INFORMATICA CORP
Form 10-K
February 28, 2007

Table of Contents

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

FORM 10-K

þ **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the year ended December 31, 2006

or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number: 0-25871

INFORMATICA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	77-0333710
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 Cardinal Way
Redwood City, California 94063
(Address of principal executive offices and zip code)

(650) 385-5000
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of exchange on which registered**
Common Stock, par value $0.001 per share (Including associated Preferred Stock Purchase Rights)	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities registered pursuant to Section 12(g) of the Act:
None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. þ Yes o No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the Exchange Act). o Yes þ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of 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. þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2006 was approximately $1,121,122,000 (based on the last reported sale price of $13.16 on June 30, 2006 on the NASDAQ Global Select Market).

As of January 31, 2007, there were approximately 86,500,000 shares of the registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the registrant s 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K to the extent stated herein. The Proxy Statement will be filed within 120 days of the registrant s fiscal year ended December 31, 2006.

INFORMATICA CORPORATION

TABLE OF CONTENTS

		Page No.
	PART I	
Item 1.	Business	2
Item 1A.	Risk Factors	9
Item 1B.	Unresolved Staff Comments	21
Item 2.	Properties	21
Item 3.	Legal Proceedings	22
Item 4.	Submission of Matters to a Vote of Security Holders	23
	Executive Officers of the Registrant	23
	PART II	
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	24
Item 6.	Selected Financial Data	26
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	28
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	43
Item 8.	Financial Statements and Supplementary Data	44
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	85
Item 9A.	Controls and Procedures	85
Item 9B.	Other Information	85
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance	85
Item 11.	Executive Compensation	85
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	86
Item 13.	Certain Relationships and Related Transactions, and Director Independence	86
Item 14.	Principal Accountant Fees and Services	86
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	86
	Signatures	88

EXHIBIT 2.1
EXHIBIT 21.1
EXHIBIT 23.1
EXHIBIT 31.1
EXHIBIT 31.2
EXHIBIT 32.1

Table of Contents

PART I

ITEM 1. BUSINESS

Overview

Informatica Corporation (Informatica) is a leading provider of enterprise data integration software and services that enable organizations to gain greater business value by integrating their information assets. Informatica software handles a wide variety of complex enterprise-wide data integration initiatives, including data migration, data consolidation, data synchronization, data warehousing, establishment of data hubs, data services, cross-enterprise data exchange, and data quality. The Informatica enterprise data integration platform enables and accelerates data integration initiatives, allowing enterprises to meet new business requirements by utilizing cost-effective information technology (IT) systems; to reduce overall IT expenses by extending and adapting IT systems; and to implement best practices. We have also recently introduced solutions with partners designed to meet the on-demand data needs of the software-as-a-service market. Using our products, business users gain a holistic and consistent view of their enterprise information. IT management can be more responsive to the business demands for information despite dramatically increasing data volumes and real-time delivery requirements and IT developers benefit from reduced time to results and significant productivity gains.

Over the last two decades, companies have made significant investments in process automation resulting in islands of data created by a variety of packaged transactional applications such as enterprise resource planning (ERP), customer relationship management (CRM), and supply chain management (SCM) software and custom operational systems deployed in various departments. The ultimate goal of deploying these applications was to make businesses more efficient through automation. However, these applications have further increased data fragmentation throughout the enterprise because they generate massive volumes of data in disparate software systems that were not designed to share data. As these systems have proliferated, the challenge of data fragmentation has intensified, leaving companies to grapple with multiple data silos, multiple data formats, multiple data definitions and, most notably, highly varied data quality.

Organizations are now finding that the strategic value of information technology goes far beyond process automation. Organizations of all sizes require information to run their business, and most information is derived from data. Operational activities generate a constant flow of data inside and outside the enterprise, but unless the various data streams can be integrated, and the quality of that data assured, the amount of real, useful business information derived from such data is limited. Companies are realizing that they must integrate a wide variety of data structured, semi-structured, and unstructured to support their business processes, such as providing a single view of the customer, migrating away from legacy systems to new technologies, or consolidating multiple instances of an ERP system. They are also realizing that they must implement data quality processes to measure, monitor, track, and improve the quality of data delivered to the business. The current climate of industry consolidation and corporate divestitures adds to the need facing many organizations: the need to migrate, integrate, and ensure the quality of their data.

With Informatica s robust enterprise data integration platform, business and IT decision makers can facilitate sophisticated information delivery across the enterprise. Based on an open, platform-neutral architecture, the Informatica platform is designed to access, discover, cleanse, and integrate data from a large variety of enterprise systems, in a wide variety of formats, and deliver that data throughout the enterprise. The Informatica platform addresses the challenges of data integration as a mission-critical, enterprise-wide solution to complex problems such as migrating off of legacy systems, consolidating application instances, and synchronizing data across multiple operational systems.

We have more than 2,700 customers representing a worldwide variety of industries, ranging from high technology and financial services to manufacturing and telecommunications. We market and sell our software and services through our global direct sales force in North America (consisting of the United States and Canada), Europe (including France, Germany, the Netherlands, Switzerland, Ireland, and the United Kingdom), and Asia-Pacific (including Australia, China, Japan, India, South Korea, Singapore, and Taiwan). We maintain relationships with a variety of strategic partners to jointly develop, market, sell, recommend, and/or implement our solutions. We also have relationships with distributors in various regions, including Europe, Asia-Pacific, and Latin America who sublicense our products and provide services and support within their territories. More than 20 independent software vendors, including several of our strategic partners, have licensed our technology for inclusion in their products.

We began selling our first products in 1996. Through December 31, 2006, substantially all of our revenues have been derived from the sale of our data integration products (and related services): Informatica PowerCenter, Informatica PowerExchange, Informatica Data Explorer, and Informatica Data Quality.

Table of Contents

Our corporate headquarters are located at 100 Cardinal Way, Redwood City, California 94063, and our telephone number at that location is (650) 385-5000. We can be reached at our Web site at *www.informatica.com*; however, the information in, or that can be accessed through, our Web site is not part of this Report. We were incorporated in California in February 1993 and reincorporated in Delaware in April 1999.

Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act) are available, free of charge, on our Web site as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). The SEC also maintains a Web site that contains our SEC filings. The address of the site is *www.sec.gov.*

Recent Developments

On January 26, 2006, we acquired Similarity Systems Limited (Similarity), a provider of a software product suite that includes data profiling, data standardization, data cleansing, data matching, and data quality monitoring. We have extended our enterprise data integration platform by working to incorporate certain components of Similarity s product suite, including its patented data quality technology.

