INFORMATICA CORP
Form 10-Q
August 07, 2003

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003
or

o **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** *(IRS Employer Identification No.)*
2100 Seaport Blvd. **Redwood City, California** *(Address of principal executive offices)*	**94063** *(Zip Code)*

(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 þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

As of July 31, 2003, there were 80,403,199 shares of the registrant s Common Stock outstanding.

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FORM 10-Q

For the Quarter Ended June 30, 2003

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PART I. FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

INFORMATICA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	June 30, 2003	December 31, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$130,791	$122,490
Short-term investments	111,088	113,385
Accounts receivable, net of allowances of $1,270 and $1,349, respectively	26,119	29,982
Prepaid expenses and other current assets	5,376	8,680
Total current assets	273,374	274,537
Restricted cash	12,166	12,166
Property and equipment, net	42,861	47,370
Goodwill	30,274	30,274
Intangible assets, net	92	517
Other assets	355	330
Total assets	$359,122	$365,194
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,721	$ 2,269
Accrued liabilities	23,861	24,384
Accrued compensation and related expenses	13,077	12,666
Income taxes payable	2,103	2,064
Accrued restructuring charges	4,866	4,812
Deferred revenue	50,478	51,702
Total current liabilities	97,106	97,897
Accrued restructuring charges, less current portion	12,548	14,894
Commitments and contingencies		
Stockholders equity	249,468	252,403
Total liabilities and stockholders equity	$359,122	$365,194

See 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 June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Revenues:				
License	$24,197	$26,392	$47,778	$52,906
Service	26,350	22,754	51,317	44,767
Total revenues	50,547	49,146	99,095	97,673
Cost of revenues:				
License	637	1,720	1,224	3,106
Service	9,679	9,727	18,916	19,598
Total cost of revenues	10,316	11,447	20,140	22,704
Gross profit	40,231	37,699	78,955	74,969
Operating expenses:				
Research and development	11,339	11,695	22,679	23,606
Sales and marketing	20,782	22,110	41,922	43,870
General and administrative	5,395	5,026	10,791	9,823
Amortization of stock-based compensation	19	65	43	138
Amortization of intangible assets	140	285	425	570
Total operating expenses	37,675	39,181	75,860	78,007
Income (loss) from operations	2,556	(1,482)	3,095	(3,038)
Interest income and other, net	1,257	2,177	2,380	3,479
Income before income taxes	3,813	695	5,475	441
Income tax provision	596	261	1,089	261
Net income	$ 3,217	$ 434	$ 4,386	$ 180
Net income per share:				
Basic and diluted	$ 0.04	$ 0.01	$ 0.05	$ 0.00
Weighted shares used in calculation of net income per share:				
Basic	80,143	79,308	80,335	79,137
Diluted	82,777	82,796	82,959	83,760

See notes to condensed consolidated financial statements.

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INFORMATICA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
	(In thousands) (Unaudited)	
Operating activities		
Net income	$ 4,386	$ 180
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,751	4,725
Provision for doubtful accounts	177	661
Amortization of stock-based compensation	43	138
Amortization of intangible assets	425	570
Gain on the sale of investments	(18)	(154)
Loss on disposal of property and equipment	4	357
Other	76	
Changes in operating assets and liabilities:		
Accounts receivable	3,686	(3,215)
Prepaid expenses and other current assets	3,304	1,567
Other assets	(25)	341
Accounts payable	452	401
Accrued liabilities	(522)	5,198
Accrued compensation and related expenses	411	(187)
Income taxes payable	39	(32)
Accrued restructuring charges	(2,293)	(2,544)
Deferred revenue	(1,224)	2,153
Net cash provided by operating activities	14,672	10,159
Investing activities		
Purchase of property and equipment, net	(1,246)	(4,715)
Purchases of investments	(67,287)	(128,980)
Proceeds from the sales and maturities of investments	69,390	86,313
Net cash provided by (used in) investing activities	857	(47,382)
Financing activities		
Proceeds from issuances of common stock, net of payments for repurchases	3,052	3,794
Repurchases and retirements of common stock	(10,445)	
Net cash provided by (used in) financing activities	(7,393)	3,794
Effect of foreign currency translation on cash and cash equivalents	165	377
Increase (decrease) in cash and cash equivalents	8,301	(33,052)
Cash and cash equivalents at beginning of period	122,490	131,264

Cash and cash equivalents at end of period	$130,791	$ 98,212
Supplemental disclosures:		
Income taxes paid	$ 1,035	$ 628
Supplemental disclosures of noncash investing and financing activities:		
Unrealized loss on available-for-sale securities	$ (212)	$ (75)

See notes to condensed consolidated financial statements.

INFORMATICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. 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) 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 as of June 30, 2003 are unaudited. The interim results presented are not necessarily indicative of results for any subsequent interim period, the year ended December 31, 2003 or any future period.

These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2002 included in the Company s Annual Report on Form 10-K, as amended, filed with the SEC. The condensed consolidated balance sheet as of December 31, 2002 has been derived from the audited consolidated financial statements of the Company.

2. Revenue Recognition

The Company generates revenues from sales of software licenses and services, which consist of maintenance, consulting and training. The Company s license revenues are derived from its data integration and business intelligence software and are also derived from analytic application suites and data warehouse modules, which the Company ceased selling directly in July 2003. The Company receives software license revenues from licensing its products directly to end users and indirectly through resellers, distributors and OEMs. The Company receives service revenues from maintenance contracts, consulting services and training that it performs for customers that license its products either directly from the Company or indirectly through resellers, distributors and OEMs.

The Company recognizes revenue in accordance with AICPA Statement of Position (SOP) 97-2 (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, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price is established by the Company s authorized management. If an acceptance period is required, the Company recognizes revenue upon customer acceptance or the expiration of the acceptance period. Credit-worthiness and collectibility for end users are first assessed on a country level and then, for those customers in countries deemed to have sufficient timely payment history, customers are assessed based on payment history and credit profile. For the data integration and business intelligence software and data warehouse modules sold directly to end users, the Company recognizes revenue upon shipment when collectibility is probable. When a customer is not deemed credit-worthy, revenue is recognized upon cash receipt. For the Company s analytic application suites, it recognizes both the license and maintenance revenue ratably over the maintenance period, generally one year. Support for the analytic application suites for the first year is never sold separately and in consideration of the complexities of the implementation the customer is entitled to receive support services that are different than the standard annual support services of the Company s other products. The Company s standard agreements do not contain product return rights.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company also enters into reseller and distributor arrangements that 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 data integration and business intelligence software and data warehouse modules 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. Credit-worthiness and collectibility for resellers and distributors are first assessed on a country level and then, for those resellers and distributors in countries deemed to have sufficient timely payment history, resellers and distributors are assessed based on established credit history consisting of sales of at least $1.0 million and with timely payment history, generally for the last twelve months. When resellers and distributors are not deemed credit-worthy, revenue is recognized upon cash receipt.

The Company also enters into OEM arrangements that provide for license fees based on inclusion of the Company s products in the OEMs products. These arrangements provide for fixed, irrevocable royalty payments. Credit-worthiness and collectibility for OEMs are first assessed on a country level and then, for those OEMs in countries deemed to have sufficient timely payment history, OEMs are assessed based on established credit history consisting of sales of at least $1.0 million and with timely payment history, generally for the last twelve months. For credit-worthy OEMs, royalty payments are recognized when due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt.

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 a very infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of our software products. Training revenues are generated from classes offered at the Company s headquarters, sales offices and customer locations. Revenues from consulting and training 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 revenue includes deferred license, maintenance, consulting and training revenue. Deferred revenue amounts do not include items that are both deferred and unbilled. 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.

