

INFORMATICA CORP  
Form 10-Q  
August 09, 2006

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

**FORM 10-Q**

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2006  
OR**

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

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**100 Cardinal Way  
Redwood City, California 94063**  
(Address of principal executive offices) (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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

As of July 31, 2006, there were approximately 86,517,000 shares of the registrant's common stock outstanding.

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(In thousands)

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 189,455	\$ 76,545
Short-term investments	229,527	185,649
Accounts receivable, net	48,042	50,533
Prepaid expenses and other current assets	11,730	9,342
Total current assets	478,754	322,069
Restricted cash	12,016	12,166
Property and equipment, net	17,207	21,026
Goodwill	127,555	81,066
Intangible assets, net	9,320	4,163
Other assets	6,812	532
Total assets	\$ 651,664	\$ 441,022
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,988	\$ 3,404
Accrued liabilities	19,730	17,424
Accrued compensation and related expenses	21,201	20,450
Income taxes payable	5,510	4,566
Accrued facilities restructuring charges	19,075	18,718
Deferred revenues	72,241	69,748
Total current liabilities	139,745	134,310
Convertible senior notes	230,000	
Accrued facilities restructuring charges, less current portion	71,177	75,815
Deferred revenues, less current portion	8,793	8,167
Total liabilities	449,715	218,292
Commitments and contingencies		
Stockholders equity:		
Common stock	86	87

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Additional paid-in capital	349,825	384,653
Deferred stock-based compensation		(187)
Accumulated other comprehensive income (loss)	425	(539)
Accumulated deficit	(148,387)	(161,284)
Total stockholders' equity	201,949	222,730
Total liabilities and stockholders' equity	\$ 651,664	\$ 441,022

See accompanying notes to condensed consolidated financial statements.

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**INFORMATICA CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Revenues:				
License	\$ 36,851	\$ 28,103	\$ 69,655	\$ 53,059
Service	43,959	36,102	84,212	69,537
Total revenues	80,810	64,205	153,867	122,596
Cost of revenues:				
License	1,389	1,135	2,916	1,845
Service	15,003	11,387	28,184	21,868
Amortization of acquired technology	544	233	996	469
Total cost of revenues (1)	16,936	12,755	32,096	24,182
Gross profit	63,874	51,450	121,771	98,414
Operating expenses:				
Research and development	14,185	10,460	27,243	20,707
Sales and marketing	35,442	29,028	66,965	54,386
General and administrative	6,935	4,994	13,578	10,100
Amortization of intangible assets	162	47	292	94
Facilities restructuring charges	1,129	70	2,278	1,628
Purchased in-process research and development			1,340	
Total operating expenses (2)	57,853	44,599	111,696	86,915
Income from operations	6,021	6,851	10,075	11,499
Interest income	4,843	1,699	7,515	3,063
Interest expense	(1,804)		(2,166)	
Other income (expense), net	(11)	(128)	47	(459)
Income before provision for income taxes	9,049	8,422	15,471	14,103
Provision for income taxes	1,420	781	2,574	2,153
Net income	\$ 7,629	\$ 7,641	\$ 12,897	\$ 11,950
Basic net income per common share	\$ 0.09	\$ 0.09	\$ 0.15	\$ 0.14
Diluted net income per common share	\$ 0.08	\$ 0.09	\$ 0.14	\$ 0.13
	85,860	86,876	86,682	86,881

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Shares used in computing basic net income per common share

Shares used in computing diluted net income per common share

93,062	89,760	93,832	89,502
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Includes share-based payment compensation expense as follows:

(1) Cost of service revenues	\$ 346	\$ 12	\$ 676	\$ 24
(2) Research and development	746	168	1,429	344
(2) Sales and marketing	1,204	44	2,271	93
(2) General and administrative	1,124		2,044	1
	\$ 3,420	\$ 224	\$ 6,420	\$ 462

See accompanying notes to condensed consolidated financial statements.

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**INFORMATICA CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>		
Net income	\$ 12,897	\$ 11,950
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,968	4,467
Allowance for doubtful accounts and sales returns allowances	(33)	(203)
Share-based payment compensation expense and amortization of stock-based compensation	6,420	462
Amortization of intangible assets and acquired technology	1,705	563
Impairment of property and equipment, net	1,035	
Non-cash facilities restructuring charges	2,278	1,628
Purchased in-process research and development	1,340	
Changes in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable	5,139	12,068
Prepaid expenses and other assets	(1,823)	(4,677)
Accounts payable and accrued liabilities	(4,101)	(5,266)
Accrued compensation and related expenses	636	(999)
Income taxes payable	944	1,715
Accrued facilities restructuring charges	(6,477)	(9,239)
Deferred revenues	2,505	5,817
Net cash provided by operating activities	27,433	18,286
<b>Investing activities</b>		
Purchases of property and equipment	(1,879)	(6,892)
Purchases of investments	(200,205)	(117,842)
Maturities of investments	103,663	32,535
Sales of investments	52,702	61,100
Acquisition, net of cash acquired	(46,720)	
Net cash used in investing activities	(92,439)	(31,099)
<b>Financing activities</b>		
Net proceeds from issuance of common stock	14,941	11,762
Repurchases and retirement of common stock	(61,559)	(12,217)
Issuance of convertible senior notes	230,000	
Payment of issuance costs on convertible senior notes	(6,241)	
Net cash provided by (used in) financing activities	177,141	(455)
Effect of foreign exchange rate changes on cash and cash equivalents	775	(1,506)
Net increase (decrease) in cash and cash equivalents	112,910	(14,774)



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Cash and cash equivalents at beginning of period	76,545	88,941
Cash and cash equivalents at end of period	\$ 189,455	\$ 74,167
<b>Supplemental disclosures:</b>		
Interest paid	\$	\$ 122
Income taxes paid	\$ 1,548	\$ 649
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Common stock issued for acquisitions	\$ 1,583	\$
Unrealized gain (loss) on short-term investments	\$ 38	\$ (20)

See accompanying notes to condensed consolidated financial statements.

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**INFORMATICA CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Summary of Significant Accounting Policies*****Basis of Presentation***

The accompanying condensed consolidated financial statements of Informatica Corporation ( Informatica, or the Company ) have been prepared in conformity with accounting principles generally accepted in the United States ( GAAP ). However, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP 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 (see Note 2. Acquisition and Note 6. Facilities Restructuring Charges) for the adjustments other than normal recurring adjustments) for the fair presentation of the results of the interim periods presented. All of the amounts included in this report related to the condensed consolidated financial statements and notes thereto as of and for the three and six months ended June 30, 2006 and 2005 are unaudited. The interim results presented are not necessarily indicative of results for any subsequent interim period, the year ending December 31, 2006, or any future period.

As discussed later in Note 3. Share-Based Payment Compensation Expense, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), *Share-Based Payment*, on January 1, 2006 using the modified prospective transition method. Accordingly, the Company s income from operations for the three and six months ended June 30, 2006 includes approximately \$3.4 million and \$6.4 million, respectively, in share-based employee compensation expense for stock options and its Employee Stock Purchase Plan ( ESPP ). Because the Company elected to use the modified prospective transition method, results for prior periods have not been restated.

Certain reclassifications have been made to the prior period s condensed consolidated financial statements to conform to the current period s presentation.

The preparation of the Company s condensed consolidated financial statements in conformity with GAAP requires management to make certain estimates, judgments, and assumptions. The Company believes that the estimates, judgments, and assumptions upon which it relies are reasonable based upon information available to it 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 and actual results, Informatica s financial statements would have been 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 any available alternative would not produce a materially different result.

These unaudited, condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto for the year ended December 31, 2005 included in the Company s Annual Report on Form 10-K filed with the SEC. The condensed consolidated balance sheet as of December 31, 2005 has been derived from the audited consolidated financial statements of the Company.

***Revenue Recognition***

The Company derives revenues from software license fees, maintenance fees, and professional services, which consist of consulting and education services. The Company recognizes revenue in accordance with American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) 97-2, *Software Revenue Recognition*, as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*, SOP 81-1, *Accounting for Performance of Construction-type and Certain Production-type Contracts*, the Securities and Exchange Commission s Staff Accounting Bulletin ( SAB ) 101, *Revenue Recognition in Financial Statements*, SAB 104, *Revenue Recognition*, and other authoritative accounting literature.

Under SOP 97-2, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable.

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

*Persuasive evidence of an arrangement exists.* The Company determines that persuasive evidence of an arrangement exists when it has a written contract, signed by both the customer and the Company, and written purchase authorization.

*Delivery has occurred.* Software is considered delivered when title to the physical software media passes to the customer or, in the case of electronic delivery, when the customer has been provided the access codes to download and operate the software.

*The fee is fixed or determinable.* The Company considers arrangements with extended payment terms not to be fixed or determinable. If the license fee in an arrangement is not fixed or determinable, revenue is recognized as payments become due. 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. The Company's standard agreements do not contain product return rights.

*Collection is probable.* Credit worthiness and collectibility are first assessed at a country level based on the country's overall economic climate and general business risk. For customers in countries deemed credit worthy, credit and collectibility are then assessed based on payment history and credit profile. When a customer is not deemed credit worthy, revenue is recognized when payment is received.

The Company also enters into OEM arrangements that provide for license fees based on inclusion of its technology and/or products in the OEM's products. These arrangements provide for fixed, irrevocable royalty payments. Royalty payments are recognized as revenue based on the activity in the royalty report the Company receives from the OEM or, in the case of OEMs with fixed royalty payments, revenue is recognized upon execution of the agreement, delivery of the software, and when all other criteria for revenue recognition are met.

The Company's software license arrangements include multiple elements: software license fees, maintenance fees, consulting, and/or education services. The Company uses the residual method to recognize license revenue when the license arrangement includes elements to be delivered at a future date and vendor-specific objective evidence (VSOE) of fair value exists to allocate the fee to the undelivered elements of the arrangement. VSOE is based on the price charged when an element is sold separately. If VSOE does not exist for undelivered elements, all revenue is deferred and recognized when delivery occurs or VSOE is established. Consulting services, if included as part of the software arrangement, generally do not involve significant modification or customization of the software. If the software arrangement includes significant modification or customization of the software, software license revenue is recognized as the consulting services revenue is recognized.

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 configurations performed on a time-and-materials basis and, occasionally, on a fixed fee basis. Education services revenues are generated from classes offered at both Company and customer locations. Revenues from consulting and education services are recognized as the services are performed.

Deferred revenue includes deferred license, maintenance, consulting and education services revenue. For customers not deemed credit worthy, the Company's practice is to net unpaid deferred revenue for that customer against the related receivable balance.

***Net Income Per Common Share***

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



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

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income	\$ 7,629	\$ 7,641	\$ 12,897	\$ 11,950
Weighted average shares outstanding	85,994	86,900	86,823	86,913
Weighted average unvested shares of common stock subject to repurchase	(134)	(24)	(141)	(32)
Shares used in computing basic net income per common share	85,860	86,876	86,682	86,881
Dilutive effect of employee stock options*	7,202	2,884	7,150	2,621
Shares used in computing dilutive net income per common share	93,062	89,760	93,832	89,502
Basic net income per common share	\$ 0.09	\$ 0.09	\$ 0.15	\$ 0.14
Diluted net income per common share	\$ 0.08	\$ 0.09	\$ 0.14	\$ 0.13

\* The Company does not anticipate recognizing excess tax benefits from share-based payments for the foreseeable future and therefore, such benefits have been excluded from the diluted net income per common share calculation under the treasury stock method.

The 11.5 million shares of common stock attributable to the assumed conversion of outstanding convertible senior notes were not included in the calculation of diluted net income per share for the three and six months ended June 30, 2006 as the effect would be antidilutive.

***Share-Based Payment Compensation Expense***

Effective January 1, 2006, the Company adopted the Financial Accounting Standards Board's (FASB) SFAS No. 123(R), *Share-Based Payment (Revised 2004)*, on a modified prospective basis. As a result, the Company includes share-based payments in its results of operations for the three and six months ended June 30, 2006. See Note 3. Share-Based Payment Compensation Expense.

**Note 2. Acquisition**

On January 26, 2006, the Company acquired Similarity Systems Limited (Similarity), a private company incorporated in Ireland, providing data quality and data profiling software. The acquisition extends Informatica's data integration software to include Similarity's data quality technology. Management believes that it is the investment value of this synergy related to future product offerings that principally contributed to a purchase price that resulted in the recognition of goodwill. The Company paid \$54.9 million, consisting of \$48.3 million of cash, 122,045 shares of Informatica common stock (which were fully vested but subject to escrow) with a fair value of \$1.6 million, and 392,333 of Informatica stock options with a fair value of \$5.0 million, to acquire all of the outstanding common stock, preferred stock, and stock options of Similarity. In connection with the acquisition, the Company also incurred estimated transaction costs of \$2.3 million.

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

The acquisition was accounted for using the purchase method of accounting, and a summary of the purchase price of the acquisition is as follows (in thousands):

Cash paid	\$ 48,329
Common stock issued	1,583
Fair value of options assumed	4,984
Total considerations paid to Similarity	54,896
Transaction costs	2,266
Fair value of unvested options assumed (share-based payment)	(1,011)
Total purchase price	\$ 56,151

The allocation of the purchase price for this acquisition, as of the date of the acquisition, is as follows (in thousands):

Net tangible assets acquired	\$ 1,456
Developed technology	5,050
Customer relationships	1,830
Purchased in-process research and development	1,340
Goodwill	46,475
Total purchase price	\$ 56,151

The amount of the total purchase price allocated to the net tangible assets acquired of \$1.5 million was assigned based on the fair values as of the date of acquisition. The identified intangible assets acquired were assigned fair values in accordance with the guidelines established in SFAS No. 141, *Business Combinations*, Financial Accounting Standards Board Interpretations ( FIN ) No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, and other relevant guidance. The Company believes that these identified intangible assets have no residual value. The purchase price allocated to purchased in-process research and development ( IPR&D ) and to identifiable intangible assets was determined by a third-party appraisal. The fair value assigned to IPR&D represented projects that had not reached technological feasibility and had no alternative uses. These were classified as IPR&D and expensed in the quarter ended March 31, 2006, which was the quarter of the acquisition, in accordance with FIN No. 4. The amortization periods of identifiable intangible assets were determined using the estimated economic useful life of the asset. The developed technology and customer relationships are being amortized on a straight-line basis over four years. Of the developed technology, the Company recorded amortization of acquired technology expense of \$0.5 million in the six months ended June 30, 2006, and expects to record approximately \$0.6 million, \$1.3 million, \$1.3 million, \$1.3 million, and \$0.1 million in the remainder of 2006, 2007, 2008, 2009, and 2010, respectively. Of the customer relationships, the Company recorded amortization of intangible assets expense of \$0.2 million in the six months period ended June 30, 2006, and expects to record approximately \$0.2 million, \$0.5 million, \$0.4 million, \$0.4 million, and \$0.1 million in the remainder of 2006, 2007, 2008, 2009, and 2010, respectively.

The excess of the purchase price over the identified tangible and intangible assets was recorded as goodwill. The Company anticipates that none of the goodwill and intangible assets recorded in connection with the Similarity acquisition will be deductible for income tax purposes.

