce worldwide by approximately 50 employees (less than 1%), consolidating facilities, closing offices in unprofitable locations, and disposing of excess property and equipment. The following table summarizes the activity during fiscal 2002 related to the second quarter fiscal 2002 restructuring.

	<u>Total</u> <u>Restructuring Charge</u>	<u>Cash</u> <u>Payments</u>	<u>Non-Cash</u> <u>Charges</u>	<u>Balance at</u> <u>July 31, 2002</u>
(Amounts in thousands)				
Severance and benefits	\$ 14,748	\$ (7,743)	\$ (1,318)	\$ 5,687
Excess facilities and property and equipment	5,146	(556)	--	4,590
Other restructuring-related costs	<u>492</u>	<u>(3)</u>	<u>(150)</u>	<u>339</u>
	<u>\$ 20,386</u>	<u>\$ (8,302)</u>	<u>\$ (1,468)</u>	<u>\$ 10,616</u>

As of July 31, 2002, the remaining balance of the second quarter 2002 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the next four quarters and redundant facilities and other fixed contracts, which will be paid over the respective remaining contract terms.

At the end of the fourth quarter of fiscal 2001, the Company recorded \$50.7 million of pre-tax, restructuring charges resulting from changes in general market conditions, changing customer demands, and the Company's evolution of its business strategy, all of which required the Company to restructure its operations. This business strategy focuses on Net business solutions along with Net services software designed to secure and power the networked world across leading operating systems. The execution of this strategy included refining the Company's consulting initiatives, refocusing research and development efforts, defining sales and marketing efforts to be more customer and solutions

oriented, and adjusting the overall cost structure given current revenue levels and the Company's direction.

Specific actions included reducing the Company's workforce worldwide by approximately 1,100 employees (approximately 16%), consolidating excess facilities and disposing of excess property and equipment, terminating a management consulting contract that no longer fits with the Company's strategic focus, and abandoning and writing off technologies that no longer fit within the Company's new strategy. The Company also realigned its remaining resources to better manage and control its business. The following table summarizes the costs and activities during the first nine months of fiscal 2002, related to the fourth quarter 2001 restructuring.

(Amounts in thousands)	Balance at October 31, 2001	Cash Payments	Non-Cash Charges / Adjustments	Balance at July 31, 2002
Severance and benefits	\$ 32,793	\$ (26,646)	\$ (4,000)	\$ 2,147
Excess facilities and property and equipment	10,896	(5,271)	1,970	7,595
Other restructuring-related costs	911	(226)	—	685
	<u>\$ 44,600</u>	<u>\$ (32,143)</u>	<u>\$ (2,030)</u>	<u>\$ 10,427</u>

As of July 31, 2002, the remaining balance of the fourth quarter 2001 restructuring charge included accrued liabilities largely related to severance and benefits, which will be paid out during fiscal 2002, and redundant facilities costs, which will be paid over the respective remaining lease terms.

During the third quarter of fiscal 2001, the Company recorded a restructuring charge of approximately \$30.4 million, pre-tax, as a result of the Company's acquisition of Cambridge Technology Partners ("Cambridge") and changes in the Company's business to move towards a Net business solutions strategy.

Specific actions included reducing the Company's workforce worldwide by approximately 280 employees (approximately 5% before the addition of Cambridge) across all functional areas, consolidating facilities and disposing of excess property and equipment, abandoning and writing off technologies that no longer fit within the integrated Company's new strategy, and discontinuing unprofitable product lines. The following table summarizes the activity during the first nine months of 2002, related to the third quarter 2001 restructuring costs.

(Amounts in thousands)	Balance at October 31, 2001	Cash Payments	Non-Cash Charges	Balance at July 31, 2002
Severance and benefits	\$ 3,377	\$ (2,128)	\$ —	\$ 1,249
Abandoned technology	211	(211)	—	—
Excess facilities and property and equipment	9,736	(5,191)	—	4,545
Exit unprofitable product lines	486	(486)	—	—
Other restructuring-related costs	527	(340)	—	187
	<u>\$ 14,337</u>	<u>\$ (8,356)</u>	<u>\$ —</u>	<u>\$ 5,981</u>

As of July 31, 2002, the remaining balance of the third quarter 2001 restructuring charge included accrued liabilities largely related to severance benefits and excess facilities costs, which will be paid over the respective remaining lease terms.

As a result of the fiscal 2002 and two 2001 restructurings, the Company estimates that its operating expenses will be reduced by approximately \$180 million annually compared to fourth quarter fiscal 2001 operating expense levels, before increased strategic expenditures. Year-to-date 2002, the Company had recognized approximately \$125 million in savings due to the restructurings over the fourth quarter 2001 expense levels.