3. Intangible Assets

Intangible assets consist of the following (in thousands):

	June 30, 2003			December 31, 2002		
	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets
Core technology	$3,122	$(3,046)	$ 76	$3,122	$(2,670)	$452
Patents	297	(281)	16	297	(232)	65
Total intangible assets	$3,419	$(3,327)	$ 92	$3,419	$(2,902)	$517

Amortization expense of intangible assets was approximately $0.1 million and $0.3 million for the three months ended June 30, 2003 and 2002, respectively, and approximately $0.4 million and $0.6 million for the

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

six months ended June 30, 2003 and 2002, respectively. The expected amortization expense related to identifiable intangible assets is $0.5 million for the year ended December 31, 2003.

4. Stock-Based Compensation

In accordance with Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees,* the Company applies the intrinsic value method in accounting for employee stock options. Accordingly, the Company generally recognizes no compensation expense with respect to stock-based awards to employees. Pro forma information regarding net income (loss) and net income (loss) per share is required by Statement of Financial Accounting Standards (SFAS) No. 123 (SFAS 123), *Accounting for Stock-Based Compensation,* which also requires that the information be determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123 and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure.* The fair value of these stock-based awards to employees was estimated using the Black-Scholes option valuation model.

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 highly subjective assumptions. Because the Company s stock-based awards have characteristics significantly different from those in traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock-based awards.

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 model, the Company s net income and basic and diluted net income per share would have decreased to the pro forma net loss amounts indicated below (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income, as reported	$ 3,217	$ 434	$ 4,386	$ 180
Add: stock-based compensation expense included in reported net income, net of related tax effects	19	65	43	138
Deduct: total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(6,708)	(13,364)	(13,329)	(27,823)
Net loss, pro forma	$ (3,472)	$ (12,865)	$ (8,900)	$ (27,505)
Basic and diluted net income per share, as reported	$ 0.04	$ 0.01	$ 0.05	$ 0.00
Basic and diluted net loss per share, pro forma	$ (0.04)	$ (0.16)	$ (0.11)	$ (0.35)

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

5. Net Income Per Share

Basic and diluted net income per share is presented in conformity with the SFAS No. 128, *Earnings Per Share,* for all periods presented. Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution of securities by adding the dilutive effect of other common stock equivalents, including outstanding stock options

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

using the treasury stock method, to the weighted average number of common shares outstanding during the period, if dilutive. The calculation of basic and diluted net income per share is as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income	$ 3,217	$ 434	$ 4,386	$ 180
Weighted average shares of common stock outstanding used in calculation of net income per share:				
Basic	80,143	79,308	80,335	79,137
Dilutive effect of employee stock plans	2,634	3,488	2,624	4,623
Diluted	82,777	82,796	82,959	83,760
Net income per share:				
Basic and diluted	$ 0.04	$ 0.01	$ 0.05	$ 0.00

6. Comprehensive Income

The components of comprehensive income are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income	$3,217	$ 434	$4,386	$180
Other comprehensive income (loss):				
Unrealized gain (loss) on investments	(163)	464	(212)	(75)
Foreign currency translation adjustment	206	402	165	377
Comprehensive income	$3,260	$1,300	$4,339	$482

7. Recent Accounting Pronouncements

In November 2002, the Emerging Issue Task Force reached a consensus on Issue No. 00-21 (EITF 00-21), *Revenue Arrangements with Multiple Deliverables.* EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company has not yet assessed the impact of the adoption of EITF 00-21 on its consolidated financial position or results of operations.

8. Restructuring Charges

During the third quarter of 2001, the Company announced a 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 the third quarter of 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

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leasehold improvement and asset write-offs related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas as a result of continued deterioration of the commercial real estate market in these areas. These charges represented 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 with the assistance of current market information and trend analysis provided by a commercial real estate brokerage firm retained by the Company.

Net cash payments for the three and six months ended June 30, 2003 related to the obligations under operating leases amounted to $1.1 million and $2.3 million, respectively. Actual future cash requirements may differ from the restructuring liability balances as of June 30, 2003 if the Company is 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. As of June 30, 2003, $17.4 million of facilities operating lease obligations, net of related costs and anticipated sublease income related to facilities expected to be subleased, remains accrued and is expected to be paid by 2007. If the Company is unable to sublease any of the available vacant facilities during the remaining lease terms from the fourth quarter of 2004 through 2007, restructuring charges could increase by approximately $3.2 million. If the Company does not occupy certain available vacant facilities during the remaining lease terms from 2008 through 2013, restructuring charges could increase by approximately an additional $15.5 million.

A summary of the activity of the accrued restructuring charges for the six months ended June 30, 2003 is as follows (in thousands):

	Accrued Restructuring Charges at December 31, 2002	Adjustments	Cash Payments	Non-Cash Charges	Accrued Restructuring Charges at June 30, 2003
Excess leased facilities	$19,706	$	$(2,292)	$	$17,414

As of June 30, 2003, $4.9 million of the $17.4 million accrued restructuring charges was classified as current liabilities and the remaining $12.5 million was classified as noncurrent liabilities.

In February 2003, the Company signed a sublease agreement with a privately-held company for leased office space in San Francisco, California. The Company received sublease payments under the sublease agreement, which commenced in April 2003, of $0.1 million in the three months ended June 30, 2003 and expects to receive additional sublease payments of $0.1 million for the remaining six months of 2003, $0.3 million in 2004, $0.4 million in 2005, $0.4 million in 2006 and $0.1 million in 2007. The total payments of approximately $1.4 million under the sublease agreement exceed the restructuring sublease assumptions for the leased space by $0.8 million. The Company has deemed the subleasee to be not credit-worthy based on its financial condition. As a result, accrued restructuring charges were not reduced by the $0.8 million upon signing of the lease, and the Company will recognize the payments from the subleasee as a benefit to its results of operations as the $0.8 million payments of incremental sublease income are received. The payments received to date have been recorded as a reduction in accrued restructuring charges. If remaining payments are received when due, the benefit to the results of operations would be $0.3 million in 2005, $0.4 million in 2006 and $0.1 million in 2007.

9. Stock Repurchase Plan

In September 2002, the Company s Board of Directors authorized a one-year stock repurchase program for up to five million shares of the Company s common stock. Purchases will 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, general business and market

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

conditions, and other factors, including alternative investment opportunities. For the three and six months ended June 30, 2003, the Company purchased 412,037 and 1,502,498 shares, respectively, at a cost of $2.9 million and $10.5 million, respectively. As of June 30, 2003, a total of 1,854,732 shares have been purchased under this program at a cost of $12.2 million. These shares were retired and reclassified as authorized and unissued shares of common stock.

10. Warranties and Indemnification

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 SFAS No. 5 (SFAS 5), *Accounting for Contingencies.* The Company s software products media are generally warranted to be free of defects in materials and workmanship under normal use and the products are also generally warranted to substantially perform as described in certain Company documentation. 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 June 30, 2003 and December 31, 2002. To date, the Company s product warranty expense has not been significant.

The Company generally agrees to indemnify its customers against legal claims that the Company s software products infringe certain third-party intellectual property rights and accounts for its indemnification obligations under SFAS 5. In the event of such a claim, the Company is generally obligated to defend its customer against the claim and to either settle the claim at the Company s expense or pay damages that the customer is legally required to pay to the third-party claimant. In addition, in the event of an infringement, the Company agrees to modify or replace the infringing product, or, if those options are not reasonably possible, to refund the cost of the software, as pro-rated over a five-year period. To date, the Company has not been required to make any payment resulting from infringement claims asserted against our customers. As such, the Company has not recorded a liability for infringement costs as of June 30, 2003.

11. 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, one of the Company s current officers, and one 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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Section 10(a) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(a) and 20(a) claims against the Informatica defendants and 62 other individual defendants.

The Company has decided to accept 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.

On July 15, 2002, the Company filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc., asserting that certain Acta products infringe on three of our 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 products, as well as damages for past sales of the infringing products. The Company has asserted that Acta s infringement of the Informatica patents was willful and deliberate. Acta answered the complaint on September 5, 2002, and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. Acta did not make any claims for monetary relief against us. The case is currently in the claim construction and discovery phase.