The Company assumed all of the outstanding stock options issued pursuant to Similarity's stock option plan, which became options to purchase 392,333 shares of Informatica common stock with a weighted average fair value of

\$12.70 per share at the closing date. The total fair value of the options assumed was \$5.0 million, of which 311,961 fully vested options with \$4.0 million fair value was included in the purchase price. The remaining 80,372 unvested options with \$1.0 million fair value will be expensed over the remaining vesting period of the underlying awards. The Company expects to recognize share-based payment expense in connection with these assumed options of approximately \$0.2 million, \$0.3 million, \$0.2 million, and \$0.1 million in the remainder of 2006, 2007, 2008, and 2009, respectively.

The purchase method of accounting requires the Company to reduce Similarity's reported deferred revenue to an amount equal to the fair value of the legal liability, resulting in lower revenue in periods following the merger than Similarity would have achieved as a separate company.



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

The results of Similarity's operations have been included in the condensed consolidated financial statements since the acquisition date. The following unaudited pro forma adjusted summary reflects the Company's condensed results of operations for the six months ended June 30, 2006, assuming Similarity had been acquired on January 1, 2006., and includes the acquired in-process research and development charge of \$1.3 million. The unaudited pro forma adjusted summary for the six months ended June 30, 2005 combines the historical results for the Company for that period with the historical results for Similarity for the same period. The following unaudited pro forma adjusted summary is not intended to be indicative of future results (in thousands, except per share amounts):

	<b>Six Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2005</b>
Pro forma adjusted total revenue	\$ 154,163	\$ 124,289
Pro forma adjusted net income	\$ 11,994	\$ 10,808
Pro forma adjusted net income per share basic	\$ 0.14	\$ 0.12
Pro forma adjusted net income per share diluted	\$ 0.13	\$ 0.12
Pro forma weighted-average basic shares	86,818	87,010
Pro forma weighted-average diluted shares	93,966	89,894

**Note 3. Share-Based Payment Compensation Expense*****Changes in Accounting Principle***

On January 1, 2006, the Company adopted the FASB SFAS No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative to financial statement recognition. The Company elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and therefore has not restated its financial results for prior periods. Under this transition method, the post adoption share-based payment includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. The fair value of all share-based payment transactions granted subsequent to January 1, 2006 will be based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company recognizes compensation expense for post adoption share-based awards on a straight-line basis over the requisite service period of the award.

Prior to January 1, 2006, the Company accounted for stock issued to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees*, and complied with the disclosure provisions of Statement of Financial Accounting Standard ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. Under APB No. 25, compensation expense of fixed stock options was based on the difference, if any, on the date of the grant between the fair value of the Company's stock and the exercise price of the option. The Company amortized its stock-based compensation under APB No. 25 using a straight-line basis over the remaining vesting term of the related options.

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

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's income from operations and net income for the three and six months ended June 30, 2006 are \$3.2 million and \$6.1 million lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share were both \$0.04 lower for the three months ended June 30, 2006, and \$0.07 and \$0.06 lower for the six months ended June 30, 2006, respectively, than if the Company had continued to account for share-based compensation under APB No. 25.

**Summary of Assumptions**

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. The Company has been using a blend of average historical and market-based implied volatilities for calculating the expected volatilities for employee stock options and market-based implied volatilities for its ESPP since the third quarter of 2005. Prior to the third quarter of 2005, expected volatilities were based on historical volatility. The expected term of employee stock options granted is derived from historical exercise patterns of the options while the expected term of ESPP is based on the contractual terms. The risk-free interest rate for the expected term of the option and ESPP is based on the U.S. Treasury yield curve in effect at the time of grant. SFAS No. 123(R) also requires the Company to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company used historical employee turnover experience to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For purposes of calculating pro forma information under SFAS No. 123 for periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Option Grants:				
Expected volatility	47- 48%	61%	43 -48%	63%
Weighted-average volatility	47%	61%	45%	63%
Expected dividends				
Expected term of options (in years)	3.9	3.0	3.9	3.0
Risk-free interest rate	4.9 - 5.0%	3.7%	4.4 -5.0%	3.8%
ESPP:				
Expected volatility	44%	45%	44%	45%
Weighted-average volatility	44%	45%	44%	45%
Expected dividends				
Expected term of ESPP (in years)	0.5	1.25	0.5	1.25
Risk-free interest rate ESPP	4.7%	3.1%	4.7%	3.1%

**Stock Option Plan Activity**

A summary of option activity through June 30, 2006 is presented below (in thousands, except per share amounts):

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual-Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	17,113	\$ 7.56		
Granted	1,224	10.30		

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Exercised	(1,374)		6.37		
Forfeited or expired	(133)		8.90		
Outstanding at March 31, 2006	16,830	\$	7.84	5.51	\$ 131,184
Granted	1,985		15.05		
Exercised	(396)		6.70		
Forfeited or expired	(255)		13.62		
Outstanding at June 30, 2006	18,164	\$	8.58	5.45	\$ 89,794
Exercisable at June 30, 2006	9,573	\$	7.33	4.73	\$ 57,443

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

The weighted-average grant date fair value of options granted during the three months ended June 30, 2006 was \$6.32 per option. The total intrinsic value of options exercised during the three months ended June 30, 2006 was \$3.3 million. The weighted-average grant date fair value of employee stock purchase shares granted under the ESPP during the quarter ended June 30, 2006 was \$4.19 per share. The total intrinsic value of stock purchase shares granted under the ESPP exercised during the six months ended June 30, 2006 was \$5.4 million. Upon the exercise of options and stock purchase shares granted under the ESPP, the Company issues new common stock from its authorized shares. As of June 30, 2006, there was \$20.6 million in compensation cost related to unvested awards not yet recognized, which the Company expects to recognize over a weighted-average period of 2.8 years.

**Pro Forma Disclosure for Three and Six Months Ended June 30, 2005**

Pro forma information regarding net income (loss) and net income (loss) per share was required by SFAS No. 148. The fair value of the Company's stock-based awards to employees was estimated using the multiple option approach of the Black-Scholes option-pricing model. The related expense was amortized using an accelerated method over the vesting terms of the option. Had compensation cost for the Company's stock-based compensation plans and Employee Stock Purchase Plan (ESPP) been determined using the fair value at the grant dates for awards under those plans calculated using the Black-Scholes method of SFAS No. 123, the Company's net income (loss) and basic and diluted net income (loss) per share would have been changed to the pro forma amounts for the three months and six months ended June 30, 2005 indicated below (in thousands, except per share amounts):

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net income, as reported	\$ 7,641	\$ 11,950
Stock-based employee compensation included in net income as reported, net of related tax effects *	224	462
Stock-based employee compensation using the fair value method, net of related tax effects *	(4,254)	(8,956)
Net income, pro forma	\$ 3,611	\$ 3,456
Basic net income per common share:		
As reported	\$ 0.09	\$ 0.14
Pro forma	\$ 0.04	\$ 0.04
Diluted net income per common share:		
As reported	\$ 0.09	\$ 0.13
Pro forma	\$ 0.04	\$ 0.04

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

***Summary of Plans***

***1999 Stock Incentive Plan***

The Company's stockholders approved the 1999 Stock Incentive Plan (the 1999 Incentive Plan) in April 1999 under which 2,600,000 shares have been reserved for issuance. In addition, any shares not issued under the 1996 Stock Plan are also available for grant. The number of shares reserved under the 1999 Incentive Plan automatically

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increases annually beginning on January 1, 2000 by the lesser of 16,000,000 shares or 5% of the total amount of fully diluted shares of common stock outstanding as of such date. Under the 1999 Incentive Plan, eligible employees, officers, and directors may purchase stock options, stock appreciation rights, restricted shares, and stock units. The exercise price for incentive stock options and non-qualified options may not be less than 100% and 85%, respectively, of the fair value of the Company's common stock at the option grant date. Options granted are exercisable over a maximum term of 7 to 10 years from the date of the grant and generally vest ratably over a period of 4 years, with options for new employees generally including a 1-year cliff period. It is the current practice of the Board to limit option grants under this plan to 7-year terms and to issue only non-qualified stock options. As of June 30, 2006, the Company had approximately 12,580,000 authorized options available for grant and 16,476,000 options outstanding under the 1999 Incentive Plan.

***1999 Non-Employee Director Stock Incentive Plan***

The Company's stockholders adopted the 1999 Non-Employee Director Stock Option Incentive Plan (the Directors Plan) in April 1999 under which 1,000,000 shares have been reserved for issuance. Each non-employee joining the Board of Directors following the completion of the initial public offering would automatically receive options to purchase 100,000 shares of common stock at an exercise price per share equal to the fair market value of the common stock. In April 2003, the Board of Directors amended the Directors Plan such that each non-employee joining the Board of Directors will automatically receive options to purchase 60,000 shares of common stock. These options were exercisable over a maximum term of five years and would vest in four equal annual installments on each yearly anniversary from the date of the grant. The Directors Plan was amended in April 2003 such that one-third of the options vest one year from the grant date and the remainder shall vest ratably over 24 months. In May 2004, the Directors Plan was amended such that each non-employee director who has been a member of the Board for at least six months prior to each annual stockholders meeting will automatically receive options to purchase 25,000 shares of common stock at each such meeting. Each option will have an exercise price equal to the fair value of the common stock on the automatic grant date and will vest on the first anniversary of the grant date. There was an initial grant for a new Board member totaling 60,000 shares of common stock and five automatic annual options granted for a total of 125,000 shares of the Company's common stock in 2004 under the Directors Plan. As of June 30, 2006, the Company had approximately 55,000 authorized options available for grant and 925,000 options outstanding under the Directors Plan.

***2000 Employee Stock Incentive Plan***

In January 2000, the Board of Directors approved the 2000 Employee Stock Incentive Plan (the 2000 Incentive Plan) under which 1,600,000 shares have been reserved for issuance. Under the 2000 Incentive Plan, eligible employees and consultants may purchase stock options, stock appreciation rights, restricted shares, and stock units. The exercise price for non-qualified options may not be less than 85% of the fair value of common stock at the option grant date. Options granted are exercisable over a maximum term of 10 years from the date of the grant and generally vest over a period of 4 years from the date of the grant. As of June 30, 2006, the Company had approximately 764,000 authorized options available for grant and 413,000 options outstanding under the 2000 Incentive Plan.

***Assumed Option Plans***

In connection with certain acquisitions made by the Company, Informatica assumed options in the Influence 1996 Incentive Stock Option Plan, the Zimba 1999 Stock Option Plan, the Striva 2000 Stock Plan, and the Similarity 2002 Option Plan (the Assumed Plans). No further options will be granted under the Assumed Plans. As of June 30, 2006, the Company had approximately 350,000 options outstanding under the assumed option plans.

***Employee Stock Purchase Plan***

The stockholders adopted the 1999 Employee Stock Purchase Plan (ESPP) in April 1999 under which 1,600,000 shares have been reserved for issuance. The number of shares reserved under the ESPP automatically increases beginning on January 1 of each year by the lesser of 6,400,000 shares or 2% of the total amount of fully diluted common stock shares outstanding on such date. Under the ESPP, eligible employees may purchase common



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stock in an amount not to exceed 10% of the employees' cash compensation. Historically, the purchase price per share has been 85% of the lesser of the common stock fair market value either at the beginning of a rolling two-year offering period or at the end of each six-month purchase period within the two-year offering period. As of June 30, 2006, the Company had approximately 7,672,000 authorized shares available for grant under the ESPP.

During the fourth quarter of 2005, the Board of Directors approved an amendment to the ESPP. Effective 2006, under the amended ESPP, the new participants will be entitled to purchase shares at 85% of the lesser of the common stock fair market value either at the beginning or at the end of the 6-month offering period, which was shortened from a 24-month offering period. The purchase price will then be reset at the start of the next offering period. The existing 2005 participants will be able to apply their subscription prices within their remaining two-year offering periods, which will expire at various purchase dates through July 31, 2007. Furthermore, the existing 2005 participants' offering periods would also expire if, on the first day of one of the remaining purchase periods, the purchase price is lower than the purchase price that was set at the commencement of their two-year offering period.

**Disclosures Pertaining to All Share-Based Award Plans**

Cash received from option exercises and ESPP contributions under all share-based payment arrangements for the six months ended 2006 and 2005 were \$14.9 million and \$11.8 million, respectively. The Company has been in full valuation allowance since inception and has not been recognizing excess tax benefits from share-based awards. The Company does not anticipate recognizing excess tax benefits from share-based payments for the foreseeable future, and the Company believes it would be reasonable to exclude such benefits from deferred tax assets and net income per common share calculations. The Company did not realize any tax benefits from tax deductions related to share-based payment awards during the six months ended June 30, 2006 and 2005.

**Note 4. Comprehensive Income**

Other comprehensive income (loss) refers to gains and losses that, under GAAP, are recorded as an element of stockholders' equity and are excluded from net income. Comprehensive income consisted of the following items (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income, as reported	\$ 7,629	\$ 7,641	\$ 12,897	\$ 11,950
Other comprehensive income (loss):				
Unrealized gain (loss) on investments	(41)	244	38	(20)
Foreign currency translation adjustment	692	(1,138)	926	(1,766)
Comprehensive income	\$ 8,280	\$ 6,747	\$ 13,861	\$ 10,164

Accumulated other comprehensive income (loss) as of June 30, 2006 and December 31, 2005 consisted of the following (in thousands):

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Unrealized loss on investments	\$ (664)	\$ (702)
Cumulative foreign currency translation adjustment	1,089	163
	\$ 425	\$ (539)





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The carrying amount of intangible assets other than goodwill as of June 30, 2006 and December 31, 2005 is as follows (in thousands):

	June 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Developed and core technology	\$ 11,388	\$ (6,175)	\$ 5,213	\$ 6,357	\$ (5,178)	\$ 1,179
Purchased technology	2,500	(451)	2,049	2,500	(35)	2,465
Customer relationships	2,775	(717)	2,058	945	(426)	519
Total intangible assets	\$ 16,663	\$ (7,343)	\$ 9,320	\$ 9,802	\$ (5,639)	\$ 4,163

Amortization expense of intangible assets was approximately \$0.9 million and \$0.3 million for the three months ended June 30, 2006 and 2005, respectively, and \$1.7 million and \$0.6 million for the six months ended June 30, 2006 and 2005, respectively. The weighted-average amortization periods of the Company's core and developed technology, purchased technology, and customer relationships are 3.6 years, 3.0 years, and 4.3 years, respectively. In the first quarter of 2005, the Company purchased a source code license with a value of \$2.5 million. The amortization expense related to identifiable intangible assets as of June 30, 2006 is expected to be \$1.8 million for the remainder of 2006, and \$3.0 million, \$2.7 million, \$1.7 million, and \$0.1 million in 2007, 2008, 2009, and 2010, respectively.

Core technology at June 30, 2006 and December 31, 2005 totaling \$0.2 million and \$0.4 million, net, related to the 2003 acquisition, was recorded in a European local currency; therefore, the gross carrying amount and accumulated amortization are subject to periodic translation adjustments.