On March 8, 2006, we issued and sold convertible senior notes with an aggregate principal amount of $230 million due in 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.

On December 15, 2006, we acquired Itemfield, Inc. (Itemfield), an innovative provider of data transformation technologies that enable near-universal access to unstructured and semi-structured data. Incorporation of such technology extends our data integration platform to allow customers to integrate these data sources with traditional structured data sources. With the acquisition of Itemfield, Informatica gained 59 employees, based primarily in Israel and the United States.

Our Products

Our products are designed to enable customers to gain greater business value by integrating their information assets. We help our customers simplify their IT infrastructure by providing a unified platform for all enterprise data integration initiatives.

Our data integration platform is designed to empower the business user with holistic information, reduce the cost and complexity of enterprise IT infrastructure for the IT manager, provide increased productivity to IT practitioners to improve their responsiveness to the business, and deliver those capabilities through a service-oriented architecture to enable the IT architect to maximize existing and future technical environments.

For the business customer, our products deliver complete, accurate, and timely information. Our products provide near-universal access to enterprise data structured data in databases as well as unstructured and semi-structured enterprise data locked in documents and industry-specific data formats. Our products feature the unique ability to access batch, federated, and changed data from mainframe, legacy, and relational systems and deliver that data at the frequency demanded by the business. In addition, our products provide a comprehensive data quality solution to ensure the accuracy and integrity of information delivered to the business.

For the IT manager, our products reduce risk and cost by providing a highly secure, scalable, and high performance environment, with the flexibility to deploy on a wide variety of operating systems including Windows, UNIX, Linux, and mainframe systems, including ADABAS, DB2, IMS, and VSAM. We also run on 64-bit hardware and we facilitate complete user authentication, granular privacy management, and encryption in data transport. We deliver near-linear scalability, fully parallel processing, and a unique ability to deploy a set of business logic across a heterogeneous grid of operating platforms to accommodate the most demanding of large and growing global organizations. For the IT architect, our products are based on a service-oriented architecture that is metadata-driven for flexibility and Web services enablement. Our products are fully extensible through open application program interfaces (APIs) and are designed to be interoperable to accommodate existing IT standards and future IT architectures.

For the IT practitioner, our products supply a highly productive environment with complete version control and configuration management that enables individuals to work collaboratively across teams, multiple projects, and

geographically dispersed locations, including onshore/offshore and in-source/out-source models. In addition, our metadata-driven environment accelerates initial design and evolution by providing data profiling, search, impact analysis, and high reuse of development assets via our patented global and local object management technology, so that work can be designed once, deployed anywhere across a network of installations.

Products included in the Informatica platform are summarized below:

PowerCenter 8 Standard Edition **(SE)** is a single, unified enterprise data integration platform that consists of a high-performance, highly available, and secure data server, a global metadata infrastructure, and a Graphical User Interface based (GUI-based) development and administration tools.

PowerCenter 8 Advanced Edition **(AE)** supports development of a wide spectrum of data integration initiatives, including Integration Competency Centers, by expanding the breadth of PowerCenter SE with Metadata Manager, a powerful metadata analysis feature, Team-based Development, and Data Analyzer, which affords Web-based reporting capabilities.

Informatica PowerExchange provides on-demand access to data in all critical enterprise data systems, including mainframe, midrange, and file-based systems, and makes it available without requiring manual coding of data extraction programs. Tightly integrated with Informatica PowerCenter, PowerExchange simplifies data integration for even the most complex data sources.

Informatica Data Explorer puts powerful, easy-to-use data profiling and mapping capabilities in the hands of the business user. Data analysts and data stewards use the software to create a complete and accurate picture of the content, quality, and structure of enterprise data, which is used as the foundation for addressing data quality enterprise-wide.

Informatica Data Quality is specifically designed to put the control of data quality processes in the hands of the business user. The software delivers powerful data cleansing, matching, and reporting and monitoring capabilities in a single solution, empowering business information owners to implement and manage effective and lasting data quality processes enterprise-wide.

Additional Options. Informatica offers 10 PowerCenter options to extend the data integration platform s core capabilities. These options are available with either PowerCenter Standard Edition or PowerCenter Advanced Edition:

1. **Data Cleanse and Match Option** supplies powerful, integrated cleansing and matching capabilities. This option corrects and removes duplicate customer data to maximize the value of an organization s information assets.

2. **Data Federation Option** provides virtual data federation services or Enterprise Information Integration (EII) capabilities. Combining traditional physical and virtual data integration approaches in a single platform, this option creates a powerful tool for delivering holistic data quickly, easily, and cost-effectively.

3. **Data Profiling Option** offers comprehensive, accurate information about the content, quality, and structure of data in virtually any operational system.

4. **Enterprise Grid Option** provides scalability within a grid computing environment. This option reduces the administrative overhead of supporting a grid. It also delivers optimal performance by automatically load balancing in response to runtime changes in data volumes or node utilization rates.

5. **High Availability Option** provides high availability and seamless failover and recovery of all PowerCenter components. This option minimizes service interruption in the event of a hardware and/or software outage and reduces costs associated with data downtime.

6. **Mapping Generation Option** provides the ability to automatically generate PowerCenter data integration mappings from best practice templates, as well as the ability to reverse-engineer existing mappings into reusable template form. This option increases developer productivity, reduces time-to-results, and simplifies the data integration lifecycle.

7. **Metadata Exchange Options** coordinate technical and business metadata from data modeling tools, business intelligence tools, source and target database catalogs, and PowerCenter repositories. This family of options helps organizations leverage the time and effort already invested in defining data structures.

8. **Partitioning Option** executes optimal parallel sessions by dividing data processing into subsets that run in parallel and are spread among available CPUs in a multi-processor system. This option helps organizations maximize their technology investments by enabling hardware and software to jointly scale to handle large volumes of data and users.

9. **PowerCenter Connect Options** extend broad connectivity to enterprise data. This family of options eliminates the need for manually coding data extraction programs and ensures that mission-critical operational data can be leveraged across the enterprise.

10. **Pushdown Optimization Option** enables data transformation processing, where appropriate, to be pushed down into any relational database. This option saves hardware costs by making better use of existing database assets and helps organizations cost-effectively scale to meet increased data demand.

    Real Time Option extends PowerCenter s capabilities to transform and process operational data in real time. This option helps organizations integrate real-time operational data with historical information stored in enterprise data warehouses, powering business processes and accelerating decision-making.