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

In management s opinion, resolution of any of these matters is not expected to have a material adverse impact on our results of operations, cash flows or its financial position. However, depending on the amount and timing, an unfavorable resolution of these matters could materially and adversely affect the Company s future results of operations, cash flows or financial position in a particular period.

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

This Form 10-Q includes forward-looking statements within the meaning of the federal securities laws, particularly statements referencing our expectations relating to our service revenues; trends in our cost of revenues and operating expenses; the sufficiency of our cash balances and cash flows for the next twelve months; 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 in Risk Factors and elsewhere in this report. 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 data integration and business intelligence software that helps our customers to automate the integration, analysis and delivery of critical corporate information. Using our products, managers and executives gain valuable business insight they can use to help improve operational performance and enhance competitive advantage.

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (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. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting among available alternatives would not produce a materially different result.

Our senior management has reviewed these critical accounting policies and related disclosures with our Audit Committee. We believe our most critical accounting policies include the following:

Revenue Recognition

We generate revenues from sales of software licenses and services, which consist of maintenance, consulting and training. Our license revenues are derived from our data integration and business intelligence software and are also derived from analytic application suites and data warehouse modules, which we ceased selling directly in July 2003. 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 training that we perform for customers that license our products either directly from us or indirectly through resellers, distributors and OEMs.

We recognize revenue in accordance with SOP 97-2, as amended and modified by SOP 98-9. We recognize license revenues when a noncancelable license agreement has been signed, the product has been shipped, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. In the case of an element not yet sold separately, the price is established by our authorized management. If an acceptance period is required, we recognize revenue upon customer acceptance or the expiration of the acceptance period. Credit-worthiness and collectibility for end users are first assessed on a country level and then, for those customers in countries deemed to have sufficient timely payment history, customers are assessed based on payment history and credit profile. For the data integration and business intelligence software and data warehouse modules sold directly to end users, we recognize revenue upon shipment when collectibility is probable. When a customer is not deemed credit-worthy, revenue is recognized upon cash receipt. For our analytic application suites, we recognize both the license and maintenance revenue ratably over the maintenance period, generally one year. Support for the analytic application suites for the first year is never sold separately and in consideration of the complexities of the implementation the customer is entitled to receive support services that are different than the standard annual support services of our other products. Our standard agreements do not contain product return rights.

We also enter into reseller and distributor arrangements that 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 data integration and business intelligence software and data warehouse modules sold indirectly through the 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. Credit-worthiness and collectibility for resellers and distributors are first assessed on a country level and then, for resellers and distributors in countries deemed to have sufficient timely payment history, resellers and distributors are assessed based on established credit history consisting of sales of at least $1.0 million and with timely payment history, generally for the last twelve months. When resellers and distributors are not deemed credit-worthy, revenue is recognized upon cash receipt.

We also enter into OEM arrangements that provide for license fees based on inclusion of our products in the OEMs products. These arrangements provide for fixed, irrevocable royalty payments. Credit-worthiness and collectibility for OEMs are first assessed on a country level and then, for those OEMs in countries deemed to have sufficient timely payment history, OEMs are assessed based on established credit history consisting of sales of at least $1.0 million and with timely payment history, generally for the last twelve months. For credit-worthy OEMs, royalty payments are recognized when due. When OEMs are not deemed credit-worthy, revenue is recognized upon cash receipt.

We recognize 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 a very infrequent basis, a fixed fee arrangement under separate service arrangements related to the installation and implementation of our software products. Training revenues are generated from classes offered at our headquarters, sales offices and customer locations. Revenues from consulting and training 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 revenue includes deferred license, maintenance, consulting and training revenue. Deferred revenue amounts do not include items that are both deferred and unbilled. 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 revenue in the same period as the related revenues are recorded. These estimates require management judgment and are based on historical sales returns and other known factors. If these estimates do not adequately reflect future sales returns, revenue could be overstated.

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. For example, we recorded an additional bad debt expense in 2002 related to customers that filed for bankruptcy.

Impairment of Goodwill

We assessed goodwill for impairment in accordance with SFAS No. 142 (SFAS 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 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 applications. Goodwill was tested for impairment on the adoption of SFAS 142 on January 1, 2002 and in the annual impairment test on October 31, 2002 using the two-step process required by SFAS 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 and with the assistance of third-party analysts. Management s cash flow forecasts were based on assumptions that are consistent with the plans and estimates being used to manage the underlying assumptions. 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 142, to its carrying amount to determine the impairment loss, if any.

Based on these estimates, we determined that as of October 31, 2002 there were no indications of impairment of goodwill. Since October 31, 2002, there have been no indications of impairment and the next annual impairment test will occur on October 31, 2003. However, future changes in market capitalization or estimates used in discounted cash flows analyses could result in significantly different fair value of the Reporting Unit, which may result in impairment of goodwill.

Restructuring Charges

During 2002 and 2001, we recorded significant charges in connection with our excess facilities. The accrued restructuring charges represent gross lease obligations and estimated commissions and other costs (principally leasehold improvements and asset write-offs), offset by estimated gross sublease income expected to be received over the remaining lease terms. These liabilities include management s estimates pertaining to sublease activities. The charges we recorded in 2002 represented adjustments to the original assumptions we made in connection with the changes we recorded in 2001. We will continue to evaluate the commercial real estate market conditions quarterly 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. If we determine that there is further deterioration in the estimated sublease rates or in the expected time to sublease our vacant space, we may incur additional restructuring charges in the future and our cash position could be adversely affected. See Note 8 of notes to condensed financial statements in Item 1.

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Deferred Taxes

We recorded a valuation allowance to reduce 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 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.

Three and Six Months Ended June 30, 2003 and 2002

The following table presents certain financial data for the three and six months ended June 30, 2003 and 2002 as a percentage of total revenues:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Consolidated Statements of Operations Data:				
Revenues:				
License	48%	54%	48%	54%
Service	52	46	52	46
Total revenues	100	100	100	100
Cost of revenues:				
License	1	3	1	3
Service	19	20	19	20
Total cost of revenues	20	23	20	23
Gross profit	80	77	80	77
Operating expenses:				
Research and development	23	24	23	24
Sales and marketing	41	45	42	45
General and administrative	11	10	11	10
Amortization of stock-based compensation				
Amortization of intangible assets		1	1	1
Total operating expenses	75	80	77	80
Income (loss) from operations	5	(3)	3	(3)
Interest income and other, net	2	4	2	3
Income before income taxes	7	1	5	
Income tax provision	1		1	
Net income	6%	1%	4%	%
Cost of license revenues, as a percentage of license revenues	3%	7%	3%	6%
Cost of service revenues, as a percentage of service revenues	37%	43%	37%	44%

Revenues

Our total revenues were $50.5 million and $49.1 million for the three months ended June 30, 2003 and 2002, respectively, and $99.1 million and $97.7 million for the six months ended June 30, 2003 and 2002, respectively. Our license revenues decreased 8% to $24.2 million from $26.4 million for the three months ended June 30, 2003 and 2002, respectively, and decreased 10% to $47.8 million from $52.9 million for the six months ended June 30, 2003 and 2002, respectively. The decreases were due to decreases in the average transaction size and the number of licenses sold. We believe these decreases were caused primarily by continued general weak global economic conditions, principally reflecting reduced and delayed information technology (IT) spending by our customers. Service revenues increased 16% to $26.3 million from $22.8 million for the three months ended June 30, 2003 and 2002, respectively and increased 15% to $51.3 million from $44.8 million for the six months ended June 30, 2003 and 2002, respectively. The increase in both 2003 periods was primarily due to an increase in maintenance revenues associated with strong renewal maintenance, partially offset by a small decrease in consulting services. For the remaining quarters of 2003, we expect maintenance revenue to remain strong based on our growing installed customer base, and we expect contributions from consulting and training services to remain relatively consistent with the first half of 2003 level.