The Company adopted SFAS No. 142 effective January 1, 2002 and, as a result, ceased to amortize goodwill at that time. The changes in the carrying amount of goodwill for the six months ended June 30, 2006 is as follows (in thousands):

	<b>June 30, 2006</b>
Beginning balance, as of December 31, 2005	\$ 81,066
Goodwill recorded in acquisition	46,489
Ending balance, as of June 30, 2006	\$ 127,555

**Note 6. Facilities Restructuring Charges****2004 Restructuring Plan**

In October 2004, the Company announced a restructuring plan ( 2004 Restructuring Plan ) related to the December 2004 relocation of the Company's corporate headquarters within Redwood City, California. In 2005, the Company subleased the available space at the Pacific Shores Center under the 2004 Restructuring Plan with two subleases expiring in 2008 and 2009 with rights to extend for a period of one and four years, respectively. The Company recorded restructuring charges of approximately \$103.6 million, consisting of \$21.6 million in leasehold improvement and asset write-offs and \$82.0 million related to estimated facility lease losses, which consist of the present value of lease payment obligations for the remaining nine-year lease term of the previous corporate headquarters, net of actual and estimated sublease income. The Company has assumed actual and estimated sublease income, including the reimbursement of certain property costs such as common area maintenance, insurance and

property tax, net of estimated broker commissions, of \$4.3 million in 2006, \$4.5 million in 2007, \$4.4 million in 2008, \$2.4 million in 2009, \$0.9 million in 2010, \$3.3 million in 2011, \$3.9 million in 2012, and \$2.1 million in 2013. If the subtenants do not extend their subleases and the Company is unable to sublease any of the related Pacific Shores facilities during the remaining lease terms through 2013, restructuring charges could increase by approximately \$10.2 million.

The Company records accretion charges on the cash obligations related to the 2004 Restructuring Plan. The accretion charges represent imputed interest and is the difference between our non-discounted future cash obligations and the discounted present value of these cash obligations. At June 30, 2006, the Company will recognize approximately \$17.9 million of accretion as a restructuring charge over the remaining term of the lease, or approximately seven years, as follows: \$2.1 million for the remainder of 2006, \$4.0 million in 2007, \$3.6 million in 2008, \$3.1 million in 2009, \$2.4 million in 2010, \$1.6 million in 2011, \$0.9 million in 2012, and \$0.2 million in 2013.

Table of Contents**INFORMATICA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2001 Restructuring Plan**

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

During 2002, the Company recorded additional restructuring charges of approximately \$17.0 million, consisting of \$15.1 million related to estimated facility lease losses and \$1.9 million in leasehold improvement and asset write-offs. The timing of the restructuring accrual adjustment was a result of negotiated and executed subleases for the Company's excess facilities in Dallas, Texas and Palo Alto, California during the third quarter of 2002. These subleases included terms that provided a lower level of sublease rates than the initial assumptions. The terms of these new subleases were consistent with the continued deterioration of the commercial real estate market in these areas. In addition, cost containment measures initiated in the same quarter, such as delayed hiring and salary reductions, resulted in an adjustment to management's estimate of occupancy of available vacant facilities. These charges represent adjustments to the original assumptions, including the time period that the buildings will be vacant, expected sublease rates, expected sublease terms, and the estimated time to sublease. The Company calculated the estimated costs for the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area.

In December 2004, the Company recorded additional restructuring charges of \$9.0 million related to estimated facility lease losses. The restructuring accrual adjustments recorded in the third and fourth quarters of 2004 were the result of the relocation of its corporate headquarters within Redwood City, California in December 2004, an executed sublease for the Company's excess facilities in Palo Alto, California during the third quarter of 2004, and an adjustment to management's estimate of occupancy of available vacant facilities. These charges represent adjustments to the original assumptions in the 2001 Restructuring Plan charges, including the time period that the buildings will be vacant, expected sublease rates, expected sublease terms, and the estimated time to sublease. The Company calculated the estimated costs for the additional restructuring charges based on current market information and trend analysis of the real estate market in the respective area. In 2005, the Company subleased the available space at the Pacific Shores Center under the 2001 Restructuring Plan through May 2013.

A summary of the activity of the accrued restructuring charges for the six months ended June 30, 2006 and 2005 follows (in thousands):

	<b>Accrued Restructuring Charges at December 31, 2005</b>	<b>Restructuring Charges</b>	<b>Net</b>		<b>Accrued Restructuring Charges at June 30, 2006</b>
			<b>Cash Payment</b>	<b>Non-cash Reclass</b>	
<b>2004 Restructuring Plan</b>					
Excess lease facilities	\$ 78,129	\$ 2,278	\$ (4,391)	\$ (82)	\$ 75,934
<b>2001 Restructuring Plan</b>					
Excess lease facilities	16,404		(2,086)		14,318
	\$ 94,533	\$ 2,278	\$ (6,477)	\$ (82)	\$ 90,252

In the six months ended June 30, 2006, the Company recorded \$2.3 million of restructuring charges, which includes \$2.2 million from accretion charges related to the 2004 Restructuring Plan.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Accrued Restructuring Charges at December 31, 2004	Restructuring Charges		Net		Accrued Restructuring Charges at June 30, 2005
		Charges	Adjustments	Cash Payment	Non-cash Reclass	
<i><b>2004 Restructuring Plan</b></i>						
Excess lease facilities	\$ 88,521	\$ 2,465	\$ (823)	\$ (7,082)	\$ (21)	\$ 83,060
<i><b>2001 Restructuring Plan</b></i>						
Excess lease facilities	20,730		(14)	(2,157)		18,559
	\$ 109,251	\$ 2,465	\$ (837)	\$ (9,239)	\$ (21)	\$ 101,619

Net cash payments for the six months ended June 30, 2006 and 2005 for facilities included in the 2001 Restructuring Plan amounted to \$2.1 million and \$2.2 million, respectively. Actual future cash requirements may differ from the restructuring liability balances as of June 30, 2006 if the Company is unable to sublease the excess leased facilities after the expiration of the subleases, there are changes to the time period that facilities are vacant, or the actual sublease income is different from current estimates.

Inherent in the estimation of the costs related to the restructuring efforts are assessments related to the most likely expected outcome of the significant actions to accomplish the restructuring. The estimates of sublease income may vary significantly depending, in part, on factors that may be beyond the Company's control, such as the time periods required to locate and contract suitable subleases should the Company's existing sublessees elect to terminate their sublease agreements in 2008 and 2009 and the market rates at the time of entering into new sublease agreements.

Because the related facilities associated with the restructured properties are no longer being used in the Company's operations, the Company reclassified the deferred rent liability to accrued restructuring charges in 2004. As of June 30, 2006, \$19.1 million of the \$90.3 million accrued restructuring charges was classified as current liabilities and the remaining \$71.2 million was classified as non-current liabilities.

**Note 7. Convertible Senior Notes**

On March 8, 2006, the Company issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 (Notes). The Company pays interest at 3.0% per annum to holders of the Notes, payable semi-annually on March 15 and September 15 of each year, commencing September 15, 2006. Each \$1,000 principal amount of Notes is initially convertible, at the option of the holders, into 50 shares of our common stock prior to the earlier of the maturity date (March 15, 2026) or the redemption or repurchase of the Notes. The initial conversion price represents a premium of approximately 29.28% relative to the last reported sale price of common stock of the Company on the Nasdaq National Market of \$15.47 on March 7, 2006. The conversion rate is subject to certain adjustments. The conversion rate initially represents a conversion price of \$20.00 per share. After March 15, 2011, the Company may from time to time redeem the Notes, in whole or in part, for cash, at a redemption price equal to the full principal amount of the notes, plus any accrued and unpaid interest. Holders of the Notes may require the Company to repurchase all or a portion of their Notes at a purchase price in cash equal to the full principal amount of the Notes plus any accrued and unpaid interest on March 15, 2011, March 15, 2016, and March 15, 2021, or upon the occurrence of certain events including a change in control. The Company has the right to redeem some or all of the Notes after March 15, 2011. Future minimum payments related to the Notes in total which represent interest as of June 30, 2006 are as follows: remaining 2006 \$3.5 million; 2007 \$6.9 million; 2008 \$6.9 million; 2009 \$6.9 million; 2010 \$6.9 million. Future minimum payments related to the Notes as of June 30, 2006 for 2011 and thereafter \$107 million represents interest and \$230 million represents principal for a total of \$337 million.

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Pursuant to a Purchase Agreement (the Purchase Agreement ), the Notes were sold for cash consideration in a private placement to an initial purchaser, UBS Securities LLC, an accredited investor, within the meaning of Rule 501 under the Securities Act of 1933, as amended ( the Securities Act ), in reliance upon the private placement exemption afforded by Section 4(2) of the Securities Act. The initial purchaser reoffered and resold the Notes to qualified institutional buyers under Rule 144A of the Securities Act without being registered under the Securities Act, in reliance on applicable exemptions from the registration requirements of the Securities Act. In connection with the issuance of the Notes, the Company filed a shelf registration statement with the SEC for the resale of the Notes and the common stock issuable upon conversion of the Notes, which became effective on June 21, 2006. The Company also agreed to periodically update the shelf registration and to keep it effective until the earlier of the date

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the Notes or the common stock issuable upon conversion of the Notes is eligible to be sold to the public pursuant to Rule 144(k) of the Securities Act or the date on which there are no outstanding registrable securities. The Company has evaluated the terms of the call feature, redemption feature, and the conversion feature under applicable accounting literature, including SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, and concluded that none of these features should be separately accounted for as derivatives.

The Company used approximately \$50 million of the net proceeds from the offering to fund the purchase of shares of its common stock concurrently with the offering of the Notes and intends to use the balance of the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or additional purchases of common stock.

In connection with the issuance of the Notes, the Company incurred \$6.2 million of issuance costs, which primarily consisted of investment banker fees and legal and other professional fees. These costs are classified within Other Assets and are being amortized as a component of interest expense using the effective interest method over the life of the Notes from issuance through March 15, 2026. If the holders require repurchase of some or all of the Notes on the first repurchase date, which is March 15, 2011, the Company would accelerate amortization of the pro rata share of the unamortized balance of the issuance costs on such date. If the holders require conversion of some or all of the Notes when the conversion requirements are met, the Company would accelerate amortization of the pro rata share of the unamortized balance of the issuance cost to additional paid-in capital on such date. Amortization expense related to the issuance costs was \$78,000 and \$93,000 for the three and six months ended June 30, 2006, respectively. Interest expense on the Notes was \$1.7 million and \$2.1 million for the three and six months ended June 30, 2006, respectively. No payments of interest were made in the six months ended June 30, 2006.

**Note 8. Commitments and Contingencies*****Lease Obligations***

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

The Company entered into two lease agreements in February 2000 for two office buildings at the Pacific Shores Center in Redwood City, California, which was used as its former corporate headquarters from August 2001 through December 2004. The leases expire in July 2013. As part of these agreements, the Company purchased certificates of deposit totaling approximately \$12 million as a security deposit for lease payments. These certificates of deposit are classified as long-term restricted cash on the Company's consolidated balance sheet.

The Company leases certain office facilities under various non-cancelable operating leases, including those described above, which expire at various dates through 2013 and require the Company to pay operating costs, including property taxes, insurance, and maintenance. Operating lease payments in the table below include approximately \$116.1 million for operating lease commitments for facilities that are included in restructuring charges. See Note 6. Facilities Restructuring Charges, above, for a further discussion.

Future minimum lease payments as of June 30, 2006 under non-cancelable operating leases with original terms in excess of one year are summarized as follows (in thousands):

	<b>Operating Leases</b>	<b>Sublease Income</b>	<b>Net</b>
Remaining 2006	\$ 11,526	\$ (1,589)	\$ 9,937
2007	21,475	(2,731)	18,744
2008	17,644	(2,752)	14,892
2009	17,773	(1,623)	16,150
2010	17,809	(424)	17,385

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Thereafter	48,052	(1,114)	46,938
	\$ 134,279	\$ (10,233)	\$ 124,046



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Of these future minimum lease payments, the Company has accrued \$90.3 million in the facilities restructuring accrual at June 30, 2006. This accrual, in addition to minimum lease payments of \$116.1 million, includes estimated operating expenses of \$21.6 million and sublease commencement costs associated with excess facilities and is net of estimated sublease income of \$29.5 million and a present value discount of \$17.9 million recorded in accordance with SFAS No. 146.

In December 2005, the Company subleased 35,000 square feet of office space at the Pacific Shores Center, its former corporate headquarters, in Redwood City, California through May 2013. In June 2005, the Company subleased 51,000 square feet of office space at the Pacific Shores Center, its previous corporate headquarters, in Redwood City, California through August 2008 with an option to renew through July 2013. In February 2005, the Company subleased 187,000 square feet of office space at the Pacific Shores Center for the remainder of the lease term through July 2013 with a right of termination by the subtenant that is exercisable in July 2009. In 2004, the Company signed sublease agreements for leased office space in Palo Alto and Scotts Valley, California. In 2003, the Company signed sublease agreements for leased office space in San Francisco, Palo Alto, and Redwood City, California. During 2002, the Company signed a sublease agreement for leased office space in Palo Alto, California.

***Warranties***

The Company generally provides a warranty for its software products and services to its customers for a period of three to six months and accounts for its warranties under the SFAS No. 5, *Accounting for Contingencies*. The Company's software products' media are generally warranted to be free from defects in materials and workmanship under normal use, and the products are also generally warranted to substantially perform as described in certain Company documentation and the product specifications. The Company's services are generally warranted to be performed in a professional manner and to materially conform to the specifications set forth in a customer's signed contract. In the event there is a failure of such warranties, the Company generally will correct or provide a reasonable work-around or replacement product. The Company has provided a warranty accrual of \$0.2 million as of June 30, 2006 and December 31, 2005. To date, the Company's product warranty expense has not been significant.

***Indemnification***

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

The Company believes its internal development processes and other policies and practices limit its exposure related to the indemnification provisions of the License Agreement. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which assigns the rights to its employees' development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions, and no material claims against the Company are outstanding as of June 30, 2006. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under the License Agreement, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

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In addition, we indemnify our officers and directors under the terms of indemnity agreements entered into with them, as well as pursuant to our certificate of incorporation, bylaws, and applicable Delaware law. To date, we have not incurred any costs related to these indemnifications.

The Company accrues for loss contingencies when available information indicates that it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated, in accordance with SFAS No. 5, *Accounting for Contingencies*.

***Litigation***

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

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

The Company accepted a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Informatica defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims the Company may have against the underwriters. The Informatica defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which the Company does not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. At the hearing on April 24, 2006, the judge took the approval of the settlement under submission. The ruling is expected later this year.

On July 15, 2002, the Company filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. (Acta), now known as Business Objects Data Integration, Inc. (BODI), asserting that certain Acta products infringe on three Company patents: U.S. Patent No. 6,014,670, entitled *Apparatus and Method for Performing Data Transformations in Data Warehousing*; U.S. Patent No. 6,339,775, entitled *Apparatus and Method for Performing Data Transformations in Data Warehousing* (this patent is a continuation-in-part of and claims the benefit of U.S. Patent No. 6,014,670); and U.S. Patent No. 6,208,990, entitled *Method and Architecture for Automated Optimization of ETL Throughput in Data Warehousing Applications*. On July 17, 2002, the Company filed an amended complaint alleging that Acta products also infringe on one additional patent: U.S. Patent No. 6,044,374, entitled *Object References for Sharing Metadata in Data Marts*. In the suit, the Company is seeking an injunction against future sales of the infringing Acta/BODI products, as well as damages for past sales of the infringing products. The Company has asserted that BODI's infringement of the Informatica patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a

declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI has not made any claims for monetary relief against the Company and has not filed any counterclaims alleging that the Company has infringed any of BODI's patents. The parties presented their respective claim constructions to the Court on September 24, 2003, and on August 1, 2005, the Court issued its claims construction order. The Company believes

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

that the issued claims construction order is favorable to the Company's position on the infringement action. The matter is currently at the end of the discovery phase. Informatica is preparing to argue motions for summary judgment on both patent infringement and validity in the third quarter of 2006.

