

INFORMATICA CORP
Form 10-Q
November 07, 2005

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

FORM 10-Q

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2005**

OR

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 0-25871
INFORMATICA CORPORATION
(Exact name of registrant as specified in its charter)**

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0333710
(I.R.S. Employer
Identification No.)

**100 Cardinal Way
Redwood City, California 94063**
(Address of principal executive offices)

(650) 385-5000

(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 (the Exchange Act) 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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes No

As of October 31, 2005, there were approximately 87,924,000 shares of the registrant's common stock outstanding.

**INFORMATICA CORPORATION
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Table of Contents**PART I: FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****INFORMATICA CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

	September 30, 2005	December 31, 2004
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 65,761	\$ 88,941
Short-term investments	190,735	152,160
Accounts receivable, net	32,928	42,535
Prepaid expenses and other current assets	9,841	7,837
Total current assets	299,265	291,473
Restricted cash	12,166	12,166
Property and equipment, net	22,287	20,063
Goodwill	81,897	82,245
Intangible assets, net	4,484	2,880
Other assets	768	941
Total assets	\$ 420,867	\$ 409,768
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 4,934	\$ 7,476
Accrued liabilities	14,855	15,581
Accrued compensation and related expenses	11,752	15,681
Income taxes payable	5,132	3,142
Accrued facilities restructuring charges	18,363	20,080
Accrued merger costs	64	209
Deferred revenues	69,015	62,443
Total current liabilities	124,115	124,612
Accrued facilities restructuring charges, less current portion	79,757	89,171
Accrued merger costs, less current portion	113	263
Total liabilities	203,985	214,046
Commitments and contingencies		
Stockholders equity:		
Common stock	392,273	390,035

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Deferred stock-based compensation	(292)	(1,000)
Accumulated deficit	(174,837)	(195,088)
Accumulated other comprehensive income (loss)	(262)	1,775
Total stockholders' equity	216,882	195,722
Total liabilities and stockholders' equity	\$ 420,867	\$ 409,768

See accompanying notes to condensed consolidated financial statements.

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INFORMATICA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Revenues:				
License	\$ 28,168	\$ 22,024	\$ 81,227	\$ 70,234
Service	36,829	30,404	106,366	89,401
Total revenues	64,997	52,428	187,593	159,635
Cost of revenues:				
License	862	727	2,707	2,452
Service	11,548	10,399	33,416	30,145
Amortization of acquired technology	227	585	696	1,740
Total cost of revenues	12,637	11,711	36,819	34,337
Gross profit	52,360	40,717	150,774	125,298
Operating expenses:				
Research and development	10,777	12,339	31,484	39,565
Sales and marketing	28,312	22,574	82,698	67,716
General and administrative	5,146	5,950	15,246	15,616
Amortization of intangible assets	47	47	141	150
Facilities restructuring charges	1,274	9,673	2,902	9,673
Total operating expenses	45,556	50,583	132,471	132,720
Income (loss) from operations	6,804	(9,866)	18,303	(7,422)
Interest income and other, net	1,911	1,014	4,515	2,129
Income (loss) before provision for income taxes	8,715	(8,852)	22,818	(5,293)
Income taxes provision (benefit)	414	(267)	2,567	422
Net income (loss)	\$ 8,301	\$ (8,585)	\$ 20,251	\$ (5,715)
Basic net income (loss) per common share	\$ 0.09	\$ (0.10)	\$ 0.23	\$ (0.07)
Diluted net income (loss) per common share	\$ 0.09	\$ (0.10)	\$ 0.22	\$ (0.07)
	87,568	86,002	87,112	85,566

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Shares used in computing basic net income (loss) per
common share

Shares used in computing diluted net income (loss) per
common share

93,571	86,002	91,126	85,566
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See accompanying notes to condensed consolidated financial statements.

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INFORMATICA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	September 30,	
	2005	2004
Operating activities		
Net income (loss)	\$ 20,251	\$ (5,715)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,691	7,468
Provision for doubtful accounts and sales and returns allowances	(151)	(126)
Amortization and compensation expense related to stock options	674	3,105
Amortization of intangible assets and acquired technology	837	1,890
Non-cash facilities restructuring charges	2,902	
Loss on sale of property and equipment	3	19
Changes in operating assets and liabilities:		
Accounts receivable	9,758	(3,605)
Prepaid expenses and other assets	(4,331)	(1,482)
Accounts payable and accrued liabilities	(3,268)	(1,680)
Accrued compensation and related expenses	(3,929)	(3,243)
Income taxes payable	1,893	(418)
Accrued facilities restructuring charges	(13,972)	6,399
Accrued merger costs	(58)	(232)
Deferred revenues	6,572	4,799
Net cash provided by operating activities	23,872	7,179
Investing activities		
Purchases of property and equipment	(9,219)	(2,067)
Purchases of investments	(174,650)	(150,397)
Maturities and sales of investments	135,906	138,232
Net cash used in investing activities	(47,963)	(14,232)
Financing activities		
Net proceeds from issuance of common stock	18,636	11,730
Repurchases and retirements of common stock	(16,156)	(6,118)
Net cash provided by financing activities	2,480	5,612
Effect of foreign exchange rate changes on cash and cash equivalents	(1,569)	172
Net decrease in cash and cash equivalents	(23,180)	(1,269)
Cash and cash equivalents at beginning of period	88,941	82,903

Cash and cash equivalents at end of period	\$ 65,761	\$ 81,634
Supplemental disclosures:		
Income taxes paid	\$ 294	\$ 188
Supplemental disclosures of non-cash investing and financing activities:		
Unrealized loss on short-term investments	\$ (169)	\$ (514)

See accompanying notes to condensed consolidated financial statements.

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Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1. Summary of Significant Accounting Policies*****Basis of Presentation***

The accompanying condensed consolidated financial statements of Informatica Corporation (the Company) have been prepared in conformity with accounting principles generally accepted in the United States. However, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, the financial statements include all adjustments necessary (which are of a normal and recurring nature, except see Note 4. Restructuring Charges for a description of other than normal recurring adjustments) for the fair presentation of the results of the interim periods presented. All of the amounts included in this report related to the condensed consolidated financial statements and notes thereto as of and for the three and nine months ended September 30, 2005 and 2004 are unaudited. The interim results presented are not necessarily indicative of results for any subsequent interim period, the year ended December 31, 2005 or any future period.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2004 included in the Company's Annual Report on Form 10-K filed with the SEC. The condensed consolidated balance sheet as of December 31, 2004 has been derived from the audited consolidated financial statements of the Company.

Revenue Recognition

The Company follows detailed revenue recognition guidelines, which are discussed below. The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America that have been prescribed for the software industry. The accounting rules related to revenue recognition are complex and are affected by interpretations of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant judgments, such as determining if collectibility is probable and if a customer is credit-worthy.

The Company recognizes revenue in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. The Company recognizes license revenues when a noncancelable license agreement has been signed, the product has been shipped or the Company has provided the customer with the access codes that allow for immediate possession of the software (collectively delivered), the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence (VSOE) of fair value exists to allocate the fee to the undelivered elements of the arrangement. VSOE is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price, which does not change before the element is made generally available, is established by authorized management. If an acceptance period is required, the Company recognizes revenue upon customer acceptance or the expiration of the acceptance period after all other revenue recognition criteria under SOP 97-2 have been met. The Company's standard agreements do not contain product return rights.

Credit-worthiness and collectibility are first assessed on a country level basis. Then, for those customers, including direct end users and the Company's indirect channel partners (resellers, distributors and original equipment manufacturers (OEMs)) in countries deemed to have sufficient timely payment history; customers are assessed based on their payment history and credit profile.

The country level assessment of credit-worthiness and collectibility has generally been performed annually with any changes in assessment effective on January 1st of the next fiscal year. In the beginning of 2005, the Company performed a country level assessment of credit-worthiness and determined 10 additional countries to be credit-worthy based on geopolitical and economic stability. These countries include France, where the Company has a direct sales channel, and Japan, where the Company has both direct and indirect sales channels, as well as Spain, Italy, Norway, Sweden, Denmark, Finland, Australia and New Zealand, where the sales channel consists of distributors. In each of the nine countries excluding France, the Company assessed the credit-worthiness and

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collectibility of its existing distributors and will continue to recognize revenue through these distributors upon cash receipt. However, effective January 1, 2005, in France, where the country level criteria have been met and individual customers are deemed credit-worthy, the Company has begun recognizing revenue upon shipment, rather than on cash receipt, after all other revenue recognition criteria under SOP 97-2 have been met, including, for resellers and distributors, evidence of sell-through to an identified end user. In the other nine countries where the individual distributors have not met the credit-worthiness and collectibility requirements, the Company will continue to reassess their status quarterly.

The Company's reseller and distributor arrangements typically provide for sublicense or end user license fees based on a percentage of list prices. Revenue arrangements with resellers and distributors require evidence of sell-through, that is, persuasive evidence that the products have been sold to an identified end user. For products sold indirectly through the Company's resellers and distributors, the Company recognizes revenue upon shipment and receipt of evidence of sell-through if the reseller or distributor has been deemed credit-worthy.

The Company also enters into OEM arrangement that provide for license fees based on inclusion of the Company's products in the OEM's products. These arrangements provide for fixed, irrevocable royalty payments. For credit-worthy OEMs, royalty payments are recognized based on the activity in the royalty report the Company receives from the OEM, or in the case of OEMs with fixed royalty payments, revenue is recognized when the related payment is due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt. In both cases, revenue is recognized after all other revenue recognition criteria under SOP 97-2 have been met.

The assessment of credit-worthiness for resellers, distributors and OEMs within countries that have been deemed to be credit-worthy generally takes place quarterly, with any changes effective at the beginning of the next fiscal quarter. Credit-worthiness for these partners is assessed based on established credit history consisting of sales of at least one million dollars and with timely payment history, generally for the last 12 months. In the third quarter of 2004, the Company's assessment of three resellers and OEMs determined that these customers were credit-worthy and effective October 2004, the Company began recognizing revenue from these customers upon shipment, after all other revenue recognition criteria under SOP 97-2 have been met.

Recently, for transactions to all customers, including direct end users, resellers, distributors and OEMs, where the customer was deemed credit-worthy, but where the stated payment terms of the transaction were greater than 45 days from the invoice date, the Company recognized revenue when the payments became due. In assessing this policy in light of the Company's continuing international expansion where stated payment terms can be slightly longer, the Company determined, effective January 1, 2005, that extending the threshold to 60 days on a world-wide basis is more reflective of the Company's standard payment terms with its customers. Therefore, effective January 1, 2005, the Company began to recognize revenue upon shipment for transactions with credit-worthy customers in credit-worthy countries with stated payment terms up to and including 60 days, after all other revenue recognition criteria under SOP 97-2 have been met. The Company has analyzed the impact of this change as though it had been implemented during 2004 and determined that this change would not have been material to its quarterly or annual revenue or results of operations in 2004. Those transactions with stated terms of more than 60 days will continue to be recognized when payments become due.

When a customer, including direct end users, resellers, distributors and OEMs, is not deemed credit-worthy, revenue is recognized when cash is received, after all other revenue recognition criteria under SOP 97-2 have been met.

The Company recognizes maintenance revenues, which consist of fees for ongoing support and product updates, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to implementation services and product enhancements performed on a time-and-materials basis or, on an infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of its software products. Education services revenues are generated from classes offered at the Company's headquarters, sales offices and customer locations. Revenues from consulting and education services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the

software or cash collections, provided services do not include significant customization or modification of the base product, and are not otherwise essential to the functionality of the software, and the payment terms for licenses are not dependent on additional acceptance criteria.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Deferred revenues include deferred license, maintenance, consulting, and education services revenue. The Company's practice is to net unpaid deferred items against the related receivables balances from those OEMs, specific resellers, distributors and specific international customers for which the Company defers revenue until payment is received.

Net Income (Loss) Per Common Share

Under the provisions of SFAS No. 128, *Earnings per Share*, basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share reflects the potential dilution of securities by adding other common stock equivalents, primarily stock options, to the weighted-average number of common shares outstanding during the period, if dilutive. Potentially dilutive securities have been excluded from the computation of diluted net income (loss) per share if their inclusion is antidilutive.

The calculation of basic and diluted net income (loss) per common share is as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss)	\$ 8,301	\$ (8,585)	\$ 20,251	\$ (5,715)
Weighted average shares outstanding	87,576	86,080	87,136	85,685
Weighted average unvested shares of common stock subject to repurchase	(8)	(78)	(24)	(119)
Shares used in computing basic net income (loss) per common share	87,568	86,002	87,112	85,566
Effect of dilutive securities	6,003		4,014	
Shares used in computing dilutive net income (loss) per common share	93,571	86,002	91,126	85,566
Basic net income (loss) per common share	\$ 0.09	\$ (0.10)	\$ 0.23	\$ (0.07)
Diluted net income (loss) per common share	\$ 0.09	\$ (0.10)	\$ 0.22	\$ (0.07)

Stock-based Compensation

The Company accounts for stock issued to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and complies with the disclosure provisions of Statement of Financial Accounting Standard (SFAS) No. 123, *Accounting for Stock-Based Compensation* and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. Under APB No. 25, compensation expense of fixed stock options is based on the difference, if any, on the date of the grant between the fair value of the Company's stock and the exercise price of the option. The Company amortizes its stock-based compensation under APB 25 using a straight-line basis over the remaining vesting term of the related options. The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

Pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS No. 148 as if the Company had accounted for its employee stock options and shares issued under the Employee Stock Purchase

Plan (ESPP) under the fair value method of SFAS No. 123. The fair value of the Company's stock-based awards to employees was estimated using the multiple option approach of the Black-Scholes option-pricing model. The related expense is amortized using an accelerated method over the vesting terms of the option as required by

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Financial Accounting Standards Board Interpretation (FIN) No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Awards Plans (an interpretation of APB Opinions No. 15 and 25)*.

The fair value of the Company's stock-based awards was estimated assuming no expected dividends with the following weighted-average assumptions:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Option Grants:				
Expected life of options (years)	3.9	3.1	3.1	3.0
Risk-free interest rate	4.0%	2.8%	3.8%	2.9%
Volatility	44%	78%	61%	83%
ESPP:				
Expected life of options (years)	1.25	1.25	1.25	1.25
Risk-free interest rate	3.9%	2.1%	3.5%	1.8%
Volatility	45%	56%	45%	60%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes model requires the input of subjective assumptions. In the third quarter of 2005, the Company re-evaluated the assumptions used in the Black-Scholes model and as a result, changed its computation of expected volatility from one based solely on historical volatility to volatility based on a combination of historical and market-based implied volatility. The Company's computation of expected life was also adjusted to be more representative of expected future exercise patterns. Also, during the first quarter of 2005, the Company modified its approach and updated certain assumptions with respect to determining the estimated fair value of shares granted under its employee stock purchase plan, and made other corrections to its 2004 pro forma charges. The previous amounts for the three and nine months ended September 30, 2004 have been revised to reflect these corrections. The pro forma stock-based compensation expense reported under the fair value method was previously reported as \$4.2 million and \$11.7 million for the three and nine months ended September 30, 2004, respectively.