Our international revenues were $12.9 million and $11.7 million for the three months ended June 30, 2003 and 2002, respectively, representing a 2003 increase of 10%, and $28.3 million and $22.3 million for the six months ended June 30, 2003 and 2002, respectively, representing a 2003 increase of 27%. International revenues as a percentage of total revenues were 26% and 24% for the three months ended June 30, 2003 and 2002, respectively, and 29% and 23% for the six months ended June 30, 2003 and 2002, respectively. The increase in both 2003 periods was due primarily to the return to a historical range of contribution from our international business for the first half of 2003 compared to the weak worldwide macroeconomic environment, primarily in the United Kingdom, Japan and Australia that we experienced in the first half of 2002. Most of our international sales have been in Europe. Sales outside of North America and Europe to date were 2% or less of total consolidated revenues for each quarter in the year ended December 31, 2002 and 7% and 4% of total consolidated revenues for the three months ended March 31, 2003 and June 30, 2003, respectively.

As a result of the factors that affected our license revenue and the continued uncertainty in IT spending by our customers and prospects, our ability to meet our forecasted sales for the remaining quarters of 2003 is likely to be dependent on our success in converting our sales pipeline into license revenues from orders received and shipped within each of the remaining quarters. In 2002, the general economic slowdown caused customer purchases to be reduced in amount, deferred or cancelled, and thereby reduced our overall license pipeline conversion rates through most of 2002. These trends continued to affect us in the first half of 2003, and they could continue to reduce the rate of conversion of the sales pipeline into license revenue in the third quarter of 2003, and future periods. See *Risk Factors If we are unable to accurately forecast revenues, it may harm our business or results of operations.* and *Risk Factors We expect seasonal trends to cause our quarterly revenues to fluctuate.* In addition, we recently released new versions of our business intelligence and data integration software. The degree of market acceptance for these products is currently uncertain. If we are not able to successfully license our products, our business would be adversely affected. See *Risk Factors Because we sell a limited number of products, if these products do not achieve broad market acceptance, our revenues will be adversely affected* .

In July 2003, we ceased direct sales of our analytic application suites and data warehouse modules; however, we will continue to make this packaged analytic content available to our indirect channel partners. We will not receive any future revenue from the use or distribution of this packaged analytic content by our independent channel partners. In addition, we will make appropriate efforts to provide support to our existing analytic application customers and to encourage our existing and prospective customers to work with these partners. If we are unable to successfully manage this transition, our results of operations could be adversely affected. See *Risk Factors Changes in our product offerings may impact market acceptance of our products or adversely affect our results of operations.*

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. In addition, we have historically recognized a substantial portion of our revenues in the last month of each quarter, and more recently, in the last few weeks of each quarter. See *Risk Factors The expected fluctuation of our quarterly results could cause our stock price to experience significant fluctuations or declines.*

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Cost of Revenues

Cost of License Revenues

Our cost of license revenues consists primarily of software royalties, product packaging, documentation, and production costs. Cost of license revenues was $0.6 million and $1.7 million for the three months ended June 30, 2003 and 2002, respectively, representing approximately 3% and 7% of license revenues for those periods. Cost of license revenues was $1.2 million and $3.1 million for the six months ended June 30, 2003 and 2002, respectively, representing approximately 3% and 6% of license revenues for those periods. The decrease in absolute dollar amounts during the periods was due primarily to decreases in our percentage mix of royalty-bearing products. In addition, cost of license revenues for the second quarter of 2003 benefited from the renegotiation of certain OEM agreements. For the remaining quarters of 2003, we expect the cost of license revenues as a percentage of license revenues to fluctuate between the first half of 2003 level and the historical 2002 level.

Cost of Service Revenues

Our cost of service revenues is a combination of costs of maintenance, consulting and training revenues. Our cost of maintenance revenues consists primarily of costs associated with software upgrades, telephone and on-line support services and on-site visits. Cost of consulting revenues consists primarily of personnel costs and expenses incurred in providing consulting services at customers facilities. Cost of training revenues consists primarily of the costs of providing training classes and materials at our headquarters, sales and training offices and customer locations. Because we believe that providing a high level of support to customers is a strategic advantage, we have invested significantly in personnel and infrastructure. Cost of service revenues was $9.7 million for each of the three months ended June 30, 2003 and 2002, representing approximately 37% and 43% of service revenues for those periods. Cost of service revenues was $18.9 million and $19.6 million for the six months ended June 30, 2003 and 2002, respectively, representing approximately 37% and 44% of service revenues for those periods. The decrease in absolute dollar amounts for each of the 2003 periods compared to 2002 was primarily due to lower headcount and related compensation expenses. For the remaining quarters of 2003, we expect our cost of service revenues as a percentage of service revenues to be relatively consistent with the first half of 2003 level.

Operating Expenses

Research and Development

Our research and development expenses consist primarily of salaries and other personnel-related expenses 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 were $11.3 million and $11.7 million for the three months ended June 30, 2003 and 2002, respectively, representing approximately 23% and 24% of total revenues for those periods. Research and development expenses were $22.7 million and $23.6 million for the six months ended June 30, 2003 and 2002, respectively, representing approximately 23% and 24% of total revenues for those periods. The decrease in absolute dollar amounts for the 2003 periods was due primarily to a slight decrease in research and development personnel costs. 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. In the first half of 2003, we opened an office in Bangalore, India with the goal of increasing research and development output while maintaining the same, or a lower, level of costs. For the remaining quarters of 2003, we expect research and development expenses as a percentage of total revenues will remain at or slightly below the first half of 2003 level.

Sales and Marketing

Our sales and marketing expenses consist primarily of personnel costs, including commissions, as well as costs of public relations, seminars, marketing programs, lead generation, travel and trade shows. Sales and marketing expenses were $20.8 million and $22.1 million for the three months ended June 30, 2003 and 2002, respectively, representing approximately 41% and 45% of total revenues for those periods. Sales and marketing expenses were $41.9 million and $43.9 million for the six months ended June 30, 2003 and 2002, respectively, representing approximately 42% and 45% of total revenues for those periods. The decrease in absolute dollar amounts for the 2003 periods was due primarily to decreased cost of sales programs, travel expense and compensation costs as a result of decreased headcount. For the remaining quarters of 2003, we expect sales and marketing expenses as a percentage of total revenues will remain relatively consistent with the first half of 2003 level.

General and Administrative

Our general and administrative expenses consist primarily of personnel costs for finance, human resources, legal and general management, as well as professional services expense associated with recruiting, legal and accounting. General and administrative expenses were $5.4 million and $5.0 million for the three months ended June 30, 2003 and 2002, respectively, representing approximately 11% and 10% of total revenues for those periods, respectively. General and administrative expenses were $10.8 million and $9.8 million for the six months ended June 30, 2003 and 2002, respectively, representing approximately 11% and 10% of total revenues for those periods. The increase in absolute dollar amounts for the 2003 periods was primarily due to increased costs paid to outside legal and financial professional service providers. For the remaining quarters of 2003, we expect general and administrative expenses as a percentage of total revenues will remain at or slightly below the first half of 2003 level.

Bad debt expense charged to operations was $0.1 million for each of the three months ended June 30, 2003 and 2002, and $0.2 million for each of the six months ended June 30, 2003, respectively, representing less than 1% of total revenues in each of these periods.

Amortization of Stock-Based Compensation

Amortization of stock-based compensation amounted to $19,000 and $65,000 for the three months ended June 30, 2003 and 2002, respectively, and $43,000 and $138,000 for the six months ended June 30, 2003 and 2002, respectively. We expect to record amortization of stock-based compensation of approximately $31,000 for the last six months of the year ended December 31, 2003.

Amortization of Intangible Assets

Goodwill represents the excess of the aggregate purchase price over the fair value of the tangible and identifiable intangible assets we have acquired. Other intangible assets include core technology and patents. We recorded goodwill and other intangible assets in connection with the acquisitions of syn-T-sys and Informatica Partners in 2001 and Delphi Solutions AG, Zimba and QRB Developers in 2000 as well as the strategic alliance with PricewaterhouseCoopers (PwC) in 2000.

