

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

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FORM 10-Q

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

For the quarterly period ended March 31, 2005

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-20725

**SIEBEL SYSTEMS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**94-3187233**

(I.R.S. Employer Identification No.)

**2207 Bridgepointe Parkway**

**San Mateo, CA 94404**

(Address of Principal Executive Offices, Including Zip Code)

**(650) 477-5000**

(Registrant's Telephone Number, Including Area Code)

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Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

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

YES  NO

The number of shares outstanding of the Registrant's common stock, par value \$.001 per share, as of April 22, 2005 was 516,674,822.

**SIEBEL SYSTEMS, INC.**  
**FORM 10-Q**  
**For the Quarterly Period Ended March 31, 2005**

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## Part I. Financial Information

### Item 1. Financial Statements

**SIEBEL SYSTEMS, INC.**  
**Consolidated Balance Sheets**  
(in thousands, except per share data; unaudited)

	<b>December 31, 2004</b>	<b>March 31, 2005</b>
<b><u>Assets</u></b>		
<b>Current assets:</b>		
Cash and cash equivalents.....	\$ 560,377	\$ 545,340
Short-term investments.....	1,686,111	1,650,936
Total cash, cash equivalents and short-term investments.....	2,246,488	2,196,276
Accounts receivable, net.....	293,527	254,951
Deferred income taxes.....	17,542	22,542
Prepays and other.....	53,894	34,396
Total current assets.....	2,611,451	2,508,165
Property and equipment, net.....	83,908	78,568
Goodwill.....	208,306	286,886
Intangible assets, net.....	23,004	42,693
Other assets.....	36,937	33,757
Deferred income taxes.....	123,828	116,487
Total assets.....	\$ 3,087,434	\$ 3,066,556
<b><u>Liabilities and Stockholders' Equity</u></b>		
<b>Current liabilities:</b>		
Accounts payable.....	\$ 10,048	\$ 18,522
Accrued expenses.....	346,672	266,652
Restructuring obligations.....	30,639	29,953
Deferred revenue.....	357,223	365,979
Total current liabilities.....	744,582	681,106
Restructuring obligations, less current portion.....	75,227	67,354
Other long-term liabilities.....	20,981	24,506
Total liabilities.....	840,790	772,966
Commitments and contingencies		
<b>Stockholders' equity:</b>		
Common stock; \$0.001 par value; 2,000,000 shares authorized; 508,953 and 516,095 shares issued and outstanding, respectively.....	509	516
Additional paid-in capital.....	1,635,652	1,723,011
Deferred compensation.....	(2,993)	(13,150)
Accumulated other comprehensive income.....	70,541	44,277
Retained earnings.....	542,935	538,936
Total stockholders' equity.....	2,246,644	2,293,590
Total liabilities and stockholders' equity.....	\$ 3,087,434	\$ 3,066,556

See accompanying notes to consolidated financial statements.

**SIEBEL SYSTEMS, INC.**  
**Consolidated Statements of Operations and Comprehensive Income (Loss)**  
(in thousands, except per share data; unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
<b>Revenues:</b>		
Software license.....	\$ 126,799	\$ 74,978
Professional services, maintenance and other.....	202,488	223,960
Total revenues.....	<u>329,287</u>	<u>298,938</u>
<b>Cost of revenues:</b>		
Software license.....	3,207	3,898
Professional services, maintenance and other.....	108,214	112,964
Total cost of revenues.....	<u>111,421</u>	<u>116,862</u>
Gross margin.....	<u>217,866</u>	<u>182,076</u>
<b>Operating expenses:</b>		
Product development.....	72,633	74,717
Sales and marketing.....	86,398	92,274
General and administrative.....	21,699	25,618
Restructuring and related expenses.....	571	492
Purchased in-process product development.....	--	10,890
Total operating expenses.....	<u>181,301</u>	<u>203,991</u>
Operating income (loss).....	<u>36,565</u>	<u>(21,915)</u>
<b>Other income (expense), net:</b>		
Interest and other income, net.....	12,075	15,994
Interest expense.....	(320)	(231)
Total other income (expense), net.....	<u>11,755</u>	<u>15,763</u>
Income (loss) before income taxes.....	48,320	(6,152)
Income taxes (benefit).....	17,340	(2,153)
Net income (loss).....	<u>\$ 30,980</u>	<u>\$ (3,999)</u>
Diluted net income (loss) per share.....	<u>\$ 0.06</u>	<u>\$ (0.01)</u>
Basic net income (loss) per share.....	<u>\$ 0.06</u>	<u>\$ (0.01)</u>
Shares used in diluted share computation.....	<u>546,401</u>	<u>512,963</u>
Shares used in basic share computation.....	<u>501,128</u>	<u>512,963</u>
<b>Comprehensive income (loss):</b>		
Net income (loss).....	\$ 30,980	\$ (3,999)
Other comprehensive income (loss), net of taxes:		
Foreign currency translation adjustments.....	(3,844)	(18,765)
Realized loss (gain) on marketable investments previously recognized in other comprehensive income.....	(1,123)	143
Unrealized gain (loss) on investments, net.....	4,163	(7,643)
Other comprehensive income (loss).....	<u>(804)</u>	<u>(26,265)</u>
Total comprehensive income (loss).....	<u>\$ 30,176</u>	<u>\$ (30,264)</u>

See accompanying notes to consolidated financial statements.

**SIEBEL SYSTEMS, INC.**  
**Consolidated Statements of Cash Flows**  
(in thousands; unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net income (loss).....	\$ 30,980	\$ (3,999)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Write-off of purchased in-process product development.....	--	10,890
Depreciation and other amortization.....	31,478	18,019
Amortization of identifiable intangible assets.....	1,710	3,088
Stock-based compensation, net.....	195	1,012
Provision for (recovery of) doubtful accounts and sales returns.....	(1,000)	--
Tax benefit from exercise of stock options.....	1,500	51,379
Deferred income taxes.....	(465)	--
Net realized loss (gain) on cost-method investments.....	1,083	(2,059)
Net realized loss (gain) on marketable investments.....	(1,872)	238
Changes in operating assets and liabilities:		
Accounts receivable.....	30,234	51,900
Prepays and other.....	14,305	22,171
Accounts payable and accrued expenses.....	(33,843)	(95,742)
Restructuring obligations.....	(13,641)	(9,051)
Deferred revenue.....	29,135	71
Net cash provided by operating activities.....	89,799	47,917
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments.....	(413,446)	(249,872)
Sales and maturities of short-term investments.....	382,507	268,648
Purchases of property and equipment, net.....	(225)	(3,096)
Proceeds from sale of venture investments.....	--	4,979
Purchase consideration for acquired businesses, net of cash received.....	(4,817)	(93,088)
Net cash used in investing activities.....	(35,981)	(72,429)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock.....	29,379	24,749
Repayments of capital lease obligations.....	(3,278)	(2,024)
Net cash provided by financing activities.....	26,101	22,725
Effect of exchange rate fluctuations.....	(3,766)	(13,250)
Change in cash and cash equivalents.....	76,153	(15,037)
Cash and cash equivalents, beginning of period.....	546,542	560,377
Cash and cash equivalents, end of period.....	\$ 622,695	\$ 545,340

See accompanying notes to consolidated financial statements.