Had compensation cost for the Company's stock-based compensation plans been determined using the fair value at the grant dates for awards under those plans calculated using the Black-Scholes method of SFAS No. 123, the Company's net income (loss) and basic and diluted net income (loss) per share would have been changed to the pro forma amounts indicated below (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Net income (loss), as reported	\$ 8,301	\$ (8,585)	\$ 20,251	\$ (5,715)
Stock-based employee compensation included in net income as reported, net of related tax effects *	212	405	674	3,105
Stock-based employee compensation using the fair value method, net of related tax effects *	(3,937)	(4,271)	(12,400)	(13,654)
Net income (loss), pro forma	\$ 4,576	\$ (12,451)	\$ 8,525	\$ (16,264)
Basic net income (loss) per common share:				
As reported	\$ 0.09	\$ (0.10)	\$ 0.23	\$ (0.07)

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Pro forma	\$ 0.05	\$ (0.14)	\$ 0.10	\$ (0.19)
Diluted net income (loss) per common share:				
As reported	\$ 0.09	\$ (0.10)	\$ 0.22	\$ (0.07)
Pro forma	\$ 0.05	\$ (0.14)	\$ 0.09	\$ (0.19)

* The tax effects on stock-based compensation have been fully reserved by way of a valuation allowance.

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These pro forma amounts may not be representative of the effects on reported income (loss) for future years as options vest over several years and additional awards are generally made each year.

Note 2. Comprehensive Income (Loss)

Other comprehensive income refers to gains and losses that, under the accounting principles generally accepted in the United States of America, are recorded as an element of stockholders' equity and are excluded from net income (loss).

Comprehensive income (loss) consisted of the following items (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss), as reported	\$ 8,301	\$ (8,585)	\$ 20,251	\$ (5,715)
Other comprehensive income (loss):				
Unrealized gain (loss) on investments *	(149)	226	(169)	(514)
Foreign currency translation adjustment *	(102)	73	(1,868)	(71)
Comprehensive income (loss)	\$ 8,050	\$ (8,286)	\$ 18,214	\$ (6,300)

Accumulated other comprehensive income (loss) as of September 30, 2005 and December 31, 2004 consisted of the following (in thousands):

	September 30, 2005	December 31, 2004
Unrealized loss on investments	\$ (814)	\$ (645)
Cumulative foreign currency translation adjustment	552	2,420
	\$ (262)	\$ 1,775

* The tax effect on unrealized gain (loss) on investment and foreign currency translation adjustment has not been significant.

Note 3. Goodwill and Intangible Assets

The carrying amount of the goodwill and intangible assets as of September 30, 2005 and December 31, 2004 is as follows (in thousands):

	September 30, 2005			December 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount

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Core technology	\$ 6,371	\$ (4,953)	\$ 1,418	\$ 6,429	\$ (4,257)	\$ 2,172
Purchased technology	2,500		2,500			
Developed technology	1,775	(1,775)		1,775	(1,775)	
Customer relationships	945	(379)	566	945	(237)	708
Patents	297	(297)		297	(297)	
Total intangible assets	\$ 11,888	\$ (7,404)	\$ 4,484	\$ 9,446	\$ (6,566)	\$ 2,880

Goodwill \$ 81,897 \$ 82,245

Amortization expense of intangible assets was approximately \$0.3 million and \$0.6 million for the three months ended September 30, 2005 and 2004, respectively, and \$0.8 million and \$1.9 million for the nine months ended September 30, 2005 and 2004, respectively. The weighted-average amortization periods of the Company's core technology, purchased technology, developed technology, customer relationships and patents are 3.5 years, 3 years, 1.25 years, 5 years and 3 years, respectively. In the first quarter of 2005, the Company purchased a source code license with a value of \$2.5 million of which \$35,000 is expected to be amortized in cost of revenues during the remainder of 2005, with approximately \$0.8 million, \$0.8 million, \$0.8 million and \$0.1 million amortized in cost of

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

revenues in 2006, 2007, 2008 and 2009, respectively. The remaining amortization expense related to identifiable intangible assets as of September 30, 2005 is expected to be \$0.3 million for the remainder of 2005, and \$1.1 million, \$0.5 million and \$0.1 million in 2006, 2007 and 2008, respectively. The total amortization expense related to identifiable intangible assets as of September 30, 2005 is expected to be \$0.3 million for the remainder of 2005, and \$1.9 million, \$1.3 million, \$0.9 million and \$0.1 million in 2006, 2007, 2008 and 2009, respectively.

Core technology at September 30, 2005 and December 31, 2004 totaling \$0.6 million and \$1.0 million, net, related to the Company's acquisition of Striva Corporation in September 2003, was recorded in a European local currency; therefore, the gross carrying amount and accumulated amortization are subject to periodic currency translation adjustments.

In the first quarter of 2005, the Company recorded a \$0.1 million decrease in goodwill related to closing out an escrow account. In the second quarter of 2005, the Company recorded a \$0.2 million decrease in goodwill related to a reduction of accrued merger costs.

Note 4. Facilities Restructuring Charges***2004 Restructuring Plan***

In October 2004, the Company announced a restructuring plan (2004 Restructuring Plan) related to the December 2004 relocation of the Company's corporate headquarters within Redwood City, California. In February 2005, the Company subleased approximately 187,000 square feet of its previous corporate headquarters at Pacific Shores Center through July 2013 with a right of termination by the tenant which is exercisable in July 2009. As a result, the Company recorded facilities restructuring charges (restructuring charges) of approximately \$103.6 million, consisting of \$21.6 million in leasehold improvement and asset write-offs and \$82.0 million related to estimated facility lease losses, which is comprised of the present value of lease payment obligations for the remaining nine year lease term of the previous corporate headquarters, net of actual and estimated sublease income. In June 2005, the Company entered into a sublease agreement to sublease approximately 51,000 square feet of its excess space at Pacific Shores Center through August 2008 with an option to renew through July 2013. The Company has actual and estimated sublease income, including the reimbursement of certain property costs such as common area maintenance, insurance and property tax, net of estimated broker commissions, of \$1.1 million for the remainder of 2005, \$4.3 million in 2006, \$4.5 million in 2007, \$4.4 million in 2008, \$2.3 million in 2009, \$0.8 million in 2010, \$3.1 million in 2011, \$3.7 million in 2012 and \$3.0 million in 2013. If the Company is unable to sublease the Pacific Shores Center facilities during the remaining optional lease term through 2013, restructuring charges could increase by approximately \$10.8 million.

The Company will recognize approximately \$21.3 million of accretion as a restructuring charge over the remaining term of the lease, or approximately eight years, as follows: \$1.1 million for the remainder of 2005; \$4.3 million in 2006; \$4.0 million in 2007; \$3.6 million in 2008; \$3.1 million in 2009; \$2.4 million in 2010; \$1.7 million in 2011; \$0.9 million in 2012; and \$0.2 million in 2013. Accretion represents imputed interest and is the difference between the Company's non-discounted future cash obligations and the discounted present value of these cash obligations.

2001 Restructuring Plan

During 2001, the Company announced a restructuring plan (2001 Restructuring Plan) and recorded restructuring charges of approximately \$12.1 million, consisting of \$1.5 million in leasehold improvement and asset write-offs and \$10.6 million related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas.

During 2002, the Company recorded additional restructuring charges of approximately \$17.0 million, consisting of \$15.1 million related to estimated facility lease losses and \$1.9 million in leasehold improvement and asset write-offs. The timing of the restructuring accrual adjustment was a result of negotiated and executed subleases for the Company's excess facilities in Dallas, Texas and Palo Alto, California during the third quarter of 2002. These subleases included terms that provided a lower level of sublease rates than the initial assumptions. The terms of

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

these new subleases were consistent with the continued deterioration of the commercial real estate market in these areas. In addition, cost containment measures initiated in the same quarter, such as delayed hiring and salary reductions, resulted in an adjustment to management's estimate of occupancy of available vacant facilities. These charges represent adjustments to the original assumptions, including the time period that the buildings will be vacant, expected sublease rates, expected sublease terms and the estimated time to sublease. The Company calculated the estimated costs for the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area.

In December 2004, the Company recorded additional restructuring charges of \$9.0 million related to estimated facility lease losses. The restructuring accrual adjustments recorded in the third and fourth quarters of 2004 were the result of the relocation of its corporate headquarters within Redwood City, California in December 2004, an executed sublease for the Company's excess facilities in Palo Alto, California during the third quarter of 2004 and an adjustment to management's estimate of occupancy of available vacant facilities. These charges represent adjustments to the original assumptions in the 2001 Restructuring Plan charges, including the time period that the buildings will be vacant; expected sublease rates; expected sublease terms; and the estimated time to sublease. The Company calculated the estimated costs for the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area. If the Company is unable to sublease any of the available vacant Pacific Shores facilities included in its 2001 Restructuring Plan during the remaining lease term through 2013, restructuring charges could increase by approximately \$3.3 million.

Inherent in the estimation of the costs related to the restructuring efforts are assessments of the Company's ability to generate sublease income. The estimates of sublease income may vary significantly depending, in part, on factors which may be beyond the Company's control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases.

A summary of the activity of the accrued restructuring charges for the nine months ended September 30, 2005 and 2004 are as follows (in thousands):

	Accrued Restructuring Charges at December 31, 2004	Restructuring Charges	Adjustments	Net		Accrued Restructuring Charges at September 30, 2005
				Cash Payment	Non-cash Reclass	
2004 Restructuring Plan						
Excess lease facilities	\$ 88,521	\$ 3,633	\$ (784)	\$ (10,711)	\$ (61)	\$ 80,598
2001 Restructuring Plan						
Excess lease facilities	20,730		53	(3,261)		17,522
	\$ 109,251	\$ 3,633	\$ (731)	\$ (13,972)	\$ (61)	\$ 98,120

	Accrued Restructuring Charges at December 31, 2003	Restructuring Charges	Net		Accrued Restructuring Charges at September 30, 2004
			Cash Payment	Non-cash Reclass	
2001 Restructuring Plan					
Excess lease facilities	\$ 15,167	\$ 9,673	\$ (3,274)		\$ 21,566

In the three months ended September 30, 2005, the Company recorded \$1.3 million of restructuring charges. This charge included \$1.2 million of accretion charges and a \$0.1 million adjustment related to the 2004 Restructuring Plan due to an increase in lease operating expense assumptions. In the nine months ended September 30, 2005, the Company recorded \$2.9 million of restructuring charges. This charge included \$3.6 million of accretion charges, and a \$0.6 million adjustment related to the 2004 Restructuring Plan due to an increase in lease operating expense assumptions, offset by an adjustment to reflect a \$1.3 million increase in the Company's assumed sublease income. As of September 30, 2005, \$18.4 million of the \$98.1 million accrued restructuring charges was classified as current liabilities and the remaining \$79.7 million was classified as noncurrent liabilities.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The accrued merger costs include transaction costs and an accrual for excess leased facilities formerly occupied by Striva. In accordance with EITF No. 95-3, *Recognition of Liabilities in Connection with a Business Combination*, the liability associated with this restructuring is considered a liability assumed in the purchase price allocation. The \$2.1 million merger accrual was adjusted by \$0.2 million in both 2004 and 2003 to \$1.7 million. Of the \$1.7 million accrued merger costs included in the purchase price, \$0.2 million and \$1.0 million were paid in 2004 and 2003, respectively, and \$21,000 and \$57,000 were paid during the three and nine months ended September 30, 2005, respectively. During the second quarter of 2005, the Company reduced accrued merger costs by approximately \$0.2 million, resulting in a decrease in the goodwill balance due to an adjustment in facility restructuring assumptions. As of September 30, 2005, \$64,000 of these costs was classified as current liabilities and \$0.1 million was classified as noncurrent liabilities.

Note 5. Commitments and Contingencies***Lease Obligations***

In December 2004, the Company relocated its corporate headquarters within Redwood City, California and entered into a new lease agreement. The lease term is from December 15, 2004 to December 31, 2007 (with a three-year renewal option). Minimum contractual lease payments are \$1.5 million, \$1.9 million and \$2.1 million for the years ended December 31, 2005, 2006 and 2007, respectively.

The Company entered into two lease agreements in February 2000 for two office buildings in Redwood City, California, which it occupied in August 2001. The lease expires in July 2013. As part of these agreements, the Company purchased certificates of deposit totaling \$12.2 million as a security deposit for lease payments until certain financial milestones are met. The letter of credit may be reduced to an amount not less than three months of the base rent at the then current rate if the Company's annual revenues reach \$750 million, and the Company has quarterly operating profits of at least \$100 million for no less than four consecutive calendar quarters. These certificates of deposit are classified as long-term restricted cash on the Company's consolidated balance sheet.

The Company leases certain office facilities under various noncancelable operating leases, including those described above, which expire at various dates through 2013 and require the Company to pay operating costs, including property taxes, insurance and maintenance. Operating lease payments in the table below include approximately \$128.7 million, net of actual sublease income, for operating lease commitments for facilities that are included in restructuring charges. See Note 4, Restructuring Charges, above for a further discussion.

Future minimum lease payments as of September 30, 2005 under noncancelable operating leases with original terms in excess of one year are summarized as follows (in thousands):

	Operating Leases	Sublease Income	Net
Remaining 2005	\$ 5,319	\$ (868)	\$ 4,451
2006	21,397	(3,163)	18,234
2007	20,267	(2,397)	17,870
2008	16,815	(2,392)	14,423
2009	17,270	(1,242)	16,028
Thereafter	61,692		61,692
	\$ 142,760	\$ (10,062)	\$ 132,698

In June 2005, the Company subleased 51,000 square feet of office space at Pacific Shores Center, its previous corporate headquarters, in Redwood City, California through August 2008 with an option to renew through July 2013. In February 2005, the Company subleased 187,000 square feet of office space at Pacific Shores Center for the remainder of the lease term through July 2013 with a right of termination by the subtenant which is exercisable in July 2009. In 2004, the Company signed sublease agreements for leased office space in Palo Alto and Scotts Valley,

California. In 2003, the Company signed sublease agreements for leased office space in San Francisco, Palo Alto and Redwood City, California. During 2002, the Company signed sublease agreements for leased office space in Palo Alto, California and Carrollton, Texas.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Warranties***

The Company generally provides a warranty for its software products and services to its customers for a period of three to six months and accounts for its warranties under the Financial Accounting Standards Board (FASB) SFAS No. 5, *Accounting for Contingencies*. The Company s software products media are generally warranted to be free from defects in materials and workmanship under normal use, and the products are also generally warranted to substantially perform as described in certain Company documentation and the product specifications. The Company s services are generally warranted to be performed in a professional manner and to materially conform to the specifications set forth in a customer s signed contract. In the event there is a failure of such warranties, the Company generally will correct or provide a reasonable work around or replacement product. The Company has provided a warranty accrual of \$0.2 million as of September 30, 2005 and December 31, 2004. To date, the Company s product warranty expense has not been significant.