As required by SFAS 142, we ceased amortization of goodwill as of January 1, 2002. We continue to amortize identifiable intangible assets on a straight-line basis over their expected useful lives ranging from two to three years. Amortization of intangible assets amounted to $0.1 million and $0.3 million for the three months ended June 30, 2003 and 2002, respectively, and $0.4 million and $0.6 million for the six months ended June 30, 2003 and 2002, respectively. For the intangible assets that we will continue to amortize, we expect amortization expense to be approximately $0.1 million for the last six months of the year ended December 31, 2003. It is likely that we will continue to expand our business both through acquisitions and internal development. Any additional acquisitions could result in additional merger and acquisition related expenses and any impairment of goodwill and other intangible assets could result in incremental expense.

Restructuring Charges

In the third quarter of 2001, we announced a restructuring plan and recorded restructuring charges of approximately $12.1 million, consisting of $10.6 million related to estimated facility lease losses and $1.5 million in leasehold improvement and asset write-offs related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas.

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In the third quarter of 2002, we 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 related to the consolidation of excess leased facilities as a result of continued deterioration of the commercial real estate market in these areas. These charges represented adjustments to the original charges recorded in September 2001, including the time period that the buildings are expected to be vacant, expected sublease rates and expected sublease terms. We estimated the additional costs for restructuring charges using current market information and trend analysis provided by an independent commercial real estate brokerage firm retained by us.

Net cash payments for the three and six months ended June 30, 2003 related to the obligations under operating leases amounted to $1.1 million and $2.3 million, respectively. Actual future cash requirements may differ from the restructuring liability balances as of June 30, 2003 if the Company is 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. As of June 30, 2003, $17.4 million of facilities operating lease obligations, net of related costs and anticipated sublease income related to facilities expected to be subleased, remains accrued and is expected to be paid by 2007. If we are unable to sublease any of the available vacant facilities during the remaining lease terms from the fourth quarter of 2004 through 2007, restructuring charges could increase by approximately $3.2 million. If we do not occupy certain available vacant facilities during the remaining lease terms from 2008 through 2013, restructuring charges could increase by approximately an additional $15.5 million.

In February 2003, we signed a sublease agreement with a privately-held company for leased office space in San Francisco, California. We expect to receive sublease payments under the sublease agreement, which commenced in April 2003, of $0.1 million for the remaining six months of 2003, $0.3 million in 2004, $0.4 million in 2005, $0.4 million in 2006 and $0.1 million in 2007. The payments of approximately $1.4 million under the sublease agreement exceed the restructuring sublease assumptions for the leased space by $0.8 million. We have deemed the subleasee to be not credit-worthy based on its financial condition. As a result, accrued restructuring charges were not reduced by the $0.8 million upon signing of the lease, and we will recognize the payments from the subleasee as a benefit to our results of operations as the $0.8 million payments of incremental sublease income are received. In the three and six months ended June 30, 2003, payments of $0.1 million were received and recorded as a reduction in accrued restructuring charges. If remaining payments are received when due, the benefit to the results of operations would be $0.3 million in 2005, $0.4 million in 2006 and $0.1 million in 2007.

Interest Income and Other, Net; Interest Expense

Interest income and other, net represents primarily interest income earned on our cash, cash equivalents, investments and restricted cash. Interest income and other, net was $1.3 million and $2.2 million for the three months ended June 30, 2003 and 2002, respectively, and $2.4 million and $3.5 million for the six months ended June 30, 2003 and 2002, respectively. The decreases during the 2003 periods were primarily due to lower interest income earned on our cash, cash equivalents, investments and restricted cash, partially offset by foreign currency gains. 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.

Income Tax Provision

We recorded an income tax provision of $0.6 million and $1.1 million for the three and six months ended June 30, 2003, respectively, which primarily represents federal alternative minimum taxes, income taxes currently payable on income generated in non-U.S. jurisdictions, and foreign withholding taxes. We recorded a provision for income tax of $0.3 million for both the three and six months ended June 30, 2002, which primarily represents income and withholding taxes attributable to foreign operations. The expected tax provision derived in each period from applying the federal statutory rate to our income before income taxes differed from the recorded income tax provision primarily due to the realization of a portion of previously unbenefitted tax attributes and foreign withholding taxes.

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Recent Accounting Pronouncements

In November 2002, the Emerging Issue Task Force reached a consensus on Issue No. 00-21 (EITF 00-21), *Revenue Arrangements with Multiple Deliverables.* EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 apply to revenue arrangements we enter into in fiscal periods beginning after June 15, 2003. We have not yet assessed the impact of the adoption of EITF 00-21 on our consolidated financial position or results of operations.

Liquidity and Capital Resources

We have funded our operations primarily through cash flows from operations and public offerings of our common stock. In the past, we also funded our operations through private sales of preferred equity securities and capital equipment leases. As of June 30, 2003, we had $241.9 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.

Operating activities provided cash of $14.7 million and $10.2 million for the six months ended June 30, 2003 and 2002, respectively. For both periods, cash provided by operating activities was primarily due to net income adjusted for non-cash charges for depreciation and amortization, and the changes in operating assets and liabilities. The cash provided by operating activities for the six months ended June 30, 2003 included decreases in accounts receivable and prepaid expenses and other current assets, partially offset by an increase in deferred revenue and payments of accrued restructuring charges. The cash provided by operating activities for the six months ended June 30, 2002 included a decrease in prepaid expenses and other current assets and increases in accounts payable, accrued liabilities and deferred revenue, partially offset by a decrease in accounts receivable and the payment of accrued restructuring charges.

Investing activities provided cash of $0.9 million for the six months ended June 30, 2003 and used cash of $47.4 million for the six months ended June 30, 2002. Of the $0.9 million cash provided by investing activities for the six months ended June 30, 2003, $69.4 million was generated from the sale and maturities of investments, offset by $67.3 million used in the purchase of investments and $1.2 million was used in the purchase of property and equipment. Of the $47.4 million cash used in investing activities for the six months ended June 30, 2002, $129.0 million was used in the purchase of investments and $4.7 million was used in the purchase of property and equipment, offset by $86.3 million generated from the sale and maturities of investments.

Financing activities used cash of $7.4 million for the six months ended June 30, 2003 and provided cash of $3.8 million for the six months ended June 30, 2002. Of the $7.4 million cash used in financing activities for the six months ended June 30, 2003, $10.4 million was used in the repurchases and retirements of common stock, offset by the proceeds from the issuances of common stock of $3.0 million. For the six months ended June 30, 2002, cash provided by financing activities of $3.8 million consisted entirely of proceeds from the issuances of common stock.

We lease certain office facilities and equipment under noncancelable operating leases. Our payment obligations under these operating leases are included in the table below under the caption Operating Leases. During 2002 and 2001, we recorded restructuring charges related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas. Our operating lease obligations in the table below include approximately $14.8 million, net of anticipated sublease income, for operating lease commitments for those facilities that are included in accrued restructuring charges as of June 30, 2003. See Note 8 of notes to the condensed consolidated financial statements in Item 1. During 2002 and 2003, we signed sublease agreements for leased office space in Palo Alto and San Francisco, California and Carrollton, Texas. Our expected sublease income from these sublease agreements is included in the table below under the caption Sublease Income.

Our future minimum lease payments as of June 30, 2003 under noncancelable operating leases with original terms in excess of one year and sublease income are summarized as follows (in thousands):

	Operating Leases	Sublease Income	Net
Remaining 2003	$ 8,942	$ 453	$ 8,489
2004	17,916	922	16,994
2005	18,080	822	17,258
2006	17,982	432	17,550
2007	16,785	101	16,684
Thereafter	93,951		93,951
Total	$173,656	$2,730	$170,926

In February 2000, we entered into two lease agreements for new corporate headquarters in Redwood City, California. We occupied the new corporate headquarters in August 2001. 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 covenants are met. These certificates of deposit are classified as long-term restricted cash on the condensed consolidated balance sheet.

Deferred revenue includes deferred license, maintenance, consulting and training revenue. Deferred license revenue amounts do not include items which are both deferred and unbilled. 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.