During the second quarter of fiscal 2002, the Company also released approximately \$1.3 million of excess accruals related to a fiscal 2000 restructuring, which reduced the restructuring costs reflected on the statement of operations

for the nine months ended July 31, 2002. These excess accruals relate to facilities and legal costs that were not required.

The Company could incur additional restructuring charges in the future as it continues to develop its Net solutions strategy and react to market conditions.

Employee Headcount

<u>Employees at end of period</u>	<u>July 31, 2002</u>	<u>July 31, 2001</u>	<u>Change</u>
Cost of Goods	2,589	3,277	(21.0)%
Sales & marketing	1,491	1,584	(5.9)
Product development	1,378	1,312	<u>5.0</u>
General & administrative	<u>880</u>	<u>1,114</u>	(21.0)
Total headcount	6,338	7,287	(13.0)
Annualized sales per average employee	\$ 182	\$ 163	11.7%

Headcount decreased from the third quarter of 2001, primarily due the elimination of duplicate functions related to the acquisition of Cambridge, and headcount reductions resulting from the restructurings that occurred during the third and fourth quarters of fiscal 2001 and second quarter of fiscal 2002, offset somewhat by the addition of 455 SilverStream employees.

Other Income (Loss), Net

<i>(Amounts in thousands)</i>	<u>Quarter ended July 31,</u>			<u>Year-to-date July 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>Change</u>	<u>2002</u>	<u>2001</u>	<u>Change</u>
Other income (loss), net	\$ 7,230	\$ 10,506	(31.2)%	\$ (698)	\$(103,854)	99.3%
Percentage of net sales	2.6%	4.2%		(0.1)%	(14.1)%	

The primary component of other income is related to investment income or losses. During the third quarter of fiscal 2002, investment income was \$5.3 million compared to investment income of \$13.6 million offset by investment impairment losses of \$5.0 million during the third quarter of fiscal 2001. Year-to-date fiscal 2002, investment income of \$20.5 million was offset by investment impairment losses of \$29.8 million compared to investment income of \$42.3 million offset by \$149.7 million of investment impairment losses in the same period of fiscal 2001. Investment impairment losses relate to certain investments in the Company's portfolio, whose declines in market values were determined to be other than temporary. Also included in other income during year-to-date fiscal 2002 was an \$8.8 million gain on the sale of a building.

Income Taxes Expense (Benefit)

	<u>Quarter ended July 31,</u>			<u>Year-to-date July 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>Change</u>	<u>2002</u>	<u>2001</u>	<u>Change</u>
Income tax expense (benefit) (thousands)	\$ 5,549	\$(3,794)	246.3%	\$ 6,835	\$(5,386)	226.9%
Percentage of net sales	2.0%	(1.5)%		0.8%	(0.7)%	
Effective tax expense (benefit) rate	35.8%	(16.4)%		148.1%	(3.1)%	
Effective tax expense (benefit) rate on income before change in accounting method, purchased in-process R&D, and asset impairment	30.0%	(21.0)%		30.0%	(21.0)%	

The Company's effective tax rate, before the write-off of purchased in-process research and development, investment impairment charges, and the accounting change, for the third quarter and the full year of fiscal 2002 is estimated to be 30%, compared to 21% in fiscal 2001. The third quarter and fiscal year 2002 rates differ from the effective tax rate for fiscal 2001 primarily as a result of changes in the forecasted income before taxes for fiscal 2002. There is no tax benefit for the investment impairment because corporations can only use capital losses to offset capital gains. The Company cannot be assured at this time that it can generate sufficient capital gains during the five-year carry-over period to recognize the tax benefit of this capital loss. Accordingly, a valuation allowance has been established. There is no tax benefit for the change in accounting method since goodwill is not deductible for tax purposes in this situation. The write-off of purchased in-process research and development is not deductible for tax purposes.

Net Loss and Net Loss Per Share

<i>(dollars in thousands, except per share data)</i>	<u>Quarter ended July 31,</u>			<u>Year-to-date July 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>Change</u>	<u>2002</u>	<u>2001</u>	<u>Change</u>
Income (loss) before accounting change	\$ 9,949	\$(19,274)	151.6%	\$(11,449)	\$(167,311)	93.2%
Percentage of net sales	3.5%	(7.7)%		(1.4)%	(22.8)%	
Net income (loss)	\$ 9,949	\$(19,274)	151.6%	\$(155,151)	\$(178,359)	13.0%
Percentage of net sales	3.5%	(7.7)%		(18.6)%	(24.3)%	
Income (loss) per share, before accounting change – basic and diluted	\$ 0.03	\$ (0.06)		\$ (0.03)	\$ (0.52)	
Net income (loss) per share – basic and diluted	\$ 0.03	\$ (0.06)		\$ (0.43)	\$ (0.55)	