**SIEBEL SYSTEMS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying unaudited consolidated financial statements include the accounts of Siebel Systems, Inc. and its wholly owned subsidiaries (the "Company"). The accompanying unaudited consolidated financial statements have been prepared on substantially the same basis as the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations regarding interim financial statements. All amounts included herein related to the consolidated financial statements as of March 31, 2005 and the three months ended March 31, 2004 and 2005 are unaudited. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

In the opinion of management, these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for their fair presentation. The interim results presented are not necessarily indicative of results for any subsequent quarter or for the year ending December 31, 2005. Certain prior year amounts have been reclassified to conform to the current year presentation.

*Use of Estimates*

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that the Company make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition, provision for doubtful accounts and sales returns, fair value of investments, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, restructuring obligations, and contingencies and litigation, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ significantly from the estimates made by management with respect to these and other items.

*Stock-Based Compensation*

The Company accounts for its employee stock-based compensation plans using the intrinsic value method, as prescribed by APB No. 25 "Accounting for Stock Issued to Employees" and interpretations thereof (collectively referred to as "APB 25"). Accordingly, the Company records deferred compensation costs, if any, related to its stock-based compensation as follows:

- Stock options—The Company records and measures deferred compensation for stock options granted to its employees and members of its Board of Directors when the market price of the underlying stock exceeds the exercise price of the stock option on the date of the grant. The Company records and measures deferred compensation for stock options granted to non-employees based on the fair value of the stock options.
- Restricted stock and restricted stock units ("RSUs")—The Company records and measures deferred compensation for restricted stock and RSUs based on the market price of the Company's common stock on the date of grant.

Deferred compensation is expensed on a straight-line basis over the respective vesting period of the equity instrument. The terms of Company's stock options and restricted stock vary, but generally provide for ratable vesting over five years, with 20% of the underlying shares vesting one year from grant and the remaining shares vesting 5% quarterly thereafter. The vesting terms of the Company's RSUs range from approximately three months to five years.

The Company did not grant any stock options at exercise prices below the fair market value of the Company's common stock during any period presented.

An alternative to the intrinsic value method of accounting for stock-based compensation is the fair value approach prescribed by SFAS No. 123 "Accounting for Stock-Based Compensation," as amended by SFAS No. 148 "Accounting for Stock-Based Compensation—Transition and Disclosure" (collectively referred to as "SFAS 123"). If the Company followed the fair value approach, the Company would record deferred compensation based on the fair value of the stock option at the date of grant as determined using the Black-Scholes option valuation model. The deferred compensation calculated under the fair value method would then be amortized on a straight-line basis over the respective vesting period of the stock option.

As required by SFAS 123, the Company has prepared a reconciliation of its earnings as reported on the statement of operations to the earnings that the Company would have reported if it had followed SFAS 123 in accounting for its stock-based compensation arrangements. In accordance with SFAS 123, in preparing this reconciliation the Company must first add back all stock-based compensation expense reflected in its statement of operations, then deduct the stock-based employee compensation expense determined under SFAS 123. Summarized below are the pro forma effects on the Company's earnings and earnings per share, as if the Company had elected to use the fair value approach prescribed by SFAS 123 to account for its employee stock-based compensation plans (in thousands, except per share data):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<u>2004</u>	<u>2005</u>
<b>Net income (loss):</b>		
As reported.....	\$ 30,980	\$ (3,999)
<b>Compensation expense related to:</b>		
<b>Stock options dilutive to stockholders:</b>		
Stock-based compensation accounted for under APB 25.....	195	1,012
In-the-money stock options and restricted stock units.....	(4,308)	(4,224)
Stock purchase rights under the Purchase Plan.....	<u>(2,559)</u>	<u>(2,228)</u>
Subtotal.....	<u>(6,672)</u>	<u>(5,440)</u>
<b>Stock options not dilutive to stockholders:</b>		
Out-of-the-money stock options.....	(37,336)	(23,355)
Stock options forfeited in connection with terminations.....	<u>(3,135)</u>	<u>--</u>
Subtotal.....	<u>(40,471)</u>	<u>(23,355)</u>
Total pro forma expense giving effect to SFAS 123.....	<u>(47,143)</u>	<u>(28,795)</u>
<b>Tax benefit related to SFAS 123 expense.....</b>	<u>--</u>	<u>2,287</u>
<b>Pro forma net loss giving effect to SFAS 123.....</b>	<u>\$ (16,163)</u>	<u>\$ (30,507)</u>
<b>Diluted net income (loss) per share:</b>		
As reported.....	<u>\$ 0.06</u>	<u>\$ (0.01)</u>
Pro forma giving effect to SFAS 123.....	<u>\$ (0.03)</u>	<u>\$ (0.06)</u>
<b>Basic net income (loss) per share:</b>		
As reported.....	<u>\$ 0.06</u>	<u>\$ (0.01)</u>
Pro forma giving effect to SFAS 123.....	<u>\$ (0.03)</u>	<u>\$ (0.06)</u>

The Company has provided a tax benefit on the pro forma expense in the above table in a manner consistent with the Company's accounting for deferred tax assets resulting from the exercise of employee stock options in the accompanying consolidated financial statements. Accordingly, the Company has not provided a tax benefit on the pro forma expense in the above table during the first quarter of 2004.

During the first quarter of 2005, the Company determined that it would be able to utilize certain net operating loss carryforwards ("NOL") associated with stock option exercises that occurred in previous years. As a result of the utilization of these NOLs, the Company has reflected a \$51.4 million increase to additional paid-in capital in the accompanying unaudited consolidated financial statements. In accordance with SFAS 123, the Company's tax benefit in the above table associated with this utilization of NOLs is limited to the lesser of the actual tax benefit in the Company's income tax return or the SFAS 123 pro forma expense associated with these same options. As a result of the tax benefit exceeding the SFAS 123 pro forma expense, the Company's pro forma tax benefit was limited to \$2.3 million compared to the \$51.4 million tax benefit reflected as an increase to additional paid-in capital.

In-the-money stock options in the above table have exercise prices below the closing price of the Company's common stock as of the end of each of the respective periods, and out-of-the-money stock options have exercise prices equal to or greater than the closing price of the Company's common stock as of the end of each of the respective periods. The closing prices as of March 31, 2004 and 2005 were \$11.53 and \$9.13, respectively.

As the table above illustrates, total pro forma expense for stock options includes \$40.5 million and \$23.4 million of expense during the three months ended March 31, 2004 and 2005, respectively, related to (i) stock options forfeited by employees upon termination for no consideration and (ii) stock options that are significantly out of the money (e.g., the weighted-average exercise price of the out-of-the-money stock options was \$20.20 per share compared to a closing price of \$9.13 per share as of March 31, 2005). These items represented 86% and 81% of the pro forma expense during the three months ended March 31, 2004 and 2005, respectively.