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

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

**Note 9. Income Taxes**

The Company recorded an income tax provision of \$1.4 million and \$2.6 million for the three and six months ended June 30, 2006, respectively, which primarily represents income and withholding taxes attributable to foreign operations, and federal and state minimum taxes. The Company recorded an income tax provision of \$0.8 million and \$2.2 million for the three months and six months ended June 30, 2005, respectively, which primarily represents income and withholding taxes attributable to foreign operations, and federal and state minimum taxes. The expected tax provision derived from applying the federal statutory rate to the Company's income before income taxes for the six months period ended June 30, 2006 differed from the recorded income tax provision primarily due to the reversal of a portion of the Company's valuation allowance to reflect the utilization of approximately \$4.7 million of tax attributes, partially offset by foreign income and withholding taxes of \$1.1 million and state taxes of \$0.7 million.

**Note 10. Stock Repurchases**

On March 8, 2006, the Company used a portion of the proceeds from the issuance of convertible senior notes to repurchase \$50 million of common stock (3,232,062 shares at \$15.47 per share). These shares were repurchased and retired to the status of authorized and unissued shares immediately.

In April 2006, Informatica's Board of Directors authorized a stock repurchase program for a one-year period for up to \$30 million of the Company's common stock. Purchases can be made from time to time in the open market and privately negotiated transactions and will be funded from available working capital. The purpose of the Company's stock repurchase program is, among other things, to help offset the dilution caused by the issuance of stock under the Company's employee stock option plans. The number of shares acquired and the timing of the repurchases are based on several factors, including general market conditions and the trading price of its common stock. These repurchased shares will be retired and reclassified as authorized and unissued shares of common stock. As of July 31, 2006, the Company purchased 915,000 shares at cost of \$13.1 million under this program.

**Note 11. Recent Accounting Pronouncements**

In June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, (SFAS No. 154), which replaces APB No. 20, *Accounting Changes*, and FAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. APB No. 20 previously required that most voluntary changes in accounting principles be recognized by including the cumulative effect of changing to the new accounting principle in net income in the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable. SFAS No. 154 enhances the consistency of financial information between periods. The Company adopted SFAS No. 154 in the first quarter of 2006. The adoption of SFAS No. 154 did not materially affect the company's Condensed Consolidated Financial Statements in the period of adoption. See *Changes in Accounting Principle* under Note 3. Share-Based Payment Compensation Expense. The effect on future periods will depend on the nature and significance of any future accounting changes.

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

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occurring in fiscal years beginning after September 15, 2006. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. The Company will adopt SFAS No. 155 in the first quarter of 2007. The Company does not expect the adoption of SFAS No. 155 to have a material impact on its consolidated financial position, results of operations or cash flows.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*, ( EITF 06-3 ). EITF 06-3 provides guidance for income statement presentation and disclosure of any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, including but not limited to, sales, use, value added, and some excise taxes. Presentation of taxes within the scope of this EITF may be made on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues), with appropriate accounting policy disclosure. EITF 06-3 is effective for reporting periods beginning after December 15, 2006. The Company will adopt this consensus as required, and adoption is not expected to have an impact on the consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement 109* ( FIN 48 ), which is effective in fiscal years beginning after December 15, 2006. FIN 48 prescribes a comprehensive model for recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken on the Company's tax return. The cumulative effect of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of retained earnings for that fiscal year, presented separately. The Company is currently evaluating the accounting and disclosure requirements of FIN 48 and expects to adopt it as required in the beginning of the first quarter of 2007.

**Note 12. Significant Customer Information and Segment Reporting**

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

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

The following table presents geographic information (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Revenues:				
North America	\$ 58,644	\$ 45,737	\$ 109,886	\$ 83,905
Europe	18,625	15,913	36,178	34,601
Other	3,541	2,555	7,803	4,090

	\$ 80,810	\$ 64,205	\$ 153,867	\$ 122,596
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	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Long-lived assets (excluding goodwill):		
North America	\$ 23,240	\$ 21,708
Europe	2,511	2,571
Other	776	910
	<b>\$ 26,527</b>	<b>\$ 25,189</b>

No customer accounted for more than 10% of the Company's total revenues in the three and six months ended June 30, 2006 and 2005. At June 30, 2006 and 2005, no single customer accounted for more than 10% of the accounts receivable balance.

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

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the federal securities laws, particularly statements referencing our expectations relating to revenues, cost of revenues as a percentage of revenues, and operating expenses as a percentage of total revenues; the recording of amortization of acquired technology, the dilutive impact of the Similarity Systems Limited ( Similarity ) acquisition; the neutral to slightly accretive impact to earnings of our Notes through 2006; continuing impacts on our results of operations from our 2004 and 2001 Restructuring Plans; the sufficiency of our cash balances and cash flows for the next 12 months investment and 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 terms. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, these expectations or any of the forward-looking statements could prove to be incorrect, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to risks and uncertainties, including but not limited to the factors set forth under Part II, Item 1A. Risk Factors. All forward-looking statements and reasons why results may differ included in this Report are made as of the date hereof, and we assume no obligation to update any such forward-looking statements or reasons why actual results may differ.

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

**Overview**

We are a leading provider of enterprise data integration software. We generate revenues from sales of software licenses for our enterprise data integration software products and from sales of services, which consist of maintenance, consulting, and education services.

We receive revenues from licensing our products under perpetual licenses directly to end users and indirectly through resellers, distributors, and OEMs in the United States and internationally. Most of our international sales have been in Europe, and revenue outside of Europe and North America has comprised 6% or less of total consolidated revenues during the last three years. We receive service revenues from maintenance contracts, consulting services, and education services that we perform for customers that license our products either directly or indirectly.

We license our software and provide services to many industry sectors, including, but not limited to, energy and utilities, financial services, insurance, government & public sector, healthcare, high-technology, manufacturing, retail, services, telecommunications, and transportation.

In the second quarter of 2006, our total revenues grew 26% to \$80.8 million compared to the second quarter of 2005. The increase in license revenues was a result of year-over-year increases in the volume and the average size of our transactions. The increase in service revenues was due primarily to increased maintenance revenues driven by strong renewals from our expanding customer base and contributions from the new releases of existing products and an increase in customer projects for broader data integration that drove additional consulting and education revenues.

On January 26, 2006, we acquired Similarity, a private company incorporated in Ireland. Similarity's software product suite includes data profiling, data standardization, data cleansing, data matching, and data quality monitoring. We are extending our enterprise data integration platform by working to incorporate certain components of Similarity's product suite including its patented data quality technology. In connection with the acquisition, we have incurred additional expenses, including amortization of intangible assets and acquired technology, purchased in-process research and development costs, stock-based compensation, and other charges. As a result of these charges, we expect the acquisition to be dilutive to earnings in 2006. See Note 2. Acquisition of Notes to the Condensed Consolidated Financial Statements in Part I, Item I of this report.

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On March 8, 2006, we issued and sold convertible senior notes with an aggregate principal amount of \$230 million due 2026 ( Notes ). We used approximately \$50 million of the net proceeds from the offering to fund the purchase of shares of our common stock concurrently with the offering of the Notes, and we intend to use the balance of the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments or additional purchases of common stock. We expect the Notes to be neutral to slightly accretive to earnings through 2006. See Note 7. Convertible Senior Notes of Notes to the Condensed Consolidated Financial Statements in Part I, Item I of this Report.

Because our market is a dynamic one, we face both significant opportunities and challenges. As such, we focus on several key factors:

- § **Competition:** Inherent in our industry are risks arising from competition with existing software solutions, technological advances from other vendors, and the perception of cost-savings by solving data integration challenges through internal development. Our prospective customers may view these alternative solutions as more attractive than our offerings. Additionally, the consolidation activity in our industry (including IBM's acquisition of Ascential Software and Business Objects' recent acquisition of FirstLogic) could pose challenges as competitors could potentially offer our prospective customers a broader suite of software products or solutions.
  
- § **New Product Introductions:** To address the expanding data integration and data integrity needs of our customers and prospective customers, we continue to introduce new products and technology enhancements on a regular basis. After our acquisition of Similarity, we commenced integration of Similarity's data quality technology into the PowerCenter product suite. Accordingly, in May 2006, we released the general availability version of PowerCenter 8.0 which included new products, Informatica Data Quality and Informatica Data Explorer, that deliver advanced data quality capabilities. We also announced in May the strategic roadmap for Informatica On-Demand, a Software-as-a-Service ( SaaS ) offering, to enable cross-enterprise data integration. As part of Phase One (offering connectivity to leading SaaS vendors), we concurrently introduced Informatica PowerCenter Connect for salesforce.com which allows customers to integrate data managed by salesforce.com with data managed by on-premise applications. New product introductions and/or enhancements have inherent risks including, but not limited to, product availability, product quality and interoperability, and customer adoption or the delay in customer purchases. Given the risks and new nature of the products, we cannot predict their impact on overall sales and revenues.
  
- § **Quarterly and Seasonal Fluctuations:** Historically, purchasing patterns in the software industry have followed quarterly and seasonal trends and they are likely to do so in the future. We typically recognize a substantial portion of our new license orders in the last month of each quarter and sometimes in the last few weeks of each quarter, although such fluctuations are mitigated by backlog orders entering into a quarter. Seasonally, in recent years, the fourth quarter has had the highest level of license revenue and order backlog, and we have generally had weaker demand for our software products and services in the first and third quarters. Additionally, our consulting and education services have sometimes been negatively impacted in the fourth quarter and first quarter due to the holiday season and internal meetings, which result in fewer billable hours for our consultants and fewer education classes.

To address these potential risks, we have focused on a number of key initiatives, including the strengthening of our partnerships, the broadening of our distribution capability worldwide, and the focusing of our sales force and distribution channel on new products.

We are concentrating on maintaining and strengthening our relationships with our existing strategic partners and building relationships with additional strategic partners. These partners include systems integrators, resellers and distributors, and strategic technology partners, including enterprise application providers, database vendors, and enterprise information integration vendors, in the United States and internationally. Recently, we have become a global OEM partner with Hyperion Solutions and have partnered with salesforce.com. Our alliance managers are focused on developing new and enhancing existing strategic partnerships and, in the past year, we have added



employees in Europe to drive deeper relationships with partners based in that geography. We have increased joint marketing initiatives and have experienced more lead sharing from our partners.

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We continued to broaden our distribution efforts in the first six months of 2006 by selling data warehouse products to the enterprise level and selling more strategic data integration solutions beyond data warehousing to our customers enterprise architects and chief information officers. We also continued our international expansion efforts, begun in 2005, by opening new offices in Sydney, Australia and Singapore. As the result of this international expansion, as well as the increase in our direct sales headcount in the U.S. during 2005, our sales and marketing expenses have increased accordingly during 2005 and the first half of 2006. We expect these investments to result in increased revenue, increased sales productivity, and increased profitability. However, if we experience an increase in sales personnel turnover, do not achieve expected increases in our sales pipeline, experience a decline in our sales pipeline conversion ratio, or do not achieve increases in productivity and efficiencies from our new sales personnel as they gain more experience, then we may not achieve our expected increases in revenue, productivity or profitability.

To address the risks of introducing new products, we have continued to invest in programs to help train our internal sales force and our external distribution channel on new product functionalities, key differentiations, and key business values. These programs include our annual sales kickoff conference for all sales and key marketing personnel in January of this year, Webinars for our direct sales force and indirect distribution channel, in-person technical seminars for our pre-sales consultants, the building of product demonstrations, and creation and distribution of targeted marketing collateral. We have also invested in partner enablement programs, including product-specific briefings to partners and the inclusion of several partners in our beta programs.

**Critical Accounting Policies and Estimates**

In preparing our condensed consolidated financial statements, we make assumptions, judgments, and estimates that can have a significant impact on amounts reported in our condensed consolidated financial statements. We base our assumptions, judgments, and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments, and estimates and make changes accordingly. We also discuss our critical accounting estimates with the Audit Committee of the Board of Directors. We believe that the assumptions, judgments, and estimates involved in the accounting for revenue recognition, facilities restructuring charges, income taxes, accounting for impairment of goodwill, acquisitions, and share-based payment compensation expense have the greatest potential impact on our condensed consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. Historically, our assumptions, judgments, and estimates relative to our critical accounting policies have not differed materially from actual results. For further information on our significant accounting policies, see the discussion in Note 1. Summary of Significant Accounting Policies and Note 11. Recent Accounting Pronouncements of Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report.

***Revenue Recognition***

We follow detailed revenue recognition guidelines, which are discussed below. We recognize revenue in accordance with generally accepted accounting principles in the United States of America ( GAAP ) that have been prescribed for the software industry. The accounting rules related to revenue recognition are complex and are affected by interpretations of the rules, which are subject to change. Consequently, the revenue recognition accounting rules require management to make significant judgments, such as determining if collectibility is probable.

We derive revenues from software license fees, maintenance fees (which entitle the customer to receive product support and unspecified software updates), and professional services, consisting of consulting and education services. We follow the appropriate revenue recognition rules for each type of revenue. The basis for recognizing software license revenue is determined by American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) 97-2 *Software Revenue Recognition*, together with other authoritative literature. For other authoritative literature, see the subsection *Revenue Recognition* in Note 1. Summary of Significant Accounting

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Policies of Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report. Substantially all of our software licenses are perpetual licenses under which the customer acquires the perpetual right to use the software as provided and subject to the conditions of the license agreement. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. In applying these criteria to revenue transactions, we must exercise judgment and use estimates to determine the amount of software, maintenance and professional services revenue to be recognized each period.

Our judgment in determining the collectibility of amounts due from our customers impacts the timing of revenue recognition. We assess credit worthiness and collectibility and when a customer is not deemed credit worthy, revenue is recognized when payment is received.

We assess whether fees are fixed or determinable prior to recognizing revenue. We must make interpretations of our customer contracts and exercise judgments in determining if the fees associated with a license arrangement are fixed or determinable. We consider factors including extended payment terms, financing arrangements, the category of customer (end-user customer or reseller), rights of return or refund, and our history of enforcing the terms and conditions of customer contracts. If the fee due from a customer is not fixed or determinable due to extended payment terms, revenue is recognized when payment becomes due or upon cash receipt, whichever is earlier. If we determine that a fee due from a reseller is not fixed or determinable upon shipment to the reseller, we defer the revenue until the reseller provides us with evidence of sell through to an end-user customer or upon cash receipt.

Our software license arrangements include multiple elements: software license fees, maintenance fees, consulting, and/or education services. We use the residual method to recognize license revenue upon delivery when the arrangement includes elements to be delivered at a future date and vendor-specific objective evidence ( VSOE ) of fair value exists to allocate the fee to the undelivered elements of the arrangement. VSOE is based on the price charged when an element is sold separately. If VSOE does not exist for any undelivered element of the arrangement, all revenue is deferred until all elements have been delivered, or VSOE is established. We are required to exercise judgment in determining if VSOE exists for each undelivered element.

Consulting services, if included as part of the software arrangement, generally do not require significant modification or customization of the software. If, in our judgment, the software arrangement includes significant modification or customization of the software, software license revenue is recognized as the consulting services revenue is recognized.

Consulting revenues are primarily related to implementation services and product configurations performed on a time-and-materials basis and, occasionally, on a fixed fee basis. Revenue is generally recognized as these services are performed. If uncertainty exists about our ability to complete the project, our ability to collect the amounts due, or in the case of fixed fee consulting arrangements, our ability to estimate the remaining costs to be incurred to complete the project, revenue is deferred until the uncertainty is resolved.