Change in Accounting Principle

Effective November 1, 2001 the Company adopted SFAS No. 142." SFAS No. 142 requires, among other things, the discontinuance of amortization related to goodwill and indefinite lived intangible assets. These assets will then be subject to an impairment test at least annually. In addition, the statement includes provisions requiring companies to identify reporting units upon adoption, for the purpose of assessing potential future impairments and to perform an initial impairment analysis within the first six months after adoption. The Company completed its goodwill impairment analysis during the second quarter of fiscal 2002 and recognized a transitional goodwill impairment loss of \$143.7 million as of November 1, 2001, which was recorded as the cumulative effect of a change in accounting principle in the Company's consolidated Statements of Operations. Any further impairment losses recorded in the future could have a material adverse impact on our financial conditions and results of operations.

Liquidity and Capital Resources

	<u>July 31, 2002</u>	<u>October 31, 2001</u>	<u>Change</u>
Cash and short-term investments (000s)	\$607,310	\$705,243	(13.9)%
Percentage of total assets	35.4%	37.0%	

During the nine months ended July 31, 2002, cash and short-term investments decreased by \$97.9 million to \$607.3 million at July 31, 2002, down from \$705.2 million at October 31, 2001, primarily due to the acquisition of SilverStream. The Company paid approximately \$210.8 million cash to SilverStream shareholders for the acquisition and acquired approximately \$108.3 million cash from SilverStream, resulting in a net cash outflow of approximately \$102.5 million. In addition, cash decreased by \$18.7 million for purchases of property, plant and equipment, and \$18.3 million in net purchases of investments and other long-term investing activities. These decreases in cash were offset somewhat by \$18.6 million cash provided by operating activities, \$16.1 million cash received from the sale of a building, and \$6.9 million from the net issuance of common stock. Included in the cash provided by operating activities amount were payments made during the first nine months of fiscal 2002 related to fiscal 2001 and 2002 merger and restructuring actions. Restructuring and merger related expenses will continue to be paid out during the next several quarters, including those related to the acquisition of SilverStream.

The Company's short-term investment portfolio is diversified among security types, industry groups, and individual issuers. To achieve potentially higher returns, a portion of the Company's investment portfolio is invested in equity securities and mutual funds, which incur market risk. The Company's short-term investment portfolio includes gross unrealized gains of \$3.2 million and gross unrealized losses of \$3.8 million as of July 31, 2002. The Company monitors its investments and records losses when a decline in the investment's market value is determined to be other than temporary.

The Company also invests excess cash in long-term investments through the Novell Venture account, Cambridge Technology Capital Fund I L.P. ("CTC I"), and strategic long-term equity investments. Investments made through the Novell Venture account, CTC I, generally are in expansion-stage private companies, primarily small capitalization stocks, in the high-technology industry sector. The Novell Venture account funds are managed largely by external venture capitalists. CTC I is managed internally. The value of the investments made through the Novell Venture account and CTC I is dependent on the performance, successful acquisition, and/or initial public offering of the investees. The Company monitors its investments and records losses when a decline in the investment's market value is determined to be other than temporary. The Company analyzes each investment based on factors such as the investee's financial statements, the business environment in which the investee operates, as well as information obtained from the investee regarding its operations.

As of July 31, 2002, Novell had cash and other short-term investments of \$366 million held in accounts outside the United States. Repatriation of any portion of this amount would be subject to U.S. federal income taxes. The Company has provided for the tax liability on these amounts for financial statement purposes. Repatriation, however, could result in a loss of certain tax attributes of up to \$30 million and result in additional federal income tax payments of such amounts in future years.

The Company's principal source of liquidity has been from operations and investment income. In addition, at July 31, 2002, the Company's principal unused sources of liquidity consisted of cash and short-term investments and available borrowing capacity of approximately \$3.4 million under its credit facilities. The Company's liquidity needs are principally for the Company's financing of accounts receivable, capital assets, strategic investments, product development and flexibility in a dynamic and competitive operating environment.