In September 2002, our Board of Directors authorized a one-year stock repurchase program for up to five million shares of our common stock. Purchases will 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 our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. For the three and six months ended June 30, 2003, we purchased 412,037 and 1,502,498 shares, respectively, at a cost of $2.9 million and $10.5 million, respectively. As of June 30, 2003, a total of 1,854,732 shares have been purchased under this program at a cost of $12.2 million. These shares were retired and reclassified as authorized and unissued shares of common stock.

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 twelve 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 your ownership interests.

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.

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RISK FACTORS

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. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently believe are immaterial may also impair our business operations. 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, 2002.

The expected fluctuation of our quarterly results could cause our stock price to experience significant fluctuations or declines.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. These fluctuations could cause our stock price to also significantly fluctuate or experience declines. Some of the factors that could cause our operating results to fluctuate include:

- the size and timing of customer orders, which can be affected by customer order deferrals in anticipation of future new product introductions or product enhancements and customer budgeting and purchasing cycles;
- the length and variability of our sales cycle for our products;
- general economic and political conditions, including warfare and terrorist activities, which may affect our customers capital investment and information technology spending levels;
- market acceptance of our products;
- the mix of our products and services sold and the mix of distribution channels utilized;
- announcement, introduction or enhancement of our products or our competitors products and changes in our or our competitors pricing policies;
- our ability to develop, introduce and market new products on a timely basis;
- our success with our sales and marketing programs;
- technological changes in computer systems and environments; and
- increased competition from partnerships formed by our current and former partners and our competitors.

Our license revenues are not predictable with any significant degree of certainty and are vulnerable to short-term fluctuations in customer demand. Because we do not have a substantial backlog of orders, our license revenues generally reflect orders shipped in the same quarter they are received. In addition license revenues from certain international customers, resellers and distributors, and OEMs are dependent on cash collections. Historically, we have 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. If customers cancel or delay orders it can have a material adverse impact on our revenues and results of operations for the quarter. To the extent any such cancellations or delays are for large orders, this impact will be greater. To the extent that the average size of our orders increases, customer cancellations or delays of orders will more likely harm our revenues and results of operations.

Our license revenues are also difficult to forecast because the market for our products is rapidly evolving, and our sales cycles, which may last many months, vary substantially from customer to customer and vary in general due to a number of factors, some of which we have little or no control over, such as (1) size and timing of individual license transactions, the closing of which tends to be delayed by customers until the end of a fiscal quarter as a negotiating tactic, (2) potential for delay or deferral of customer implementations of our

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software, (3) changes in customer budgets, (4) seasonality of technology purchases, (5) direct sales force efforts to meet or exceed quarterly and year-end quotas, (6) lower European sales during the summer months, and (7) other general economic and political conditions. By comparison, our short-term expense levels are relatively fixed and based in part on our expectations of future revenues.

The difficulty we have in predicting our quarterly revenue means revenue shortfalls may occur at some time, and our inability to adequately reduce short-term expenses means such shortfalls will affect not only our revenue, but also our overall business, results of operations and financial condition. Due to the uncertainty surrounding our revenues, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. Therefore, you should not take our quarterly results to be indicative of our future performance. Moreover, our future operating results may fall below the expectations of stock analysts and investors. If this happens, the price of our common stock may fall.

Changes in our product offerings may impact market acceptance of our products or adversely affect our results of operations.

We recently ceased direct sales of our analytic application suites and data warehouse modules; however, we have made this packaged analytic content available to our indirect channel partners. The success of this product transition is subject to significant risks, including the following:

- customers may be confused by the change in the product offerings and may delay or defer purchases;
- existing customers may disagree with our change in product direction and be less likely to purchase additional products in the future;
- existing customers of our analytic application suites and data warehouse modules may not renew their support services agreements, which may reduce our overall maintenance revenues and maintenance renewal rates;
- we will need to spend time and resources to refocus our sales and marketing efforts on our data integration and business intelligence software;
- we may experience difficulties in managing the transition of this packaged analytic content to our indirect channel partners; and
- our overall reputation in the marketplace may be impaired as a result of these changes in our product offerings.

To the extent that we encounter or are unable to successfully manage any of the risks outlined above, our results of operations may be adversely affected.

If we are unable to accurately forecast revenues, it may harm our business or results of operations.

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 estimates are necessarily speculative and may not consistently correlate to revenues in a particular quarter or over a longer period of time. In addition, our current sales pipeline may contain forecasted opportunities for our analytic application suites or our data warehouse modules that will be transitioned to our systems integration and software application partners, which may impact: (1) our ability to convert the sales pipeline into license revenues; and (2) the amount of license revenues generated from the sales pipeline. 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 plan or budget and thereby adversely affect our business, financial

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condition or results of operations. In particular, the general economic slowdown has caused customer purchases to be reduced in amount, deferred or cancelled, and therefore has reduced the overall license pipeline conversion rates in 2002. In the first half of 2003, we continued to experience a decrease in our pipeline conversion rate due to the war in Iraq and continued lag of the general economy and IT spending. This economic slowdown could continue to adversely affect the size of the sales pipeline and the rate of conversion of the sales pipeline into license revenue in the future.

The market in which we sell our products is highly competitive.

The market for our products is highly competitive, quickly evolving and subject to rapidly changing technology. Many of our competitors or potential 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 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. If our competitors develop products with similar or superior functionality, we may have difficulty competing on the basis of price.

Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, thereby increasing the ability of their products to address the needs of our prospective customers. 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. Additionally, if any of our current or potential competitors consolidate their operations, and as a result provide a broader suite of software products or solutions, our ability to market and sell our software products could be impaired. Competitive pressures could reduce our market share or require us to reduce our prices, either of which could harm our business, results of operations or financial condition. We compete principally against providers of integration software products. Such competitors include Ascential Software, Embarcadero Technologies, Group 1 Software, Sagent Technologies and certain privately-held companies.

In addition, we compete against business intelligence vendors that currently offer, or may develop, products with functionalities that compete with our products, such as Brio Technology, Business Objects, 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, PeopleSoft, SAP and Siebel Systems.

If we do not maintain and strengthen our relationships with our strategic partners, our ability to generate revenue and control implementation costs will be adversely affected.

We believe that our ability to increase the sales of our products and our future success will depend in part upon maintaining and strengthening successful relationships with our current or 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 and data quality vendors, for the promotion and implementation of our products.

In particular, our ability to market our products depends substantially on our relationships with significant strategic partners, including Accenture, Bearing Point, Deloitte Consulting, Firstlogic, Hewlett-Packard, i2 Technologies, IBM, Mitsubishi Electric, PeopleSoft, Siebel Systems, Sybase and webMethods. In addition, our strategic partners may offer products of 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.

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

General economic or political conditions and world health issues may reduce our revenues and harm our business.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic and political conditions. For example, we believe that companies in a variety of industries have delayed, reduced or cancelled technology purchases because of such events as the terrorist actions of September 11, 2001 and the recent military actions in Afghanistan and Iraq. In particular, we experienced the impact of the September 11, 2001 events in the fourth quarter of 2001 and the economic slowdown in 2001 and 2002 with reductions in capital expenditures by our end-user customers, longer sales cycles, deferral or delay of purchase commitments for our products. We also believe that in the first half of 2003 our license revenues were negatively impacted by the war in Iraq. Moreover, these factors may have also negatively impacted the rate of market acceptance of our business intelligence product. As a result, if the current economic conditions in the U.S. and Europe continue or worsen, if a wider or global economic slowdown occurs, or if there is an escalation in regional or global conflicts, we may fall short of our revenue expectations for the third quarter of 2003 or for the entire year. These conditions would negatively affect our business and results of operations. In addition, weakness in the end-user market could negatively affect the cash flow of our reseller customers who could, in turn, delay their payment obligations to us. This would increase our credit risk exposure, which would harm our financial condition.