    Unstructured Data Option expands PowerCenter s data access capabilities to include unstructured and semi-structured data formats. This option provides organizations with virtually unlimited access to all enterprise data formats, creating a powerful tool to help organizations achieve a holistic view of data, increase IT productivity, and achieve regulatory compliance.

Services

Informatica offers a comprehensive set of services, including product-related customer support, consulting services, and education services. Through strategically located Support Centers in the United States, the United Kingdom, the Netherlands, and India, we support Informatica software deployment be it a regional installation or a geographically-dispersed project. Informatica s Global Customer support offers a well-engineered and comprehensive set of support programs tailored to fit customer needs. Customers and partners can access our 24x7 technical support over the phone using toll-free lines, via email, and online through Informatica s Web portal my.informatica.com.

Our consulting services range from the initial configuration of our products with knowledge transfer to customers and partners to designing and implementing custom data integration/transformation solutions, to project audit and performance tuning services, to helping customers implement best practices for their integration competency centers (ICCs). ICCs are a shared IT function that enables project teams to complete data integration efforts rapidly and efficiently by following best-practice processes, leveraging the expertise of staff with integration-specific roles, and using standard technologies. Our consulting strategy is to provide specialized expertise on our products to enable our customers and partners to successfully implement their customized business solutions using our data integration products.

Informatica professional services consultants use a services methodology called Informatica Velocity to guide the successful implementation of our data integration software. Our services methodology reflects the best practices that

Informatica has developed and refined through hundreds of successful data integration projects. Informatica Velocity covers each of the major implementation project phases, including manage, analyze, design, build, test, deploy, and operate. Where applicable, Informatica Velocity includes technical white papers as well as sample project documentation and even sample implementations (mappings) of specific technical solutions.

Informatica also offers a comprehensive role-based curriculum of product and solution-related education services to help our customers and strategic partners build proficiency in using our products. We have established the Informatica Certification Program to create a database of expert professionals with verifiable skills in the design and administration of Informatica-based systems.

Our Strategic Partners

Informatica s strategic partners include industry leaders in enterprise software, computer hardware, and systems integration. We offer a comprehensive strategic partner program for major companies in these areas so that they can provide sales and marketing leverage, have access to required technology, and furnish complementary products and services to our joint customers. Our strategic business partners that resold and/or influenced more than $2,000,000 each in license and services orders in 2006 are Accenture, BearingPoint, Capgemini, Deloitte Consulting, EDS, Hewlett-Packard, Infosys, Lockheed Martin, SAP, Tata Consultancy Services, Teradata, and Wipro. Our original equipment manufacturer (OEM) partners that generated more than $400,000 in license revenues for us in 2006 are Hyperion and Oracle.

Our Customers

More than 2,700 companies worldwide rely on Informatica for their end-to-end enterprise data integration needs. Our customers represent a wide range of corporations and governmental and educational institutions. Our targeted markets include energy and utilities, financial services, government and public sector, healthcare, high technology, insurance, manufacturing, retail, services, telecommunications, and transportation. No single customer accounted for 10% or more of our total revenues in 2006, 2005, or 2004.

Our Market Strategy

Broader Enterprise Data Integration: Beyond the Data Warehouse. Our goal is to be the market leader in the enterprise data integration market which includes data migration, data consolidation, data synchronization, data warehousing, the establishment of data hubs, data services, cross-enterprise data exchange, and data quality. Our strategy is to grow at a rate faster than the market by leveraging our success, knowledge, and the strength of our proven products that have helped our customers deploy thousands of large data warehouse and data integration initiatives. We address the growing enterprise data integration market with a product set that we believe is well-suited to rapidly deliver value to our customers.

Data Quality: Strategic Product and Market Opportunity. Poor quality data has become a fundamental problem for large organizations. Data that is incomplete, inconsistent, and inaccurate leads to information that cannot be trusted to make business decisions or improve business operations. Informatica believes that improving the quality of data is an integral part of data integration and doing so involves a life-cycle-based approach to achieve optimal results. On January 26, 2006, Informatica acquired Similarity Systems Limited, a recognized technology leader in data quality. During 2006, we integrated the products acquired with Similarity into our core product line (PowerCenter) and made available new standalone versions of these new data quality products.

Horizontal Data Integration Solutions: Migration and Consolidation. The data migration phase of an application implementation, upgrade, or instance consolidation project can extend to multiple years, is often underestimated in complexity and cost, and requires rigorous project planning and significant manual effort. Detailed project planning is required because organizations have traditionally underestimated the challenges involved in the data migration process, including the quality of the data being migrated and the high cost of system maintenance, administration, and development. Organizations now increasingly recognize the need for an enterprise data integration platform to automate the data migration and consolidation of IT systems. We believe that along with our strategic system integrator partners, we can address this growing requirement by providing customers with a tailored solution, including software and services to speed the deployment of data migration and consolidation initiatives.

Informatica On Demand: Solving the Cross-Enterprise Data Integration Challenge. Today, nearly every organization must manage a growing amount of data that resides outside its own IT network. Most of this data is off-premise, within the systems and services of outsourced providers, such as information technology outsourcers (ITO) and business process outsourcers (BPO) as well as software-as-a-service (SaaS) providers. Although these outsourced services are helping to drive a new level of efficiency and agility into organizations of every size, managing the resulting outsourced enterprise data can be a challenge. For several years, Informatica has worked with leading ITO and BPO providers to ensure the data they create and manage (on behalf of an enterprise customer) can be integrated with the enterprise data that resides in on-premise systems, using PowerCenter. This past year, Informatica has made available its first in a series of intelligent connectors that enable a PowerCenter customer to access and integrate all of the data that exists within a SaaS provider s system (off-premise) with the enterprise data that resides in its on-premise systems. This first connector has been released for the salesforce.com SaaS environment and is certified within salesforce.com s AppExchange partner framework.

Complex Data Exchange: Integrating Additional Data Formats. Organizations are inundated with complex data that is proliferating rapidly in volume and diversity. Complex data includes unstructured data (spreadsheets, documents, print streams), semi-structured data (HL7, EDI, HIPAA, SWIFT), and complex structured data (MISMO, ACORD XML) and contains increasingly important and high-value business information. A high percentage of corporate financial information is maintained in complex data formats, such as spreadsheets. Business drivers, such as regulatory compliance (e.g., Sarbanes-Oxley) and operational efficiency, rely on high-performance, mission-critical applications that require translation among a variety of complex formats. Informatica provides translation of these complex formats to a structured format for processing and then back out to complex formats for distribution.