***Facilities Restructuring Charges***

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

These liabilities include management's estimates pertaining to sublease activities. Inherent in the assessment of the costs related to our restructuring efforts are estimates related to the most likely expected outcome of the significant actions to accomplish the restructuring. We will continue to evaluate the commercial real estate market conditions periodically to determine if our estimates of the amount and timing of future sublease income are reasonable based on current and expected commercial real estate market conditions. Our estimates of sublease

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income may vary significantly depending, in part, on factors that may be beyond our control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases. Currently, we have subleased our excess facilities in connection with our 2004 and 2001 facilities restructuring, but for durations that are generally less than the remaining lease terms.

If we determine that there is a change in the estimated sublease rates or in the expected time it will take us to sublease our vacant space, we may incur additional restructuring charges in the future and our cash position could be adversely affected. For example, we increased our 2001 Restructuring Plan charges in 2002 and 2004 based on the continued deterioration in the San Francisco Bay Area and Dallas, Texas real estate markets. See Note 6. Facilities Restructuring Charges of Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Report. Future adjustments to the charges could result from a change in the time period that the buildings will be vacant, expected sublease rates, expected sublease terms, and the expected time it will take to sublease. We will periodically assess the need to update the original restructuring charges based on current real estate market information and trend analysis and executed sublease agreements.

***Accounting for Income Taxes***

We use the asset and liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 109, *Accounting for Income Taxes*. Under this method, income tax expenses or benefits are recognized for the amount of taxes payable or refundable for the current year and for deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. We also account for any income tax contingencies in accordance with SFAS No. 5, *Accounting for Contingencies*. The measurement of current and deferred tax assets and liabilities are based on provisions of currently enacted tax laws. The effects of future changes in tax laws or rates are not contemplated.

As part of the process of preparing consolidated financial statements, we are required to estimate our income taxes and tax contingencies in each of the tax jurisdictions in which we operate prior to the completion and filing of tax returns for such periods. This process involves estimating actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in net deferred tax assets and liabilities. We must then assess the likelihood that the deferred tax assets will be realizable and to the extent we believe that realizability is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or adjust such allowance in a period, we must include a tax expense or benefit within the tax provision in the statement of operations. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust our valuation allowance, which could impact our results of operations in the quarter in which such determination is made.

***Accounting for Impairment of Goodwill***

We assess goodwill for impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that goodwill be tested for impairment at the reporting unit level ( Reporting Unit ) at least annually and more frequently upon the occurrence of certain events, as defined by SFAS No. 142. Consistent with our determination that we have only one reporting segment, we have determined that there is only one Reporting Unit, specifically the license, implementation, and support of our software products. Goodwill was tested for impairment in our annual impairment tests on October 31 in each of the years in 2005, 2004, and 2003 using the two-step process required by SFAS No. 142. First, we reviewed the carrying amount of the Reporting Unit compared to the fair value of the Reporting Unit based on quoted market prices of our common stock. If such comparison reflected potential impairment, we would then prepare the discounted cash flow analyses. Such analyses are based on cash flow assumptions that are consistent with the plans and estimates being used to manage the business. An excess carrying value compared to fair value would indicate that goodwill may be impaired. Finally, if we determined that goodwill may be impaired, then we would compare the implied fair value of the goodwill, as defined by SFAS No. 142, to its carrying amount to determine the impairment loss, if any.

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

***Acquisitions***

We are required to allocate the purchase price of acquired companies to the tangible and intangible assets acquired, liabilities assumed, as well as purchased in-process research and development ( IPR&D ) based on their estimated fair values. We engage independent third-party appraisal firms to assist us in determining the fair values of assets acquired and liabilities assumed. This valuation requires management to make significant estimates and assumptions, especially with respect to long-lived and intangible assets.

Critical estimates in valuing certain of the intangible assets include but are not limited to future expected cash flows from customer contracts, customer lists, distribution agreements, and acquired developed technologies and patents; expected costs to develop the IPR&D into commercially viable products and estimating cash flows from the projects when completed; the acquired company's brand awareness and market position, as well as assumptions about the period of time the brand will continue to be used in the combined company's product portfolio; and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur.

***Share-Based Payment Compensation Expense***

We account for share-based compensation related to share-based transactions in accordance with the provisions of SFAS No. 123(R). Under the fair value recognition provisions of SFAS 123(R), share-based payment expense is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life.

We have estimated the expected volatility as an input into the Black-Scholes valuation formula when assessing the fair value of options granted. Our current estimate of volatility was based upon a blend of average historical and market-based implied volatilities of our stock price. To the extent volatility of our stock price increases in the future, our estimates of the fair value of options granted in the future could increase, thereby increasing share-based payment expense in future periods. For instance, an estimate in volatility 10 percentage points higher would have resulted in a \$2.6 million increase in the fair value of options granted during the six months ended June 30, 2006. In addition, we apply an expected forfeiture rate when amortizing share-based payment expense. Our estimate of the forfeiture rate was based primarily upon historical experience of employee turnover. To the extent we revise this estimate in the future, our share-based payment expense could be materially impacted in the quarter of revision, as well as in following quarters. An estimated forfeiture rate of 10 percentage points lower would have resulted in an increase of \$1.0 million in share-based payment expense for the six months ended June 30, 2006. Our expected term of options granted was derived from the historical option exercises, post-vesting cancellations, and estimates concerning future exercises/cancellations of vested/unvested options that remain outstanding. In the future, as empirical evidence regarding these input estimates are able to provide more directionally predictive results, we may change or refine our approach of deriving these input estimates. These changes could impact our fair value of options granted in the future.

**Table of Contents****Recent Accounting Pronouncements**

For recent accounting pronouncements see Note 11. Recent Accounting Pronouncements to the Condensed Consolidated Financial Statements under Part I, Item. 1 of this Report.

**Results of Operations**

The following table presents certain financial data for the three and six months ended June 30, 2006 and 2005 as a percentage of total revenues:

	<b>Three Months</b>		<b>Six Months</b>	
	<b>Ended June 30,</b>	<b>2005</b>	<b>Ended June 30,</b>	<b>2005</b>
	<b>2006</b>		<b>2006</b>	
Revenues:				
License	46%	44%	45%	43%
Service	54	56	55	57
Total revenues	100	100	100	100
Cost of revenues:				
License	2	2	2	2
Service	19	18	18	18
Amortization of acquired technology			1	
Total cost of revenues	21	20	21	20
Gross margin	79	80	79	80
Operating expenses:				
Research and development	18	16	18	17
Sales and marketing	44	45	44	44
General and administrative	9	8	9	8
Amortization of intangible assets				
Facilities restructuring charges	1		1	1
Purchased in-process research and development				
Total operating expenses	72	69	72	70
Income from operations	7	11	7	10
Interest income	6	2	5	2
Interest expense	(2)		(2)	
Other, net				
Income before provision for income taxes	11	13	10	12
Provision for income taxes	2	1	2	2
Net income	9%	12%	8%	10%

**Revenues**

Our total revenues increased to \$80.8 million for the three months ended June 30, 2006 from \$64.2 million for the three months ended June 30, 2005 representing an increase of \$16.6 million or 26%. Total revenues increased to \$153.9 million for the six months ended June 30, 2006 from \$122.6 million for the six months ended June 30, 2005 representing an increase of \$31.3 million or 26%.

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
License revenues	\$ 36,851	\$ 28,103	31%	\$ 69,655	\$ 53,059	31%
Service revenues:						
Maintenance	30,613	25,385	21%	59,406	49,122	21%
Consulting and education	13,346	10,717	25%	24,806	20,415	22%
Total service revenues	43,959	36,102	22%	84,212	69,537	21%
	\$ 80,810	\$ 64,205	26%	\$ 153,867	\$ 122,596	26%

**Table of Contents*****License Revenues***

Our license revenues increased to \$36.9 million and \$69.7 million for the three and six months ended June 30, 2006, respectively, from \$28.1 million and \$53.1 million for the three and six months ended June 30, 2005, respectively. The \$8.8 million or 31% increase for the three months ended June 30, 2006 and the \$16.6 million or 31% increase for the six months ended June 30, 2006 compared to the same periods in 2005 were primarily due to an increase in both the volume and the average transaction amount in the second quarter of 2006. The average transaction amount for orders greater than \$100,000 in the second quarter of 2006 increased to \$326,000 from \$307,000 in the second quarter of 2005. We believe that the increase in average transaction amount is primarily the result of larger deployments by customers and continued growth in the broader data integration market.

***Service Revenues******Maintenance Revenues***

Maintenance revenues increased to \$30.6 million for the three months ended June 30, 2006 from \$25.4 million for the three months ended June 30, 2005 and increased to \$59.4 million for the six months ended June 30, 2006 from \$49.1 million for the six months ended June 30, 2005. The \$5.2 million or 21% increase and \$10.3 million or 21% increase for the three and six months ended June 30, 2006, respectively, compared to the same periods in 2005, were primarily due to consistently strong renewals of maintenance contracts in 2006 coupled with the increasing size of our customer base. For the remainder of 2006, we expect maintenance revenues to increase from the second quarter of 2006 as we continue to increase our customer base.

***Consulting and Education Services Revenues***

Consulting and education services revenues increased to \$13.3 million for the three months ended June 30, 2006 from \$10.7 million for the three months ended June 30, 2005 and increased to \$24.8 million for the six months ended June 30, 2006 from \$20.4 million for the six months ended June 30, 2005. The \$2.6 million or 25% increase and \$4.4 million or 22% increase for the three and six months ended June 30, 2006, respectively, compared to the same periods in 2005 were primarily due to an increase in demand for consulting in both our North America and Europe regions. North America represented approximately 50% of the increase for both the three and six months ended June 30, 2006, respectively. Europe represented 27% and 30% of the increase for the three and six months ended June 30, 2006, respectively. For the remainder of 2006, we expect revenues from consulting and education services to remain relatively consistent with, or increase slightly from the second quarter of 2006.

***International Revenues***

Our international revenues increased to \$22.2 million for the three months ended June 30, 2006 from \$18.5 million for the three months ended June 30, 2005 and increased to \$44.0 million for the six months ended June 30, 2006 from \$38.7 million for the six months ended June 30, 2005. The \$3.7 million or 20% increase for the three months ended June 30, 2006 compared to the same period in 2005 is primarily due to an 11% increase in license revenues, an 18% increase in maintenance revenues, and a 71% increase in education services revenues. The \$5.3 million or 14% increase for the six months ended June 30, 2006, compared to the same period in 2005 was primarily due to a 21% increase in maintenance revenues and a 58% increase in consulting and education services revenues. International revenues as a percentage of total revenues were 27% and 29% for the three and six months ended June 30, 2006 and 29% and 32% for the three and six months ended June 30, 2005, respectively.



**Table of Contents*****Future Revenues (New Orders, Backlog and Deferred Revenues)***

Our future revenues are dependent upon (1) new orders received, shipped, and recognized in a given quarter and (2) our backlog and deferred revenues entering a given quarter. Our backlog consists primarily of product license orders that have not shipped as of the end of a given quarter and orders to certain distributors, resellers, and OEMs where revenue is recognized upon cash receipt. Our deferred revenues are primarily comprised of (1) maintenance revenues that we recognize over the term of the contract, typically one year, (2) license product orders that have shipped but where the terms of the license agreement contain acceptance language or other terms that require that the license revenues be deferred until all revenue recognition criteria are met or recognized ratably over an extended period, and (3) consulting and education services revenues that have been prepaid but for which services have not yet been performed. We typically ship products shortly after the receipt of an order, which is common in the software industry, and historically our backlog of license orders awaiting shipment at the end of any given quarter has varied. Aggregate backlog and deferred revenues at June 30, 2006 was approximately \$97.9 million compared to \$83.6 million at June 30, 2005 and \$96.5 million at March 31, 2006. The increases at June 30, 2006 are primarily due to an increase in deferred maintenance revenues, and to a lesser extent, deferred license revenues to be recognized on a ratable basis. Backlog and deferred revenues as of any particular date are not necessarily indicative of future results.

**Cost of Revenues**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Cost of license revenues	\$ 1,389	\$ 1,135	22%	\$ 2,916	\$ 1,845	58%
Cost of service revenues	15,003	11,387	32%	28,184	21,868	29%
Amortization of acquired technology	544	233	133%	996	469	112%
	\$ 16,936	\$ 12,755	33%	\$ 32,096	\$ 24,182	33%
Cost of license revenues, as a percentage of license revenues	4%	4%		4%	3%	
Cost of service revenues, as a percentage of service revenues	34%	32%		33%	31%	

***Cost of License Revenues***

Our cost of license revenues consists primarily of software royalties, product packaging, documentation, and production costs. Cost of license revenues increased to \$1.4 million for the three months ended June 30, 2006 from \$1.1 million for the three months ended June 30, 2005 due to increased license revenues, representing 4% of license revenues for both periods. Cost of license revenues increased to \$2.9 million for the six months ended June 30, 2006 from \$1.8 million for the six months ended June 30, 2005, representing 4% and 3% of license revenues for those periods, respectively. For the remainder of 2006, we expect the cost of license revenues as a percentage of license revenues to be relatively consistent with, or increase slightly from the second quarter of 2006.

***Cost of Service Revenues***

Our cost of service revenues is a combination of costs of maintenance, consulting, and education services revenues. Our cost of maintenance revenues consists primarily of costs associated with customer service personnel expenses and royalty fees for maintenance related to third-party software providers. Cost of consulting revenues consists primarily of personnel costs and expenses incurred in providing consulting services at customers' facilities. Cost of education services revenues consists primarily of the costs of providing training classes and materials at our headquarters, sales

and training offices, and customer locations. Cost of service revenues increased to \$15.0 million for the three months ended June 30, 2006 from \$11.4 million for the three months ended June 30, 2005, representing 34% and 32% of service revenues for those periods, respectively, and increased to \$28.2 million for the six months ended June 30, 2006 from \$21.9 million for the six months ended June 30, 2005, representing 33% and 31% of

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service revenues for those periods, respectively. The \$3.6 million or 32% increase and \$6.3 million or 29% increase for the three and six months ended June 30, 2006 compared to the same periods in 2005, respectively, were primarily due to headcount growth in the customer support, consulting, and education service groups, and higher share-based payment compensation expense. Cost of service revenues as a percentage of service revenues increased in both the three and six month periods in 2006 compared to 2005 as a result of increased headcount growth in the consulting and educational services organizations outpacing overall service revenues growth. For the remainder of 2006, we expect our cost of service revenues as a percentage of service revenues to be relatively consistent with the second quarter of 2006, or increase slightly from the current levels if the growth in our consulting services business, if any, is greater than that experienced by our maintenance and education services business.

**Amortization of Acquired Technology**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Amortization of acquired technology	\$544	\$233	133%	\$996	\$469	112%

Amortization of acquired technology is the amortization of technologies acquired through business combinations. Amortization of acquired technology increased to \$0.5 million for the three months ended June 30, 2006 from \$0.2 million for the three months ended June 30, 2005 and increased to \$1.0 million for the six months ended June 30, 2006 from \$0.5 million for the six months ended June 30, 2005. The \$0.3 million or 133% increase and \$0.5 million or 112% increase for the three and six months ended June 30, 2006, respectively, compared to the same periods in 2005 was a result of certain technologies we acquired in connection with the acquisition of Similarity in January 2006. We expect amortization of other acquired technology to be approximately \$1.0 million for the remainder of 2006.