Furthermore, our operations and sales in Asia and Canada may be adversely impacted to the extent that there are any further outbreaks of Severe Acute Respiratory Syndrome, or SARS, if our business or the businesses of our customers are disrupted by travel restrictions or the illness and quarantine of employees. The spread of SARS in the United States or Europe would also disrupt our business and adversely affect our results of operations.

The lengthy sales cycle and implementation process of our products makes our revenues susceptible to fluctuations.

Our sales cycle can be lengthy because the expense, complexity, broad functionality and company-wide deployment of our products typically require executive-level approval from our customers before they can purchase our products. In addition, to successfully sell our products, we frequently must educate our potential customers about the full benefits of our products, which also can require significant time. Due to these factors, the sales cycle associated with the purchase of our products is subject to a number of significant risks over which we have little or no control, including:

- customers budgetary constraints and internal acceptance review procedures;
- the timing of budget cycles;
- concerns about the introduction of our products or competitors new products; or
- potential downturns in general economic or political conditions.

Further, our sales cycle may lengthen as we continue to focus our sales efforts on large corporations. The implementation of our products can be a complex and time-consuming process, the length and cost of which may be difficult to predict. If our sales cycle and implementation process lengthens unexpectedly, it could adversely affect the timing of our revenues or increase costs, either of which may independently cause fluctuations in our revenue and results of operations.

If the market in which we sell our products and services does not meet our expectations, it will adversely affect our revenues.

The market for software products that enable more effective business decision-making by helping companies aggregate and utilize data stored throughout an organization, is relatively new and still emerging. Substantially all of our revenues are attributable to the sale of products and services in this market. If this market does not meet our forecasts at the rate we anticipate, we will not be able to sell as much of our software products and services, and our business, results of operations and financial condition will be adversely affected. One of the reasons this market might not grow as we anticipate is that many companies are not yet fully aware of the benefits of using these software products to help make business decisions or the benefits of our specific products. As a result, we believe that only a limited number of large companies have deployed these software products. Although we have devoted and intend to continue to devote significant resources promoting market awareness of the benefits of these products, our efforts may be unsuccessful or insufficient.

Because we sell a limited number of products, if these products do not achieve broad market acceptance, our revenues will 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, and to a lesser extent, our analytic application suites, data warehouse modules, business intelligence products and related services. We expect revenues derived from our data integration and business intelligence software and related services to comprise substantially all of our revenues for the foreseeable future since we have ceased direct sales of our analytic application suites and data warehouse modules. Even if the emerging software market in which these products are sold grows substantially, if any of these products do not achieve market acceptance, our revenues could decrease. In particular, we recently released our new business intelligence product, and the degree of market acceptance is currently uncertain. Market acceptance for these products could be affected if, among other things, competition substantially increases in the enterprise analytic software marketplace 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.

Difficulties we may encounter managing our business could harm our results of operations.

In the past, we have experienced a period of rapid and substantial growth that has placed a strain on our administrative and operational infrastructure and, if such growth resumes, will continue to place a strain on our administrative and operational infrastructure. If such growth resumes and we are unable to manage this growth effectively, our business, results of operations or financial condition may be significantly harmed. Our ability to manage our operations and growth effectively requires us to continue to improve our sales, operational, financial and management controls, reporting systems and procedures and hiring programs.

We may not be able to successfully implement improvements to our sales, customer support, management information and control systems in an efficient or timely manner, and we may discover deficiencies in existing systems and controls. We are continually implementing improvements to our control systems and have licensed technology from third parties to accomplish this objective. We may experience difficulties in managing improvements to our internal controls or in connection with third-party software, which could divert our resources, including the attention of management.

Recent terrorist activities and resulting military and other actions could adversely affect our business.

The terrorist attacks on September 11, 2001, disrupted commerce throughout the world. In response to attacks and other threats, the United States is actively contemplating and pursuing support for further military force to pursue those behind these attacks and is initiating broader actions against global terrorism. The continued threat of terrorism throughout the world, the escalation of military action in Afghanistan and Iraq, and heightened security measures in response to such threats may continue to cause significant disruption to commerce throughout the world. To the extent that such disruptions result in instability of capital markets, the imposition of further import and export restrictions, reductions in capital expenditures or spending on

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information technology, longer sales cycles, deferral or delay of customer orders, reductions of engineering resources, or an inability to effectively market our products, our business and results of operations could be materially and adversely affected.

The loss of key personnel or the inability to attract and retain additional personnel could harm our business, results of operations and financial condition.

We believe our success depends upon our ability to attract and retain highly skilled personnel and key members of our management team. 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 may not be successful in attracting, assimilating and retaining key personnel in the future.

We expect seasonal trends to cause our quarterly revenues to fluctuate.

In recent years, there has been a relatively greater demand for our products in the fourth quarter than in each of the first three quarters of the year, particularly the first quarter, which often experiences less growth than other quarters. As a result, we historically have experienced relatively higher bookings in the fourth quarter and relatively lighter bookings in the first quarter. We believe that these fluctuations are caused by customer buying patterns (often influenced by year-end budgetary pressures) and the efforts of our direct sales force to meet or exceed year-end sales quotas. In addition, European sales tend to be relatively lower during the summer months than during other periods. Due to the economic slowdown beginning in 2001, our 2001, 2002 and 2003 quarterly revenues may not be indicative of seasonal trends that were experienced in prior years. When the global economy recovers, we expect that seasonal trends may continue in the foreseeable future.

Our stock price fluctuates as a result of factors other than our operating results.

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, including our operating results and the following:

- the announcement of new products or product enhancements by our competitors;
- quarterly variations in our competitors results of operations;
- changes in earnings estimates by securities analysts;
- changes in recommendations by securities analysts;
- developments in our industry;
- changes in accounting rules, such as the recording of expenses related to employee stock option grants; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

In addition, stock prices for many companies in the technology and emerging growth sectors have experienced wide fluctuations that have often been unrelated to the operating performance of such companies. 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 officers and directors have been named as defendants in a purported class action complaint, which has been filed on behalf of certain persons who purchased our common stock between April 29, 1999 and December 6, 2000. See Part II, Item 1. Legal Proceedings. Such factors and fluctuations, as well as general economic, political and market conditions, may cause the market price of our common stock to decline, which may impact our operations.

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We rely on third-party technologies, and if we are unable to use or integrate these technologies, our product and service development may be delayed.

We intend to continue to license technologies that are developed and maintained by third parties, including applications used in our research and development activities and technologies, which are integrated into our products and services. We rely on these third parties abilities to enhance their current technologies and to respond to emerging industry standards and other technological changes. If we cannot obtain, integrate or continue to license any of these technologies, we may experience a delay in product and service development until equivalent technology can be identified, licensed and integrated. These technologies may not continue to be available to us on commercially reasonable terms or at all. Although we believe there are other sources for these technologies, any significant interruption in the supply of these technologies could adversely impact our business operations unless and until we can secure another source or develop our own equivalent technology. We may not be able to successfully integrate any licensed technology into our products or services, which would harm our business and operating results. Third-party licenses also expose us to increased risks that include:

- risks of product malfunction after new technology is integrated;
- the diversion of resources from the development of our own proprietary technology; and
- our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

Our products interoperate with a variety of third-party technologies.

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 to provide us with access to these technologies so that we can properly test and develop our products designed 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. We may not be able to continue to ensure that our products will interoperate with or provide access to these third-party developed technologies developed in the future, which may harm our business and operating results.

Our distribution channels may create additional risks.

We have a number of relationships with resellers, systems integrators and distributors which assist us in obtaining broad market coverage for our products and services. We have generally avoided exclusive relationships with resellers and distributors of our products. Our discount policies, sales commission structure and reseller licensing programs are intended to support each distribution channel with a minimum level of channel conflicts. Any failure to minimize potential channel conflicts could materially and adversely affect our business, operating results and financial condition.

Any significant defect in our products could cause us to lose revenue and expose us to product liability claims.