Indemnification

The Company sells software licenses and services to its customers under contracts, which the Company refers to as the License to Use Informatica Software (License Agreement). Each License Agreement contains the relevant terms of the contractual arrangement with the customer, and generally includes certain provisions for indemnifying the customer against losses, expenses, liabilities and damages that may be awarded against the customer in the event the Company s software is found to infringe upon a patent, copyright, trademark, or other proprietary right of a third party. The License Agreement generally limits the scope of and remedies for such indemnification obligations in a variety of industry-standard respects, including but not limited to certain time and scope limitations and a right to replace an infringing product with a non-infringing product.

The Company believes its internal development processes and other policies and practices limit its exposure related to the indemnification provisions of the License Agreement. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which assigns the rights to its employees development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions, and no material claims against the Company are outstanding as of September 30, 2005. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the License Agreement, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

Litigation

On November 8, 2001, a purported securities class action complaint was filed in the United States District Court for the Southern District of New York. The case is entitled *In re Informatica Corporation Initial Public Offering Securities Litigation*, Civ. No. 01-9922 (SAS) (S.D.N.Y.), related to *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS) (S.D.N.Y.). Plaintiffs amended complaint was brought purportedly on behalf of all persons who purchased the Company s common stock from April 29, 1999 through December 6, 2000. It names as defendants Informatica Corporation, two of the Company s former officers (the Informatica defendants), and several investment banking firms that served as underwriters of the Company s April 29, 1999 initial public offering and September 28, 2000 follow-on public offering. The complaint alleges liability as to all defendants under Sections 11 and/or 15 of the Securities Act of 1933 and Sections 10(b) and/or 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statements for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also alleges that false analyst reports were issued. No specific damages are claimed.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the Court ruled on all defendants motions to dismiss. The Court denied the motions to dismiss the claims under the Securities Act of 1933. The Court denied the motion to dismiss the Section 10(b) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(b) and 20(a) claims against the

Informatica defendants and 62 other individual defendants.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company accepted a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Informatica defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims the Company may have against the underwriters. The Informatica defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which the Company does not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. The Court has set a hearing date of January 9, 2006 to consider final approval of the settlement.

On July 15, 2002, the Company filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. (Acta), now known as Business Objects Data Integration, Inc. (BODI), asserting that certain Acta products infringe on three Company patents: U.S. Patent No. 6,014,670, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing ; U.S. Patent No. 6,339,775, entitled Apparatus and Method for Performing Data Transformations in Data Warehousing (this patent is a continuation-in-part of and claims the benefit of U.S. Patent No. 6,014,670); and U.S. Patent No. 6,208,990, entitled Method and Architecture for Automated Optimization of ETL Throughput in Data Warehousing Applications. On July 17, 2002, the Company filed an amended complaint alleging that Acta products also infringe on one additional patent: U.S. Patent No. 6,044,374, entitled Object References for Sharing Metadata in Data Marts. In the suit, the Company is seeking an injunction against future sales of the infringing Acta/BODI products, as well as damages for past sales of the infringing products. The Company has asserted that BODI s infringement of the Informatica patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI has not made any claims for monetary relief against the Company and has not filed any counterclaims alleging that the Company has infringed any BODI s patents. The parties presented their respective claim constructions to the Court on September 24, 2003, and on August 1, 2005, the Court issued its claims construction order. The Company believes that the issued claims construction order is favorable to the Company s position on the infringement action. The matter is currently in the discovery phase.

The Company is also a party to various legal proceedings and claims arising from the normal course of business activities.

Based on current available information, the Company does not expect that the ultimate outcome of these unresolved matters, individually or in the aggregate, will have a material adverse effect on its results of operations, cash flows or financial position.

Note 6. Income Taxes

The Company recorded an income tax provision of \$0.4 million and \$2.6 million for the three and nine months ended September 30, 2005, respectively. The \$0.4 million income tax provision for the three months ended September 30, 2005 includes \$1.0 million of federal alternative minimum taxes, income and withholding taxes attributable to foreign operations, and a \$0.3 million benefit based on the filing of our 2004 federal income tax returns. In addition, results from a foreign income tax examination were concluded in early November 2005 and, the Company reversed previously accrued tax reserves giving rise to a \$0.3 million benefit that is reflected in the third quarter s tax provision. The expected tax provision derived from applying the federal statutory rate to the Company s income before income taxes for the nine month period ended September 30, 2005 differed from the recorded income tax provision primarily due to the reversal of a portion of the Company s valuation allowance to reflect the utilization of approximately \$6.4 million of tax attributes partially offset by foreign income and withholding taxes of \$1 million and state taxes of \$0.6 million.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the three and nine months ended September 30, 2004, the Company recorded an income tax benefit of \$0.3 million and an income tax provision of \$0.4 million, respectively. These income tax amounts are primarily comprised of \$0.2 million and \$0.9 million of federal alternative minimum taxes, income and withholding taxes for the three and nine months ended September 30, 2004, respectively, reduced by a \$0.5 million benefit based on the Company's federal income tax returns filed in the third quarter of 2004.

Note 7. Stock Repurchases

On July 2, 2004, the Company announced a share repurchase program for up to five million shares of the Company's common stock. Purchases may be made from time to time in the open market and will be funded from available working capital. The number of shares to be purchased and the timing of purchases will be based on the level of the Company's cash balances and general business and market conditions. For the three and nine months ended September 30, 2005, the Company purchased 362,500 shares at a cost of \$3.9 million and 1,900,000 shares at a cost of \$16.2 million, respectively. These shares were retired and reclassified as authorized and unissued shares of common stock. The share repurchase program is currently scheduled to expire at the end of 2005.

Note 8. Recent Accounting Pronouncements

In June 2005, the FASB issued SFAS Statement No. 154, *Accounting Changes and Error Corrections*, (SFAS No. 154), which replaces APB No. 20, *Accounting Changes*, and FAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. APB Opinion No. 20 previously required that most voluntary changes in accounting principles be recognized by including the cumulative affect of changing to the new accounting principle in net income in the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable. SFAS No. 154 enhances the consistency of financial information between periods. SFAS No. 154 will be effective beginning with the Company's first quarter of fiscal year 2006. The Company does not expect that the adoption of SFAS No. 154 to have a material impact on its results of operations or financial position.

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004) (SFAS No. 123(R)), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative to financial statement recognition. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under current accounting rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption, but will result in no change to total cash flow. As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method. As a consequence, the Company generally recognizes no compensation cost for employee stock options and purchases under the Company's ESPP. In January 2005, the U.S. Securities Exchange Commission issued Staff Accounting Bulletin No. 107, which provides supplemental implementation guidance for SFAS No. 123(R). The Company is required to adopt SFAS No. 123(R) in the first quarter of 2006. The Company anticipates that it will adopt SFAS No. 123(R) using the modified prospective method, under which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the previous requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date. The Company has selected the Black-Scholes option pricing model as the most appropriate fair-value method for its award and will recognize compensation cost on a straight-line basis over the Company's awards' vesting periods. Although the Company has not completed its evaluation of the impact of this accounting pronouncement, the adoption of SFAS No. 123(R)'s fair value method will have no adverse impact on the Company's total cash flows, but will reduce the

Company's net income and diluted earnings per share. The actual effects of adopting SFAS No. 123(R) will depend on numerous factors including the amounts of share-based payments granted in the future, stock price volatility, employee stock option exercise behavior and estimated forfeiture rates. See Note 1. Summary of Significant Accounting Policies *Stock-Based Compensation*, above, for the effect on reported net income (loss) and earnings per share if the Company had accounted for its stock option and stock purchase plans using the fair value recognition provisions of SFAS No.123.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 9. Significant Customer Information and Segment Reporting**

The Company has adopted the provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which establishes standards for the manner in which public companies report information about operating segments in annual and interim financial statements. It also establishes standards for related disclosures about products and services, geographic areas and major customers. The method for determining the information to report is based on the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance.

The Company's chief operating decision-maker is considered to be the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. On this basis, the Company is organized and operates in a single segment: the design, development and marketing of software solutions.

The following table presents geographic information (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Revenues:				
North America	\$ 44,906	\$ 38,794	\$ 128,811	\$ 114,998
Europe	18,408	12,257	53,009	38,598
Other	1,683	1,377	5,773	6,039
	\$ 64,997	\$ 52,428	\$ 187,593	\$ 159,635

	September	December
	30,	31,
	2005	2004
Long-lived assets (excluding goodwill):		
North America	\$ 23,361	\$ 18,982
Europe	2,803	3,476
Other	607	485
	\$ 26,771	\$ 22,943

No customer accounted for more than 10% of the Company's total revenues in the three and nine months ended September 30, 2005 and 2004. At September 30, 2005 and 2004, no single customer accounted for more than 10% of the accounts receivable balance.

10. Subsequent Event

In early November 2005, results from a foreign income tax examination were concluded, and, as a result, the Company reversed previously accrued tax reserves giving rise to a \$0.3 million benefit that is reflected in the tax provision for the three and nine months ended September 30, 2005.

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

This quarterly report on Form 10-Q includes forward-looking statements within the meaning of the federal securities laws, particularly statements referencing our expectations relating to license revenues, service revenues, deferred revenues, cost of license revenues as a percentage of license revenues, cost of service revenues as a percentage of service revenues and operating expenses as a percentage of total revenues; the recording of amortization of acquired technology and stock-based compensation; provision for income taxes; deferred taxes; international expansion beyond North America and Europe; the ability of our products to meet customer demand; expected savings from our 2004 Restructuring Plan; the extent to which we may generate revenues from the use or sale of elements of our analytic applications; the sufficiency of our cash balances and cash flows for the next 12 months; our stock repurchase program; potential investments of cash or stock to acquire or invest in complementary businesses, products or technologies; the impact of recent changes in accounting standards; and assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, intends, plans, anticipates, estimates, potential, or continue, or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, these expectations or any of the forward-looking statements could prove to be incorrect, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to risks and uncertainties, including but not limited to the factors set forth under the heading "Risk Factors". All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof, and we assume no obligation to update any such forward-looking statements or reasons why actual results may differ.

The following discussion should be read in conjunction with our condensed consolidated financial statements and notes thereto appearing elsewhere in this report.

Overview

We are a leading provider of enterprise data integration software. We generate revenues from sales of software licenses and services. Our license revenues are derived from our data integration software products. We receive software license revenues from licensing our products directly to end users and indirectly through resellers, distributors and OEMs. We receive service revenues from maintenance contracts, consulting services and education services that we perform for customers that license our products either directly or indirectly.

We license our software and provide services to many industry sectors, including, but not limited to, financial services, communications, pharmaceuticals, insurance, manufacturing, utilities, government and retail. We market and sell our software and services through our global direct sales force in the United States, Canada, France, Germany, the Netherlands, Switzerland, the United Kingdom and Japan. We also maintain relationships with a variety of strategic partners to jointly develop, market, sell, recommend and/or implement our solutions. In addition, we also have relationships with distributors in various regions, including Europe, Asia-Pacific, Australia, Japan and Latin America, who sublicense our products and provide service and support within their territories. Most of our international sales have been in Europe. Revenues outside of Europe and North America, which consists of the United States and Canada, were 4% or less of total consolidated revenues in 2003, 2004 and the nine months ended September 30, 2005, but we anticipate further expansion outside of these two regions in the future.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based

upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. For further information on our critical accounting policies, see the discussion in Note 1, Summary of Significant Accounting Policies of notes to condensed consolidated financial statements and Note 8, Recent Accounting Pronouncements in this Report.

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Our senior management has reviewed these critical accounting policies and related disclosures with our Audit Committee. See Note 1 of notes to consolidated financial statements filed in our 2004 Annual Report on Form 10-K, which contains additional information regarding our significant accounting policies and other disclosures required by GAAP. We believe the following critical accounting policies involve our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

Revenue Recognition

We follow detailed revenue recognition guidelines, which are discussed below. We recognize revenue in accordance with GAAP guidance that has been prescribed for the software industry. The accounting rules related to revenue recognition are complex and are affected by interpretations of the rules and an understanding of industry practices, both of which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant judgments, such as determining if collectibility is probable and if a customer is credit-worthy.

We recognize revenue in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. We recognize license revenues when a noncancelable license agreement has been signed, the product has been shipped or we have provided the customer with the access codes that allow for immediate possession of the software (collectively delivered), the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence (VSOE) of fair value exists to allocate the fee to the undelivered elements of the arrangement. VSOE is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price, which does not change before the element is made generally available, is established by authorized management. If an acceptance period is required, we recognize revenue upon customer acceptance or the expiration of the acceptance period after all other revenue recognition criteria under SOP 97-2 have been met. Our standard agreements do not contain product return rights.

Credit-worthiness and collectibility are first assessed on a country level basis. Then, for those customers, including direct end users and our indirect channel partners (resellers, distributors and original equipment manufacturers (OEMs)) in countries deemed to have sufficient timely payment history, customers are assessed based on their payment history and credit profile.

The country level assessment of credit-worthiness and collectibility has generally been performed annually with any changes in assessment effective on January 1st of the next fiscal year. In the beginning of 2005, we performed a country level assessment of credit-worthiness and determined 10 additional countries to be credit-worthy based on geopolitical and economic stability. These countries include France, where we have a direct sales channel and Japan, where we have both direct and indirect sales channels, as well as Spain, Italy, Norway, Sweden, Denmark, Finland, Australia and New Zealand, where our sales channel consists of distributors. In each of the nine countries, excluding France, we assessed the credit-worthiness and collectibility of our existing distributors and will continue to recognize revenue through these distributors upon cash receipt. However, effective January 1, 2005, in France, where the country level criteria have been met and individual customers are deemed credit-worthy, we have begun recognizing revenue upon shipment, rather than on cash receipt, after all other revenue recognition criteria under SOP 97-2 have been met, including, for resellers and distributors, evidence of sell-through to an identified end user. In the other nine countries where the individual distributors have not met the credit-worthiness and collectibility requirements, we will continue to reassess their status quarterly.

Our reseller and distributor arrangements typically provide for sublicense or end user license fees based on a percentage of list prices. Revenue arrangements with resellers and distributors require evidence of sell-through, that is, persuasive evidence that the products have been sold to an identified end user. For products sold indirectly through our resellers and distributors, we recognize revenue upon shipment and receipt of evidence of sell-through if the reseller or distributor has been deemed credit-worthy.

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We also enter into OEM arrangements that provide for license fees based on inclusion of our products in the OEM's products. These arrangements provide for fixed, irrevocable royalty payments. For credit-worthy OEMs, royalty payments are recognized based on the activity in the royalty report we receive from the OEM, or in the case of OEMs with fixed royalty payments, revenue is recognized when the related payment is due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt. In both cases, revenue is recognized after all other revenue recognition criteria under SOP 97-2 have been met.