During the first nine months of fiscal 2002, the Company generated \$18.6 million of cash flow from operations, and anticipates generating positive cash flows from operations in addition to investment income in the fourth quarter of fiscal 2002 sufficient to fund operations. The Company anticipates being able to fund its current operations, future acquisitions, integration, restructuring and merger-related costs, and planned capital expenditures for the foreseeable future with existing cash and short-term investments together with cash generated from operations and investment income. The Company believes that borrowings under the Company's credit facilities or offerings of equity or debt securities are possible if the need arises, although such offerings may not be available to the Company on acceptable terms, given current market conditions. Investments will continue in product development and in new and existing areas of technology. Cash may also be used to acquire technology through purchases and strategic acquisitions. Capital expenditures in fiscal 2002 are anticipated to be approximately \$25 million, but could be reduced if the growth of the Company is less than presently anticipated. The Company has commitments to invest up to an additional \$77.5 million in externally managed venture capital funds over the next two to five years, which it intends to fund with cash from operations and cash and short-term investments on hand.

During the fourth quarter of 2001, the Board of Directors extended the Company's stock repurchase program through June 30, 2003 and authorized the use of up to \$500 million for the repurchase of additional outstanding shares of the Company's common stock. As of July 31, 2002, \$89 million of the authorized amount had been spent to repurchase 14 million shares under this plan at an average price of \$6.23 per share. There were no shares repurchased during the first nine months of fiscal 2002.

Recent Pronouncements

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. The provisions of SFAS 144 will be effective for fiscal year 2002 and will be

applied prospectively. The Company adopted SFAS 144 during fiscal 2002 and adoption 144 did not have a material impact on the Company's consolidated financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This statement eliminates the definition and requirements for recognition of exit costs in the Emerging Issues Task Force ("EITF") Issues 94-3, which defined the requirements for recognition of a liability at the date an entity commits to a restructuring plan. This statement also established the fair value is the objective for initial measurement of the liability. The provisions of the Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company will adopt this statement in the fourth quarter of fiscal 2002.

Risk Factors Affecting Future Results of Operations

Novell's future results of operations involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially from historical results or from Novell's expectations are the following: Novell's ability to successfully blend its products and services and continuing to transition to a solutions based Net services software company; Novell's ability to take a competitive position in the Web services industry; business conditions and the general economy; competitive factors, such as rival operating systems, directories and applications; acceptance of new products and services and price pressures; availability of third-party compatible products at below market prices; risk of nonpayment of accounts or notes receivable; risks associated with foreign operations; risk of product line or inventory obsolescence due to shifts in technologies or market demand; timing of software product introductions; further declines in the demand for information technology consulting services; risk of consulting clients terminating or reducing the scope of engagements; fluctuations in the value of investment securities; and litigation.

Other factors may also adversely affect Novell's financial results and stock price, including but not limited to:

- competition for qualified employees;
- competition from other product and service companies;
- delays in the introduction of new products and services;
- success of new products, technologies or services;
- stock market fluctuations unrelated to Company performance;
- failure to properly estimate costs of fixed fee engagements;
- failure to properly manage consulting engagements within fixed-fees agreed to by customers; and
- inability to fully utilize consultants on client engagements.

The Current Economic Climate and Outlook in the Technology and Information Technology Services Sector Is Very Weak

The weakened economic climate, particularly in the technology sector, has had an adverse impact on demand for software, has had an adverse effect on Novell's stock price and operations. Future economic projections for this sector do not anticipate a quick recovery. A continuation of the weakened economy could have further negative effects on Novell's stock price and operations in the future.

Our Financial Results May Vary

As is typical within the software industry, Novell often experiences a higher volume of sales at the end of each

quarter and during Novell's fourth quarter. Because of this, fixed costs that are out of line with sales levels may not be detected until late in any given quarter and results of operations could be adversely affected.

Operating results have been, and may in the future be affected, by other factors including, but not limited to:

- timing of orders from customers and shipments to customers;
- product mix, including a shift from higher margin to lower margin products or services;
- delays or problems with our fulfillment agents;
- impact of foreign currency exchange rates on the price of our products in international locations;
- inability to respond to the decline in sales through our distribution channel;
- inability to derive benefits from our restructurings and new corporate strategy; and
- inability to deliver solutions as expected by our consulting customers;

We Compete in a Challenging Market

Novell's solutions offerings compete in a highly challenging market. One pervasive factor underlying all of Novell's business endeavors is the presence of Microsoft in all sectors of the software business, and Microsoft's dominance in many of those sectors.

In a finding upheld by the Circuit Court for the District of Columbia, the United States District Court found that Microsoft violated Section 2 of the Sherman Act by unlawfully acting to maintain its monopoly over desktop operating systems. Novell believes that Microsoft is exploiting its desktop operating monopoly in a way that is designed to extend its market power into the market for server operating systems, and to claim control of network and web services such as authentication, using many of the same anti-competitive practices found by the United States District Court to be in violation of the nation's antitrust laws. Novell is concerned that the Second Revised Proposed Final Judgment of the litigation between the Department of Justice and Microsoft will not benefit competition or consumers in a meaningful way and, if approved, could result in continued harm to Novell.