Customers and Developers: Leveraging Installed Base and Community to Extend Informatica s Presence. We have an installed customer base that spans a wide range of industries. As of December 31, 2006, more than 2,700 customers worldwide and 85 of the Fortune 100 companies had licensed our products. The Informatica s Developer Network, created in 2001, has grown to nearly 30,000 members in over 100 countries using our products as a platform on which to build or customize a specific data integration solution. These developers extend Informatica s presence and profile in the broad data integration market and provide a network of knowledge that can be shared to amplify our brand and its influence.

Partnerships and Strategic Alliances: Extending the Ecosystem. We have alliances and strategic partnerships with leading enterprise software providers, systems integrators, and hardware system vendors. These alliances furnish sales and marketing support, and access to required technology, while also providing complementary products and services for our joint customers. More than 300 companies help market, resell, or implement Informatica s solution around the world. Additionally, more than 20 companies now embed our core products into their own, enabling their customers to benefit from the enterprise-class data integration we provide within their products.

Sales, Marketing, and Distribution

We market and sell software and services through both our direct sales force and indirect channel partners in North America, Europe, Asia-Pacific, Latin America, and other regions around the world. As of December 31, 2006, we employed 431 people in our sales and marketing organization worldwide.

Marketing programs are focused on creating awareness of Informatica and its products and services, generating interest among new customers as well as interest in new products within existing customers, documenting compelling customer references, and creating up-sell/cross-sell opportunities for our products. These programs are targeted at key executives such as chief information officers, vice presidents of IT, and vice presidents of specific functional areas, such as marketing, sales, service, finance, human resources, manufacturing, distribution, and procurement, as well as enterprise architects, and other key IT professionals focused on data integration. Our marketing personnel engage in a variety of activities, including positioning our software products and services, conducting public relations programs, establishing and maintaining relationships with industry analysts, producing collateral that describes our products, services, and solutions, and generating qualified sales leads.

Our global sales process consists of several phases: lead generation, opportunity qualification, needs assessment, product demonstration, proposal generation, and contract negotiation. Although the typical sales cycle requires three to six months, some sales cycles have lasted substantially longer. In a number of instances, our relationships with systems integrators and other strategic partners have reduced sales cycles by generating qualified sales leads, making initial customer contacts, assessing needs prior to our introduction to the customer and endorsing our products to the customer before their product selection. Also, partners have assisted in the creation of presentations and demonstrations, which we believe enhances our overall value proposition and competitive position.

In addition to our direct sales efforts, we distribute our products through systems integrators, resellers, distributors, and OEM partners in the United States and internationally. Systems integrators typically have expertise in vertical or functional markets. In some cases, they resell our products, bundling them with their broader service offerings. In other cases, they influence direct sales of our products. Distributors sublicense our products and provide service and support within their territories. OEMs embed portions of our technology in their product offerings.

Research and Development

As of December 31, 2006, we employed 330 people in our research and development organization. This team is responsible for the design, development, and release of our products. The group is organized into four disciplines: development, quality assurance, documentation, and product management. Members from each discipline, along with a

product-marketing manager from our marketing department, form focus teams that work closely with sales, marketing, services, customers, and prospects to better understand market needs and user requirements. These teams utilize a well-defined software development methodology that we believe enables us to deliver products that satisfy real business needs for the global market while also meeting commercial quality expectations.

When appropriate, we also use third parties to expand the capacity and technical expertise of our internal research and development team. On occasion, we have licensed third-party technology. We believe this approach shortens time to market without compromising competitive position or product quality, and we plan to continue drawing on third-party resources as needed in the future.

Approximately 40% of Informatica s research and development team is based in the United States and the remainder is based in India, Ireland, Israel, the Netherlands, and the United Kingdom. The international development teams are focused on development and quality assurance work of our data integration technologies. Our international development effort is intended to increase development productivity and deliver innovative product capabilities. Our research and development expenditures were $55.0 million in 2006, $42.6 million in 2005, and $51.3 million in 2004.

Future Revenues (New Orders, Backlog, and Deferred Revenue)

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. However, our backlog typically decreases from the prior quarter at the end of the first and third quarters and increases at the end of the fourth quarter. Aggregate backlog and deferred revenues at December 31, 2006 were approximately $118.1 million compared to $104.2 million at December 31, 2005. This increase in 2006 was primarily due to an increase in deferred maintenance revenues and, to a lesser extent, an increase in license orders awaiting shipment, and shipped orders where revenue is recognized upon cash receipt. Backlog and deferred revenues as of any particular date are not necessarily indicative of future results.

Competition

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 vendors of point integration solutions typically used for departmental deployment, including Embarcadero Technologies, Group 1 Software, IBM, SAS Institute, and Ab Initio, as well as various other privately held companies. We also compete with business intelligence vendors that offer data integration solutions for their combined data warehousing and business intelligence offerings, such as Business Objects, and to a lesser degree, Cognos 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. With regard to Data Quality, we compete against Trillium, SAS Institute, as well as various other privately held companies.

We currently compete on the basis of the breadth and depth of our products functionality as well as on the basis of price. Additionally, we compete on the basis of certain other factors, including neutrality, dependability, innovation, quality of products, services, support, and versatility.

We believe that we currently compete favorably with respect to the above factors. For a further discussion of our competition, see Risk Factors *If we do not compete effectively with companies selling data integration products, our revenues may not grow and could decline* in Item 1A.

Seasonality

Our business is influenced by seasonal factors, largely due to customer buying patterns. In recent years, we have generally had weaker demand for our software products and services in the first and third quarters of the year and seasonally strong demand in the fourth quarter. Our consulting and education services have sometimes been negatively impacted in the fourth and first quarters of the year due to the holiday season and internal meetings, which result in fewer billable hours for our consultants and fewer education classes.

Intellectual Property and Other Proprietary Rights

Our success depends in part upon our proprietary technology. 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. As part of our confidentiality procedures, we generally enter into non-disclosure agreements with our employees, distributors, and corporate partners and into license agreements with respect to our software, documentation, and other proprietary information. In addition, we have 14 patents granted in the United States, one patent granted in the European Union, 1 patent granted in Ireland, 7 patent applications pending in the United States, and 16 corresponding international patent applications pending.

Nonetheless, our intellectual property rights may not be successfully asserted in the future or may be invalidated, circumvented, or challenged. In addition, the laws of various foreign countries where our products are distributed do not protect our intellectual property rights to the same extent as U.S. laws. Our inability to protect our proprietary information could harm our business.