The assessment of credit-worthiness for resellers, distributors and OEMs within countries that have been deemed to be credit-worthy generally takes place quarterly, with any changes effective at the beginning of the next fiscal quarter. Credit-worthiness for these partners is assessed based on established credit history consisting of sales of at least one million dollars and with timely payment history, generally for the last 12 months. In the third quarter of 2004, our assessment of three resellers and OEMs determined that these customers were credit-worthy and effective October 2004, we began recognizing revenue from these customers upon shipment, after all other revenue recognition criteria under SOP 97-2 have been met.

For transactions to all customers, including direct end users, resellers, distributors and OEMs, where the customer is deemed credit-worthy, but where the stated payment terms of the transaction are greater than 45 days from the invoice date, we recognized revenue when the payments become due. In assessing this policy in light of our continuing international expansion where stated payment terms can be slightly longer, we determined, effective January 1, 2005, that extending the threshold to 60 days on a world-wide basis would be more reflective of the Company's standard payment terms with its customers. Therefore, effective January 1, 2005, we began to recognize revenue upon shipment for transactions with credit-worthy customers in credit-worthy countries with stated payment terms up to and including 60 days, after all other revenue recognition criteria under SOP 97-2 have been met. We have analyzed the impact of this change as though it had been implemented during 2004 and determined that this change would not have been material to our quarterly or annual revenue or results of operations in 2004. Those transactions with stated terms of more than 60 days will continue to be recognized when payments become due.

When a customer, including direct end-users, resellers, distributors and OEMs, is not deemed credit-worthy, revenue is recognized when cash is received, after all other revenue recognition criteria under SOP 97-2 have been met.

We recognize maintenance revenues, which consist of fees for ongoing support and product updates and upgrades, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to implementation services and product enhancements performed on a time-and-materials basis or, on an infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of our software products. Education services revenues are generated from classes offered at our headquarters, sales offices and customer locations. Revenues from consulting and education services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the software or cash collections, provided services do not include significant customization or modification of the base product and are not otherwise essential to the functionality of the software, and the payment terms for licenses are not dependent on additional acceptance criteria.

Deferred revenues include deferred license, maintenance, consulting and education services revenues. Our practice is to net unpaid deferred items against the related receivables balances from those OEMs, specific resellers, distributors and specific international customers for which we defer revenue until payment is received.

Allowance for Sales Returns and Doubtful Accounts

We maintain allowances for sales returns on revenues in the same period as the related revenues are recorded. We make an estimate of our expected returns and provide an allowance for sales returns in accordance with Statement of Financial Accounting Standard (SFAS) No. 48, *Revenue Recognition When Right of Return Exists*. These estimates require management judgment and are based on historical sales returns and other known factors. To date, sales returns have been infrequent and not significant in relation to our total revenues. However, if these estimates do not adequately reflect future sales returns, revenues could be overstated.

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We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. In cases where we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations to us, we record a specific allowance against amounts due to us. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are past due, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. At September 30, 2005 and December 31, 2004, our allowance for doubtful accounts balance, which related to our historical experience applied to accounts receivable not specifically reserved and to a lesser extent specific accounts where we believe collection is not probable, was \$0.6 million and \$0.8 million, respectively. These amounts represent 2% of total accounts receivable at September 30, 2005 and December 31, 2004.

Impairment of Goodwill

We assess goodwill for impairment in accordance with SFAS No. 142, *Goodwill and other Intangible Assets*, which requires that goodwill be tested for impairment at the reporting unit level (Reporting Unit) at least annually and more frequently upon the occurrence of certain events, as defined by SFAS No. 142. Consistent with our determination that we have only one reporting segment, we have determined that there is only one Reporting Unit, specifically the license, implementation and support of our software products. Goodwill was tested for impairment in our annual impairment tests on October 31 using the two-step process required by SFAS No. 142. First, we reviewed the carrying amount of the Reporting Unit compared to the fair value of the Reporting Unit based on quoted market prices of our common stock and the discounted cash flows based on analyses prepared by management. Our cash flow forecasts are based on assumptions that are consistent with the plans and estimates being used to manage the business. An excess carrying value compared to fair value would indicate that goodwill may be impaired. Second, if we determine that goodwill may be impaired, then we compare the implied fair value of the goodwill, as defined by SFAS No. 142, to its carrying amount to determine the impairment loss, if any.

Based on these estimates, we determined in our annual impairment tests as of October 31 of each year that the fair value of the Reporting Unit exceeded the carrying amount and accordingly, goodwill was not impaired. Assumptions and estimates about future values and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, different assumptions and estimates could materially impact our reported financial results. Accordingly, future changes in market capitalization or estimates used in discounted cash flows analyses could result in significantly different fair values of the Reporting Unit, which may result in impairment of goodwill.

Facilities Restructuring Charges

During the fourth quarter of 2004, we recorded significant charges (2004 Restructuring Plan) related to the relocation of our corporate headquarters to take advantage of more favorable lease terms and reduced operating expenses. In addition, we significantly increased the 2001 restructuring charges (2001 Restructuring Plan) in the third and fourth quarters of 2004 due to changes in our assumptions used to calculate the original charge as a result of our decision to relocate our corporate headquarters. The accrued restructuring charges represent gross lease obligations and estimated commissions and other costs (principally leasehold improvements and asset write-offs), offset by actual and estimated gross sublease income, which is net of estimated broker commissions and tenant improvement allowances, expected to be received over the remaining lease terms.

These liabilities include management's estimates pertaining to sublease activities. Inherent in the estimation of the costs related to the restructuring efforts are assessments of our ability to generate sublease income. The company has signed subleases with two subtenants for varying durations and rates, and is continuing to market the remaining space in this facility. The benefit of these subleases is currently reflected in the 2004 Restructuring Reserve. We will continue to evaluate the commercial real estate market conditions periodically to determine if our estimates of the amount and timing of future sublease income are reasonable based on current and expected commercial real estate market conditions. Our estimates of sublease income may vary significantly depending, in part, on factors which may be beyond our control, such as the extension or cancellation of the existing subleases, the time periods required to

locate and contract suitable new subleases and the market rates at the time of such subleases.

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If we determine that there is further deterioration in the estimated sublease rates or in the expected time it will take us to sublease our vacant space or should there be an unanticipated early termination of a sublease for the vacant space, we may incur additional restructuring charges in the future and our cash position could be adversely affected. For example, we increased our 2001 Restructuring Plan charges in 2002 and 2004 based on the continued deterioration in the San Francisco Bay Area and Dallas, Texas real estate markets. Future adjustments to the charges could result from a change in the time period that the buildings will be vacant, expected sublease rate, expected sublease terms and the expected time it will take to sublease. We will periodically assess the need to update the original restructuring charges based on current real estate market information and trend analysis and executed sublease agreements.

Deferred Taxes

We recorded a full valuation allowance to reduce all of our deferred tax assets to the amount that is likely to be realized. We have considered future taxable income and ongoing tax planning strategies in assessing the need for a valuation allowance; however, if it were determined that we would be able to realize all or part of our deferred tax assets in the future, an adjustment to the deferred tax asset would decrease our tax rate and increase income in the period in which such determination was made. Likewise, if we determined that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period in which such determination was made.

Recent Accounting Pronouncements

For recent accounting pronouncements see Note 8. Recent Accounting Pronouncements to the Condensed Consolidated Financial Statements under Part I, Item 1 of this Report.

Table of Contents**Results of Operations**

The following table presents certain financial data for the three and nine months ended September 30, 2005 and 2004 as a percentage of total revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues:				
License	43%	42%	43%	44%
Support and service	57	58	57	56
Total revenues	100	100	100	100
Cost of revenues:				
License	1	1	1	2
Support and service	18	20	18	19
Amortization of acquired technology		1		1
Total cost of revenues	19	22	20	22
Gross margin	81	78	80	78
Operating expenses:				
Research and development	17	24	17	25
Sales and marketing	43	43	44	42
General and administrative	8	11	8	10
Amortization of intangible assets				
Restructuring charges	2	18	2	6
Total operating expenses	70	96	71	83
Income (loss) from operations	11	(18)	10	(5)
Interest income and other, net	3	2	2	1
Income (loss) before income taxes	14	(16)	13	(4)
Income taxes provision (benefit)	1	(1)	2	
Net income (loss)	13%	(15)%	11%	(4)%

Revenues

The following sets forth, for the periods indicated, our revenues (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Change	2005	2004	Change
License revenues	\$ 28,168	\$ 22,024	28%	\$ 81,227	\$ 70,234	16%
Service revenues:						
Maintenance revenues	25,882	21,639	20%	75,004	64,471	16%
Consulting and education revenues	10,947	8,765	25%	31,362	24,930	26%

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Total service revenues	36,829	30,404	21%	106,366	89,401	19%
Total revenues	\$ 64,997	\$ 52,428	24%	\$ 187,593	\$ 159,635	18%

Our total revenues increased to \$65.0 million for the three months ended September 30, 2005 from \$52.4 million for the three months ended September 30, 2004 representing an increase of \$12.6 million or 24%. Total revenues increased to \$187.6 million for the nine months ended September 30, 2005 from \$159.6 million for the nine months ended September 30, 2004 representing an increase of \$28.0 million or 18%.

Table of Contents***License Revenues***

Our license revenues increased to \$28.2 million and \$81.2 million for the three and nine months ended September 30, 2005, respectively, from \$22.0 million and \$70.2 million for the three and nine months ended September 30, 2004, respectively. The \$6.1 million or 28% increase for the three months ended September 30, 2005 and the \$11.0 million or 16% increase for the nine months ended September 30, 2005 compared to the same periods in 2004 were primarily due to an increase in transaction volume. While the average transaction amount remained approximately the same in the three and nine month periods ended September 30, 2005 compared to the same periods in 2004, international license revenues increased in 2005, as a result of our continued expansion in the European and Asia-Pacific markets.

Service Revenues***Maintenance Revenues***

Maintenance revenues increased to \$25.9 million for the three months ended September 30, 2005 from \$21.6 million for the three months ended September 30, 2004 and increased to \$75.0 million for the nine months ended September 30, 2005 from \$64.5 million for the nine months ended September 30, 2004. The \$4.2 million or 20% increase and \$10.5 million or 16% increase for the three and nine months ended September 30, 2005, respectively, compared to the same periods in 2004, were primarily due to consistently strong renewals of maintenance contracts in 2005 coupled with the increasing size of our customer base. For the remainder of 2005, we expect maintenance revenues to increase from the third quarter of 2005 as we continue to increase our customer base.

Consulting and Education Services Revenues

Consulting and education services revenues increased to \$10.9 million for the three months ended September 30, 2005 from \$8.8 million for the three months ended September 30, 2004 and increased to \$31.4 million for the nine months ended September 30, 2005 from \$24.9 million for the nine months ended September 30, 2004. The \$2.2 million or 25% increase and \$6.4 million or 26% increase for the three and nine months ended September 30, 2005, respectively, compared to the same periods in 2004 were primarily due to an increase in demand in consulting and education services in North America. For the remainder of 2005, we expect revenues from consulting and education services to remain relatively consistent with, or increase modestly from the third quarter of 2005.

International Revenues

Our international revenues increased to \$20.1 million for the three months ended September 30, 2005 from \$13.6 million for the three months ended September 30, 2004 and increased to \$58.8 million for the nine months ended September 30, 2005 from \$44.6 million for the nine months ended September 30, 2004. The \$6.5 million or 47% increase and \$14.2 million or 32% increase for the three and nine months ended September 30, 2005, respectively, compared to the same periods in 2004 were primarily due to 89% and 46% increases in international license revenue for the three and nine months ended September 30, 2005, respectively, as a result of our continued expansion in Europe and Asia-Pacific. International revenues as a percentage of total revenues was 31% for the three and nine months ended September 30, 2005 and 26% and 28% for the three and nine months ended September 30, 2004, respectively.

Key Factors Affecting Revenues

Certain key factors will affect our ability to meet our forecasted revenue in the fourth quarter of 2005, including the following:

Quarterly Fluctuations. Our quarterly operating results have fluctuated in the past and are likely to do so in the future. In particular, our license revenues are not predictable with any significant degree of certainty.

Furthermore, we have historically recognized a substantial portion of our license revenues in the last month of each quarter. In addition, we typically receive a substantial portion of new license orders in the last few weeks of each quarter.

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Competition. While we believe that IBM's acquisition of Ascential Software presents us with an opportunity to be the most open data integration platform for our customers, the acquisition could lead to customer confusion or uncertainty, and may cause customers to defer or delay their purchasing decisions for data integration software. See Risk Factors - *If we do not compete effectively with companies selling data integration products, our revenues may not grow and could decline.*

Conversion of our Sales Pipeline. As a result of the continued uncertainty in IT spending by our customers and prospects, our ability to meet our forecasted revenues for the fourth quarter of 2005 will continue to be highly dependent on our success in converting our sales pipeline into license revenues from orders received and shipped within the quarter. See Risk Factors *We have experienced and could continue to experience fluctuations in our quarterly operating results, especially the amount of license revenue we recognize each quarter, and such fluctuations have caused and could cause our stock price to decline.*

New Product Introductions. We continually strive to introduce new products and to enhance existing products. In February 2005, we announced the release of PowerCenter Advanced Edition and we recently announced the anticipated release of PowerCenter 8. New product introductions and/or enhancements have inherent risks including but not limited to: delay in completion, launch, delivery or availability; delay in customer purchases in anticipation of new products not yet released; product quality including the possibility of defects; market confusion based on changes to the product packaging and pricing as a result of a new product release; interoperability issues with third party technologies; loss of existing customers which choose a competitor's product instead of upgrading or migrating to the new product; loss of maintenance revenues from existing customers which do not upgrade or migrate. Given the risks and new nature of the products, we cannot predict their impact on overall sales and revenues.

Sales Force Turnover. We experienced increased sales force turnover in the first half of 2004 and we continued to add new sales personnel in late 2004 and the first half of 2005. Because we typically experience lower productivity from newly hired sales personnel for a period of six to 12 months, these new sales personnel may not be able to generate significant license revenues in 2005. See Risk Factors *An increase in turnover rates of our sales force personnel may negatively impact our ability to generate license revenues.*

General Economic Uncertainty. The general economic uncertainty caused customer purchases to be reduced in amount, deferred or cancelled, and therefore reduced the overall license pipeline conversion rates in much of 2003 and 2004. Although we believe that the broader software market is steadily recovering from this period of uncertainty, any interruption or delay in the current recovery could cause a reduction in the rate of conversion of our sales pipeline into license revenue for the fourth quarter of 2005 and beyond. See Risk Factors *If we are unable to accurately forecast revenues, we may fail to meet stock analysts and investors' expectations of our quarterly operating results, which could cause our stock price to decline* and Risk Factors *We have experienced reduced sales pipeline and pipeline conversion rates in the past, which has adversely affected the growth of our company and the price of our common stock.*

Future Revenues (New Orders, Backlog and Deferred Revenues)

Our future revenues are dependent upon (i) new orders received, shipped and recognized in a given quarter and (ii) our backlog and deferred revenues entering a given quarter. Our backlog is comprised of product license orders that have not shipped as of the end of a given quarter and orders to distributors, resellers and OEMs where revenue is recognized upon cash receipt. Our deferred revenues are primarily comprised of (i) maintenance revenues that we recognize over the term of the contract, typically one year, (ii) license product orders that have shipped but where the terms of the license agreement contain acceptance language or other terms that require that the license revenues be deferred until all revenue recognition criteria are met or recognized ratably over an extended period, and (iii) consulting and education services revenues that have been prepaid but for which services have not yet been performed. We typically ship products shortly after the receipt of an order, which is common in the software industry,

and historically our backlog of license orders awaiting shipment at the end of any given quarter has varied.