The Company determined the assumptions used in computing the fair value of its stock options and stock purchase rights issued under its employee stock purchase plan (the "Purchase Plan") as follows:

Expected Life

In determining the appropriate expected life of its stock options, the Company segregates its optionholders into the following categories: (i) CEO and members of its Board of Directors, (ii) officers and (iii) non-officer employees. The Company determined these categories based on its experience that its CEO, officers and members of its Board of Directors generally hold stock options for longer periods than its non-officer employees.

The Company estimated the expected useful lives for each of these categories giving consideration to (i) the weighted average vesting periods (e.g., options that vest over five years have a weighted-average vesting period of 2.7 years), (ii) the contractual lives of the stock options, (iii) the relationship between the exercise price and the fair market value of the Company's common stock, (iv) expected employee turnover, (v) the expected future volatility of the Company's common stock, and (v) past and expected exercise behavior, among other factors.

During 2005 the Company's weighted average expected life assumption increased compared to 2004, primarily due to (i) an increase in the weighted average vesting period (i.e., for 65% of all stock options granted during the first quarter of 2005, the weighted average vesting period increased from 2.7 to 3.0 years) and (ii) the continued low levels of volatility of the Company's common stock (i.e., lower volatility historically results in a longer stock option life).

Volatility

The Company estimated expected volatility giving consideration to the expected useful lives of the stock options, the Company's current expected growth rate, implied expected volatility in traded options for the Company's common stock, and recent volatility of the Company's common stock, among other factors. In considering these factors, the Company noted that (i) the stock market in general, and its common stock in particular, have continued to become less volatile and (ii) implied volatility in traded options for the Company's common stock has continued to decrease relative to previous periods.

Risk-Free Interest Rate

The Company estimated the risk-free interest rate using the U.S. Treasury bill rate for the relevant expected life.

The fair value of stock options was estimated on the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Risk-free interest rate.....	2.09 %	4.11 %
Expected life (in years).....	3.4	3.6
Expected volatility.....	42 %	40 %

Using the Black-Scholes option valuation model, stock options granted during the three months ended March 31, 2004 and 2005 had weighted average fair values of \$4.39 and \$2.99 per share, respectively.



The fair value of employees' stock purchase rights granted under the Purchase Plan was estimated using the Black-Scholes option valuation model with the following weighted average assumptions:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Risk-free interest rate.....	1.00 %	2.71 %
Expected life (in years).....	0.5	0.5
Expected volatility.....	46 %	38 %

The weighted average fair value of the common stock purchase rights granted under the Purchase Plan during the three months ended March 31, 2004 and 2005 was \$3.69 and \$2.27 per share, respectively, including the 15% discount from the quoted market price.

### ***Recent Accounting Pronouncements***

#### Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) "Share-Based Payment" ("SFAS 123R"), a revision to SFAS 123. SFAS 123R addresses all forms of share-based payment ("SBP") awards, including shares issued under the Purchase Plan, stock options, restricted stock, restricted stock units and stock appreciation rights. SFAS 123R will require the Company to record compensation expense for SBP awards based on the fair value of the SBP awards.

Under SFAS 123R, restricted stock and restricted stock units will generally be valued by reference to the market value of freely tradable shares of the Company's common stock. Stock options, stock appreciation rights and shares issued under the Purchase Plan will generally be valued at fair value determined through an option valuation model, such as a lattice model or the Black-Scholes model (the model that the Company currently uses for its footnote disclosure). SFAS 123R is effective for annual periods beginning after June 15, 2005 and, accordingly, the Company must adopt the new accounting provisions effective January 1, 2006.

#### Income Taxes

In December 2004, the FASB issued two FASB Staff Positions ("FSP") related to the recently enacted American Jobs Creation Act of 2004 ("AJCA"). FSP No. 109-1 "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities" ("FSP 109-1") requires companies that qualify for a deduction for domestic production activities under the AJCA to account for the deduction as a special deduction under FASB Statement No. 109.

FSP No. 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2") allows companies additional time to evaluate whether foreign earnings will be repatriated under the repatriation provisions of the AJCA and requires specified disclosures for companies needing the additional time to complete the evaluation. Once a decision is made to repatriate the foreign earnings, companies must reflect the deferred tax liabilities attributable to foreign earnings in the period that the decision is made to remit those earnings.

## **2. Restructuring Obligations**

During 2002, 2003 and 2004, the Company initiated a series of restructurings designed to better align its operating structure with expected revenue levels (the "2002 Restructuring," the "2003 Restructuring" and the "2004 Restructuring," and collectively the "Restructurings"). The 2002 Restructuring and 2003 Restructuring included the following key measures: (i) the reduction of the Company's workforce across all functional areas; (ii) the consolidation of its excess facilities; (iii) the abandonment of certain long-lived assets, including leasehold improvements, furniture and fixtures; and (iv) the transfer of certain technical support, quality assurance and other product development positions to labor markets with lower cost structures.

In order to continue to reduce expense levels and to further improve the Company's operating margins, the Company initiated an additional restructuring of its operations during the third quarter of 2004. The 2004 Restructuring consisted primarily of the consolidation of additional facilities (located primarily in North America and Asia Pacific) and the abandonment of the related leasehold improvements and furniture and fixtures.

The following table summarizes the restructuring and related expenses incurred during the three months ended March 31, 2005, and the remaining obligations related to the Restructurings as of December 31, 2004 and March 31, 2005 (in thousands):

	<b>Employee Termination Costs (1)</b>	<b>Facility- Related Costs (2)</b>	<b>Total</b>
Restructuring obligations, December 31, 2004.....	\$ 265	\$ 105,601	\$ 105,866
Restructuring and related expenses:			
Accretion related to the Restructurings (3).....	--	492	492
Total.....	--	492	492
Cash payments.....	(24)	(9,027)	(9,051)
Restructuring obligations, March 31, 2005.....	<u>\$ 241</u>	<u>\$ 97,066</u>	<u>\$ 97,307</u>
Less: Restructuring obligations, short-term.....			29,953
Restructuring obligations, long-term.....			<u>\$ 67,354</u>

- (1) The costs associated with the Company's workforce reductions consist primarily of severance payments, COBRA benefits, payroll taxes and other associated termination costs incurred in connection with the 2003 Restructuring. The remaining obligations as of March 31, 2005 relate to less than five terminations that have yet to be completed, primarily due to regulatory requirements in certain countries outside the U.S. The Company expects to complete these terminations within 2005.
- (2) The costs associated with the Company's facilities consolidation primarily relate to lease termination costs, costs associated with satisfying remaining lease commitments, and expected brokerage and other re-letting costs, partially offset by estimated sublease income.
- (3) The Company will continue to accrete its obligations related to the Restructurings to the then present value and, accordingly, will recognize additional accretion expense as a restructuring and related expense in future periods.