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, and as a result, harm our business, results of operations or financial condition. 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. The limitation of liability provisions contained in our license agreements, however, 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. If a claimant successfully brings a product liability claim against us, it would likely significantly harm our business, results of operations or financial condition.

Technological advances and evolving industry standards could adversely impact our future product sales.

The market for our products is characterized by continuing technological development, evolving industry standards and changing customer requirements. 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 the PowerMart product 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. Failure to develop and introduce new products, or enhancements to existing products, in a timely manner in response to changing market conditions or customer requirements, will materially and adversely affect our business, results of operations and financial condition.

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 which 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 history of losses, and we may not be able to achieve profitable operations.

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. We have incurred significant net losses since our inception, and we may not consistently achieve profitability.

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

Our international operations face numerous risks. Our products must be localized customized to meet local user needs in order to be sold in particular foreign countries. Developing local versions of our products for foreign markets is difficult 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 may experience difficulties in recruiting and training an international staff. We must also be able to enter into strategic relationships with companies in international markets. If we are not able to maintain successful strategic relationships internationally or recruit additional companies to enter into strategic relationships, our future success in these international markets could be limited.

Our international business is subject to a number of risks, including the following:

- greater difficulty in staffing and managing foreign operations;
- increased costs and less flexibility in managing and deploying headcount;
- sales seasonality;
- greater risk of uncollectible accounts;
- longer collection cycles;
- greater difficulty in protecting intellectual property;
- potential unexpected changes in regulatory practices and tariffs;
- potential unexpected changes in tax laws and treaties;
- the impact of fluctuating 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.

We may encounter difficulties predicting the extent of the future impact of these conditions. 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.

We may expand our international operations in the future, and as a result, we may face significant additional risks. 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.

If we are not able to adequately protect our proprietary rights, our business could be harmed.

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 six 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. We recently filed a complaint against Ascential Software Corporation in which we asserted that Ascential, and a number of former Informatica employees recruited and hired by Ascential, misappropriated our trade secrets, including sensitive products 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. In July 2003, we settled this lawsuit with Ascential. The settlement includes a consent judgment being entered against Ascential, and a permanent injunction enjoining Ascential from using, or further

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disseminating, confidential, sensitive Informatica information and materials. Ascential also agreed to pay Informatica a sum of $1.6 million.

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. See Part II, Item 4, Legal Proceedings. Although this lawsuit is in the early stages, 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 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. Third parties could claim that our current or future products infringe their patent or 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 acceptable 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.

Our business could suffer as a result of our strategic acquisitions and investments.

In December 1999, we acquired Influence, a developer of analytic applications. In February 2000, we acquired Delphi, a distributor of our products in Switzerland. In April 2000, we acquired certain PwC intellectual property rights and personnel. In November 2000, we acquired certain intellectual property from QRB Developers. In August 2000, we acquired Zimba, a provider of applications that enable mobile professionals to have real-time access to enterprise and external information through wireless devices, voice recognition technologies and the Internet. In January 2001, we acquired syn-T-sys, a distributor of our products in the Netherlands and Belgium. In June 2001, we acquired Informatica Partners, a distributor of our

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products in France. Our attempts to effectively integrate these companies, their intellectual property, or their personnel, have placed an additional burden on our management and infrastructure. These acquisitions will subject us to a number of risks, including:

- the loss of key personnel, customers and business relationships;
- difficulties associated with assimilating and integrating the technology, new personnel and operations of the acquired company;
- the potential disruption of our ongoing business;
- the expense associated with maintenance of uniform standards, controls, procedures, employees and clients;
- the risk of product malfunction after new technology is integrated;
- the diversion of resources from the development of our own proprietary technology;
- our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs; and
- the risk of long-lived asset impairment write-offs.

There can be no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with our past or future acquisitions. To the extent that we are unable to successfully manage these risks, our business, operating results or financial condition may be negatively impacted.

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 could result in the issuance of dilutive equity securities, the incurrence of debt or contingent liabilities. There can be no assurance that any strategic acquisition or investment will succeed. Any future acquisition or investment could harm our business, financial condition and results of operation.

Our certificate of incorporation and bylaws contain provisions that could discourage a takeover.

Our basic corporate documents and Delaware law contain provisions that might enable our management to resist a takeover. These provisions might discourage, delay or prevent a change in the control of Informatica or a change in our management. 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.

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.

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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 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 in turn hurt 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*

The following discusses our exposure to market risk related to changes in interest rates and foreign currency exchange rates. This discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results could vary materially as a result of a number of factors including those set forth in Risk Factors .

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, government notes and bonds, corporate bonds and municipal securities. All investments are carried at market value, which approximates cost.

As of June 30, 2003, the average rate of return on our investments was 1.9%. A hypothetical increase or decrease in market interest rates by 10% from the market interest rates as of June 30, 2003 would not cause the fair value of our cash and cash equivalents and investments to change by a material amount. However, declines in interest rates will, over time, reduce our interest income.

Foreign Currency Risk

We market and sell our software and services through our direct sales force in the United States as well as Belgium, Canada, France, Germany, the Netherlands, Switzerland and the United Kingdom. We also have relationships with distributors in various regions, including Asia-Pacific, Australia, Europe, Japan 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 our sales are primarily in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. We translate foreign currencies into U.S. dollars for reporting purposes and currency fluctuations may have a quarterly impact on our financial results. To date, we have not engaged in any foreign currency hedging activities.

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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 internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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, one of our current officers, and one 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(a) claim against Informatica and 184 other issuer defendants. The Court denied the motion to dismiss the Section 10(a) and 20(a) claims against the Informatica defendants and 62 other individual defendants.

We have decided to accept 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 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.

On July 15, 2002, we filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc., asserting that certain Acta products infringe on three of our 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, 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 products, as well as damages for past sales of the infringing products. We have asserted that Acta s infringement of the Informatica patents was willful and deliberate. Acta answered the complaint on September 5, 2002, and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. Acta did not make any claims for monetary relief against us. The case is currently in the claim construction and discovery phase.

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

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In management s opinion, resolution of any of these matters is not expected to have a material adverse impact on our results of operations, cash flows or its financial position. However, depending on the amount and timing, an unfavorable resolution of these matters could materially and adversely affect our future results of operations, cash flows or financial position in a particular period.

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

The following matters were submitted to the stockholders in our Annual Meeting of Stockholders held on May 22, 2003. Each of the matters was approved by the requisite vote.

(a) The following individuals were re-elected to the Board of Directors for three-year terms as Class III directors:

	Votes For	Votes Withheld
Gaurav S. Dhillon	76,376,492	679,876
David W. Pidwell	73,568,540	3,487,828

Our Board of Directors is currently comprised of six members that are divided into three classes with overlapping three-year terms. On July 15, 2003, the Board elected Carl J. Yankowski to serve as a member of the Board of Directors. The term for our Class I directors, Janice D. Chaffin and Carl J. Yankowski, will expire at the Annual Meeting of Stockholders in 2004 and the term for our Class II directors, A. Brooke Seawell and Mark A. Bertelsen, will expire at the Annual Meeting of Stockholders in 2005.

(b) The following proposal was also approved at our Annual Meeting:

	Affirmative Votes	Negative Votes	Votes Abstain	Broker Non-Votes
Ratification of the appointment of Ernst & Young, LLP as independent auditors for the fiscal year ending December 31, 2003.	71,160,902	5,884,528	10,938	0

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

(a) *Exhibits*

Exhibit	
10.21	Amendment to 1999 Non-Employee Director Stock Incentive Plan.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) *Reports on Form 8-K*

During the three months ended June 30, 2003, we filed the following Current Report on Form 8-K:

We filed a Form 8-K on April 24, 2003 under Item 9. Regulation FD Disclosure (pursuant to Item 12) furnishing our press release describing our results of operations for the fiscal quarter ended March 31, 2003.

Items 2, 3 and 5 are not applicable and have been omitted.

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SIGNATURE

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

INFORMATICA CORPORATION

By: /s/ EARL E. FRY

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

Dated: August 7, 2003

EXHIBIT INDEX

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