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Aggregate backlog and deferred revenues at September 30, 2005 were approximately \$81.9 million compared to \$60.4 million at September 30, 2004. This increase at September 30, 2005 compared to September 30, 2004 was primarily due to an increase in deferred maintenance revenues and to a lesser extent license orders awaiting shipment and orders shipped which will be recognized as revenue upon cash receipt. We do not believe that backlog and deferred revenues as of any particular date is indicative of future results.

Cost of Revenues

The following sets forth, for the periods indicated, our cost of revenues (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Change	2005	2004	Change
Cost of license revenues	\$ 862	\$ 727	19%	\$ 2,707	\$ 2,452	10%
Cost of service revenues	11,548	10,399	11%	33,416	30,145	11%
Amortization of acquired technology	227	585	(61)%	696	1,740	(60)%
	\$ 12,637	\$ 11,711	8%	\$ 36,819	\$ 34,337	7%

Cost of license revenues,
as a percentage of license
revenues

3%	3%	3%	3%
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Cost of service revenues,
as a percentage of service
revenues

31%	34%	31%	34%
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Cost of License Revenues

Our cost of license revenues consists primarily of software royalties, product packaging, documentation, production costs and personnel costs for packaging and shipping. Cost of license revenues increased to \$0.9 million for the three months ended September 30, 2005 from \$0.7 million for the three months ended September 30, 2004, representing 3% of license revenues for those periods, respectively. Cost of license revenues increased to \$2.7 million for the nine months ended September 30, 2005 from \$2.5 million for the nine months ended September 30, 2004, representing 3% of license revenues for each of those periods, respectively. The \$0.1 million or 19% increase and \$0.2 million or 10% increase for the three and nine months ended September 30, 2005, respectively, compared to the same periods in 2004 were primarily due to higher transaction volumes which was partially offset by a favorably negotiated arrangement in the first quarter of 2005 with one of the vendors from which we license royalty-bearing software. For the fourth quarter of 2005, we expect the cost of license revenues as a percentage of license revenues to be relatively consistent with, or increase slightly from the third quarter of 2005.

Cost of Service Revenues

Our cost of service revenues is a combination of costs of maintenance, consulting and education services revenues. Our cost of maintenance revenues consists primarily of costs associated with customer service personnel expenses and royalty fees for maintenance related to third-party software providers. Cost of consulting revenues consists primarily of personnel costs and expenses incurred in providing consulting services at customers' facilities. Cost of education services revenues consists primarily of the costs of providing training classes and materials at our headquarters, sales and training offices and customer locations. Cost of service revenues increased to \$11.5 million for the three months ended September 30, 2005 from \$10.4 million for the three months ended September 30, 2004, representing 31% of service revenues for each of those periods, respectively, and increased to \$33.4 million for the nine months ended September 30, 2005 from \$30.1 million for the nine months ended September 30, 2004, representing 34% of service revenues for each of those periods, respectively. The \$1.1 million or 11% increase and \$3.3 million or 11% increase

for the three and nine months ended September 30, 2005 compared to the same periods in 2004, respectively, were primarily due to headcount growth in the customer support, professional service and education service groups. For the fourth quarter of 2005, we expect our cost of service revenues as a percentage of service revenues to be relatively consistent with the third quarter of 2005, or increase slightly from the current levels if the growth in our consulting services business, if any, is greater than that experienced by our maintenance and education services business.

Table of Contents***Amortization of Acquired Technology***

Amortization of acquired technology is the amortization of technologies acquired through business combinations. Amortization of acquired technology decreased to \$0.2 million for the three months ended September 30, 2005 from \$0.6 million for the three months ended September 30, 2004 and decreased to \$0.7 million for the nine months ended September 30, 2005 from \$1.7 million for the nine months ended September 30, 2004. The \$0.4 million or 61% decrease and \$1.0 million or 60% decrease for the three and nine months ended September 30, 2005, respectively, compared to the same periods in 2004 were primarily due to certain developed technology acquired in our 2003 acquisition of Striva being fully amortized as of December 31, 2004. We expect amortization of other acquired technology to be approximately \$0.2 million for the fourth quarter of 2005.

Operating Expenses***Research and Development***

The following sets forth, for the periods indicated, our research and development expenses (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Change	2005	2004	Change
Research and development	\$10,777	\$12,339	(13)%	\$31,484	\$39,565	(20)%

Our research and development expenses consist primarily of salaries and other personnel-related expenses, consulting services, facilities and related overhead costs associated with the development of new products, the enhancement and localization of existing products, quality assurance and development of documentation for our products. Research and development expenses decreased to \$10.8 million for the three months ended September 30, 2005 from \$12.3 million for the three months ended September 30, 2004, representing approximately 17% and 24%, respectively, of total revenues for those periods. The \$1.6 million or 13% decrease for the three months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$2.0 million decrease in facilities and related overhead costs in connection with the 2004 Restructuring Plan which was partially offset by a \$0.4 million increase in third-party consulting costs, as a result of product strategy development and localization efforts. Research and development expenses decreased to \$31.5 million for the nine months ended September 30, 2005 from \$39.6 million for the nine months ended September 30, 2004, representing approximately 17% and 25%, respectively, of total revenues for those periods. The \$8.1 million or 20% decrease for the nine months ended September 30, 2005 compared to the same period in 2004, was primarily due to a \$6.2 million decrease in facilities and related overhead costs in connection with the 2004 Restructuring Plan, a \$1.5 million decrease in stock-based compensation and a \$0.5 million decrease in third-party consulting costs, as a result of shifting consulting projects to our India office. To date, all software and development costs have been expensed in the period incurred because costs incurred subsequent to the establishment of technological feasibility have not been significant. For the fourth quarter of 2005, we expect the research and development expenses as a percentage of total revenues to remain relatively consistent with the third quarter of 2005.

Sales and Marketing

The following sets forth, for the periods indicated, our sales and marketing expenses (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Change	2005	2004	Change
Sales and marketing	\$28,312	\$22,574	25%	\$82,698	\$67,716	22%

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Our sales and marketing expenses consist primarily of personnel costs, including commissions and bonus, as well as costs of public relations, seminars, marketing programs, lead generation, travel and trade shows. Sales and marketing expenses increased to \$28.3 million for the three months ended September 30, 2005 from \$22.6 million for the three months ended September 30, 2004, representing approximately 43%, respectively, of total revenues for those periods. The \$5.7 million or 25% increase for the three months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$5.3 million increase in personnel-related costs including sales commissions, travel-related and telecommunication expenses, as a result of headcount increasing from 284 in September 2004 to 365 in September 2005, and a \$0.4 million increase in costs for outside services including lead generation costs and costs associated with opening new offices in Asia-Pacific. Sales and marketing expenses increased to \$82.7 million for the nine months ended September 30, 2005 from \$67.7 million for the nine months ended September 30, 2004, representing approximately 44% and 42%, respectively, of total revenues for those periods. The \$15.0 million or 22% increase for the nine months ended September 30, 2005 compared to the same period in 2004 was primarily due to an \$14.9 million increase in personnel-related costs, as a result of headcount increase described above and a \$0.9 million increase in costs for outside services including lead generation costs and costs associated with opening new offices in Asia-Pacific which were partially offset by a \$0.8 million decrease in deferred stock-based compensation. For the fourth quarter of 2005, we expect sales and marketing expenses as a percentage of total revenues to remain relatively consistent with, or decrease from, the third quarter of 2005.

General and Administrative

The following sets forth, for the periods indicated, our general and administrative expenses (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Change	2005	2004	Change
General and administrative	\$ 5,146	\$ 5,950	(14)%	\$ 15,246	\$ 15,616	(2)%

Our general and administrative expenses consist primarily of personnel costs for finance, human resources, legal and general management, as well as professional service expenses associated with recruiting, legal and accounting services. General and administrative expenses decreased to \$5.1 million for the three months ended September 30, 2005 from \$6.0 million for the three months ended September 30, 2004, representing approximately 8% and 11%, respectively, of total revenues for those periods. The \$0.8 million or 14% decrease for the three months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$0.8 million decrease in legal and consulting service costs and a \$0.4 million decrease in facilities and related overhead costs in connection with the 2004 Restructuring Plan which were partially offset by a \$0.3 million increase in bad debt expenses. General and administrative expenses decreased slightly to \$15.2 million for the nine months ended September 30, 2005 from \$15.6 million for the nine months ended September 30, 2004, representing approximately 8% and 10%, respectively, of total revenues for those periods. The \$0.4 million or 2% decrease for the nine months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$1.2 million decrease in facilities and related overhead costs in connection with the 2004 Restructuring Plan and a \$0.3 million decrease in third-party consulting service costs which were partially offset by a \$1.0 million increase in personnel related costs and a \$0.1 million increase in business insurance and fees. The increase of personnel related costs and business insurance were primarily due to the costs associated with compliance with the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). For the fourth quarter of 2005, we expect general and administrative expenses as a percentage of total revenues to remain relatively consistent with, or decrease slightly from, the third quarter of 2005.

Amortization of Intangible Assets

The following sets forth, for the periods indicated, our amortization of intangible assets (in thousands, except percentages):

	Three Months Ended September 30,	Nine Months Ended September 30,
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	2005	2004	Change	2005	2004	Change
Amortization of Intangible assets	\$ 47	\$ 47	0%	\$ 141	\$ 150	(6)%
		27				

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Amortization of intangible assets is the amortization of customer relationships acquired through business combinations. Amortization of intangible assets was relatively flat during these periods. We expect amortization of the intangible assets to be approximately \$47,000 in the fourth quarter of 2005.

Facilities Restructuring Charges

The following sets forth, for the periods indicated, our restructuring and excess facilities charges (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2005	2004	Change	2005	2004	Change
Facilities restructuring charges	\$ 1,274	\$ 9,673	(87)%	\$ 2,902	\$ 9,673	(70)%

In the three months ended September 30, 2005, we recorded \$1.3 million of restructuring charges. This charge included \$1.2 million of accretion charges and a \$0.1 million adjustment related to the 2004 Restructuring Plan due to an increase in lease operating expense assumptions. In the nine months ended September 30, 2005, we recorded \$2.9 million of restructuring charges. This charge included \$3.6 million of accretion charges and a \$0.6 million adjustment related to the 2004 Restructuring Plan due to an increase in lease operating expense assumptions, offset by an adjustment to reflect a \$1.3 million increase in our assumed sublease income. (See Note 4, Restructuring Charges, in Notes to Condensed Consolidated Financial Statements in Part I, Item I of this Report)

As of September 30, 2005, \$ 98.1 million of total lease termination costs, net of actual and expected sublease income, less broker commissions and tenant improvement costs related to facilities to be subleased, was included in accrued restructuring charges and is expected to be paid by 2013.

2004 Restructuring Plan. Net cash payments for facilities included in the 2004 Restructuring Plan amounted to \$3.6 million and \$10.7 million for three and nine months ended September 30, 2005, respectively. Actual future cash requirements may differ from the restructuring liability balances as of September 30, 2005 if we continue to be unable to sublease the excess leased facilities, there are changes to the time period that facilities are vacant, or the actual sublease income is different from current estimates.

2001 Restructuring Plan. Net cash payments for facilities included in the 2001 Restructuring Plan amounted to \$1.1 million and \$3.3 million for three and nine months ended September 30, 2005, respectively. Actual future cash requirements may differ from the restructuring liability balances as of September 30, 2005 if we continue to be unable to sublease the excess leased facilities, there are changes to the time period that facilities are vacant, or the actual sublease income is different from current estimates.

In addition, we will continue to evaluate our current facilities requirements to identify facilities that are in excess of our current and estimated future needs, as well as evaluate the assumptions related to estimated future sublease income for excess facilities. Accordingly, any changes to these estimates of excess facilities costs could result in additional charges that could materially affect our consolidated financial position and results of operations.

Interest Income and Other, Net

The following sets forth, for the periods indicated, our interest income and other (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2005	2004	Change	2005	2004	Change
Interest income and other, net	\$ 1,911	\$ 1,014	88%	\$ 4,515	\$ 2,129	112%

Interest income and other, net is primarily interest income earned on our cash, cash equivalents, investments and restricted cash. Interest income and other, net increased to \$1.9 million for the three months ended September 30, 2005 from \$1.0 million for the three months ended September 30, 2004. The \$0.9 million increase for the three months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$0.9 million increase

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in interest income, as a result of higher average cash and investment balances and higher interest rates compared to the same period in 2004. Interest income and other, net increased to \$4.5 million for the nine months ended September 30, 2005 from \$2.1 million for the nine months ended September 30, 2004. The \$2.4 million increase for the nine months ended September 30, 2005 compared to the same period in 2004 was primarily due to a \$1.8 million increase in interest income, as a result of higher average cash and investment balances and higher interest rates compared to the same period in 2004 and a \$0.5 million decrease in foreign exchange loss, as a result of the weakening of the U.S. dollar against the Euro and British pound compared to the same period in 2004. We currently do not engage in any foreign currency hedging activities and, therefore, are susceptible to fluctuations in foreign exchange gains or losses in our results of operations in future reporting periods.

Provision for Income Taxes

The following sets forth, for the periods indicated, our provision for income taxes (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	2005	2004	Change	2005	2004	Change
Provision for income taxes	\$ 414	\$ (267)	(255)%	\$2,567	\$ 422	508%

We recorded an income tax provision of \$0.4 million and \$2.6 million for the three and nine months ended September 30, 2005, respectively. The \$0.4 million income tax provision for the three months ended September 30, 2005 includes \$1.0 million of federal alternative minimum taxes, income and withholding taxes attributable to foreign operations, and a \$0.3 million benefit based on the filing of our 2004 federal income tax returns. In addition, results from a foreign income tax examination were concluded in early November 2005 and, we reversed previously accrued tax reserves giving rise to a \$0.3 million benefit that is reflected in the third quarter's tax provision. The expected tax provision derived from applying the federal statutory rate to our income before income taxes for the nine month period ended September 30, 2005 differed from the recorded income tax provision primarily due to the reversal of a portion of our valuation allowance to reflect the utilization of approximately \$6.4 million of tax attributes partially offset by foreign income and withholding taxes of \$1 million and state taxes of \$0.6 million.

For the three and nine months ended September 30, 2004, we recorded an income tax benefit of \$0.3 million and an income tax provision of \$0.4 million, respectively. These income tax amounts are primarily comprised of federal alternative minimum taxes, income and withholding taxes that are attributable to foreign operations of \$0.2 million and \$0.9 million, respectively, for the three and nine months ended September 30, 2004, and a \$0.5 million benefit based on our federal income tax returns filed in the third quarter of 2004.