The total restructuring charge and related cash outlay are based on management's current estimates, which may change materially if further consolidations are required or if actual lease-related expenditures or sublease income differ from amounts currently expected. The Company will review the status of its restructuring activities quarterly and, if appropriate, record changes to its restructuring obligations in current operations based on management's most current estimates.

### 3. Commitments and Contingencies

#### *Legal Actions*

##### Regulation FD

On May 6, 2003, the Enforcement Division staff ("Staff") of the Securities & Exchange Commission ("SEC") contacted the Company and indicated that a May 1, 2003 article on CBS MarketWatch had raised questions regarding the Company's compliance with Regulation FD. In August 2003, the Staff notified the Company and two of its officers of the Staff's preliminary decision to recommend that the SEC take enforcement action against the Company and these officers in regard to statements allegedly made prior to and during an April 30, 2003 dinner. The Company and its officers filed submissions with the SEC in response to the SEC notices that the Company believes contained numerous meritorious defenses to these allegations. Despite these submissions, on June 29, 2004, the SEC filed a lawsuit in the United States District Court of the Southern District of New York against the Company and the two officers alleging, among other things, that the Company and its officers violated Regulation FD in connection with the statements described above.

In September 2004, the Company filed a motion to dismiss the complaint. A hearing on the motion occurred on March 15, 2005. The Company believes the allegations in this action are without merit and it intends to defend vigorously against them. Due to the uncertainty surrounding the litigation process, there exists the possibility that the Company may incur costs in excess of amounts already recognized. The Company cannot currently estimate the amount of such additional costs, if any.

### Stock Option Grant Inquiry

On March 7, 2005, the SEC provided the Company with a copy of an order of investigation regarding certain stock option grants by a number of companies, including the Company. The SEC has advised the Company that this is a confidential fact finding inquiry and has confirmed that the issuance of the order does not indicate that it has concluded that the Company has violated any securities laws. The Company intends to cooperate with the SEC as this investigation continues to develop. In accordance with the disclosures required by SFAS 5, the Company is unable to estimate the potential financial impact this matter could have on the Company.

### Shareholder Class Actions

On March 10, 2004, William Wollrab, on behalf of himself and purportedly on behalf of a class of the Company's stockholders, filed a complaint in the United States District Court for the Northern District of California against the Company and certain of its officers. This complaint was consolidated and amended on August 27, 2004, with the Policemen's Annuity and Benefit Fund of Chicago being appointed to serve as lead plaintiff. In October 2004, the Company filed a motion for dismissal of this case, which was granted on January 28, 2005. Plaintiffs in this case filed a second amended complaint on February 28, 2005, and the Company intends to file a motion to dismiss as soon as practical.

On April 12, 2004, Pamela Plotkin, on behalf of herself and purportedly on behalf of a class of the Company's stockholders, filed a complaint in the Superior Court of California (the "Superior Court") against the Company and certain members of the Company's Board of Directors. The Superior Court dismissed the complaint by Ms. Plotkin on September 23, 2004, but gave Ms. Plotkin leave to file a new, amended complaint, which was subsequently filed by Ms. Plotkin. The Superior Court dismissed the amended complaint on December 28, 2004, but again gave Ms. Plotkin leave to file a new, amended complaint. Ms. Plotkin filed a new amended complaint on January 14, 2005. On February 2, 2005, the parties to this complaint agreed to stay (i.e., place on hold) the entire case until June 1, 2005.

These complaints allege claims in connection with various public statements made by the Company and seek damages together with interest and reimbursement of costs and expenses of litigation. The Company believes the allegations in each of these actions are without merit and it intends to defend vigorously against these claims.

### General

The Company is subject to legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these proceedings and claims cannot be predicted with certainty, management does not believe that the outcome of any pending legal matter will have a material adverse effect on the Company's consolidated financial position, although results of operations or cash flows could be affected in a particular period.

### ***Income, Payroll and Sales and Use Tax Audits***

#### Income Tax Audits

In March of 2005 the Company received formal notification from the Internal Revenue Service ("IRS") that its examination of the Company's U.S. federal income tax returns for 1998 through 2000 has been completed. The final settlement with the IRS was consistent with the preliminary settlement disclosed in our annual report on Form 10-K for the year ended December 31, 2004. The Company determined that as a result of the settlement, it would be able to utilize certain NOL carryforwards associated with stock option exercises that occurred in previous years. The majority of the final settlement of \$54.3 million was offset by available NOL carryforwards of \$51.4 million associated with previous exercises of stock options. The Company has reflected the utilization of these NOLs as an increase to additional paid-in capital in the accompanying unaudited consolidated financial statements. The remaining portion of the settlement is expected to result in a cash outlay of approximately \$2.9 million, which has been accrued by the Company. The Company's U.S. federal income tax returns for 2001 through 2003 remain under examination by the IRS.

While the final resolution of the IRS's on-going examination of the Company's income tax returns remains uncertain, the Company believes it has made adequate provision in the accompanying consolidated financial statements for any adjustments that the IRS has or may propose with respect to the U.S. federal income tax returns. Based on currently available information, management believes that the ultimate outcome of these examinations will not have a material adverse effect on the Company's financial position, cash flows or results of operations.

### Payroll Taxes

The Company's U.S. payroll tax returns for 1999 through 2003 are currently under examination by the IRS, primarily related to the timing of the payment of taxes associated with stock option exercises. While the Company has not received any notices of proposed adjustments with respect to this examination, the Company expects that the IRS may issue a notice of proposed adjustment to its payroll tax returns in 2005. While the final resolution of this on-going examination of the Company's payroll tax returns is uncertain, based on currently available information, the Company believes it has made adequate provision in the accompanying consolidated financial statements for any adjustments that may result from the IRS audit of the Company's U.S. payroll tax returns.

### Sales, Use and Value Added Taxes

The Company's sales and use tax returns in various states in the United States for 2000 through 2003 and certain international sales and value added tax returns for 2002 through 2004 are currently under examination and/or review by the applicable taxing authorities. While the final resolutions of these on-going examinations are uncertain, the Company believes it has made adequate provision in the accompanying consolidated financial statements for any adjustments that may result from the audits of these tax returns.

### Summary

The Company may receive assessments related to the audits and/or reviews of its U.S. and foreign income tax returns, payroll tax returns, sales and use tax returns, and value added tax returns that exceed amounts provided for by the Company. In the event of such an assessment, there exists the possibility of a material adverse impact on the Company's results of operations for the period in which the matter is ultimately resolved or an unfavorable outcome becomes probable and reasonably estimable. Due to the uncertainty surrounding the audit/review process, there exists the possibility that the Company may incur costs in excess of amounts already recognized; however, the amount of such additional loss, if any, is not currently estimable.