**Operating Expenses****Research and Development**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Research and development	\$14,185	\$10,460	36%	\$27,243	\$20,707	32%
Percent of total revenues	18%	16%	2%	18%	17%	1%

Our research and development expenses consist primarily of salaries and other personnel-related expenses, consulting services, facilities and related overhead costs associated with the development of new products, the enhancement and localization of existing products, quality assurance and development of documentation for our products. Research and development expenses increased to \$14.2 million for the three months ended June 30, 2006 from \$10.5 million for the three months ended June 30, 2005, representing approximately 18% and 16%, respectively, of total revenues for those periods. The \$3.7 million or 36% increase for the three months ended June 30, 2006 compared to the same period in 2005 was due to a \$1.3 million increase in legal fees associated with the patent litigation as discovery continued and summary judgment preparations commenced, a \$0.8 million increase in personnel-related costs due to the Similarity acquisition, a \$0.6 million increase in share-based payment compensation expense due to the adoption of SFAS 123(R), a \$0.5 million increase in consulting services, and a \$0.5 million increase from facilities and other overhead related costs. Research and development expenses increased to \$27.2 million for the six months ended June 30, 2006 from \$20.7 million for the six months ended June 30, 2005, representing approximately 18% and 17%, respectively, of total revenues for those periods. The \$6.5 million or 32%

increase for the six months ended June 30, 2006 compared to the same period in 2005, was due

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to a \$2.1 million increase in personnel-related costs due to Similarity acquisition, a \$2.1 million increase in legal fees associated with the patent litigation as discovery continued and summary judgment preparations commenced, a \$1.1 million increase in share-based payment compensation expense due to the adoption of SFAS 123(R), a \$0.7 million increase in consulting services, and a \$0.5 million increase from facilities and other overhead related 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. For the remainder of 2006, we expect the research and development expenses as a percentage of total revenues to remain relatively consistent with, or decrease from, the second quarter of 2006.

**Sales and Marketing**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Sales and marketing	\$35,442	\$29,028	22%	\$66,965	\$54,386	23%
Percent of total revenues	44%	45%	(1%)	44%	44%	

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 increased to \$35.4 million for the three months ended June 30, 2006 from \$29.0 million for the three months ended June 30, 2005, representing approximately 44% and 45%, respectively, of total revenues for those periods. The \$6.4 million or 22% increase for the three months ended June 30, 2006 compared to the same period in 2005 was primarily due to a \$4.0 million increase in personnel-related costs resulting from headcount increases associated with the Similarity acquisition. Also contributing to the increase was an increase of \$1.2 million in share-based payment compensation expense associated with the adoption of SFAS 123(R), a \$0.7 million increase in marketing programs, and a \$0.5 million increase in facilities and other overhead related costs. Sales and marketing expenses increased to \$67.0 million for the six months ended June 30, 2006 from \$54.4 million for the six months ended June 30, 2005, representing approximately 44% of total revenues for both periods. The \$12.6 million or 23% increase for the six months ended June 30, 2006 compared to the same period in 2005 was primarily due to a \$8.3 million increase in personnel-related costs, \$2.2 million increase in share-based payment compensation expense associated with the adoption of SFAS 123(R), a \$1.0 million increase in marketing programs, a \$0.6 million increase in facilities and other overhead related costs, and a \$0.5 million increase in outside services. For the remainder of 2006, we expect sales and marketing expenses as a percentage of total revenues to remain relatively consistent with, or decrease from, the second quarter of 2006, depending upon our ability to attract and retain sales personnel and achieve increases in sales productivity and efficiencies from our new sales personnel as they gain experience.

**General and Administrative**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
General and administrative	\$6,935	\$4,994	39%	\$13,578	\$10,100	34%
Percent of total revenues	9%	8%	1%	9%	8%	1%

Our general and administrative expenses consist primarily of personnel costs for finance, human resources, legal, and general management, as well as professional service expenses associated with recruiting, legal and accounting services. General and administrative expenses increased to \$6.9 million for the three months ended June 30, 2006 from \$5.0 million for the three months ended June 30, 2005, representing approximately 9% and 8%, respectively, of

total revenues for those periods. The \$1.9 million or 39% increase for the three months ended

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June 30, 2006 compared to the same period in 2005 was primarily due to a \$1.1 million increase in share-based payment compensation expense related to the adoption of SFAS 123(R), a \$0.4 million increase in personnel-related costs, a \$0.2 million increase in the provision for bad debts, and a \$0.1 million increase in both third-party consulting service costs and facilities and other overhead related costs. General and administrative expenses increased to \$13.6 million for the six months ended June 30, 2006 from \$10.1 million for the six months ended June 30, 2005, representing approximately 9% and 8%, respectively, of total revenues for those periods. The \$3.5 million or 34% increase for the six months ended June 30, 2006 compared to the same period in 2005 was primarily due to a \$2.1 million increase in share-based payment compensation expense related to the adoption of SFAS 123(R), a \$0.8 million increase in personnel-related costs, a \$0.2 million increase in third-party consulting service costs, a \$0.2 million increase in the provision for bad debts, and a \$0.2 million increase in facilities and other overhead related costs. For the remainder of 2006, we expect general and administrative expenses as a percentage of total revenues to remain relatively consistent with, or decrease slightly from, the second quarter of 2006.

**Amortization of Intangible Assets**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Amortization of intangible assets	\$162	\$47	245%	\$292	\$94	211%

Amortization of intangible assets is the amortization of customer relationships acquired through business combinations. Amortization of intangible assets increased to \$162,000 and \$292,000 for the three and six months ended June 30, 2006, respectively, from \$47,000 and \$94,000 for the three and six months ended June 30, 2005, respectively as a result of the Similarity acquisition in January 2006. We expect amortization of the remaining intangible assets to be approximately \$0.3 million for the remainder of 2006.

**Facilities Restructuring Charges**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Facilities restructuring charges	\$1,129	\$70	1,513%	\$2,278	\$1,628	40%

For the three months ended June 30, 2006, we recorded \$1.1 million of restructuring charges from accretion charges related to the 2004 Restructuring Plan. In the six months ended June 30, 2006, we recorded \$2.3 million of restructuring charges. These charges included \$2.2 million of accretion charges, and a \$0.1 million adjustment related to the 2004 Restructuring Plan. For the three and six months ended June 30, 2005, we recorded facilities restructuring charges of \$70,000 and \$1.6 million, respectively. These charges primarily represent \$1.2 million and \$2.4 million of accretion charges, respectively, offset by a \$1.4 million increase in our assumed sublease income in both periods under the 2004 Restructuring Plan.

As of June 30, 2006, \$90.3 million of total lease termination costs, net of actual and expected sublease income, less broker commissions and tenant improvement costs related to facilities to be subleased, was included in accrued restructuring charges and is expected to be paid by 2013.

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**2004 Restructuring Plan** Net cash payments for facilities included in the 2004 Restructuring Plan for the three and six months ended June 30, 2006 related to the consolidation of excess facilities were \$1.8 million and \$4.4 million, respectively. Actual future cash requirements may differ from the restructuring liability balances as of June 30, 2006 if there are changes to the time period that facilities are vacant or the actual sublease income is different from current estimates.

**2001 Restructuring Plan** Net cash payments for facilities included in the 2001 Restructuring Plan amounted to \$0.9 million and \$1.0 million for three months ended June 30, 2006 and 2005, respectively, and \$2.1 million and \$2.2 million for the six months ended June 30, 2006 and 2005, respectively. Actual future cash requirements may differ from the restructuring liability balances as of June 30, 2006 if there are changes to the time period that facilities are vacant or the actual sublease income is different from current estimates.

Going forward, our results of operations should be positively affected by a significant decrease in rent expense and decreases to non-cash depreciation and amortization expense for the leasehold improvements and equipment written off. We estimate that these combined savings will be approximately \$10 to \$11 million annually, after accretion charges.

In addition, we will continue to evaluate our current facilities requirements to identify facilities that are in excess of our current and estimated future needs, as well as evaluate the assumptions related to estimated future sublease income for excess facilities. Accordingly, any changes to these estimates of excess facilities costs could result in additional charges that could materially affect our consolidated financial position and results of operations. See Note 6. Facilities Restructuring Charges of Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report.

**Purchased In-Process Research and Development**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Purchased in-process research and development	\$	\$	*%	\$1,340	\$	*%

\* Percentage is not meaningful

In the six months ended June 30, 2006, in conjunction with our acquisition of Similarity, we recorded in-process research and development charges of \$1.3 million. The in-process research and development charges were associated with software development efforts in process at the time of the business combination that had not yet achieved technological feasibility, and no future alternative uses had been identified. The purchase price allocated to in-process research and development was determined, in part, by a third-party appraiser through established valuation techniques. We may further incur in-process research and development expense in the future to the extent we make additional acquisitions.



**Table of Contents****Interest Income, Interest Expense and Other**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Interest income, expense and other, net	\$3,028	\$1,571	93%	\$5,396	\$2,604	107%

Interest income, interest expense and other consist primarily of interest income earned on our cash, cash equivalents, short-term investments, and restricted cash; interest expense; and gains and losses on foreign exchange transactions. Interest income, interest expense and other increased to \$3.0 million for the three months ended June 30, 2006 from \$1.6 million for the three months ended June 30, 2005. The \$1.4 million increase for the three months ended June 30, 2006 compared to the same period in 2005 was primarily due to a \$3.1 million increase in interest income received from higher investment yields and higher average cash balances from the proceeds of the Notes, and a \$0.1 million decrease in foreign exchange losses, which was offset by the \$1.8 million increase in interest expense and related costs on the Notes. Interest income, interest expense and other increased to \$5.4 million for the six months ended June 30, 2006 from \$2.6 million for the six months ended June 30, 2005. The \$2.8 million increase for the six months ended June 30, 2006 compared to the same period in 2005 was primarily due to a \$4.5 million increase in interest income, as a result of higher average cash and investment balances and higher interest rates compared to the same period in 2005 and a \$0.5 million decrease in foreign exchange loss, offset by the \$2.2 million increase in interest expense and related costs on the Notes. 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**

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

	Three Months Ended			Six Months Ended		
	2006	June 30, 2005	Change	2006	June 30, 2005	Change
Provision for income taxes	\$1,420	\$781	82%	\$2,574	\$2,153	20%

We recorded an income tax provision of \$1.4 million and \$2.6 million for the three and six months ended June 30, 2006, respectively, which primarily represents income and withholding taxes attributable to foreign operations, and federal and state minimum taxes. We recorded an income tax provision of \$0.8 million and \$2.2 million for the three and six months ended June 30, 2005, respectively, which primarily represents income and withholding taxes attributable to foreign operations, and federal and state minimum taxes. The expected tax provision derived from applying the federal statutory rate to our income before income taxes for the six months ending June 30, 2006 differed from the recorded income tax provision primarily due to the reversal of a portion of our valuation allowance to reflect the utilization of approximately \$4.7 million of tax attributes, partially offset by foreign income and withholding taxes of \$1.1 million and state taxes of \$0.7 million. Our tax provision for the remainder of 2006 remains heavily dependent upon the jurisdictional mix in which we generate pretax income, the level of earnings subject to foreign incomes taxes, and the amount of foreign withholding taxes paid.

**Liquidity and Capital Resources**

We have funded our operations primarily through cash flows from operations and public offerings of our common stock and the issuance of Notes. As of June 30, 2006, we had \$419 million in available cash and cash equivalents and short-term investments and \$12.0 million of restricted cash under the terms of our Pacific Shores property leases. In January 2006, as a result of the Similarity acquisition, Similarity stockholders received approximately \$48.3 million in cash and approximately 122,045 shares of Informatica common stock (which were fully vested but subject to escrow)

valued on the date of close at \$1.6 million. In addition, we assumed Similarity's outstanding options, which became exercisable for 392,333 shares of Informatica common stock valued on the date of close at \$5.0 million of which \$1.0 million was classified as share-based payment compensation expense. Furthermore, approximately \$8.3 million of the consideration was placed into escrow for approximately 15 months following the closing to be held as security for losses incurred by us in the event of certain breaches of the representations and warranties or certain other events. On March 8, 2006, we issued and sold Notes with an aggregate principal amount of \$230 million due 2026. We used approximately \$50 million of the net proceeds from the offering to fund the purchase of shares of Informatica common stock concurrently with the offering of the Notes,

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and we intend to use the balance of the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments or additional purchases of common stock. We expect the issuance of the Notes in March 2006 to be neutral to slightly accretive to earnings through 2006.

Other than the Notes issued in March 2006, our primary sources of cash are the collection of accounts receivable from our customers, and proceeds from the exercise of stock options and stock purchased under our employee stock purchase plan. Our uses of cash include payroll and payroll-related expenses and operating expenses such as marketing programs, travel, professional services and facilities and related costs. We have also used cash to purchase property and equipment, repurchase common stock from the open market to reduce the dilutive impact of stock option exercises and acquire businesses and technologies to expand our product offerings.

*Operating Activities:* Cash provided by operating activities for the six months ended June 30, 2006 was \$27.4 million, representing an improvement of \$9.1 million from the six months ended June 30, 2005. This improvement primarily resulted from a \$0.9 million increase in net income, after adjusting for non-cash expenses, a decrease in accounts receivable, and an increase in income taxes payable, offset by payments to reduce our accrual for excess facilities, accounts payable and accrued liabilities. Our days sales outstanding in accounts receivable ( days outstanding ) increased from 43 days at June 30, 2005 to 54 days at June 30, 2006. Non-cash share-based payment compensation expense (formerly amortization of stock-based compensation) increased primarily due to the adoption of SFAS No. 123(R). Cash provided by operating activities for the six months ended June 30, 2005 was \$18.3 million and primarily resulted from our net income, after adjusting for non-cash depreciation and amortization expenses, and payments against accounts payable and accrued liabilities. Our operating cash flows will also be impacted in the future based on the timing of payments to our vendors, the nature of vendor arrangements, and management's assessment of our cash inflows.

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

*Financing Activities:* On March 8, 2006, we received \$223.8 million principal amount from the Notes offering net of \$6.2 million in issuance costs. We used approximately \$50 million of the net proceeds from the offering to fund the purchase of shares of Informatica common stock concurrently with the offering of the Notes, and we intend to use the balance of the net proceeds for working capital and general corporate purposes, which may include the acquisition of businesses, products, product rights or technologies, strategic investments, or additional purchases of common stock.

We typically receive cash from the exercise of common stock options and the sale of common stock under our employee stock purchase plan. Although we expect to continue to receive these proceeds in future periods, the timing and amount of such proceeds are difficult to predict and are contingent on a number of factors including the price of our common stock, the number of employees participating in our stock option plans and our employee stock purchase plan, and general market conditions.

In April 2006, our Board of Directors authorized a stock repurchase program for a one-year period for up to \$30 million of our common stock. Purchases can be made from time to time in the open market and will be funded from available working capital. The purpose of our stock repurchase program is, among other things, to help offset the dilution caused by the issuance of stock under our employee stock option plans. The number of shares acquired and the timing of the repurchases are based on several factors, including general market conditions and the trading price of our common stock. These repurchased shares will be retired and reclassified as authorized and unissued shares of

common stock.

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We believe that our cash balances and the cash flows generated by operations will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, we may require or desire additional funds to support our operating expenses and capital requirements or for other purposes, such as acquisitions, and we may seek to raise such additional funds through public or private equity or debt financing or from other sources. We may not be able to obtain adequate or favorable financing at that time, and any financing we obtain might be dilutive to our stockholders.