Additionally, Novell does not have the product breadth and market power of Microsoft. Microsoft's ability to ship networking products with features and functionality that compete with Novell's, together with its ability to offer incentives to customers to purchase certain products in order to obtain favorable sales terms or necessary compatibility or information with respect to other products, may significantly inhibit Novell's ability to grow its business. Microsoft has significant financial resources, which could allow it to aggressively price its products and services for long periods of time to the potential detriment of competitors. Microsoft in the past has also employed tactics that limit or block effective and efficient interoperability with Novell's products. Microsoft frequently bundles software features, which compete directly with stand-alone products from Novell, into its operating system for free. As Microsoft creates new operating systems and applications, there can be no assurance that Novell will be able to ensure its products will be compatible with those of Microsoft.

Although these market conditions and the judgments reached in litigation concerning Microsoft may affect overall Novell performance, Novell believes its strong product offering and "One Net" business strategy will be competitive in the marketplace. Additionally, if the more meaningful relief being sought by the nine litigating states is imposed on Microsoft, there could be a restoration of competition in the marketplace that would benefit Novell.

Novell's solutions offerings also face competition from several large consulting firms specializing in the information systems area such as Hewlett-Packard Company, IBM, Accenture, Cap Gemini and the three remaining consulting arms of the "Big Four" accounting firms. Many of these companies have greater financial, technical and marketing resources and greater name recognition in the solutions area, which could inhibit Novell's ability to grow its

consulting business.

Additionally, Novell may face competition from other industry companies, which could introduce competitive products and/or services. If any of these competing products or services achieves market acceptance, Novell's business and results of operations could be materially adversely affected. Novell believes that additional factors that affect success in the marketplace include technical innovation to meet dynamic market needs, marketing strength, system performance, customer service and support, reliability, ease of use, security, and price compared to performance. Novell seeks to address all of these factors with its marketing and product development. However, these factors are also addressed by competitors, including Microsoft, in ways that may cause Novell's chances of success to be diminished.

We Face Intense Competition for Qualified Personnel and Executives in the Computer and Consulting Industries

The ability of Novell to maintain its competitive technological position will depend, in large part, on its ability to attract and retain highly qualified development, consulting, and managerial personnel. We compete for such personnel in the software and consulting industries. The loss of a significant group of key personnel would adversely affect Novell's performance. The failure to successfully promote and hire suitable replacements in a timely manner could have a material adverse effect on Novell's business.

Novell's Business May be Adversely Impacted by Acquisitions Which May Affect its Ability to Manage and Maintain its Business.

Since Novell's inception, it has acquired a number of businesses, including Cambridge Technology Partners in July 2001 and SilverStream Software, Inc. in July 2002. In the future, Novell may undertake additional acquisitions of businesses that complement its existing operations. Past or future acquisitions by Novell could involve a number of risks, including:

- the possibility that one or more such acquisitions may not close due to closing conditions in the acquisition agreements, the inability to obtain regulatory approval, or the inability to meet conditions imposed for government or court approvals for the transaction;
- the diversion of the attention of management and other key personnel;
- the inability to effectively integrate an acquired business into Novell's culture,
- failure to combine product and service delivery methodology and other standards, controls, procedures and policies;
- the inability to retain the management, key personnel and other employees of an acquired business;
- the inability to retain the customers of an acquired business;
- the possibility that Novell's reputation will be affected by customer satisfaction problems of an acquired business;
- potential known or unknown liabilities associated with an acquired business, including but not limited to regulatory, environmental and tax liabilities;
- the write down of acquired identifiable intangibles, which may adversely affect Novell's reported results of operations; and
- litigation which has or which may arise in the future in connection with such acquisitions.

We Have Experienced Delays in the Introduction and Acceptance of New Products and Solutions Due to Various Factors

As is common in the computer software industry, Novell has in the past experienced delays in the introduction of new products due to a number of factors, including the complexity of software products, the need for extensive testing of software to ensure compatibility of new releases with a wide variety of application software and hardware devices, and the need to “debug” products prior to extensive distribution. Novell could, in the future, experience the same difficulties in introducing new solutions. Significant delays in developing, completing or shipping new or enhanced products and solutions would adversely affect Novell.