### ***Indemnifications***

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

The Company believes its internal development processes and other policies and practices are designed to limit its exposure related to the indemnification provisions of the SLSA. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which, with limited exception, assigns the rights to its employees' development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions and no material claims are outstanding as of March 31, 2005. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement claims under the SLSA, the Company cannot determine the amount of potential future payments, if any, related to such indemnification provisions.

## ***Lease Obligations***

As of March 31, 2005, the Company leased facilities and certain equipment under non-cancellable operating leases expiring between 2005 and 2022. The Company also leases certain assets, primarily computer equipment, under capital leases expiring in 2007. Future minimum lease payments under both operating and capital leases as of March 31, 2005 are as follows (in thousands):

	<b>Capital Leases</b>	<b>Operating Leases</b>
Nine months ending December 31, 2005.....	\$ 5,924	\$ 54,637
Year ending December 31, 2006.....	1,599	67,488
Year ending December 31, 2007.....	1,599	64,494
Year ending December 31, 2008.....	--	63,993
Year ending December 31, 2009.....	--	63,164
Year ending December 31, 2010, and thereafter.....	--	311,166
Total minimum lease payments.....	9,122	<u>\$ 624,942</u>
Amounts representing interest.....	(415)	
Present value of minimum lease payments.....	8,707	
Less: capital lease obligations, short-term portion (included in accrued expenses).....	6,034	
Capital lease obligations, long-term portion (included in other long-term liabilities).....	<u>\$ 2,673</u>	

Operating lease commitments related to properties included in the Restructurings are not reflected in the above table, as the Company has reflected the fair value of these obligations in the accompanying consolidated balance sheet under the caption “restructuring obligations.” Please refer to Note 2 for further discussion of the restructuring obligations.

## **4. Acquisitions, Goodwill and Intangible Assets**

The following is a summary of the Company’s acquisitions during 2004 and 2005, each of which has been accounted for as a purchase:

### ***2005 Acquisitions***

#### ***Acquisition of edocs, Inc.***

On January 14, 2005, the Company acquired all of the issued and outstanding shares of edocs, Inc. (“edocs”), a leading provider of electronic bill presentment and customer self-service software solutions, for initial consideration of approximately \$118.5 million (“Initial Purchase Price”). The Initial Purchase Price consisted of the following: (i) the payment of cash consideration of \$101.7 million, (ii) purchase consideration payable of \$15.0 million and (iii) transaction costs of \$1.8 million, consisting primarily of professional fees incurred related to investment bankers, attorneys, accountants and valuation advisors. As of March 31, 2005, the Company had paid \$103.2 million of the Initial Purchase Price and expects to pay the remaining \$15.3 million during the second quarter of 2005.

In the event certain revenue targets and other contractual milestones defined in the purchase agreement are met for 2005, the Company could be required to pay up to an additional \$42.5 million in cash to the former shareholders of edocs. Any amounts paid by the Company to the edocs’ shareholders will be recorded as an increase to goodwill.

edocs’ solutions enable companies to improve customer service and increase customer loyalty while reducing the cost of serving their customers. Companies use edocs’ solutions to move the most common customer inquiries and transactions—such as billing, account management and service order issues—from expensive channels such as paper correspondence and contact center calls to lower-cost self-service and assisted care channels such as the web, email and chat.

The Company believes that edocs’ existing technology and certain products and functionality under development by edocs at the time of purchase will enhance the Company’s current self-service offerings. The Company plans to integrate its CRM solutions with edocs’ customer service and electronic bill presentment applications to deliver one of the industry’s most comprehensive self-service solutions enabling companies to drive higher levels of customer satisfaction and adoption.

The Company allocated the Initial Purchase Price to the tangible net assets and liabilities and intangible assets acquired, based on their estimated fair values. Under the purchase method of accounting, the Initial Purchase Price does not include the contingent earnout amounts described above. The Initial Purchase Price has been allocated as follows (in thousands):

**Tangible assets:**

Cash and cash equivalents.....	\$	10,081
Accounts receivable and other current assets.....		15,883
Property and equipment.....		1,747
Other assets, long-term.....		30
Total tangible assets.....		<u>27,741</u>

**Intangible assets:**

Acquired technology.....		20,270
Customer relationships.....		3,260
Customer contracts.....		120
Acquired in-process research and development ("IPR&D").....		10,890
Goodwill.....		82,166
Total intangible assets.....		<u>116,706</u>

**Liabilities assumed:**

Accounts payable and accrued liabilities.....		(9,938)
Accrued purchase price and acquisition-related expenses.....		(15,359)
Deferred revenue.....		(8,639)
Deferred tax liability.....		(7,342)
Total liabilities assumed.....		<u>(41,278)</u>
Net assets acquired.....	\$	<u>103,169</u>

In performing the purchase price allocation of acquired intangible assets, the Company considered its intention for future use of the assets, analyses of historical financial performance and estimates of future performance of edocs' products, among other factors. In addition to the identifiable intangible assets in the above table, the Company also purchased certain technologies being developed by edocs at the time of the acquisition, which is commonly referred to as IPR&D. The IPR&D acquired primarily related to edocs' products designed specifically for the telecommunications, healthcare and credit card industries.

Because the IPR&D had not yet reached technological feasibility and had no alternative future use, the Company reflected a \$10.9 million expense under the heading "purchased in-process product development" in the accompanying unaudited statements of operations for 2005. At the date of the Company's acquisition of edocs, there were six products under development, with percentage completion for each of the IPR&D products ranging from approximately 50% to 75%. The Company expects to incur between \$1.5 and \$2.5 million to complete the development of these products. The Company expects to complete these products at various dates in 2005.

The Company determined the fair values of the above identifiable intangible assets and the IPR&D using the "income" valuation approach and discount rates ranging from 15% to 32%. The discount rates selected were based in part on considerations of the rate of return implied by the purchase price and the risk associated with achieving forecasted cash flows for edocs. Further, the Company also considered risks associated with achieving anticipated levels of market acceptance and penetration, successful completion of various research and development efforts, market growth rates and risks related to the impact of potential changes in future target markets.

The acquired technology and customer contract intangible assets are currently being amortized over their estimated useful lives of four years and one year, respectively, using the straight-line method. The customer relationship intangible assets are currently being amortized over their estimated useful lives of six years based on the greater of the straight-line method or the estimated customer attrition rates.

The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired of \$82.2 million was assigned to goodwill. In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill will not be amortized but will be tested for impairment at least annually. This amount is not deductible for tax purposes.

The following table presents unaudited summarized combined results of operations of the Company and edocs, on a pro forma basis, as though the companies had been combined as of January 1, 2004. Because the acquisition was completed near the beginning of the first quarter of 2005, the pro forma information for this period would not differ materially from the actual results of the Company presented herein and therefore has not been included below. The operating results of edocs have been included in the Company's consolidated financial statements from the date of acquisition. The following unaudited pro forma amounts are in thousands, except the per share amount:

	<b>Three Months Ended March 31, 2004</b>
Total revenues.....	\$ 339,949
Net income.....	\$ 27,702
Diluted net income (loss) per share.....	\$ 0.05

The above unaudited pro forma summarized results of operations are intended for informational purposes only and, in the opinion of management, are neither indicative of the financial position or results of operations of the Company had the acquisition actually taken place as of January 1, 2004, nor indicative of the Company's future results of operations. In addition, the above unaudited pro forma summarized results of operations do not include potential cost savings from operating efficiencies or synergies that may result from the Company's acquisition of edocs.