**Other Uses of Cash**

In January 2006, in connection with the Similarity acquisition, we used approximately \$48.3 million in cash as part of the consideration. A portion of our cash may be further used to acquire or invest in other complementary businesses or products or to obtain the right to use other complementary technologies. From time to time, in the ordinary course of business, we may evaluate potential acquisitions of such businesses, products, or technologies. The nature of these transactions makes it difficult to predict the amount and timing of such cash requirements.

**Letter of Credit**

We have a \$12.0 million letter of credit issued by a financial institution that is required as collateral for our former corporate headquarter leases at the Pacific Shores Center in Redwood City, California until the leases expire in 2013. These certificates of deposit are classified as long-term restricted cash on our consolidated balance sheet. The letter of credit currently bears interest of 3.9%. There are no financial covenant requirements under our line of credit.

**Contractual Obligations**

We lease certain office facilities and equipment under non-cancelable operating leases. During 2004, 2002, and 2001, we recorded restructuring charges related to the consolidation of excess leased facilities in the San Francisco Bay Area and Texas. Operating lease payments in the table below include approximately \$116.1 million, net of actual sublease income, for operating lease commitments for those facilities that are included in restructuring charges. See Note 6. Facilities Restructuring Charges and Note 8. Commitments and Contingencies, in Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report.

Our future minimum payments under non-cancelable contractual obligations with original terms in excess of one year, net of future sublease income, as of June 30, 2006 are summarized as follows (in thousands):

	Total	Payment Due by Period			
		Remaining 2006	2007 and 2008	2009 and 2010	2011 and Thereafter
Operating lease obligations:					
Operating lease payments	\$ 134,279	\$ 11,526	\$ 39,119	\$ 35,582	\$ 48,052
Future sublease income	(10,233)	(1,589)	(5,483)	(2,047)	(1,114)
Net operating lease obligations	124,046	9,937	33,636	33,535	46,938
Debt obligations:					
Principal payments	230,000				230,000
Interest payments	138,038	3,488	13,800	13,800	106,950
Other obligations *	1,500	300	1,200		
	\$ 493,584	\$ 13,725	\$ 48,636	\$ 47,335	\$ 383,888

\* Other purchase obligations and commitments include minimum royalty

payments under  
license  
agreements and  
do not include  
purchase  
obligations  
discussed  
below.

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Of these future minimum operating lease payments, we have \$90.3 million recorded in the restructuring and excess facilities accrual at June 30, 2006. This accrual, in addition to minimum lease payments of \$116.1 million, includes estimated operating expenses of \$21.6 million, is net of estimated sublease income of \$29.5 million, and is net of the present value impact of \$17.9 million recorded in accordance with SFAS No. 146. Our sublease income assumptions are based on existing sublease agreements and current market conditions, among other factors. Our estimates of sublease income for periods following the expiration of our sublease agreements may vary significantly from actual amounts realized depending, in part, on factors that may be beyond our control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases.

In relation to our excess facilities, we may decide to negotiate and enter into lease termination agreements, if and when the circumstances are appropriate. These lease termination agreements would likely require that a significant amount of the remaining future lease payments be paid at the time of execution of the agreement, but would release us from future lease payment obligations for the abandoned facility. The timing of a lease termination agreement and the corresponding payment could materially affect our cash flows in the period of payment.

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different.

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

In February 2000, we entered into two lease agreements for two buildings in Redwood City, California (our former corporate headquarters), which we occupied from August 2001 through December 2004. The leases expire in July 2013. As part of these agreements, we have purchased certificates of deposit totaling approximately \$12 million as a security deposit for lease payments, which are classified as long-term restricted cash as of June 30, 2006.

***Off-Balance Sheet Arrangements***

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

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

All market risk sensitive instruments were entered into for non-trading purposes. We do not use derivative financial instruments for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. As of June 30, 2006, we did not hold derivative financial instruments.

**Interest Rate Risk**

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

For the six months ended June 30, 2006, the average rate of return on our investments was 4.5%. Our cash equivalents and short-term investments are subject to interest rate risk and will decline in value if market interest rates increase. As of June 30, 2006, we had net unrealized losses of \$0.7 million associated with these securities. If market interest rates were to increase immediately and uniformly by 100 basis points from levels as of June 30, 2006, the fair market value of the portfolio would decline by approximately \$1.0 million. Additionally, we have the ability to hold our investments until maturity and, therefore, we would not necessarily expect to realize an adverse impact on income or cash flows.

**Table of Contents****Foreign Currency Risk**

We market and sell our software and services through our direct sales force and indirect channel partners in North America, Europe, Asia-Pacific, and Latin America. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. For example, the strengthening of the U.S. dollar compared to any of the local currencies in the markets in which we do business could over time make our products less competitive in these markets. Because we translate foreign currencies into U.S. dollars for reporting purposes, currency fluctuations, especially between the U.S. dollar and the Euro and British pound, may have an impact on our financial results. In the six months ended June 30, 2006, the impact from these fluctuations on our revenues, expenses, and net income was insignificant. Because our foreign subsidiaries transact business in their local currencies, gains and losses typically arise on the settlement of intercompany transactions with the corporate parent company, Informatica Corporation.

To date, we have not engaged in any foreign currency hedging activities. We regularly review our foreign currency strategy and may as part of this review determine at any time to change our strategy.

**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 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to Informatica's management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our disclosure controls and procedures is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

*Changes in Internal Control over Financial Reporting.* There was no change in our system of internal control over financial reporting during the three months ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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

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



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

We accepted a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Informatica defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Informatica defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance that we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. At the hearing on April 24, 2006, the judge took the approval of the settlement under submission. The ruling is expected later this year.

On July 15, 2002, we filed a patent infringement action in U.S. District Court in Northern California against Acta Technology, Inc. ( Acta ), now known as Business Objects Data Integration, Inc. ( BODI ), asserting that certain Acta products infringe on three of 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/BODI products, as well as damages for past sales of the infringing products. We have asserted that BODI's infringement of our patents was willful and deliberate. On September 5, 2002, BODI answered the complaint and filed counterclaims against us seeking a declaration that each patent asserted is not infringed and is invalid and unenforceable. BODI has not made any claims for monetary relief against us and has not filed any counterclaims alleging that we have infringed any of BODI's patents. The parties presented their respective claim constructions to the Court on September 24, 2003, and on August 1, 2005, the Court issued its claims construction order. We believe that the issued claims construction order is favorable to our position on the infringement action. The matter is currently at the end of the discovery phase. Informatica is preparing to argue motions for summary judgment on both patent infringement and validity in the third quarter of 2006.

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

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

**ITEM 1A. 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 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, 2005.

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

The market for our products is highly competitive, quickly evolving, and subject to rapidly changing technology. Our competition consists of hand-coded, custom-built data integration solutions developed in-house by various companies in the industry segments that we target, as well as other vendors of integration software products, including Ab Initio, Business Objects, Embarcadero Technologies, IBM (which acquired Ascential Software), SAS Institute, and certain other privately held companies. In the past, we have competed with business intelligence vendors that currently offer, or may develop, products with functionalities that compete with our products, such as Cognos, Hyperion Solutions, MicroStrategy, and certain privately held companies. We also compete against certain database and enterprise application vendors, which offer products that typically operate specifically with these competitors proprietary databases. Such competitors include IBM, Microsoft, Oracle, and SAP. Many of these competitors have longer operating histories, substantially greater financial, technical, marketing, or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. 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 on the basis of the breadth and depth of our products' functionality as well as on the basis of price. We may have difficulty competing on the basis of price in circumstances where our competitors develop and market products with similar or superior functionality and pursue an aggressive pricing strategy or bundle data integration technology at no cost to the customer or at deeply discounted prices. These difficulties may increase as larger companies target the data integration market. As a result, increased competition and bundling strategies could seriously impede our ability to sell additional products and services on terms favorable to us.

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

***New product introductions and product enhancements may impact market acceptance of our products and affect our results of operations.***

For new product introductions and existing product enhancements, changes can occur in product packaging and pricing. After our acquisition of Similarity, we commenced integration of Similarity's data quality technology into the PowerCenter product suite. Accordingly, in May 2006, we released the general availability version of PowerCenter 8.0 which included new products, Informatica Data Quality and Informatica Data Explorer, that deliver advanced data quality capabilities. We also announced in May the strategic roadmap for Informatica On-Demand, a Software-as-a-Service ( SaaS ) offering, to enable cross-enterprise data integration. As part of Phase One (offering connectivity to leading SaaS vendors), we concurrently introduced Informatica PowerCenter Connect for salesforce.com which allows customers to integrate data managed by salesforce.com with data managed by on-premise applications. New product introductions and/or enhancements such as these have inherent risks, including but not limited to:

- § delay in completion, launch, delivery, or availability;
- § delay in customer purchases in anticipation of new products not yet released;
- § product quality issues, including the possibility of defects;
- § market confusion based on changes to the product packaging and pricing as a result of a new product release;

§ interoperability issues with third-party technologies;

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§ loss of existing customers that choose a competitor's product instead of upgrading or migrating to the new product; and

§ loss of maintenance revenues from existing customers that do not upgrade or migrate.

In addition, we plan to continue to partner with our existing data quality vendors in terms of support for our existing customers. However, it is unclear how successful the ongoing partnering will be and how our customers will react. Given the risks associated with the introduction of new products, we cannot predict their impact on overall sales and revenues.

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

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

Moreover, historically our backlog of license orders at the end of a given fiscal period has tended to vary. This has particularly been the case at the end of the first and third fiscal quarters when our backlog typically decreases from the prior quarter and increases at the end of the fourth quarter. For example, in the first quarter of 2004, we experienced greater seasonal reduction in license orders than we had initially expected.

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

We also continued our international expansion efforts, begun in 2005, by opening new offices in the Asia Pacific region in Sydney, Australia and Singapore. As the result of this international expansion, as well as the increase in our direct sales headcount in the U.S. during 2005, our sales and marketing expenses have increased accordingly during 2005 and the first half of 2006. We expect these investments to result in increased revenue, increased sales productivity and increased profitability. However, if we experience an increase in sales personnel turnover, do not achieve expected increases in our sales pipeline, experience a decline in our sales pipeline conversion ratio, or do not achieve increases in productivity and efficiencies from our new sales personnel as they gain more experience, then we may not achieve our expected increases in revenue, productivity and profitability.

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

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

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



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application providers, database vendors, data quality vendors, and enterprise integrator vendors, for the promotion and implementation of our products. Recently, we have become a global OEM partner with Hyperion Solutions and have partnered with salesforce.com.

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

Although our strategic partnership with IBM's Business Consulting Services (BCS) group has been successful in the past, IBM's acquisition of Ascential Software may make it more critical that we strengthen our relationships with our other strategic partners. Business Objects' recent acquisition of FirstLogic, a former strategic partner, may also make such strengthening with other strategic partners more critical. We cannot guarantee that we will be able to strengthen our relationships with our strategic partners or that such relationships will be successful in generating additional revenue.

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

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

We use a pipeline system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of all proposals, including the date when they estimate that a customer will make a purchase decision and the potential dollar amount of the sale. We aggregate these estimates periodically in order to generate a sales pipeline. We assess 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. Additionally, because we have historically recognized a substantial portion of our license revenues in the last month of each quarter and sometimes, 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 rate of the pipeline into customer sales or in the pipeline itself could cause us to improperly budget for future expenses that are in line with our expected future revenues, which would adversely affect our operating margins and results of operations and could cause the price of our common stock to decline.

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

In 2002, we experienced a reduced conversion rate of our overall license pipeline, primarily as a result of the general economic slowdown, which caused the amount of customer purchases to be reduced, deferred, or cancelled. In the first half of 2003, we continued to experience a decrease in our sales pipeline as well as our pipeline conversion rate, primarily as a result of the negative impact of the war in Iraq on the capital spending budgets of our customers, as well as the continued general economic slowdown. While the U.S. economy improved in the second half of 2003 and in 2004 and 2005, we experienced, and continue to experience, uncertainty regarding our sales pipeline and our ability to convert potential sales of our products into revenue. Although we experienced an increase in the size of our sales pipeline and our pipeline conversion rate in 2005 and continuing in 2006 as a result of our increased investment in sales personnel and a gradually improving IT spending environment which has continued in 2006, if we are unable to continue to increase the size of our sales pipeline and our pipeline conversion rate, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline.



**Table of Contents*****Our international operations expose us to greater risks, including but not limited to those regarding intellectual property, collections, exchange rate fluctuations, and regulations, which could limit our future growth.***

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

In addition, we have only a limited history of marketing, selling, and supporting our products and services internationally. As a result, we must hire and train experienced personnel to staff and manage our foreign operations. However, we have experienced difficulties in recruiting, training, managing, and retaining an international staff, in particular related to sales management and sales personnel, which have affected our ability to increase sales productivity, and related to turnover rates and wage inflation in India, which have increased costs. We may continue to experience such difficulties in the future.

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

Business practices in the international markets that we serve may differ from those in North America and may require us to include terms in our software license agreements, such as extended payment or warranty terms, or performance obligations that may require us to defer license revenues and recognize them ratably over the warranty term or contractual period of the agreement. For example, in 2004, we were unable to recognize a portion of license fees for two large software license agreements signed in Europe in the third quarter of 2004. We deferred the license revenues related to these software license agreements in September 2004 due to extended warranties that contained provisions for additional unspecified deliverables and began amortizing the deferred revenues balances to license revenues in September 2004 for a two- to five-year period. Although historically we have infrequently entered into software license agreements that require ratable recognition of license revenue, we may enter into software license agreements in the future that may include non-standard terms related to payment, maintenance rates, warranties, or performance obligations.

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

- § greater difficulty in protecting our ownership rights to intellectual property developed in foreign countries, which may have laws that materially differ from those in the United States;
- § communication delays between our main development center in Redwood City, California and our development centers in India, the Netherlands, and the United Kingdom as a result of time zone differences, which may delay the development, testing, or release of new products;
- § greater difficulty in relocating existing trained development personnel and recruiting local experienced personnel, and the costs and expenses associated with such activities; and
- § increased expenses incurred in establishing and maintaining office space and equipment for the development centers.





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Additionally, our international operations as a whole are subject to a number of risks, including the following:

- § greater risk of uncollectible accounts and longer collection cycles;
- § greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;
- § greater risk of a failure of our foreign employees to comply with both U.S. and foreign laws, including antitrust regulations, the Foreign Corrupt Practices Act, and unfair trade regulations;
- § potential conflicts with our established distributors in countries in which we elect to establish a direct sales presence;
- § our limited experience in establishing a sales and marketing presence and the appropriate internal systems, processes, and controls in Asia-Pacific, especially China, Hong Kong, Korea, and Taiwan;
- § fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business, if we continue to not engage in hedging activities; and
- § general economic and political conditions in these foreign markets.

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

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 ( SOX 404 ), and the rules and regulations promulgated by the SEC to implement SOX 404, we are required to furnish an annual report in our Form 10-K regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement regarding the effectiveness of our internal control over financial reporting. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

Management's assessment of internal control over financial reporting requires management to make subjective judgments and, because this requirement to provide a management report has only been in effect since 2004, some of our judgments will be in areas that may be open to interpretation. Therefore, we may have difficulties in assessing the effectiveness of our internal controls, and our auditors, who are required to issue an attestation report along with our management report, may not agree with management's assessments.