Our tax provision for the fourth quarter of 2005 remains heavily dependent upon the jurisdictional mix in which we generate pretax income, the level of earnings subject to foreign incomes taxes, and the amount of foreign withholding taxes paid.

Liquidity and Capital Resources

We have funded our operations primarily through cash flows from operations and public offerings of our common stock. As of September 30, 2005, we had \$256.5 million in available cash and cash equivalents and short-term investments and \$12.2 million of restricted cash under the terms of our Pacific Shores property leases.

Our primary sources of cash are the collection of accounts receivable from our customers and proceeds from the exercise of stock options and stock purchased under our employee stock purchase plan. Our uses of cash include payroll and payroll-related expenses and operating expenses such as marketing programs, travel, professional services and facilities and related costs. We have also used cash to purchase property and equipment, repurchase common stock from the open market to reduce the dilutive impact of stock option issuances and acquire businesses and technologies to expand our product offerings.

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A number of non-cash items were charged to expenses and decreased our net income (loss) in the nine months ended September 30, 2005 and 2004. These items include depreciation and amortization of property and equipment and intangible assets and acquired technology, non-cash facilities restructuring charges and amortization of deferred stock-based compensation. The extent to which these non-cash items increase or decrease in amount and increase or decrease our future operating income will have no corresponding impact on our operating cash flows.

Operating activities: Cash provided by operating activities for the nine months ended September 30, 2005 was \$23.9 million, representing an improvement of \$16.7 million from the nine months ended September 30, 2004. This improvement primarily resulted from a \$26.0 million increase in net income, after adjusting for non-cash expenses, an increase in cash collections against accounts receivable, an increase in deferred revenues and income taxes payable offset by payments to reduce our accrual for excess facilities, accounts payable and accrued liabilities and increases in prepaid expenses and other assets primarily for insurance and third-party software maintenance. Our days sales outstanding in accounts receivable (days outstanding) decreased from 66 days at September 30, 2004 to 46 days at September 30, 2005. Days outstanding at September 30, 2005 were primarily impacted by improvements to our collection program. Deferred revenues increased primarily due to increased maintenance renewals. Cash provided by operating activities for the nine months ended September 30, 2004 was \$7.2 million and primarily resulted from non-cash item adjustments to our net loss, including non-cash depreciation and amortization expenses, an increase in facilities restructuring charges, an increase in deferred revenues, payments against accounts payable and accrued liabilities, and increases in prepaid expenses and other assets. Our operating cash flows will also be impacted in the future based on the timing of payments to our vendors by the nature of vendor arrangements and management's assessment of our cash inflows.

Investing Activities: We anticipate that we will continue to purchase necessary property and equipment in the normal course of our business. The amount and timing of these purchases and the related cash outflows in future periods is difficult to predict and is dependent on a number of factors including the hiring of employees, the rate of change of computer hardware and software used in our business, and our business outlook. We have classified our investment portfolio as available for sale, and our investment objectives are to preserve principal and provide liquidity while at the same time maximizing yields without significantly increasing risk. We may sell an investment at any time if the quality rating of the investment declines, the yield on the investment is no longer attractive or we are in need of cash. Because we invest only in investment securities that are highly liquid with a ready market, we believe that the purchase, maturity or sale of our investments has no material impact on our overall liquidity.

Financing Activities: We receive cash from the exercise of common stock options and the sale of common stock under our employee stock purchase plan. While we expect to continue to receive these proceeds in future periods, the timing and amount of such proceeds is difficult to predict and is contingent on a number of factors including the price of our common stock, the number of employees participating in our stock option plans and our employee stock purchase plan and general market conditions. From time to time, our Board of Directors has approved common stock repurchase programs to repurchase shares of our common stock in the open market.

We believe that our cash balances and the cash flows generated by operations will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, because our operating results may fluctuate significantly as a result of a decrease in customer demand or the acceptance of our products, we may not in the future be able to generate positive cash flows from operations. If this occurred, we would require additional funds to support our working capital requirements, or for other purposes, and may seek to raise such additional funds through public or private equity financings or from other sources. We may not be able to obtain adequate or favorable financing at that time. Any financing we obtain may dilute our stockholders' ownership interests.

Other Uses of Cash

In July 2004, our Board of Directors authorized a stock repurchase program for up to five million shares of our common stock. Purchases may be made from time to time in the open market through the end of 2005 and will be funded from available working capital. The number of shares to be purchased and the timing of purchases will be based on the level of our cash balances and general business and market conditions. In 2004, we purchased 1,055,000 shares at a cost of \$6.1 million under this program. In the nine months ended September 30, 2005, we purchased 1,900,000 shares at a cost of \$16.2 million under this program. These shares were retired and reclassified as

authorized and unissued shares of common stock. The share repurchase program is currently scheduled to expire at the end of 2005. See Part II. Item 2 of this Report for more information regarding the stock repurchase plan.

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We may continue to repurchase shares from time to time in order to take advantage of attractive share price levels, as determined by management and approved by the Board of Directors. The timing and terms of the transactions will depend on market conditions, our liquidity and other considerations.

A portion of our cash may be used to acquire or invest in complementary businesses or products or to obtain the right to use complementary technologies. From time to time, in the ordinary course of business, we may evaluate potential acquisitions of such businesses, products or technologies. We are not currently a party to any contracts or letters of intent with respect to any acquisitions. The nature of these transactions makes it difficult to predict the amount and timing of such cash requirements. We may also be required to raise additional financing to complete future acquisitions.

Operating Leases

We lease certain office facilities and equipment under noncancelable operating leases. During 2004, 2002 and 2001, we recorded restructuring charges related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas. Operating lease payments in the table below include approximately \$128.7 million, net of actual sublease income, for operating lease commitments for those facilities that are included in restructuring charges. See Note 4. Restructuring Charges and Note 5. Commitments and Contingencies, in Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report.

Our future minimum lease payments as of September 30, 2005 under noncancelable operating leases with original terms in excess of one year are summarized as follows (in thousands):

	Operating Leases	Sublease Income	Net
Remaining 2005	\$ 5,319	\$ (868)	\$ 4,451
2006	21,397	(3,163)	18,234
2007	20,267	(2,397)	17,870
2008	16,815	(2,392)	14,423
2009	17,270	(1,242)	16,028
Thereafter	61,692		61,692
	\$ 142,760	\$ (10,062)	\$ 132,698

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations.

We have sublease agreements for leased office space in Palo Alto, San Francisco, Scotts Valley and Redwood City, California and Carrollton, Texas. In the event the sublessees are unable to fulfill their obligations, we would be responsible for rent due under the leases. However, we expect the sublessees will fulfill their obligations under these leases.

In February 2000, we entered into two lease agreements for two buildings in Redwood City, California (our former corporate headquarters), which we occupied from August 2001 through December 2004. The lease expires in July 2013. As part of these agreements, we have purchased certificates of deposit totaling \$12.2 million as a security deposit for lease payments until certain financial milestones are met. The letter of credit may be reduced to an amount not less than three months of the base rent at the then current rate if our annual revenues reach \$750 million and we have quarterly operating profits of at least \$100 million for no less than four consecutive calendar quarters. These certificates of deposit are classified as long-term restricted cash on the consolidated balance sheet.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet financing arrangements or transactions, arrangements or relationships with special purpose entities.

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In addition to the other information contained in this Form 10-Q, we have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operation. Investors should carefully consider the risks described below before making an investment decision. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained in our other SEC filings, including our Form 10-K for the year ended December 31, 2004.

We have experienced and could continue to experience fluctuations in our quarterly operating results, especially the amount of license revenues we recognize each quarter, and such fluctuations have caused and could cause our stock price to decline.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. These fluctuations have caused our stock price to experience declines in the past and could cause our stock price to significantly fluctuate or experience declines in the future. One of the reasons why our operating results have fluctuated is that our license revenues are not predictable with any significant degree of certainty and are vulnerable to short-term shifts in customer demand. For example, we have experienced customer order deferrals in anticipation of future new product introductions or product enhancements, as well as a result of particular budgeting and purchase cycles of our customers. By comparison, our short-term expenses are relatively fixed and based in part on our expectations of future revenues.

Moreover, historically our backlog of license orders at the end of a given fiscal period has tended to vary. This has particularly been the case at the end of the first and third fiscal quarters when it tends to decrease from the prior quarter. For example, in the three months ended March 31, 2004, we experienced greater seasonal reduction in license orders than we expected. When we experience quarters where our license revenues generally reflect orders received and shipped in that same quarter and where we have not had a substantial backlog of orders, we do not have significant visibility of expected results for future quarters.

Furthermore, we generally recognize a substantial portion of our license revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter. As a result, we cannot predict the adverse impact caused by cancellations or delays in orders until the end of each quarter. Moreover, the likelihood of an adverse impact may be greater if we experience increased average transaction sizes due to a mix of relatively larger deals in our sales pipeline.

Due to the difficulty we experience in predicting our quarterly license revenues, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. Furthermore, our future operating results could fail to meet the expectations of stock analysts and investors. If this happens, the price of our common stock could fall.

If we do not compete effectively with companies selling data integration products, our revenues may not grow and could decline.

The market for our products is highly competitive, quickly evolving and subject to rapidly changing technology. Our competition consists of hand-coded, custom-built data integration solutions developed in-house by various companies in the industry segments that we target, as well as other vendors of integration software products, including Ab Initio, Business Objects, Embarcadero Technologies, IBM, which acquired Ascential Software, SAS Institute and certain other privately-held companies. In the past, we have competed with business intelligence vendors that currently offer, or may develop, products with functionalities that compete with our products, such as Cognos, Hyperion Solutions, MicroStrategy and certain privately-held companies. We also compete against certain database and enterprise application vendors, which offer products that typically operate specifically with these competitors proprietary databases. Such potential competitors include IBM, Microsoft, Oracle, SAP and Siebel Systems. Many of these competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Competition could

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seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products obsolete, unmarketable or less competitive. We believe we currently compete more on the basis of our products' functionality than on the basis of price. We may have difficulty competing on the basis of price in circumstances where our competitors develop and market products with similar or superior functionality and pursue an aggressive pricing strategy or bundle data integration technology at no cost to the customer or at deeply discounted prices.

Our current and potential competitors may make strategic acquisitions, consolidate their operations or establish cooperative relationships among themselves or with other solution providers, thereby increasing their ability to provide a broader suite of software products or solutions and more effectively address the needs of our prospective customers, such as IBM's recent acquisition of Ascential Software. Such acquisitions could cause customers to defer their purchasing decisions. Our current and potential competitors may establish or strengthen cooperative relationships with our current or future strategic partners, thereby limiting our ability to sell products through these channels. If any of this were to occur, our ability to market and sell our software products would be impaired. In addition, competitive pressures could reduce our market share or require us to reduce our prices, either of which could harm our business, results of operations and financial condition.

We rely on our relationships with our strategic partners. If we do not maintain and strengthen these relationships, our ability to generate revenue and control expenses could be adversely affected, which could cause a decline in the price of our common stock.

We believe that our ability to increase the sales of our products depends in part upon maintaining and strengthening relationships with our strategic partners and any future strategic partners. In addition to our direct sales force, we rely on established relationships with a variety of strategic partners, such as systems integrators, resellers and distributors, for marketing, licensing, implementing and supporting our products in the United States and internationally. We also rely on relationships with strategic technology partners, such as enterprise application providers, database vendors, data quality vendors and enterprise integrator vendors, for the promotion and implementation of our products.

Our strategic partners offer products from several different companies, including, in some cases, products that compete with our products. We have limited control, if any, as to whether these strategic partners devote adequate resources to promoting, selling and implementing our products as compared to our competitors' products.

While our strategic partnership with IBM's BCS group has been successful in the past, IBM's recent acquisition of Ascential Software may make it more critical that we strengthen our relationships with our other strategic partners. We cannot guarantee that we will be able to strengthen our relationships with our strategic partners or that such relationships will be successful in generating additional revenue.

We may not be able to maintain our strategic partnerships or attract sufficient additional strategic partners who have the ability to market our products effectively, are qualified to provide timely and cost-effective customer support and service or have the technical expertise and personnel resources necessary to implement our products for our customers. In particular, if our strategic partners do not devote sufficient resources to implement our products, we may incur substantial additional costs associated with hiring and training additional qualified technical personnel to implement solutions for our customers in a timely manner. Furthermore, our relationships with our strategic partners may not generate enough revenue to offset the significant resources used to develop these relationships. If we are unable to leverage the strength of our strategic partnerships to generate additional revenues, our revenues and the price of our common stock could decline.

If we are unable to accurately forecast revenues, we may fail to meet stock analysts and investors' expectations of our quarterly operating results, which could cause our stock price to decline.

We use a pipeline system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of all proposals, including the date when they estimate that a customer will make a purchase decision and the potential dollar amount of the sale. We aggregate these estimates periodically in order to generate a sales pipeline. We compare the pipeline at various points in time to look for trends in our business. While this pipeline analysis may provide us with some guidance in business planning and budgeting, these pipeline

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estimates are necessarily speculative and may not consistently correlate to revenues in a particular quarter or over a longer period of time. Additionally, because we have historically recognized a substantial portion of our license revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter, we may not be able to adjust our cost structure in a timely manner in response to variations in the conversion of the sales pipeline into license revenues. Any change in the conversion of the pipeline into customer sales or in the pipeline itself could cause us to improperly budget for future expenses that are in line with our expected future revenues, which would adversely affect our operating margins and results of operations and could cause the price of our common stock to decline.

We have experienced reduced sales pipeline and pipeline conversion rates in prior years, which have adversely affected the growth of our company and the price of our common stock.

In 2002, we experienced a reduced conversion rate of our overall license pipeline, primarily as a result of the general economic slowdown which caused the amount of customer purchases to be reduced, deferred or cancelled. In the first half of 2003, we continued to experience a decrease in our sales pipeline as well as our pipeline conversion rate, primarily as a result of the negative impact of the war in Iraq on the capital spending budgets of our customers, as well as the continued general economic slowdown. While the U.S. economy improved in the second half of 2003 and in 2004, we experienced, and continue to experience, uncertainty regarding our sales pipeline and our ability to convert potential sales of our products into revenue. Although we have experienced an increase in the size of our sales pipeline and our pipeline conversion rate in 2005 as a result of our increased investment in sales personnel and a gradually improving IT spending environment, if we are unable to continue to increase the size of our sales pipeline and our pipeline conversion rate, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline.

Our international operations expose us to greater intellectual property, collections, exchange rate fluctuations, regulatory and other risks, which could limit our future growth.

We have significant operations outside the United States, including software development centers in India, the Netherlands and the United Kingdom, sales offices in Belgium, Canada, France, Germany, the Netherlands, Switzerland and the United Kingdom, and customer support centers in the Netherlands, India and the United Kingdom. Additionally, we have recently opened offices in Japan, Korea, China, Taiwan, Hong Kong and we plan to continue to expand our international operations in the Asia-Pacific market. Our international operations face numerous risks. For example, in order to sell our products in certain foreign countries, our products must be localized, that is, customized to meet local user needs. Developing local versions of our products for foreign markets is difficult, requires us to incur additional expenses and can take longer than we anticipate. We currently have limited experience in localizing products and in testing whether these localized products will be accepted in the targeted countries. We cannot assure you that our localization efforts will be successful.