### **2004 Acquisitions**

#### Acquisition of Eontec Limited

On April 20, 2004, the Company acquired all of the outstanding issued share capital of Eontec Limited ("Eontec"), a global provider of multichannel retail banking solutions, for initial cash consideration of \$73.6 million (the "Initial Consideration"). The Initial Consideration consisted of the following: (i) the payment of cash consideration of \$70.0 million for all of the outstanding securities of Eontec and (ii) transaction costs of \$3.6 million, consisting primarily of professional fees incurred related to investment bankers, attorneys, accountants and valuation advisors.

As a result of Eontec meeting certain revenue-related targets, as defined in the purchase agreement, for the period from April 20, 2004 to March 31, 2005, the Company may be required to pay the former holders of Eontec common stock additional consideration of \$15.8 million, subject to offset for certain claims, if any, that the Company is entitled to under the purchase agreement. Amounts paid to the former holders of Eontec common stock, if any, will be recorded as an increase to goodwill at the time of payment.

The following table presents unaudited summarized combined results of operations of the Company and Eontec, on a pro forma basis, as though the companies had been combined as of January 1, 2003. The operating results of Eontec have been included in the Company's consolidated financial statements from the date of acquisition. The following unaudited pro forma amounts are in thousands, except the per share amount:

	<b>Three Months Ended March 31, 2004</b>
Total revenues.....	\$ 331,788
Net loss.....	\$ 23,649
Diluted net loss per share.....	\$ 0.04

The above unaudited pro forma summarized results of operations are intended for informational purposes only and, in the opinion of management, are neither indicative of the financial position or results of operations of the Company had the acquisition actually taken place as of January 1, 2003, nor indicative of the Company's future results of operations. In addition, the above unaudited pro forma summarized results of operations do not include potential cost savings from operating efficiencies or synergies that may result from the Company's acquisition of Eontec.

## *Intangible Assets and Goodwill*

### Goodwill

The changes in the carrying amount of goodwill during the three months ended March 31, 2005 were as follows (in thousands):

Balance as of December 31, 2004.....	\$	208,306
Purchase of edocs.....		82,166
Foreign currency fluctuation and other.....		(3,586)
Balance as of March 31, 2005.....	\$	<u>286,886</u>

The Company tests its goodwill for impairment annually on July 1 and more frequently upon the occurrence of certain events in accordance with the provisions of SFAS 142.

### Intangible Assets

Intangible assets as of December 31, 2004 and March 31, 2005, along with the weighted average useful lives as of March 31, 2005, are as follows (in thousands, except years):

	<u>December 31,</u> <u>2004</u>	<u>March 31,</u> <u>2005</u>	<u>Wtd. Avg.</u> <u>Life</u> <u>(in Years)</u>
<b>Gross assets:</b>			
Acquired technology.....	\$ 14,103	\$ 33,705	4.2
Customer relationships.....	12,673	15,677	5.6
Customer contracts.....	2,880	2,844	3.4
Non-compete agreements.....	750	750	2.0
Intangible assets, gross.....	<u>30,406</u>	<u>52,976</u>	4.6
<b>Accumulated amortization:</b>			
Acquired technology.....	(2,696)	(4,394)	
Customer relationships.....	(3,425)	(4,207)	
Customer contracts.....	(937)	(1,245)	
Non-compete agreements.....	(344)	(437)	
Total accumulated amortization.....	<u>(7,402)</u>	<u>(10,283)</u>	
Intangible assets, net.....	<u>\$ 23,004</u>	<u>\$ 42,693</u>	

The Company is amortizing its intangible assets as follows: (i) acquired technology, customer contracts and non-compete agreements are currently being amortized over their estimated useful lives using the straight-line method and (ii) customer relationship intangible assets are currently being amortized over their estimated useful lives based on the greater of the straight-line method or the estimated customer attrition rates. Based on identified intangible assets recorded as of March 31, 2005 and assuming no subsequent impairment of the underlying assets, amortization expense is expected to be as follows (in thousands):

<u>Period</u>	
Nine months ending December 31, 2005.....	\$ 9,030
Year ending December 31, 2006.....	10,842
Year ending December 31, 2007.....	9,802
Year ending December 31, 2008.....	9,544
Year ending December 31, 2009.....	2,776
Year ending December 31, 2010, and thereafter.....	699
Total.....	<u>\$ 42,693</u>



## 5. Net Income (Loss) per Share

The following is a reconciliation of the number of shares used in the basic and diluted net income (loss) per share computations for the periods presented (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<u>2004</u>	<u>2005</u>
Shares used in basic net income (loss) per share computation.....	501,128	512,963
Effect of dilutive potential common shares resulting from stock options.....	45,197	--
Effect of dilutive potential common shares resulting from restricted stock units and common stock subject to repurchase.....	76	--
Shares used in diluted net income (loss) per share computation.....	<u>546,401</u>	<u>512,963</u>

Shares used in the diluted net income (loss) per share computation in the above table include the dilutive impact of the Company's stock equivalents (i.e., stock options, restricted stock and RSUs). Because the Company reported a net loss during the three months ended March 31, 2005, the Company excluded the impact of its common stock equivalents in the computation of dilutive earnings per share for this period, as their effect would be anti-dilutive. The dilutive impact of the Company's common stock equivalents for the three months ended March 31, 2004 is calculated using the treasury stock method, based on the average share price of the Company's common stock during this period of \$13.23 per share. Under the treasury stock method, the proceeds that would be hypothetically received from the exercise of all stock options with exercise prices below the average share price of the Company's common stock are assumed to be used to repurchase shares of the Company's common stock.

The Company excludes all potentially dilutive securities from its diluted earnings per share computation when their effect would be anti-dilutive. The following common stock equivalents were excluded from the earnings per share computation, as their inclusion would have been anti-dilutive (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<u>2004</u>	<u>2005</u>
Stock options excluded due to the exercise price exceeding the average fair value of the Company's common stock during the period.....	63,033	65,265
Weighted average common stock equivalents, calculated using the treasury stock method, that were excluded due to the Company reporting a net loss during the period.....	--	27,460
Total common stock equivalents excluded from diluted net income (loss) per share computation.....	<u>63,033</u>	<u>92,725</u>

Under the treasury stock method, stock options with exercise prices exceeding the average share price of the Company's common stock during the applicable period are excluded from the diluted earnings per share computation. These stock options had weighted average exercise prices of \$22.46 and \$20.12 per share during the three months ended March 31, 2004 and 2005, respectively. In addition, as discussed above, stock options with exercise prices equal to or below the average fair value of the Company's common stock were excluded from the diluted earnings per share computation because the Company reported a net loss during the three months ended March 31, 2005. The weighted average fair value of the Company's common stock during the three months ended March 31, 2005 was \$8.91 per share.