Employees

As of December 31, 2006, we had a total of 1,221 employees, including 330 people in research and development, 431 people in sales and marketing, 318 people in consulting, customer support, and education services, and 142 people in general and administrative services. None of our employees is represented by a labor union. We have not experienced any work stoppages, and we consider employee relations to be good.

ITEM 1A. RISK FACTORS

In addition to the other information contained in this Form 10-K, 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.

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 (which acquired FirstLogic), Embarcadero Technologies, IBM (which acquired Ascential Software), Oracle (which acquired Sunopsis), 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 Business Objects, and to a lesser degree, Cognos 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 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 generally available version of PowerCenter 8, 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 the following:

- 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;
- 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.

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, our backlog of license orders at the end of a given fiscal period has tended to vary. Historically, our backlog typically decreases from the prior quarter at the end of the first and third quarters and increases from the prior quarter at the end of the fourth quarter.

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 began expanding our international operations in 2005 and we have recently opened new sales offices in Brazil, China, India, Japan, South Korea and Taiwan. As a 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 2006. We expect these investments to increase our revenues, sales productivity, and eventually our 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. While we have experienced some increases in revenue and productivity in the United States, we have not yet achieved such increases in productivity internationally.

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.

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. We experienced an increase in the size of our sales pipeline and some increases in our pipeline conversion rate in 2005 and 2006 as a result of our increased investment in sales personnel and a gradually improving IT spending environment that continued in 2006. However, the size of our sales pipeline and our conversion rate are not consistent on a quarter to quarter basis and our conversion rate declined slightly in the third quarter of 2006 before increasing in the fourth quarter of 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.

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 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. We have also recently expanded and extended our OEM relationship with Oracle.

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 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.

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, Ireland, Israel, 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 India, the Netherlands, and the United Kingdom. Additionally, we have recently opened sales offices in Brazil, China, India, Japan, South Korea, and Taiwan, 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, and in order to meet the requirements of certain markets, particularly some in Asia, our product must be double-byte enabled. Developing internationalized 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 internationalizing products and in testing whether these internationalized products will be accepted in the target countries. We cannot ensure that our internationalization 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, Ireland, Israel, the Netherlands, and the United Kingdom also subject our business to certain risks, including the following risks:

- 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, Ireland, Israel, the Netherlands, and the United Kingdom as a result of time zone differences, which may delay the development, testing, or release of new products;
- greater difficulty in relocating existing trained development personnel and recruiting local experienced personnel, and the costs and expenses associated with such activities; and
- increased expenses incurred in establishing and maintaining office space and equipment for the development centers.

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

- greater risk of uncollectible accounts and longer collection cycles;
- greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;
- greater risk of a failure of our foreign employees to comply with both U.S. and foreign laws, including antitrust regulations, the Foreign Corrupt Practices Act, and any trade regulations ensuring fair trade practices;
- 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, South 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 s assessment of our internal control over financial reporting as of the end of our fiscal year 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 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 have been met. We also have provided business practices training to our sales teams. 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 for our adoption of Financial Accounting Standards Board Interpretations (FIN 48) No. 48, Accounting for Uncertainty in Income Taxes, further add to the reporting complexity and increase the potential risks of our ability to maintain the effectiveness of our internal controls. Overall, the combination of our increased complexity and the ever increasing regulatory complexity make it more critical for us to attract and retain qualified and technically competent finance employees.

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.

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 addition of Brian 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 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. Additionally, we expect growth in the areas of data quality and on-demand (SaaS) offerings. 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 these markets do 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.

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 have experienced the adverse effect of economic slowdowns in the past 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.

If the U.S. economy does not continue to grow, 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. Any further economic slowdown in Europe could adversely affect our pipeline conversion rate, which could impact our ability to meet our revenue expectations. 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 and our Itemfield acquisition, we intend to further integrate Similarity s data quality technology and Itemfield s data transformation technologies 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 and Itemfield s data transformation technologies, 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;
- changes in earnings estimates and recommendations by securities analysts;
- developments in our industry; and
- changes in accounting rules.

16

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 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 had and will continue to have a significant adverse impact on our consolidated results of operations. See subsection, *Share-Based Payments* in Note 2, *Summary of Significant Accounting Policies*. 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 is not predictable because the underlying assumptions, including volatility, interest rate, and expected life, of the Black-Scholes model could vary over time. Further, our forfeiture rate might vary from quarter to quarter due to change in employee turnover.

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.

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 2006, 2005, and 2003, when we had net income of $36.2 million, $33.8 million and $7.3 million, respectively, since our inception we have incurred significant annual net losses, resulting in an accumulated deficit of $125.1 million as of December 31, 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.

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. See Note 16. *Litigation* in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report. Litigating claims related to the enforcement of proprietary rights is 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:

- 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 also must determine 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.

To date, we have provided a full valuation allowance against our net deferred tax assets based on our historical operating performance and our cumulative net losses. Our tax rate in 2006 was significantly reduced through the realization of these deferred tax assets. Based on our current expectations, it is likely that some portion of our deferred tax assets will be supportable by either refundable income taxes or future taxable income. A majority of the remaining deferred tax assets is stock option related, the benefit of which is recorded in stockholders equity. These deferred tax assets will not provide a reduction in the Company s effective tax rate. Accordingly, we expect our effective tax rate to increase in 2007.

We may not successfully integrate Similarity s or Itemfield s technologies, employees, or business operations with our own. As a result, we may not achieve the anticipated benefits of our acquisitions, 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, and in December 2006, we acquired Itemfield, a provider of data transformation technologies. The successful integration of Similarity s and Itemfield s technologies, employees, and business operations will place an additional burden on our management and infrastructure. These acquisitions, and any others we may make in the future, will subject us to a number of risks, including:

- n the failure to capture the value of the businesses we acquired, including the loss of any key personnel, customers, and business relationships;
- n 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;
- n the assumption of any contracts or agreements from Similarity and/or Itemfield that contain terms or conditions that are unfavorable to us; and
- n the potential impairment of our goodwill and a need for a subsequent write-off or write-down of our goodwill balance based upon a failure to meet our revenue goals and objectives in the future in relation to our company market value.