In addition, we have only a limited history of marketing, selling and supporting our products and services internationally. As a result, we must hire and train experienced personnel to staff and manage our foreign operations. However, we have experienced difficulties in recruiting, training and managing an international staff, and we may continue to experience such difficulties in the future.

We must also be able to enter into strategic distributor relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited.

Business practices in the international markets that we serve may differ from those in North America and may require us to include terms in our software license agreements, such as extended payment or warranty terms, or performance obligations that may require us to defer license revenues and recognize it ratably over the warranty term or contractual period of the agreement. For example, license revenues for 2004 did not include the full amount related to two large software license agreements signed in Europe in the third quarter of 2004. We deferred the license revenues related to these software license agreements in September 2004 due to extended warranties that contained provisions for additional unspecified deliverables and began amortizing the deferred revenues balances to license revenues in September 2004 for a two- to five-year period. While historically we have infrequently entered into software license agreements that require ratable recognition of license revenue, we may enter into software license

agreements in the future that may include non-standard terms related to payment, maintenance rates, warranties or performance obligations.

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Our software development centers in India, the Netherlands and the United Kingdom also subject our business to certain risks, including:

greater difficulty in protecting our ownership rights to intellectual property developed in foreign countries, which may have laws that materially differ from those in the United States;

communication delays between our main development center in Redwood Shores, California and our development centers in India, the Netherlands and the United Kingdom as a result of time zone differences, which may delay the development, testing or release of new products;

greater difficulty in relocating existing trained development personnel and recruiting local experienced personnel, and the costs and expenses associated with such activities; and

increased expenses incurred in establishing and maintaining office space and equipment for the development centers.

Additionally, our international operations as a whole are subject to a number of risks, including the following: greater risk of uncollectible accounts and longer collection cycles;

greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;

greater risk of a failure of our foreign employees to comply with both U.S. and foreign laws, including antitrust regulations, the Foreign Corrupt Practices Act, and unfair trade regulations;

potential conflicts with our established distributors in countries in which we elect to establish a direct sales presence;

our limited experience in establishing a sales and marketing presence and the appropriate internal systems, processes and controls in Asia, especially China, Hong Kong, Taiwan and Korea;

fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business because we do not engage in any hedging activities; and

general economic and political conditions in these foreign markets.

These factors and other factors could harm our ability to gain future international revenues and, consequently, materially impact our business, results of operations and financial condition. Our failure to manage our international operations and the associated risks effectively could limit the future growth of our business. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources.

As a result of our products' lengthy sales cycles, our expected revenues are susceptible to fluctuations, which could cause us to fail to meet stock analysts and investors' expectations, resulting in a decline in the price of our common stock.

Due to the expense, broad functionality and company-wide deployment of our products, our customers' decisions to purchase our products typically require the approval of their executive decision-makers. In addition, we frequently must educate our potential customers about the full benefits of our products, which also can require significant time. This trend towards greater customer executive level involvement and customer education is likely to increase as we expand our market focus to broader data integration initiatives which may result in larger average transaction sizes. Further, our sales cycle may lengthen as we continue to focus our sales efforts on large corporations. As a result of these factors, the length of time from our initial contact with a customer to the customer's decision to purchase our products typically ranges from three to nine months. We are subject to a number of significant risks as a result of our lengthy sales cycle, including:

our customers' budgetary constraints and internal acceptance review procedures;

the timing of our customers' budget cycles;

the seasonality of technology purchases, which historically has resulted in stronger sales of our products in the fourth quarter of the year, especially when compared to lighter sales in the first quarter of the year;

our customers' concerns about the introduction of our products or new products from our competitors; or

potential downturns in general economic or political conditions that could occur during the sales cycle.

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If our sales cycle lengthens unexpectedly, it could adversely affect the timing of our revenues or increase costs, which may independently cause fluctuations in our revenues and results of operations. Finally, if we are unsuccessful in closing sales of our products after spending significant funds and management resources, our operating margins and results of operations could be adversely impacted, and the price of our common stock could decline.

While we believe we currently have adequate internal control over financial reporting, we are required to assess our internal control over financial reporting on an annual basis and any future adverse results from such assessment could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, (SOX 404) and the rules and regulations promulgated by the SEC to implement SOX 404, we are required to furnish an annual report in our Form 10-K regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

Management's assessment of internal control over financial reporting requires management to make subjective judgments and, because this requirement to provide a management report has only been in effect since 2004, some of our judgments will be in areas that may be open to interpretation. Therefore our management report may be uniquely difficult to prepare, and our auditors, who are required to issue an attestation report along with our management report, may not agree with management's assessments. While we currently believe our internal control over financial reporting is effective, the effectiveness of our internal controls in future periods is subject to the risk that our controls may become inadequate.

If we are unable to assert that our internal control over financial reporting is effective in any future period (or if our auditors are unable to provide an attestation report regarding the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our stock price.

Additionally, in 2004, we experienced turnover in our finance and accounting personnel and shifts in responsibilities at the management level. These personnel and responsibility changes adversely affected our ability to effectively follow our internal controls and contributed to a significant deficiency regarding our controls over license revenue recognition in the third quarter of 2004. We corrected this deficiency in the fourth quarter of 2004 by establishing additional controls to review revenue transactions. We will continue to enhance our internal control over financial reporting by adding resources and procedures, as necessary.

Changes in our product packaging and pricing may impact market acceptance of our products and affect our results of operations.

For new products introductions and existing product enhancements, changes can occur in product packaging and pricing. In February 2005, we announced the release of PowerCenter Advanced Edition, and we recently announced the anticipated release of PowerCenter 8. New product introductions and/or enhancements have inherent risks including but not limited to: delay in completion, launch, delivery or availability; delay in customer purchases in anticipation of new products not yet released; product quality including the possibility of defects; market confusion based on changes to the product packaging and pricing as a result of a new product release; interoperability issues with third party technologies; loss of existing customers which choose a competitor's product instead of upgrading or migrating to the new product; loss of maintenance revenues from existing customers which do not upgrade or migrate. Given the risks associated with the introduction of new products, we cannot predict their impact on overall sales and revenues.

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If our products are unable to interoperate with hardware and software technologies that are developed and maintained by third parties that are not within our control, our ability to develop and sell our products to our customers could be adversely affected which would result in harm to our business and operating results.

Our products are designed to interoperate with and provide access to a wide range of third-party developed and maintained hardware and software technologies, which are used by our customers. The future design and development plans of the third parties that maintain these technologies are not within our control and may not be in line with our future product development plans. We may also rely on such third parties, particularly certain third party developers of database and application software products, to provide us with access to these technologies so that we can properly test and develop our products to interoperate with the third-party technologies. These third parties may in the future refuse or otherwise be unable to provide us with the necessary access to their technologies. In addition, these third parties may decide to design or develop their technologies in a manner that would not be interoperable with our own. The continued consolidation in the enterprise software market may serve to heighten these risks. If any of the situations described above were to occur, we would not be able to continue to market our products as interoperable with such third party hardware and software, which could adversely affect our ability to successfully sell our products to our customers.

If the market in which we sell our products and services does not grow as we anticipate, we may not be able to increase our revenues at an acceptable rate of growth, and the price of our common stock could decline.

The market for software products that enable more effective business decision-making by helping companies aggregate and utilize data stored throughout an organization, continues to change. Substantially all of our historical revenues have been attributable to the sales of products and services in the data warehousing market. While we believe that this market is still growing, we expect most of our growth to come from the emerging market for broader data integration, which includes migration, data consolidation, data synchronization and single view projects. The use of package software solutions to address the needs of the broader data integration market is relatively new and is still emerging. Our potential customers may:

not fully value the benefits of using our products;

not achieve favorable results using our products;

experience technical difficulties in implementing our products; or

use alternative methods to solve the problems addressed by our products.

If this market does not grow as we anticipate, we would not be able to sell as much of our software products and services as we currently expect, which could result in a decline in the price of our common stock.

An increase in the turnover rate of our sales force personnel may negatively impact our ability to generate license revenues.

We experienced an increased level of turnover in our direct sales force in the fourth quarter of 2003 and the first quarter of 2004. This increase in the turnover rate impacted our ability to generate license revenues in the first nine months of 2004. Although we have hired replacements in our sales force and have seen the pace of the turnover decrease in recent quarters, we typically experience lower productivity from newly hired sales personnel for a period of six to 12 months. If we are unable to effectively train such new personnel, or if we continue to experience a heightened level of sales force turnover, our ability to generate license revenues may be negatively impacted.

The loss of our key personnel or the inability to attract and retain additional personnel could adversely affect our ability to grow our company successfully and may negatively impact our results of operations.

We believe our success depends upon our ability to attract and retain highly skilled personnel and key members of our management team. We continue to experience changes in members of our senior management team. For example, we recently hired Paul Hoffman as our Executive Vice President, Worldwide Sales and recently announced the departure of John Entenmann as our Executive Vice President, Corporate Strategy and Marketing. As new senior personnel join our company and become familiar with our business strategy and systems, their integration could result in some disruption to our ongoing operations.

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We also experienced an increased level of turnover in our direct sales force in the fourth quarter of 2003 and the first quarter of 2004. We have also recently experienced an increased level of turnover in other areas of the business. If we are unable to effectively attract and train new personnel, or if we continue to experience a heightened level of turnover, our results of operations may be negatively impacted.

We currently do not have any key-man life insurance relating to our key personnel, and their employment is at-will and not subject to employment contracts. We have relied on our ability to grant stock options as one mechanism for recruiting and retaining highly skilled talent. Potential accounting regulations requiring the expensing of stock options may impair our future ability to provide these incentives without incurring significant compensation costs. There can be no assurance that we will continue to successfully attract and retain key personnel.

If the current improvement in the U.S. and global economy does not result in increased sales of our products and services, our operating results would be harmed, and the price of our common stock could decline.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in the domestic and global economy. We experienced the adverse effect of the economic slowdown in 2002 and the first six months of 2003, which resulted in a significant reduction in capital spending by our customers, as well as longer sales cycles, and the deferral or delay of purchases of our products. In addition, terrorist actions and the military actions in Afghanistan and Iraq magnified and prolonged the adverse effects of the economic slowdown. Although the U.S. economy improved beginning in the third quarter of 2003, and we have experienced some improvement in our pipeline conversion rate, we may not experience any significant improvement in our pipeline conversion rate in the future. In particular, our ability to forecast and rely on U.S. federal government orders, especially potential orders from the U.S. Department of Defense, is uncertain due to congressional budget constraints and changes in spending priorities.

If the current improvement in the U.S. economy does not result in increased sales of our products and services, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline. Moreover, if the current economic conditions in Europe and Asia do not improve or if there is an escalation in regional or global conflicts, we may fall short of our revenue expectations for 2005. Although we have seen improvement in our European revenues, any future economic slowdown in Europe could adversely affect our pipeline conversion rate or be negatively impacted by the effects of an economic slowdown in Europe in the future, which could impact our ability to meet our revenue expectations for 2005. Although we are investing in Asia, there are significant risks with overseas investments and our growth prospects in Asia are uncertain. In addition, we could experience delays in the payment obligations of our world-wide reseller customers if they experience weakness in the end-user market, which would increase our credit risk exposure and harm our financial condition.

We rely on the sale of a limited number of products, and if these products do not achieve broad market acceptance, our revenues would be adversely affected.

To date, substantially all of our revenues have been derived from our data integration products such as PowerCenter, PowerMart, PowerConnect and related services. We expect sales of our data integration software and related services to comprise substantially all of our revenues for the foreseeable future. If any of our products do not achieve market acceptance, our revenues and stock price could decrease. In particular, with the completion of our Striva acquisition, we began selling and marketing PowerExchange as part of our complete product offering. Market acceptance for PowerExchange, as well as our current products, could be affected if, among other things, competition substantially increases in the enterprise data integration market or transactional applications suppliers integrate their products to such a degree that the utility of the data integration functionality that our products provide is minimized or rendered unnecessary.

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We may not be able to successfully manage the growth of our business if we are unable to improve our internal systems, processes and controls.

We need to continue to improve our internal systems, processes and controls to effectively manage our operations and growth, including our international growth into new geographies, particularly the Asia-Pacific market. We may not be able to successfully implement improvements to these systems, processes and controls in an efficient or timely manner, and we may discover deficiencies in existing systems, processes and controls. We have licensed technology from third parties to help us accomplish this objective. The support services available for such third-party technology may be negatively affected by mergers and consolidation in the software industry, and support services for such technology may not be available to us in the future. We may experience difficulties in managing improvements to our systems, processes and controls or in connection with third-party software, which could disrupt existing customer relationships, causing us to lose customers, limit us to smaller deployments of our products or increase our technical support costs.

The price of our common stock fluctuates as a result of factors other than our operating results, such as the actions of our competitors and securities analysts, as well as developments in our industry and changes in accounting rules.

The market price for our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price for our common stock may be affected by a number of factors other than our operating results, including:

the announcement of new products or product enhancements by our competitors;

quarterly variations in our competitors' results of operations;

changes in earnings estimates and recommendations by securities analysts;

developments in our industry; and

changes in accounting rules.

After periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We and certain of our former officers and our directors have been named as defendants in a purported class action complaint, which was filed on behalf of certain persons who purchased our common stock between April 29, 1999 and December 6, 2000. Such actions could cause the price of our common stock to decline.

The price of our common stock may fluctuate when we account for employee stock option and employee stock purchase plans using the fair value method, which could significantly reduce our net income and earnings per share.

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which will require us to measure compensation cost for all share-based payments (including employee stock options) at fair value at the date of grant and record such expense in our consolidated financial statements. We are required to adopt SFAS No. 123(R) in the first quarter of 2006. Although we have not completed our evaluation of the impact of this accounting pronouncement, the adoption of SFAS No. 123(R) is expected to have a material adverse impact on our consolidated financial position and results of operations, as we expect the adoption of SFAS No. 123(R) will result in an increase in our operating expenses and a reduction in our net income and earnings per share, all of which could result in a decline in the price of our common stock.

We rely on a number of different distribution channels to sell and market our products. Any conflicts that we may experience within these various distribution channels could result in confusion for our customers and a decrease in revenue and operating margins.

We have a number of relationships with resellers, systems integrators and distributors that assist us in obtaining broad market coverage for our products and services. Although our discount policies, sales commission structure and reseller licensing programs are intended to support each distribution channel with a minimum level of channel

conflicts, we may not be able to minimize these channel conflicts in the future. Any channel conflicts that we may experience could result in confusion for our customers and a decrease in revenue and operating margins.