## 6. Restricted Stock and Restricted Stock Units

### *Restricted Stock*

On January 31, 2005, the Nominating and Corporate Governance Committee of the Company's Board of Directors approved 2005 compensation for its non-employee directors such that each non-employee director would receive compensation equivalent to the fair value of a stock option to purchase 20,000 shares of the Company's common stock (based on the Black-Scholes valuation model and the fair market value of the Company's common stock on the date of grant) to be allocated as follows: 50% in cash and 50% in shares of restricted stock that vest in full on January 31, 2006. Accordingly, in the first quarter of 2005 the Company awarded each of its non-employee directors compensation of \$32,500 in cash and 3,750 shares of restricted stock (an aggregate of 22,500 shares) that

will vest in full on January 31, 2006 in consideration for their service as a director in 2005. The Company recorded deferred compensation of \$0.2 million related to this issuance of restricted stock, which is being expensed on a straight-line basis over the one-year vesting period.

As of December 31, 2004 and March 31, 2005, a total of 71,000 and 90,000 shares, respectively, of the Company's common stock remain subject to repurchase by the Company. In the event an employee or member of the Company's Board of Directors discontinues service prior to the expiration of the vesting period, the Company may repurchase any unvested shares of the restricted stock at the lower of (i) the original purchase price of the restricted stock or (ii) the fair value of the Company's common stock. The Company's right to repurchase the shares lapses over the vesting period of the restricted stock. No compensation expense has resulted at the time of the repurchases of the Company's restricted shares since the consideration paid by the Company equaled the lower of (i) the original purchase price of the restricted stock or (ii) the fair value of the Company's common stock.

### ***Restricted Stock Units***

RSUs are similar to restricted stock in that they are issued for no, or nominal, consideration; however, the holder generally is not entitled to the underlying shares of common stock until the RSU vests. The following table presents the activity related to RSUs during the first quarter of 2005:

	<b>Number of RSUs</b>
Balances as of December 31, 2004.....	332,500
RSUs granted to employees.....	919,361
RSUs granted to officers.....	355,000
RSUs vested during period.....	(12,500)
RSUs canceled due to employee termination.....	(8,650)
Balances as of March 31, 2005.....	<u>1,585,711</u>

The Company recorded an aggregate of \$11.0 million of deferred compensation during the three months ended March 31, 2005 in connection with the issuance of these RSUs, which the Company is amortizing on a straight-line basis over the respective vesting periods. The RSUs granted during the first quarter of 2005 generally vest on the fourth anniversary of the date of grant; provided, however that a portion of the RSUs will accelerate and become vested upon achievement of all or a specified portion of certain defined objective financial performance goals.

Specifically, the Compensation Committee has approved the following four performance goals for 2005 and 2006:

- **2005:** revenue growth of approximately 15% compared to actual revenue achieved in 2004 and operating margin of 15%.
- **2006:** revenue growth of 15% compared to actual revenue achieved in 2005 and operating margin of 17%.

The revenue-based targets set forth above will be adjusted upward to incorporate any revenue from companies acquired during the relevant year (excluding the acquisition of edocs in 2005) and the operating margin-based targets will be adjusted for the impact of any acquisitions and certain unusual charges (e.g., stock-based compensation, restructuring expenses, etc.).

For each goal that is fully achieved, vesting will be accelerated for 25% of the total shares granted, such that half of such accelerated shares will vest on January 31 of the year in which the Compensation Committee determines that a goal has been met and the remaining half will vest on January 31 of the following year.

## 7. Segment and Geographic Information

The Company is principally engaged in the design, development, marketing and support of Siebel Business Applications, its family of front-office business software applications. Substantially all revenues result from the license of the Company's front-office software products and related professional services and customer support (maintenance) services. The Company's chief operating decision-maker (i.e., chief executive officer) reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, the Company considers itself to be in a single reporting segment, specifically the license, implementation and support of its software.

The Company evaluates the performance of its geographic regions based only on revenues. The Company does not assess the performance of its geographic regions on other measures of income or expense, such as depreciation and amortization, operating income or net income. In addition, the Company's assets are primarily located in the United States and not allocated to any specific region. The Company does not produce reports for, or measure the performance of, its geographic regions using any asset-based metrics. Therefore, geographic information is presented only for revenues. The following geographic information for total revenues is presented for the three months ended March 31, 2004 and 2005 (in thousands):

	Three Months Ended	
	March 31,	
	2004	2005
United States.....	\$ 196,774	\$ 179,052
Europe.....	101,264	97,834
Asia Pacific.....	24,885	13,804
Canada and Latin America.....	6,364	8,248
	<u>\$ 329,287</u>	<u>\$ 298,938</u>

International software license revenues for the three months ended March 31, 2004 and 2005 were \$57.2 million and \$32.1 million, respectively, representing 45% and 43% of software license revenues, respectively. The Company's international software license revenues are derived from countries principally in Europe and Asia Pacific, which includes Japan.

The following is a summary of the Company's software license revenues, by front-office product, for the three months ended March 31, 2004 and 2005 (in thousands):

	Three Months Ended	
	March 31,	
	2004	2005
Sales, marketing and service automation.....	\$ 98,008	\$ 54,686
Customer and business analytics.....	25,268	17,448
Customer data integration.....	3,523	2,844
Total.....	<u>\$ 126,799</u>	<u>\$ 74,978</u>

At times the Company licenses a combination of its products to its customers, with the actual product selection and number of licensed users determined subsequent to the initial license. The Company refers to these licenses as "Enterprise Licenses." The Company recognizes revenue from its Enterprise Licenses upon delivery of the first copy, or product master, for all of the products within the license, as all products have been licensed and delivered, and the customer has the right of use. During the three months ended March 31, 2004 and 2005, software license revenues from Enterprise Licenses were \$23.1 million and \$5.5 million, respectively. The Company estimates the allocation of the revenue from these Enterprise Licenses to individual software products based upon the expected usage by its customers and in a manner consistent with its determination of compensation for its sales personnel. The actual deployment of Enterprise Licenses by the Company's customers may differ from the revenue allocated in the above table.

Although the Company believes the above methodology of allocating revenue from its Enterprise Licenses is reasonable, there can be no assurance that such allocated amounts reflect the amounts that would result had the Company individually licensed each specific software solution. Further, the Company generally does not reevaluate the allocation of its revenue from Enterprise Licenses based on actual deployment by its customers.

The following is a summary of the Company's professional services, maintenance and other revenues, by service offering, for the three months ended March 31, 2004 and 2005 (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Maintenance.....	\$ 114,877	\$ 122,578
Professional services and other.....	87,611	101,382
Total.....	<u>\$ 202,488</u>	<u>\$ 223,960</u>

No single customer accounted for 10% or more of total revenues during the three months ended March 31, 2004 and 2005.