Moreover, Novell may experience delays in market acceptance of new releases of its products and solutions as Novell engages in marketing and education of the user base regarding the advantages and system requirements for new products and solutions, and as customers evaluate the advantages and disadvantages of upgrading. Additionally, Novell has invested considerable time and resources in web services and it is unclear how the web services market will mature, if at all. Novell has encountered these issues on each major new release of its products and services, and expects that it will encounter such issues in the future. Novell’s ability to achieve desired levels of sales growth depends at least in part on the successful completion, introduction and sale of new versions of its products and sales of its solutions. There can be no assurance that Novell will be able to respond effectively to technological changes or new product announcements by others, or that Novell’s research and development efforts will be successful. Should Novell experience material delays or sales shortfalls with respect to new product or solutions releases, Novell’s sales and net income could be adversely affected.

If Third Parties Claim that We Infringed Upon Their Intellectual Property, Our Ability to Use Some Technologies and Products Could Be Limited and We May Incur Significant Costs to Resolve these Claims

Litigation regarding intellectual property rights is common in the Internet and software industries. Novell expects third-party infringement claims involving Internet technologies and software products and services to increase. If an infringement claim is filed against Novell, it may be prevented from using some technologies and may incur significant costs to resolve the claim.

Novell has in the past received letters suggesting that it is infringing upon the intellectual rights of others, and it may from time to time encounter disputes over rights and obligations concerning intellectual property. Novell’s products and services may be found to infringe on the intellectual property rights of third parties.

In addition, Novell has agreed, and may agree in the future, to indemnify customers against claims that its products infringe upon the intellectual property rights of others. Novell could incur substantial costs in defending itself and its customers against infringement claims. In the event of a claim of infringement, Novell and its customers may be required to obtain one or more licenses from third parties. In such instances, Novell or its customers may not be able to obtain necessary licenses from third parties at a reasonable cost or at all.

We May Not Be Able to Protect Our Confidential Information, Which May Adversely Affect Our Business

Novell generally enters into contractual relationships with its employees that protect its confidential information. In the event that Novell’s trade secrets or other proprietary information are misappropriated, Novell’s business could be seriously harmed. In addition, Novell may not be able to timely detect unauthorized use of its intellectual property and take appropriate steps to enforce its rights. In the event Novell is unable to enforce these contractual obligations, its business could be adversely affected.

We May Not Be Successful at Introducing New Technologies

Novell is committed to its strategy of achieving widespread acceptance and adoption of Novell’s Net Services and e-solutions products, Net Directory Services (“NDS”), and the products and applications that take advantage of directory services. Novell is also seeking to take a competitive position in the Web services industry. Novell’s ability to achieve success with its Net Services, NDS and Web services solutions is dependent on a number of factors including, but not limited to, the following: development of key Net Services, directory and Web services products and upgrades, the acceptance of those products by large industry partners, the marketing of those products through appropriate channels of distribution, and the acceptance of those products in major accounts. Novell has only had

limited success in introducing new technologies and there can be no assurance of success with Net Directory Services, Net Services or Web services solutions.

Our Existing Product Sales May Deteriorate More Rapidly Than Sales of Our New Products Increase

Novell has several existing products, which it has been selling and upgrading for many years. Technology shifts or competition could occur causing sales of these products to decline at a faster rate than Novell is able to increase sales of new products or technologies. Sales from Net Management Services decreased during the first nine months of fiscal 2002 by 13.8%, resulting in overall declines in net product sales by 1.7% in the first nine months of fiscal 2002 compared to the same period of fiscal 2001.

Catastrophic Events Could Harm Our Ability To Conduct Business

Like many multinational corporations, Novell faces business risks as a result of threats posed by major disasters, especially earthquakes and floods, power outages, telecommunication failures, application or hardware failures and terrorist acts. In addition, due to relocation, restructuring and consolidation, Novell does not have a satisfactory level of redundancy in its IT facilities. Novell is evaluating its exposure to these risks and taking protective measures, including improving its disaster recovery capabilities and improving its IT backup capacity. The occurrence of any of these events would threaten Novell's ability to continue operations, to provide essential products and services and to recover operating costs.

We Face Increased Risks in Conducting a Global Business, Which May Damage Business Results

Novell is a multi-national corporation with offices and subsidiaries around the world and, as such, it faces risks in doing business abroad that it does not face domestically. Certain aspects inherent in transacting business internationally could negatively impact the operating results of Novell, including:

- costs and difficulties in staffing and managing international operations;
- unexpected changes in regulatory requirements;
- tariffs and other trade barriers;
- difficulties in enforcing contractual and intellectual property rights;
- longer payment cycles;
- local political, social and economic conditions;
- potentially adverse tax consequences, including restrictions on repatriating earnings and the threat of "double taxation"; and
- fluctuations in currency exchange rates.

