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Jam Today or Jam Tomorrow Tech outfits like to front-load their licensing income. The game's over, but some put off the day of reckoning.

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ARTHROCARE MAKES A MEDICAL gizmo that cuts soft human tissue using radio frequency energy. But the Securities & Exchange Commission has a new accounting rule that's going to take a piece out of **ArthroCare**'s hide--along with that of other companies that depend on licensing revenue.

The SEC wants **ArthroCare** to kick the habit of booking licensing and royalty fees from multiyear contracts all at once when the contract is signed. Beginning in the fourth quarter licensing fees will have to be recognized over the life of an agreement; royalty fees, too, provided they're part of the deal.

For **ArthroCare**, licensing and royalty fees amounted to 10% of its $36 million in revenues for 2000's first six months. Booking certain fees up front has helped the company meet its high-growth earnings estimates.

Thanks in part to the fee gimmick, **ArthroCare**'s sales have doubled every year since the mid-1990s, and in 1999 the Sunnyvale, Calif. company moved into the black. So the stock, which had been dragging along at around $6 per share, took off. After it hit its high of $62 in late February, Chief Executive Michael Baker began unloading shares, reaping $10.6 million.

Some licensers, **ArthroCare** among them, saw the crackdown coming but have done all they can to postpone the crunch day. Others, though, have wisely chosen to get the pain over with early. Examples: insurance-software servicing company Mynd (formerly Policy Management Systems) and Cima Labs, a maker of fast-dissolving drug tablets. After Cima announced the change, its stock dropped to $13 from $19. "We just wanted to get it behind us," says David Feste, chief financial officer.

There will be more Cima-like stock volatility. And investors are in for some unpleasant surprises, warns Patricia McConnell, senior managing director at Bear Stearns.

ArthroCare has gone through several contortions on this issue, causing investor confusion and not helping the stock, which has tumbled to $18.

First it said in its 1999 annual report it would begin spreading out the revenue in the first quarter of 2000. Then the company said, in the first quarter report, it would start in the second. Next, in the second quarter report, the big day got put off yet again, until the fourth period. The foot-dragging may mean that Arthro will have to restate past quarters.

Other laggards include Aquila Biopharmaceuticals, which also first told investors it would quit being gluttonous in the second quarter. Oops, quick amendment: Make that the fourth, too. Chipmaker Intel, whose stock has been suffering lately, says it's waiting until the fourth as well. But it claims the rule won't have a material impact on earnings.

For **ArthroCare**, any postponement of revenue is painful. With product sales weak and competition strong, there was a chance **ArthroCare** was going to miss its second-quarter consensus estimate of 15 cents a share. It then threatened in early June to sue a rival, Stryker, for patent infringement and muscled an estimated $700,000 licensing deal out of Stryker three days before the quarter's close.

Doing so helped Arthro beat its earnings estimates by 3 cents. But with no big windfall in the third and weak sales, the company says it will miss the recent 19-cent forecast.

The folks who were buying the stock last winter should have seen this coming.

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