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, our Itemfield 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, and in December 2006 we announced our acquisition of Itemfield. 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. 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 7. *Facilities Restructuring Charges* of Notes to Consolidated Financial Statements in Part II, Item 8 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. Recently some of our facilities in Asia experienced disruption as a result of the December 2006 earthquake off the coast of Taiwan, which caused a major fiber outage throughout the surrounding regions. The outage affected network and Voice-Over-Internet Protocol (VOIP) connectivity, which has been restored to acceptable levels, though not completely to the pre-earthquake levels. Such disruption can negatively affect our operations given necessary interaction among our international facilities. In the event such an earthquake reoccurs, it could again disrupt the operations of our affected facilities. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of our 2006 fiscal year and that remained unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in a leased facility at the Seaport Plaza in Redwood City, California and consist of approximately 159,000 square feet; the lease will expire in December 2007 (with a three-year renewal option). The facility is used by our administrative, sales, marketing, product development, customer support, and services groups.

We also occupy additional leased facilities in the United States including offices located in Austin and Plano, Texas; Chicago, Illinois; and New York, New York, which are primarily used for sales, marketing, services and, to a lesser degree, product development. Leased facilities located outside of the United States and used primarily for sales, marketing, customer support, and services include offices in Toronto, Canada; Paris, France; Frankfurt and Munich,

Germany; Nieuwegein, the Netherlands; Maidenhead, the United Kingdom; Sydney, Australia; Beijing, China; Seoul, South Korea; Dublin, Ireland; Tel Aviv, Israel; Tokyo, Japan; and Singapore. We also leased facilities in Bangalore, India where our offices are primarily used for product development. In addition, we lease executive office space throughout the world for our local sales and services needs. These leased facilities expire at various times through February 2010. We are continually evaluating the adequacy of existing facilities and additional facilities in new cities, and we believe that suitable additional space will be available in the future on commercially reasonable terms as needed.

We also lease certain facilities that we no longer occupy because they exceed our current requirements. Currently, we sublease these facilities to third parties. See Note 7. Facilities Restructuring Charges, and Note 9. Commitments and Contingencies of Notes to the Consolidated Financial Statements in Item 8 of this Report.

ITEM 3. 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.

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.

In September 2005, the Court granted preliminary approval of the settlement. The Court held a hearing to consider final approval of the settlement on April 24, 2006, and took the matter under submission. The court will resume consideration of whether to grant final approval to the settlement following further appellate review, if any, of the decision in *In re Initial Public Offering Securities Litigation*, ___ F.3d ___, 2006 WL 3499937 (2d Cir. Dec. 5, 2006).

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. On October 11, 2006, in response to the parties cross-motions for summary judgment, the Court ruled that U.S. Patent No. 6,044,374 was not infringed as a matter of law. However, the Court found that there remain triable issues of fact as to infringement and validity of the three remaining patents. On February 26, 2007, as stipulated by both parties, the Court dismissed the infringement claims on U.S. Patent No. 6,208,990 as well as BODI s counterclaims on this patent. Informatica is preparing for trial, which has been set for March 12, 2007, on the remaining two patents (U.S. Patent No. 6,014,670 and U.S. Patent No. 6,339,775) originally asserted in 2002. 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.

Table of Contents

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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006

Executive Officers of the Registrant

The following table sets forth certain information concerning our executive officers as of January 31, 2007:

Name	Age	Position(s)
Sohaib Abbasi	50	Chairman of the Board, Chief Executive Officer and President
Earl Fry	48	Chief Financial Officer, Executive Vice President, and Secretary
Paul Hoffman	56	Executive Vice President, Worldwide Field Operations
Girish Pancha	42	Executive Vice President, Products
Brian Gentile	43	Chief Marketing Officer, Executive Vice President of Marketing

Our executive officers are appointed by, and serve at the discretion of, the Board of Directors. Each executive officer is a full-time employee. There is no family relationship between any of our executive officers or directors.

Mr. Abbasi has been our President and Chief Executive Officer since July 2004 and a member of our Board of Directors since February 2004. From 2001 to 2003, Mr. Abbasi was Senior Vice President, Oracle Tools Division and Oracle Education at Oracle Corporation, which he joined in 1982. From 1994 to 2000, he was Senior Vice President Oracle Tools Product Division at Oracle Corporation. Mr. Abbasi graduated with honors from the University of Illinois at Urbana-Champaign in 1980, where he earned both a B.S. and an M.S. degree in computer science.

Mr. Fry joined us as the Chief Financial Officer and Senior Vice President in December 1999. In July 2002, Mr. Fry became the Secretary. In August 2003, Mr. Fry was promoted to Executive Vice President. From November 1995 to December 1999, Mr. Fry was Vice President and Chief Financial Officer at Omnicell Technologies, Inc. From July 1994 to November 1995, he was Vice President and Chief Financial Officer at C*ATS Software, Inc. Mr. Fry holds a B.A. degree in accounting from the University of Hawaii and an M.B.A. degree in finance and marketing from Stanford University. Mr. Fry serves on the Board of Directors of Central Pacific Financial Corp.

Mr. Hoffman joined us as Executive Vice President, Worldwide Sales in January 2005. Mr. Hoffman was Executive Vice President of Worldwide Sales at Cassatt Corporation from August 2003 to December 2004. From April 1999 to June 2003, Mr. Hoffman was Vice President of the Americas at SeeBeyond Technology Corporation. He served as Vice President Worldwide Sales for Documentum from September 1996 to April 1999. Mr. Hoffman also spent 10 years at Oracle Corporation in senior sales management and executive-level positions, including the Vice President of Worldwide Operations. Mr. Hoffman holds a B.S. degree in finance from Fairfield University.

Mr. Pancha was an early employee of Informatica, serving in engineering management roles from November 1996 to October 1998. Mr. Pancha left in 1998 to co-found Zimba, a developer of mobile applications providing real-time access to corporate information via voice, wireless, and Web technologies. Upon Informatica s acquisition of Zimba in August 2000, Mr. Pancha rejoined us as Vice President and General Manager of the Platform Business Unit. In August 2002, he became Senior Vice President of Products. In August 2003, Mr. Pancha was promoted to Executive Vice President. Prior to Informatica, Mr. Pancha spent eight years in various development and management positions at Oracle. Mr. Pancha holds a B.S. degree in electrical engineering from Stanford University and an M.S. degree in electrical engineering from the University of Pennsylvania.

Mr. Gentile joined Informatica in March 2006. Most recently, Mr. Gentile was Senior Vice President and Chief Marketing Officer at Aspect Communications from 2004 to 2006. Before joining Aspect, Mr. Gentile was Executive Vice President and Chief Marketing Officer at Brio Software from 2001 to 2003. He also served as Vice President of Global Marketing at Ariba from 2000 to 2001. Additionally, Mr. Gentile held two executive positions at Sun Microsystems. He also spent nearly nine years at Apple Computer in a variety of sales and technical marketing assignments. Mr. Gentile holds a B.S. degree in business administration from the University of Arizona and an M.B.A. degree from Arizona State University.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Price Range of Common Stock

Our common stock is listed on the NASDAQ Global Select Market under the symbol INFA. Our initial public offering was April 29, 1999 at $4.00 per share (adjusted for stock splits in the form of stock dividends in February 2000 and November 2000). The price range per share in the table below reflects the highest and lowest sale prices for our stock as reported by the NASDAQ Global Select Market during the last two fiscal years.