Some of Our Short-term, Long-term, and Venture Capital Fund Investments Have Become Impaired. Additional Investments Could Become Impaired

Novell's investment portfolio includes investments in public and private equity securities, small capitalization stocks in the high-technology industry sector, and funds managed by venture capitalists. Many of these investments have lost a significant portion of their value at least on a short-term basis, and possibly on a permanent basis. Additional investments may also lose value. During the first nine months of fiscal 2002, Novell recorded an impairment charge of \$29.8 million related to some of the long-term investments in its portfolio whose market value had experienced an other-than-temporary decline. As of July 31, 2002, Novell had net unrealized gains on short-term investments of approximately \$0.3 million, net of taxes. However, there can be no assurances that these gains will be realized and that losses will not occur.

Our Existing Relationships With Other Information Technology Services Organizations May Be Impaired

Novell relies on existing relationships with information technology services organizations that recommend, design and implement solutions for their customers that include Novell Net services products. A change in the willingness of these information technology service organizations to do business with Novell could undercut Novell's efforts to continue to transition to a solutions-based Net services software company.

Our Business May Be Negatively Affected if We Do Not Continue to Adapt to Rapid Technological Change, Evolving Business Practices and Changing Consumer Requirements

The software industry and Internet professional services market is characterized by rapidly changing technology, evolving business practices and changing client needs. Accordingly, Novell's future success will depend in part on its ability to continue to adapt and meet these challenges. Among the most important challenges facing Novell are the need to continue to:

- effectively identify and use leading technologies;
- develop strategic and technical expertise;
- influence and respond to emerging industry standards and other technology changes and to orient management teams to capitalize on these changes;
- recruit and retain qualified project personnel;
- enhance current services;
- develop new services that meet changing customer needs; and
- effectively advertise and market services.

Our Services Contracts Contain Pricing Risks

Novell's Cambridge IT services business derives a significant portion of its sales from fixed-price, fixed-time contracts. Because of the complex nature of the services provided, it is sometimes difficult to accurately estimate the cost, scope and duration of particular client engagements. If Novell does not accurately estimate the resources required for a project, does not accurately assess the scope of work associated with a project, does not manage the project properly, or does not satisfy its obligations in a manner consistent with the contract, then Novell's costs to complete the project could increase substantially. Novell has occasionally had to commit unanticipated additional resources to complete projects, and it may have to take similar action in the future. Novell may not be compensated for these additional costs or the commitment of these additional resources.

Our Cambridge IT Services Clients Can Cancel or Reduce the Scope of Their Engagements With Us on Short Notice

If Novell's clients cancel or reduce the scope of an engagement with the Cambridge IT services business, Novell may be unable to reassign its professionals to new engagements without delay. Personnel and related costs constitute a substantial portion of Novell's operating expenses. Because these expenses are relatively fixed, and because Novell establishes the levels of these expenses well in advance of any particular quarter, cancellations or reductions in the scope of client engagements could result in the under-utilization of Novell's professional services employees, causing significant reductions in operating results for a particular quarter.

Our Stock Price Will Fluctuate

Novell's future financial results and stock price could be subject to significant volatility, particularly on a quarterly

basis. Any shortfall in earnings can be expected to have an immediate and significant adverse effect on the trading price of Novell's Common Stock in any given period. Sales fluctuations may also contribute to the volatility of the trading price of Novell Common Stock in any given period.

In addition, the market prices for securities of software companies have been very volatile both recently and historically. The market price of Novell Common Stock, in particular, has been subject to wide fluctuations in the past. As a result of the foregoing factors and other factors that may arise in the future, the market price of Novell's Common Stock may be subject to significant fluctuations within a short period of time. These fluctuations may be due to factors specific to Novell, to changes in analysts' earnings estimates, or to factors affecting the computer industry or the securities markets in general.

Item 3. Qualitative and Quantitative Disclosures About Market Risk

Novell is exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate some of these risks, Novell utilizes currency forward contracts and currency options. Novell does not use derivative financial instruments for speculative or trading purposes, and no derivative financial instruments were outstanding at July 31, 2002.

Interest Rate Risk

The primary objective of Novell's investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in widely diversified short-term investments, consisting primarily of investment grade securities, substantially all of which either mature within the next 12 months or have characteristics of short-term investments. A hypothetical 50 basis point increase in interest rates would result in an approximate \$0.8 million decrease (less than 0.5%) in the fair value of Novell's available-for-sale securities.

Market Risk

Novell also holds available-for-sale equity securities in its short-term investment portfolio. As of July 31, 2002, gross unrealized losses, before tax effect, on short-term public equity securities totaled \$3.5 million. A 10% adverse change in prices of these short-term equity securities would result in an approximate \$0.6 million decrease in the fair value of Novell's short-term investments.