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The software products we offer are inherently complex and, despite extensive testing and quality control, have in the past and may in the future contain errors or defects, especially when first introduced. These defects and errors could cause damage to our reputation, loss of revenue, product returns, order cancellations or lack of market acceptance of our products. We have in the past and may in the future need to issue corrective releases of our software products to fix these defects or errors. For example, we issued corrective releases to fix problems with the version of our PowerMart released in the first quarter of 1998. As a result, we had to allocate significant customer support resources to address these problems.

Our license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims. However, the limitation of liability provisions contained in our license agreements may not be effective as a result of existing or future national, federal, state or local laws or ordinances or unfavorable judicial decisions. Although we have not experienced any product liability claims to date, the sale and support of our products entails the risk of such claims, which could be substantial in light of the use of our products in enterprise-wide environments. In addition, our insurance against product liability may not be adequate to cover a potential claim.

If we are unable to successfully respond to technological advances and evolving industry standards, we could experience a reduction in our future product sales, which would cause our revenues to decline.

The market for our products is characterized by continuing technological development, evolving industry standards, changing customer needs and frequent new product introductions and enhancements. The introduction of products by our direct competitors or others embodying new technologies, the emergence of new industry standards or changes in customer requirements could render our existing products obsolete, unmarketable or less competitive. In particular, an industry-wide adoption of uniform open standards across heterogeneous applications could minimize the importance of the integration functionality of our products and materially adversely affect the competitiveness and market acceptance of our products. Our success depends upon our ability to enhance existing products, to respond to changing customer requirements and to develop and introduce in a timely manner new products that keep pace with technological and competitive developments and emerging industry standards. We have in the past experienced delays in releasing new products and product enhancements and may experience similar delays in the future. As a result, in the past, some of our customers deferred purchasing our products until the next upgrade was released. Future delays or problems in the installation or implementation of our new releases may cause customers to forego purchases of our products and purchase those of our competitors instead. Additionally, even if we are able to develop new products and product enhancements, we cannot ensure that they will achieve market acceptance.

We recognize revenue from specific customers at the time we receive payment for our products, and if these customers do not make timely payment, our revenues could decrease.

Based on limited credit history, we recognize revenue from direct end users, resellers, distributors and OEMs that have not been deemed credit-worthy at the time we receive payment for our products, rather than at the time of sale. If these customers do not make timely payment for our products, our revenues could decrease. If our revenues decrease, the price of our common stock may fall.

We have a limited operating history and a cumulative net loss, which makes it difficult to evaluate our operations, products and prospects for the future.

We were incorporated in 1993 and began selling our products in 1996; therefore, we have a limited operating history upon which investors can evaluate our operations, products and prospects. With the exception of 2003, when we had net income of \$7.3 million, since our inception we have incurred significant annual net losses, resulting in an accumulated deficit of \$174.8 million as of September 30, 2005. We cannot ensure that we will be able to sustain profitability in the future. If we are unable to sustain profitability, we may fail to meet the expectations of stock analysts and investors, and the price of our common stock may fall.

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If we are not able to adequately protect our proprietary rights, third parties could develop and market products that are equivalent to our own, which would harm our sales efforts.

Our success depends upon our proprietary technology. We believe that our product developments, product enhancements, name recognition and the technological and innovative skills of our personnel are essential to establishing and maintaining a technology leadership position. We rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights.

However, these legal rights and contractual agreements may provide only limited protection. Our pending patent applications may not be allowed or our competitors may successfully challenge the validity or scope of any of our nine issued patents or any future issued patents. Our patents alone may not provide us with any significant competitive advantage, and third parties may develop technologies that are similar or superior to our technology or design around our patents. Third parties could copy or otherwise obtain and use our products or technology without authorization, or develop similar technology independently. We cannot easily monitor any unauthorized use of our products, and, although we are unable to determine the extent to which piracy of our software products exists, software piracy is a prevalent problem in our industry in general.

The risk of not adequately protecting our proprietary technology and our exposure to competitive pressures may be increased if a competitor should resort to unlawful means in competing against us. For example, in July 2003 we settled a complaint against Ascential Software Corporation in which a number of former Informatica employees recruited and hired by Ascential, misappropriated our trade secrets, including sensitive product and marketing information and detailed sales information regarding existing and potential customers and unlawfully used that information to benefit Ascential in gaining a competitive advantage against us. Although we were ultimately successful in this lawsuit, there are no assurances that we will be successful in protecting our proprietary technology from competitors in the future.

We have entered into agreements with many of our customers and partners that require us to place the source code of our products into escrow. Such agreements generally provide that such parties will have a limited, non-exclusive right to use such code if: (1) there is a bankruptcy proceeding by or against us; (2) we cease to do business; or (3) we fail to meet our support obligations. Although our agreements with these third parties limit the scope of rights to use of the source code, we may be unable to effectively control such third-party's actions.

Furthermore, effective protection of intellectual property rights is unavailable or limited in various foreign countries. The protection of our proprietary rights may be inadequate and our competitors could independently develop similar technology, duplicate our products or design around any patents or other intellectual property rights we hold.

We may be forced to initiate litigation in order to protect our proprietary rights. For example, on July 15, 2002, we filed a patent infringement lawsuit against Acta Technology, Inc. Although this lawsuit is in the discovery stage, litigating claims related to the enforcement of proprietary rights can be very expensive and can be burdensome in terms of management time and resources, which could adversely affect our business and operating results.

We have substantial real estate lease commitments that are currently subleased to third parties, and if subleases for this space are terminated or cancelled, our operating results and financial condition could be adversely affected.

We have substantial real estate lease commitments in the United States, a significant portion of which is subleased to third parties. The terms of most of these sublease agreements account for only a portion of the period our master leases and contain rights of the subtenant to extend the term of the sublease. To the extent that (1) our subtenants do not renew their subleases at the end of the initial term and we are unable to enter into new subleases with other parties at comparable rates, or (2) our subtenants are unable to timely pay the sublease rent amounts, our cash flow would be negatively impacted and our operating results and financial condition could be adversely affected.

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We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.

As is common in the software industry, we have received and may continue from time to time to receive notices from third parties claiming infringement by our products of third-party patent and other proprietary rights. As the number of software products in our target markets increases and the functionality of these products further overlaps, we may become increasingly subject to claims by a third party that our technology infringes such party's proprietary rights. Any claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could adversely affect our business, financial condition and operating results. Although we do not believe that we are currently infringing any proprietary rights of others, legal action claiming patent infringement could be commenced against us, and we may not prevail in such litigation given the complex technical issues and inherent uncertainties in patent litigation. The potential effects on our business that may result from a third-party infringement claim include the following:

we may be forced to enter into royalty or licensing agreements, which may not be available on terms favorable to us, or at all;

we may be required to indemnify our customers or obtain replacement products or functionality for our customers;

we may be forced to significantly increase our development efforts and resources to redesign our products as a result of these claims; and

we may be forced to discontinue the sale of some or all of our products.

We may engage in future acquisitions or investments that could dilute our existing stockholders, or cause us to incur contingent liabilities, debt or significant expense.

From time to time, in the ordinary course of business, we may evaluate potential acquisitions of, or investments in, related businesses, products or technologies. Future acquisitions and investments like these could result in the issuance of dilutive equity securities, the incurrence of debt or contingent liabilities, or the payment of cash to purchase equity securities from third parties. There can be no assurance that any strategic acquisition or investment will succeed.

Delaware law, as well as our certificate of incorporation and bylaws, contains provisions that could deter potential acquisition bids, which may adversely affect the market price of our common stock, discourage merger offers and prevent changes in our management or Board of Directors.

Our basic corporate documents and Delaware law contain provisions that might discourage, delay or prevent a change in the control of Informatica or a change in our management. Our bylaws provide that we have a classified Board of Directors, with each class of directors subject to re-election every three years. This classified board has the effect of making it more difficult for third parties to insert their representatives on our Board of Directors and gain control of Informatica. These provisions could also discourage proxy contests and make it more difficult for our stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

In addition, we have adopted a stockholder rights plan. Under the plan, we issued a dividend of one right for each outstanding share of common stock to stockholders of record as of November 12, 2001, and such rights will become exercisable only upon the occurrence of certain events. Because the rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, the plan could make it more difficult for a third party to acquire us or a significant percentage of our outstanding capital stock without first negotiating with our Board of Directors regarding such acquisition.

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We may need to raise additional capital in the future, which may not be available on reasonable terms to us, if at all.

We may not generate sufficient revenue from operations to offset our operating or other expenses. As a result, in the future, we may need to raise additional funds through public or private debt or equity financings. We may not be able to borrow money or sell more of our equity securities to meet our cash needs. Even if we are able to do so, it may not be on terms that are favorable or reasonable to us. If we are not able to raise additional capital when we need it in the future, our business could be seriously harmed.

Business interruptions could adversely affect our business.

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications or network failure and other events beyond our control. We do not have a detailed disaster recovery plan. Our facilities in the State of California are currently subject to electrical blackouts as a consequence of a shortage of available electrical power, which occurred during 2001. In the event these blackouts are reinstated, they could disrupt the operations of our affected facilities. In connection with the shortage of available power, prices for electricity may continue to increase in the foreseeable future. Such price changes will increase our operating costs, which could negatively impact our profitability. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes. We do not use derivative financial instruments for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. As of September 30, 2005, we did not hold derivative financial instruments.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. Our investment policy specifies credit quality standards for our investments and limits the amount of credit exposure to any single issue, issuer or type of investment. Our investments consist primarily of commercial paper, auction rate securities, U.S. government notes and bonds, corporate bonds and municipal securities. All investments are carried at market value, which approximates cost.

For the nine months ended September 30, 2005, the average rate of return on our investments was 2.8%. If market interest rates were to increase immediately and uniformly by 100 basis points from levels as of September 30, 2005, the fair market value of our portfolio would decline by less than \$1.0 million. Declines in interest rates could, over time, reduce our interest income.

Foreign Currency Risk

We market and sell our software and services through our direct sales force and indirect channel partners in the United States as well as Belgium, Canada, France, Germany, the Netherlands, Switzerland and the United Kingdom and Japan. We also have relationships with indirect channel partners in other regions including Europe, Asia-Pacific and Latin America. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As an example, the strengthening of the U.S. dollar compared to any of the local currencies in the markets in which we do business could make our products less competitive in these markets. Because we translate foreign currencies into U.S. dollars for reporting purposes, currency fluctuations, especially between the U.S. dollar and the Euro and British pound, may have an impact on our quarterly financial results. To date, we have not engaged in any foreign currency hedging activities.

Table of Contents**ITEM 4. CONTROLS AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Control over Financial Reporting. There was no change in our system of internal control over financial reporting during the three months ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

On November 8, 2001, a purported securities class action complaint was filed in the United States District Court for the Southern District of New York. The case is entitled *In re Informatica Corporation Initial Public Offering Securities Litigation*, Civ. No. 01-9922 (SAS) (S.D.N.Y.), related to *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS) (S.D.N.Y.). Plaintiffs' amended complaint was brought purportedly on behalf of all persons who purchased our common stock from April 29, 1999 through December 6, 2000. It names as defendants Informatica Corporation, two of our former officers (the *Informatica defendants*), and several investment banking firms that served as underwriters of our April 29, 1999 initial public offering and September 28, 2000 follow-on public offering. The complaint alleges liability as to all defendants under Sections 11 and/or 15 of the Securities Act of 1933 and Sections 10(b) and/or 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statements for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The complaint also alleges that false analyst reports were issued. No specific damages are claimed.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the Court ruled on all defendants' motions to dismiss. The Court denied the motions to dismiss the claims under the Securities Act of 1933. The Court denied the motion to dismiss the Section 10(b) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(b) and 20(a) claims against the *Informatica defendants* and 62 other individual defendants.

We accepted a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the *Informatica defendants*, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The *Informatica defendants* will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. The Court has set a hearing date of January 9, 2006 to consider final approval of the settlement.

On July 15, 2002, we filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. (*Acta*), now known as Business Objects Data Integration, Inc. (*BODI*), asserting that certain *Acta* products infringe on three of Company patents: U.S. Patent No. 6,014,670, entitled *Apparatus and Method for Performing Data Transformations in Data Warehousing*; U.S. Patent No. 6,339,775, entitled *Apparatus and Method for Performing Data Transformations in Data Warehousing* (this patent is a continuation-

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in-part of and claims the benefit of U.S. Patent No. 6,014,670); and U.S. Patent No. 6,208,990, entitled Method and Architecture for Automated Optimization of ETL Throughput in Data Warehousing Applications. On July 17, 2002, we filed an amended complaint alleging that Acta products also infringe on one additional patent: U.S. Patent No. 6,044,374, entitled Object References for Sharing Metadata in Data Marts. In the suit, we are seeking an injunction against future sales of the infringing Acta/ BODI products, as well as damages for past sales of the infringing products. We have asserted that BODI's infringement of our patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI has not made any claims for monetary relief against the Company and has not filed any counterclaims alleging that the Company has infringed any BODI's patents. The parties presented their respective claim constructions to the Court on September 24, 2003, and on August 1, 2005, the Court issued its claims construction order. The Company believes that the issued claims construction order is favorable to the Company's position on the infringement action. The matter is currently in the discovery phase.

We are also a party to various legal proceedings and claims arising from the normal course of business activities.

Based on current available information, management does not expect that the ultimate outcome of these unresolved matters, individually or in the aggregate, will have a material adverse effect on our results of operations, cash flows or financial position. However, litigation is subject to inherent uncertainties and our view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on our results of operations, cash flows and financial position for the period in which the unfavorable outcome occurs, and potentially in future periods.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Repurchases of Equity Securities**

On July 2, 2004, we announced a stock repurchase program to purchase up to 5,000,000 shares of our common stock. The purpose of our stock repurchase program is, among other things, to help offset the dilution caused by the issuance of stock under our employee stock option plans. The number of shares acquired and the timing of the repurchases are based on several factors, including general market conditions and the trading price of our common stock. We repurchased a total of 362,500 and 1,900,000 shares in the three and nine months ended September 30, 2005, respectively, and at September 30, 2005, 2,045,000 shares remained available for repurchase under the program.

The following table provides information about the repurchase of our common stock during the three months ended September 30, 2005:

Period	(1) Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(2) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 - July 31				2,407,500
August 1 - August 31	362,500	\$ 10.84	362,500	2,045,000
September 1 - September 30				2,045,000
Total	362,500	\$ 10.84	362,500	2,045,000

(1)

All shares repurchased in open-market transactions under the repurchase program.

- (2) We announced the repurchase program on July 2, 2004. The repurchase program authorizes the repurchase of up to five million shares of our common stock at any time until the end of 2005.

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ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-15(a).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-15(a).
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

ITEMS 3, 4 and 5 are not applicable and have been omitted.

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SIGNATURES

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

INFORMATICA CORPORATION

November 7, 2005

/s/ Earl E. Fry.
Earl E. Fry
Chief Financial Officer
(Duly Authorized Officer and Principal Financial and
Accounting Officer)

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**INFORMATICA CORPORATION
EXHIBITS TO FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2005**

Number	Exhibit Title
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-15(a).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-15(a).
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.