	High	Low
Year ended December 31, 2006:		
Fourth quarter	$ 14.29	$ 11.37
Third quarter	$ 16.24	$ 11.60
Second quarter	$ 17.00	$ 12.40
First quarter	$ 17.07	$ 11.98
Year ended December 31, 2005:		
Fourth quarter	$ 12.63	$ 10.20
Third quarter	$ 12.54	$ 8.35
Second quarter	$ 9.02	$ 7.23
First quarter	$ 8.50	$ 6.99

Holders of Record

At January 31, 2007, there were approximately 141 stockholders of record of our common stock, and the closing price per share of our common stock was $12.56. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Table of Contents

Dividends

We have never declared or paid cash dividends on our common stock. Because we currently intend to retain all future earnings to finance future growth, we do not anticipate paying any cash dividends in the near future.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

In March 2006, we issued and sold convertible senior notes with an aggregate principal amount of $230 million due in 2026 (Notes). We used approximately $50 million of the net proceeds from the offering to fund the purchase of 3,232,062 shares of our common stock concurrently with the offering of the Notes.

In April 2006, the Board of Directors authorized us to repurchase of up to $30 million of our common stock at any time until April 2007. The following table provides information about the repurchase of our common stock for the 9 months ended December 31, 2006. See Note 10. Stockholders Equity in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report.

Period	(1) Total Number of Shares Purchased		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		(2) Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (in thousands)
April 24 - 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
July 1 - July 31	110,000	$	13.22	110,000	$	16,944
August 1 - August 31	283,000	$	13.85	283,000	$	13,025
September 1 - September 30	-	$	-	-	$	13,025
October 1 - October 31	295,000	$	12.53	295,000	$	9,328
November 1 - November 30	640,000	$	12.36	640,000	$	1,416
December 1 - December 31	-	$	-	-	$	1,416
Total	2,133,000	$	13.40	2,133,000		

(1) All shares repurchased in open-market transactions under the repurchase program.
(2) We announced the repurchase program in April 2006. It authorizes the repurchase of up to $30 million of our common stock at any time until April 2007.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data is qualified in its entirety by, and should be read in conjunction with, the consolidated financial statements and the notes thereto included in Part II Item 8, and Management s Discussion and Analysis of Financial Condition and Results of Operations included in Item 7. The selected consolidated statements of operations data and consolidated balance sheet data as of and for each of the five years in the period ended December 31, 2006, have been derived from the audited consolidated financial statements. All share and per share amounts have been adjusted to give retroactive effect to stock splits that have occurred since our inception.

Table of Contents

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Selected Consolidated Statements of Operations Data:					
Revenues:					
License	$ 146,092	$ 120,182	$ 97,941	$ 94,590	$ 99,943
Service	178,506	147,249	121,740	110,943	95,498
Total revenues	324,598	267,431	219,681	205,533	195,441
Cost of revenues:					
License	6,978	4,465	3,778	3,139	6,185
Service (1)	58,402	46,801	40,346	38,856	39,250
Amortization of acquired technology	2,118	922	2,322	1,031	1,040
Total cost of revenues	67,498	52,188	46,446	43,026	46,475
Gross profit	257,100	215,243	173,235	162,507	148,966
Operating expenses:					
Research and development (1)	54,997	42,585	51,322	47,730	45,836
Sales and marketing (1)	138,851	118,770	94,900	86,810	86,770
General and administrative (1)	28,187	20,583	20,755	20,921	20,286
Amortization of intangible assets	653	188	197	147	100
Facilities restructuring charges	3,212	3,683	112,636	-	17,030
Purchased in-process research and development	1,340	-	-	4,524	-
Total operating expenses	227,240	185,809	279,810	160,132	170,022
Income (loss) from operations	29,860	29,434	(106,575)	2,375	(21,056)
Interest income and other, net	11,823	6,544	3,391	7,059	6,363
Income (loss) before income taxes	41,683	35,978	(103,184)	9,434	(14,693)
Income tax provision	5,477	2,174	1,220	2,124	921
Net income (loss) (2)	$ 36,206	$ 33,804	$ (104,404)	$ 7,310	$ (15,614)
Basic net income (loss) per common share (2)	$ 0.42	$ 0.39	$ (1.22)	$ 0.09	$ (0.20)
Diluted net income (loss) per common share (2)	$ 0.39	$ 0.37	$ (1.22)	$ 0.09	$ (0.20)
Shares used in computing basic net income (loss) per common share	86,420	87,242	85,812	82,049	79,753
Shares used in computing diluted net income (loss) per common share	92,942	92,083	85,812	85,200	79,753

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Selected Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 120,491	$ 76,545	$ 88,941	$ 82,903	$ 105,590
Short-term investments	280,149	185,649	152,160	140,890	130,285
Restricted cash	12,016	12,166	12,166	12,166	12,166
Working capital (3)	309,949	187,759	173,816	167,011	180,750
Total assets	696,765	441,022	409,768	402,808	365,194
Long-term obligations, less current portion	-	-	-	-	-
Total stockholders equity	227,163	222,730	195,722	289,599	252,403

(1) Amortization of stock-based compensation has been reclassified for periods prior to December 31, 2004 to cost of service revenues, research and development, sales and marketing, and general and administrative expense.

(2) In fiscal 2006, net income and net income per share include the impact of SFAS 123(R) stock-based compensation ($4.1 million and $14.1 million for three and twelve months ended December 31, 2006, respectively), neither of which were present in prior years. See Note 2. Summary of Significant Accounting Polices.

(3) A portion of deferred revenues has been reclassified to long-term for periods prior to December 31, 2004.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the federal securities laws, particularly statements referencing our expectations relating to license revenues, service revenues, deferred revenues, cost of license revenues as a percentage of license revenues, cost of service revenues as a percentage of service revenues, and operating expenses as a percentage of total revenues; the recording of amortization of acquired technology, and stock-based compensation and share-based payments; provision for income taxes; deferred taxes; international expansion; the ability of our products to meet customer demand; expected savings from our 2004 and 2001 Restructuring Plans; the sufficiency of our cash balances and cash flows for the next 12 months; our stock repurchase program; 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, thereof, or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, these expectations or any of the forward-looking statements could prove to be incorrect, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to risks and uncertainties, including but not limited to the factors set forth under 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 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. We also receive a small amount of revenues under subscription-based licenses from companies making our technology available as part of their own on-demand offerings. 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 energy and utilities, financial services, insurance, government and public sector, healthcare, high-technology, manufacturing, retail, services, telecommunications, and transportation.