In addition, Novell invests in equity securities, included in its long-term portfolio of investments, for the promotion of business and strategic objectives. These investments are generally in small capitalization stocks in the high-technology industry sector, both public and private, through direct investment or through investments in venture capital funds. Because of the nature of these investments, Novell is exposed to equity price risks. Novell typically does not attempt to reduce or eliminate its market exposure on these securities. A 10% adverse change in equity prices of long-term equity securities would result in an approximately \$9.0 million decrease in the fair value of Novell's available-for-sale long-term securities.

Foreign Currency Risk

Novell uses derivatives to hedge those net assets and liabilities that, when remeasured according to accounting principles generally accepted in the United States of America, impact the condensed consolidated statement of operations. Currency forward contracts are utilized in these hedging programs. All forward contracts entered into by the Company are components of hedging programs and are entered into for the sole purpose of hedging an existing or anticipated currency exposure, not for speculation or trading purposes. Gains and losses on these currency forward contracts would generally be offset by corresponding losses and gains on the net foreign currency assets and liabilities that they hedge, resulting in negligible net gain or loss overall on hedged exposures. The Company hedges balance sheet exposures only, with all gains and losses on forward contracts recognized in other income and expense in the same period as the gains and losses on remeasurement of the foreign currency denominated assets and liabilities occur. All gains and losses related to foreign exchange contracts are included in cash flows from operating activities in the condensed consolidated statement of cash flows. The Company's hedging programs reduce, but do not eliminate, the impact of foreign currency exchange rate movements. If Company did not hedge against foreign currency exchange rate movement of foreign currency denominated assets, liabilities, and investments, an increase or

decrease of 10% in exchange rates would result in an increase or decrease in income before taxes of approximately \$7.7 million. This number represents the exposure related to balance sheet remeasurements only and assumes that all currencies move in the same direction at the same time relative to the US dollar.

All of the potential changes noted above are based on sensitivity analyses performed on Novell's financial position at July 31, 2002. Actual results may differ materially.

Item 4. Controls and Procedures

There were no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Part II. Other Information

Except as listed below, all information required by items in Part II is omitted because the items are inapplicable or the answer is negative.

Item 1. Legal Proceedings.

The information required by this item is incorporated herein by reference to Footnote I of the Company's financial statements contained in Part I, Item 1 of this Form 10-Q.

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

None

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
10.1	Key Employment Agreement dated as of July 19, 2002 between Novell, Inc. and David Litwack, incorporated by reference to Exhibit (d) (4) to the Schedule TO filed by the Registrant with the SEC on June 18, 2002..
10.2	Novell, Inc./SilverStream Software, Inc. 1997 Stock Incentive Plan, incorporated by reference to Exhibit 4.2 of the Registrant's Registration Statement on Form S-8, filed August 6, 2002 (File No. 333-97713).
10.3	Novell, Inc./SilverStream Software, Inc. 2001 Stock Incentive Plan, incorporated by reference to Exhibit 4.3 of the Registrant's Registration Statement on Form S-8, filed August 6, 2002 (File No. 333-97713).
10.4	Novell, Inc./SilverStream Software, Inc./eObject, Inc. 2000 Stock Plan, incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form S-8, filed August 6, 2002 (File No. 333-97713).
10.5	Novell, Inc./SilverStream Software, Inc./Bondi Software, Inc. Employee Stock Option Plan , incorporated by reference to Exhibit 4.5 of the Registrant's Registration Statement on Form S-8, filed August 6, 2002 (File No. 333-97713).

(b) Reports on Form 8-K.

Notice of Novell's scheduled report of second quarter results and related conference call to be held on May 23, 2002, as filed May 6, 2002 under Item 5.

Agreement and Plan of Merger dated as of June 9, 2002 by and among Novell, Delaware Planet Inc., a Delaware corporation and a wholly-owned subsidiary of Novell and SilverStream Software, Inc., a Delaware corporation, as filed June 10, 2002 under Item 5.

Announcement of the closing of the tender offer by Novell, Inc. for the shares of SilverStream on July 19, 2002, as filed on July 17, 2002 under Item 2.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Novell, Inc.
(Registrant)

Date: September 16, 2002

/s/ Ronald C. Foster
Ronald C. Foster
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

CERTIFICATIONS

I, Jack L. Messman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novell, Inc;
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;

Date: September 16, 2002

/s/ Jack L. Messman
Jack. L. Messman

President and Chief Executive Officer
[Title]

I, Ronald C. Foster, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novell, Inc;
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;

Date: September 16, 2002

/s/ Ronald C. Foster
Ronald C. Foster

Chief Financial Officer
[Title]