During the past two years, our organizational structure has increased in complexity. For example, during 2005 and in the first quarter of 2006, we expanded our presence in the Asia-Pacific region where business practices can differ from those in other regions of the world and can create internal controls risks. To address potential risks, we recognize revenue on transactions derived in this region only when the cash has been received and all other revenue recognition criteria has been met. While our organizational structure has increased in complexity as a result of our international expansion, our capital structure has also increased in complexity as a result of the issuance of the Notes in March 2006. In July 2006, we discovered a significant deficiency in the manner in which we accounted for the shares of Common Stock issued upon the conversion of the Notes for purposes of determining our weighted average diluted shares outstanding and diluted earnings per share. As a result, we issued a press release and filed a related Current Report on Form 8-K/A to correct the weighted average diluted shares outstanding and diluted earnings per share. Finally, our reorganization of various foreign entities in April 2006, which required a change in some of our internal controls over financial reporting, and the assessment of the impact of the application of FIN 48 further adds to the

reporting complexity and increases the potential risks of our ability to maintain the effectiveness of our internal controls.

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Although we currently believe our internal control over financial reporting is effective, the effectiveness of our internal controls in future periods is subject to the risk that our controls may become inadequate.

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

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

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

- § our customers' budgetary constraints and internal acceptance review procedures;
- § the timing of our customers' budget cycles;
- § the seasonality of technology purchases, which historically has resulted in stronger sales of our products in the fourth quarter of the year, especially when compared to lighter sales in the first quarter of the year;
- § our customers' concerns about the introduction of our products or new products from our competitors; or
- § potential downturns in general economic or political conditions that could occur during the sales cycle.

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

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

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

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

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

- § not fully value the benefits of using our products;
- § not achieve favorable results using our products;
- § experience technical difficulties in implementing our products; or
- § use alternative methods to solve the problems addressed by our products.

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

***The loss of our key personnel, an increase in our sales force personnel turnover rate, or the inability to attract and retain additional personnel could adversely affect our ability to grow our company successfully and may negatively impact our results of operations.***

We believe our success depends upon our ability to attract and retain highly skilled personnel and key members of our management team. We continue to experience changes in members of our senior management team with the recent addition of Brian C. Gentile, Executive Vice President and Chief Marketing Officer responsible for worldwide marketing. As new senior personnel join our company and become familiar with our business strategy and systems, their integration could result in some disruption to our ongoing operations.

We also experienced an increased level of turnover in our direct sales force in the fourth quarter of 2003 and the first quarter of 2004. This increase in the turnover rate impacted our ability to generate license revenues in the first nine months of 2004. Although we have hired replacements in our sales force and have seen the pace of the turnover decrease in recent quarters, we typically experience lower productivity from newly hired sales personnel for a period of 6 to 12 months. If we are unable to effectively train such new personnel, or if we experience an increase in the level of sales force turnover, our ability to generate license revenues may be negatively impacted.

In addition, we have experienced an increased level of turnover in other areas of the business. If we are unable to effectively attract and train new personnel, or if we continue to experience an increase in the level of turnover, our results of operations may be negatively impacted.

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

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

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in the domestic and global economies. We experienced the adverse effect of the economic slowdown in 2002 and the first six months of 2003, which resulted in a significant reduction in capital spending by our customers, as well as longer sales cycles and the deferral or delay of purchases of our products. In addition, terrorist actions and the military actions in Afghanistan and Iraq magnified and prolonged the adverse effects of the economic slowdown.



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Although the U.S. economy improved beginning in the third quarter of 2003, and we have experienced some improvement in our pipeline conversion rate, we may not experience any significant improvement in our pipeline conversion rate in the future. In particular, our ability to forecast and rely on U.S. federal government orders, especially potential orders from the U.S. Department of Defense, is uncertain due to congressional budget constraints and changes in spending priorities.

If the current improvement in the U.S. economy does not result in increased sales of our products and services, our results of operations could fail to meet the expectations of stock analysts and investors, which could cause the price of our common stock to decline. Moreover, if the economies of Europe and Asia-Pacific do not continue to grow or if there is an escalation in regional or global conflicts, we may fall short of our revenue expectations for 2006. Over the past few quarters, we have experienced less than expected overall revenue performance in Europe, especially in Germany. Any further economic slowdown in Europe could adversely affect our pipeline conversion rate, which could impact our ability to meet our revenue expectations for 2006. Although we are investing in Asia-Pacific, there are significant risks with overseas investments and our growth prospects in Asia-Pacific are uncertain. In addition, we could experience delays in the payment obligations of our worldwide reseller customers if they experience weakness in the end-user market, which would increase our credit risk exposure and harm our financial condition.

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

To date, substantially all of our revenues have been derived from our data integration products such as PowerCenter and PowerExchange and related services. We expect sales of our data integration software and related services to comprise substantially all of our revenues for the foreseeable future. If any of our products does not achieve market acceptance, our revenues and stock price could decrease. In particular, with the completion of our Similarity acquisition, we intend to further integrate Similarity's data quality technology into our PowerCenter data integration product suite. Market acceptance for our current products, as well as our PowerCenter product with Similarity's data quality technology, could be affected if, among other things, competition substantially increases in the enterprise data integration market or transactional applications suppliers integrate their products to such a degree that the utility of the data integration functionality that our products provide is minimized or rendered unnecessary.

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

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

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

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

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

§ quarterly variations in our competitors' results of operations;

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- § changes in earnings estimates and recommendations by securities analysts;
- § developments in our industry; and
- § changes in accounting rules.

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

***The recognition of share-based payment compensation expense for employee stock option and employee stock purchase plans has adversely impacted our results of operations.***

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which requires us to measure compensation cost for all share-based payments (including employee stock options) at fair value at the date of grant and record such expense in our condensed consolidated financial statements. We adopted SFAS No. 123(R) as required in the first quarter of 2006. The adoption of SFAS No. 123(R) has a significant adverse impact on our condensed consolidated results of operations. See Note 3. Share-Based Payment Compensation Expense. The adoption of SFAS No. 123(R) has increased our operating expenses and reduced our operating income, net income and earnings per share, all of which could result in a decline in the price of our common stock in the future. The effect of share-based payments on our operating income, net income and earnings per share are not predictable as the underlying assumptions, including stock price, volatility, expected life, and forfeiture rate of the Black-Scholes model could vary over time.

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

We have a number of relationships with resellers, systems integrators, and distributors that assist us in obtaining broad market coverage for our products and services. Although our discount policies, sales commission structure, and reseller licensing programs are intended to support each distribution channel with a minimum level of channel conflicts, we may not be able to minimize these channel conflicts in the future. Any channel conflicts that we may experience could result in confusion for our customers and a decrease in revenue and operating margins.

***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. 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, which could require us to allocate significant customer support resources to address these problems.

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



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

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

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

Based on limited credit history, we recognize revenue from direct end users, resellers, distributors, and OEMs that have not been deemed creditworthy when we receive payment for our products and when all other criteria for revenue recognition have been met, rather than at the time of sale. As our business grows, if these customers and partners do not make timely payment for our products, our revenues could decrease. If our revenues decrease, the price of our common stock may fall.

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

We were incorporated in 1993 and began selling our products in 1996; therefore, we have a limited operating history upon which investors can evaluate our operations, products, and prospects. With the exception of 2005 and 2003, when we had net income of \$33.8 million and \$7.3 million, respectively, since our inception we have incurred significant annual net losses, resulting in an accumulated deficit of \$148.4 million as of June 30, 2006. We cannot ensure that we will be able to sustain profitability in the future. If we are unable to sustain profitability, we may fail to meet the expectations of stock analysts and investors, and the price of our common stock may fall.

***The conversion provisions of our Notes could dilute the ownership interests of stockholders and the level of debt represented by such notes could adversely affect our liquidity and could impede our ability to raise additional capital.***

In March 2006, we issued \$230 million aggregate principal amount of Notes due 2026. The note holders can convert the Notes into shares of our common stock at any time before the Notes mature or we redeem or repurchase them. Upon certain dates or the occurrence of certain events including a change in control, the note holders can require us to repurchase some or all of the Notes. Upon any conversion of the Notes, our basic earnings per share would be expected to decrease because such underlying shares would be included in the basic earnings per share calculation. Given that events constituting a change in control can trigger such repurchase obligations, the existence of such repurchase obligations may delay or discourage a merger, acquisition or other consolidation. Our ability to meet our repurchase or repayment obligations of the Notes will depend upon our future performance which is subject to economic, competitive, financial and other factors affecting our industry and operations, some of which are beyond our control. If we are unable to meet the obligations out of cash flows from operations or other available funds, 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.

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

Our success depends upon our proprietary technology. We believe that our product development, 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 issued patents or any future issued patents. Our patents alone may not provide us with any significant competitive advantage, and third parties may develop technologies that are similar or superior to our technology or design around our patents. Third parties could copy or otherwise obtain and use our products or technology without authorization or develop similar technology independently. We cannot easily monitor any unauthorized use of our products, and, although we are unable to determine the extent to which piracy of our software products exists, software piracy is a prevalent problem in our industry in general.

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

We have entered into agreements with many of our customers and partners that require us to place the source code of our products into escrow. Such agreements generally provide that such parties will have a limited, non-exclusive right to use such code if: (1) there is a bankruptcy proceeding by or against us; (2) we cease to do business; or (3) we fail to meet our support obligations. Although our agreements with these third parties limit the scope of rights to use of the source code, we may be unable to effectively control such third parties' 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 to protect our proprietary rights. For example, on July 15, 2002, we filed a patent infringement lawsuit against Acta Technology, Inc., now known as Business Objects Data Integration, Inc. ( BODI ). Although this lawsuit is in the discovery stage, litigating claims related to the enforcement of proprietary rights are 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. 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:



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- § we may be forced to enter into royalty or licensing agreements, which may not be available on terms favorable to us, or at all;
- § we may be required to indemnify our customers or obtain replacement products or functionality for our customers;
- § we may be forced to significantly increase our development efforts and resources to redesign our products as a result of these claims; and
- § we may be forced to discontinue the sale of some or all of our products.

***Our effective tax rate is difficult to project and changes in such tax rate could adversely affect our operating results.***

The process of determining our anticipated tax liabilities involves many calculations and estimates, making the ultimate tax obligation determination uncertain. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate prior to the completion and filing of tax returns for such periods. This process requires estimating both our geographic mix of income and our current tax exposures in each jurisdiction where we operate. These estimates involve complex issues, require extended periods of time to resolve, and require us to make judgments, such as anticipating the positions that we will take on tax returns prior to our actually preparing the returns and the outcomes of audits with tax authorities. We are also required to make determinations of the need to record deferred tax liabilities and the recoverability of deferred tax assets. A valuation allowance is established to the extent recovery of deferred tax assets is not likely based on our estimation of future taxable income and other factors in each jurisdiction.

Furthermore, our overall effective income tax rate may be affected by various factors in our business including acquisitions, changes in our legal structure, changes in the geographic mix of income and expenses, changes in valuation allowances, changes in applicable accounting rules including FIN 48 and tax laws, developments in tax audits, and variations in the estimated and actual level of annual pre-tax income.

Currently, the Company has provided a full valuation allowance against its net deferred tax assets based on its historical operating performance and its reported cumulative net losses in prior years. When the Company deems that it is likely that the tax attributes will be fully supportable by either refundable income taxes or future taxable income, the reduction in valuation allowance will result in a discrete event during the quarter that it occurs. After the occurrence of this discrete event, the Company anticipates a future effective tax rate which will likely be significantly greater than the Company's current effective tax rate.

***We may not successfully integrate Similarity's technology, employees, or business operations with our own. As a result, we may not achieve the anticipated benefits of our acquisition, which could adversely affect our operating results and cause the price of our common stock to decline.***

In January 2006, we acquired Similarity, a provider of business-focused data quality and profiling solutions. The successful integration of Similarity's technology, employees, and business operations will place an additional burden on our management and infrastructure. This acquisition, and any others we may make in the future, will subject us to a number of risks, including:

- § the failure to capture the value of the business we acquired, including the loss of any key personnel, customers, and business relationships;
- § any inability to generate revenue from the combined products that offsets the associated acquisition and maintenance costs, including addressing issues related to the availability of offerings on multiple platforms; and
- § the assumption of any contracts or agreements from Similarity that contain terms or conditions that are unfavorable to us.



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There can be no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with our Similarity acquisition or any future acquisitions. To the extent that we are unable to successfully manage these risks, our business, operating results, or financial condition could be adversely affected, and the price of our common stock could decline.

***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. For example, in January 2006 we announced our acquisition of Similarity Systems. Future acquisitions and investments like these could result in the issuance of dilutive equity securities, the incurrence of debt or contingent liabilities, or the payment of cash to purchase equity securities from third parties. There can be no assurance that any strategic acquisition or investment will succeed. Risks include difficulties in the integration of the products, personnel, and operations of the acquired entity, disruption of the ongoing business, potential management distraction from the ongoing business, difficulties in the retention of key partner alliances, and potential product liability issues related to the acquired products.

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

We have substantial real estate lease commitments in the United States and internationally. However, we do not occupy many of these leases. Currently, we have substantially subleased these unoccupied properties to third parties. However, the terms of most of these sublease agreements account for only a portion of the period of our master leases and contain rights of the subtenant to extend the term of the sublease. To the extent that (1) our subtenants do not renew their subleases at the end of the initial term and we are unable to enter into new subleases with other parties at comparable rates, or (2) our subtenants are unable to pay the sublease rent amounts in a timely manner, our cash flow would be negatively impacted and our operating results and financial condition could be adversely affected. See Note 6. Facilities Restructuring Charges of Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Report.

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

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

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

***Business interruptions could adversely affect our business.***

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



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The following table provides information about the repurchase of our common stock during the three months ended June 30, 2006:

<b>Period</b>	<b>(1) Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(2) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)</b>
April 1 - April 30	145,000	\$ 15.76	145,000	\$ 27,714
May 1 - May 31	660,000	\$ 14.12	660,000	\$ 18,398
June 1 - June 30				\$ 18,398
Total	805,000	\$ 14.41	805,000	\$ 18,398

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

(2) We announced the repurchase program in April 2006. The repurchase program authorizes the repurchase of up to \$30 million of our common stock at any time until April 2007.

**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 18, 2006. Each of the matters was approved by the requisite vote.



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

	<b>Votes For</b>	<b>Votes Withheld</b>
David W. Pidwell	78,580,975	3,159,917
Sohaib Abbasi	79,505,349	2,235,543
Geoffrey W. Squire	79,911,922	1,828,970

Our Board of Directors is currently comprised of eight members who are divided into three classes with overlapping three-year terms. The term for our Class I directors, Janice D. Chaffin, Carl J. Yankowski, and Charles Robel, will expire at the Annual Meeting of Stockholders in 2007. The term of our Class II directors, A. Brooke Seawell and Mark A. Bertelsen, will expire at the Annual Meeting of Stockholders in 2008.

(b) Ernst & Young LLP was ratified as our independent registered public accounting firm for the year ending December 31, 2006.

Affirmative Votes	79,994,628
Negative Votes	1,667,272
Votes Abstain	78,891
Broker Non-Votes	

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**ITEM 6. EXHIBITS**

**Exhibit No. Description**

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

**ITEMS 3 and 5 are not applicable and have been omitted.**

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**SIGNATURES**

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

**INFORMATICA CORPORATION**

August 9, 2006

/s/ Earl E. Fry.

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

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**INFORMATICA CORPORATION  
EXHIBITS TO FORM 10-Q QUARTERLY REPORT  
For the Quarter Ended June 30, 2006**

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