In 2006, our total revenues grew 21% to $324.6 million and we generated net income of $36.2 million, or $0.39 per diluted share. The increase in license revenues was a result primarily of an increase in the average size of our transactions and, to a lesser extent, an increase in volume of transactions and an increase in international license revenues. The increase in service revenues was primarily from increased maintenance revenues driven by strong renewals from our expanding customer base, coupled with contribution from the new releases of existing products.

On January 26, 2006, we acquired Similarity Systems Limited (Similarity), a provider of a software product suite that includes data profiling, data standardization, data cleansing, data matching, and data quality monitoring. We have extended our enterprise data integration platform by working to incorporate certain components of Similarity s product suite, including its patented data quality technology.

On March 8, 2006, we issued and sold convertible senior notes with an aggregate principal amount of $230 million due in 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.

On December 15, 2006, we acquired Itemfield, Inc. (Itemfield), a private company, pursuant to a Merger Agreement. Under the Merger Agreement, Itemfield stockholders, non-employee option holders and certain employees are entitled to receive $52.1 million in cash. In addition, the options held by Itemfield employees were assumed by Informatica and converted into options to purchase approximately 158,000 shares of Informatica common stock valued on the date of close at approximately $1.9 million. Itemfield s data transformation technologies enable near-universal access to unstructured and semi-structured data. Incorporation of such technology extends our data integration platform to allow customers to integrate these data sources with traditional structured data sources. With the acquisition of Itemfield, Informatica gained 59 employees, based primarily in Israel and the United States.

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 customer hand-coded development. Our prospective customers may view these alternative solutions as more attractive than our offerings. Additionally, the consolidation activity in our industry (including Business Objects acquisition of FirstLogic, and Oracle s acquisition of Sunopsis) 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. For example, in May 2006, we delivered the generally available release of PowerCenter 8, which included new products, Informatica Data Quality and Informatica Data Explorer that deliver advanced data quality capabilities. In September 2006, we delivered general availability of the PowerCenter Connect for salesforce.com to enable joint customers to integrate data managed by salesforce.com. Also, in November 2006, we announced general availability of new versions of Informatica Data Quality and Informatica Data Explorer. 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 generated the highest level of license revenue and order backlog, and we have generally had lower levels of 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 targeting of our sales force and distribution channel on new products.

We are concentrating on expanding and extending our relationships with our existing strategic partners and building relationships with additional strategic partners. These partners include systems integrators, resellers and distributors,

as well as strategic technology partners, including enterprise application providers, database vendors, and enterprise information integration vendors, in the United States and internationally. In addition to becoming a global OEM partner with Hyperion Solutions and partnering with salesforce.com, we expanded and extended our OEM relationship with Oracle. See Risk Factors -- *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* in Item 1A. Additionally, our alliance managers have developed and continue to add new strategic partnerships with vendors in the on-demand market. In 2006, we formalized our relationship with Deloitte Consulting and jointly went to market with its Enterprise Risk Services practice and our Data Quality products. We also expanded our market reach with new reseller agreements with Teradata and Sun Microsystems.

We have also broadened our distribution efforts. In 2006, we continued to expand our sales both in terms of selling data warehouse products to the enterprise level and of selling more strategic data integration solutions beyond data warehousing, including data quality, data migrations, data consolidations, data synchronizations, data hubs and cross-enterprise data

Table of Contents

integration to our customers enterprise architects and chief information officers. We have also continued expanding our international sales presence by opening new offices and increasing headcount. This included opening sales offices in Brazil, China, India, Japan, South Korea and Taiwan. We also established training partnerships in India, Latin America and the United States to provide hands-on product training for customers and partners. As the result of this international expansion, as well as the increase in our direct sales headcount in the United States during 2005, our sales and marketing expenses have increased accordingly during 2005 and 2006. We expect these investments to result in increased revenues and productivity and ultimately higher 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. While we have experienced some increases in revenue and productivity in the United States, we have not yet achieved such increases in productivity internationally.

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 Informatica World for customers and partners, our annual sales kickoff conference for all sales and key marketing personnel, 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 consolidated financial statements, we make assumptions, judgments, and estimates that can have a significant impact on amounts reported in our 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, accounting for income taxes, accounting for impairment of goodwill, acquisitions, and share-based payment compensation expense have the greatest potential impact on our 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 2. *Summary of Significant Accounting Policies* in Notes to Consolidated Financial Statements in Part II, Item 8 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 (GAAP) in the United States 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 the 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 2. *Summary of Significant Accounting Policies* of Notes to Consolidated Financial Statements in Part II, Item 8 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 (the 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 (the 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 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 7. *Facilities Restructuring Charges* in Notes to Consolidated Financial Statements in Part II, Item 8 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 have periodically updated 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 is 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.

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FAS 109, *Accounting for Income Taxes* (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We will adopt FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded in retained earnings and other accounts as applicable. We have not determined the effect, if any, that the adoption of FIN 48 will have on our financial position and results of operations. As a result of FIN 48, we could have greater volatility in our effective tax rate in the future.

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 2006, 2005, and 2004 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.

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, trade names, non-compete 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 Payments

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 No. 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 $3.0 million increase in the fair value of options granted during the year ended December 31, 2006. In addition, we apply an expected forfeiture rate when amortizing share-based payment expense. Our estimate of the forfeiture rate is 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. In the fourth quarter of 2006, we determined that the estimated forfeiture rate for unvested options required an adjustment due to changes in retention rates, changes in the stock price, and other factors that generally increase an employee s expected length of service. We lowered our forfeiture rate from 18% during the nine months period ended December 31, 2006 to 16% in the three months ended December 31, 2006, primarily due to changes in historical employee termination rates. As a result of this change, our stock-based compensation increased approximately $0.4 million for the three months ended December 31, 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 is 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

Results of Operations

The following table presents certain financial data as a percentage of total revenues:

	Years Ended December 31,		
	2006	**2005**	**2004**
Revenues:			
License	45%	45%	45%
Service	55	55	55
Total revenues	100	100	100
Cost of revenues:			
License	2	2	2