## **8. Subsequent Events**

On April 12, 2005, the Company's chief executive officer ("CEO"), J. Michael Lawrie, resigned as both the Company's CEO and as a member of its Board of Directors. In connection with Mr. Lawrie's resignation, the Company entered into a Separation and Consulting Agreement (the "Agreement") dated April 15, 2005. Pursuant to the Agreement and consistent with the severance terms of his offer letter, the Company made a cash payment of \$4.5 million to Mr. Lawrie, which represents his base salary and targeted annual cash bonus for two years. Under the Agreement, Mr. Lawrie will also receive certain other benefits, including healthcare benefits for a period of one year following separation.

Further, under the Agreement and consistent with the terms of Mr. Lawrie's offer letter, the 200,000 unvested shares of Mr. Lawrie's RSU for 350,000 shares of common stock (150,000 shares had already vested pursuant to the normal vesting schedule), and 800,000 shares of his outstanding stock option to purchase shares of our common stock, immediately vested in full upon his resignation. As a result of the acceleration of vesting of Mr. Lawrie's RSU, the Company recognized \$1.2 million of expense, representing the remaining unamortized deferred compensation associated with the RSUs, in April 2005.

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

*The statements contained in this quarterly report that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include, without limitation, statements regarding the extent and timing of future revenues, restructuring and other expenses and customer demand, statements regarding the development and deployment of our products, and statements regarding reliance on third parties. All forward-looking statements included in this quarterly report are based on information available to us as of the date of this quarterly report. We assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless we are required to do so by law. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions, including those in the section entitled "Risk Factors" and elsewhere in this quarterly report.*

### **Executive Summary**

Our consolidated financial statements are included in Item 1 of this Quarterly Report on Form 10-Q. The following discussion is designed to provide a better understanding of our consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, a summary of our operating results and certain key financial metrics, and our outlook for the second quarter of 2005. This executive summary should be read in connection with the more detailed discussion and analysis of our financial condition and results of operations in this Item 2, the section entitled "Risk Factors" in this Item 2, and our consolidated financial statements and notes included in Item 1 of this quarterly report.

### ***Overview of Our Business and Products***

We are a leading provider of business applications software for the front office. We consider the front office to include those areas of business activity that involve customer interactions, such as sales, marketing and service. We are principally engaged in the design, development, marketing, sale and support of our front-office business applications. A majority of our revenues are derived from perpetual licenses of our software products, the related professional services, such as training and implementation services, and the related customer support, otherwise known as maintenance. Specifically, we license our software in arrangements in which the customer purchases a combination of software, maintenance and/or professional services. Payment terms for our arrangements are negotiated with our customers and are based on a variety of factors, including the customer's credit standing and our history with the customer.

Siebel Business Applications—our comprehensive family of front-office business applications—are designed to help organizations better manage their customer, partner and employee relationships, analyze critical customer data, and execute customer-focused business processes. Our applications are designed to support these critical tasks while meeting the information technology requirements of any kind of organization, any type of user and any budget. Siebel Business Applications can be installed on premise, delivered as a hosted service over the Internet, or deployed as a combination of the two.

A substantial portion of our front-office business applications is focused on the customer relationship management, or CRM, market. CRM is an integrated approach to identifying, acquiring and retaining customers in order to help organizations maximize the value of customer interactions and improve corporate performance. Our sales, service and marketing applications are designed to help organizations perform and coordinate these operations across multiple communication channels (such as the Internet, telephone, fax, email and in person) and different lines of business, while providing their customers with a single, consistently high standard of service. The partner relationship management component of our CRM applications is designed to help an organization work collaboratively with its partners and resellers in one comprehensive information system in order to increase revenues, drive customer satisfaction and reduce partnership management costs.

Our front-office solutions also include our customer and business intelligence applications (also known as analytics), customer data integration solutions, and a deeper set of service offerings to assist our customers in maximizing the value received from our products. Specifically, our analytics applications assist customers in analyzing large volumes of corporate data quickly and easily. These analytics applications can access and aggregate information contained in systems across the enterprise—including financial management, human resources and supply chain systems—helping managers and front-line employees make informed decisions. Our customer data integration solutions enable organizations to more fully leverage the value of their corporate information by allowing them to share data and processes among different software applications.

In addition to licensing our applications on a per-user basis, we also offer two hosted software solutions, Siebel CRM OnDemand and Siebel Contact OnDemand, as services available over the Internet. Siebel CRM OnDemand offers customers CRM and analytics functionality and Siebel Contact OnDemand offers customers call center functionality. We provide these OnDemand solutions for a monthly per-user subscription fee, with a typical contractual period of one year. Our OnDemand solutions allow our customers to implement software solutions quickly, easily and cost-effectively. Our OnDemand solutions

integrate with the on-premise Siebel Application Suite, enabling organizations to deploy our solutions in any combination of online hosted or on-premise delivery models.

Siebel Services, our professional services organization, provides (i) implementation services (i.e., assistance with the integration of our software with other software and hardware applications), (ii) change management services (i.e., end user adoption consulting and training services for our customers regarding how to better use our software), (iii) testing and managed services (i.e., assistance with operating, maintaining, testing and optimizing our applications) and (iv) technical support and customer care services (i.e., trouble-shooting the related software products and future product updates). Siebel Services has significant product and implementation expertise and is committed to supporting customers and systems integrators throughout every phase of their adoption and use of Siebel Business Applications.

Our professional services are typically initiated and provided over a period of three to nine months subsequent to the licensing of our software and, accordingly, our professional services revenues vary directly with the levels of software license revenue generated in the preceding three- to nine-month period. Substantially all of our professional services arrangements are billed on a time and materials basis. Maintenance is typically sold with the related software license for a period of one year and is renewable at the option of the customer on an annual basis thereafter. Our maintenance revenues depend upon both our ability to generate additional software license revenue and annual renewals of maintenance agreements by our existing customer base.

### ***Improvement of Our Operating Performance***

In July 2004 we announced an operating performance improvement plan (the “Improvement Plan”), which we believe will help us return our operations to sustainable revenue growth and expand our operating margins. As part of the Improvement Plan we have been reviewing and continue to review our business thoroughly, with our primary focus in the following three areas: revenue generation, financial structure and leadership. A summary of the key elements of our Improvement Plan is included in Item 7 of our annual report on Form 10-K for the year ended December 31, 2004. We intend to further refine this plan in 2005 to further address our revenue generation capabilities and better align our financial structure with current revenue levels.

While we believe we are making progress towards achieving the objectives of the Improvement Plan, we clearly took a step back in the first quarter of 2005. After experiencing solid improvement in many of our key financial metrics during the third and fourth quarters of 2004, we underperformed in the first quarter of 2005, with our software license revenues declining by \$51.8 million, or 41%, from \$126.8 million in the first quarter of 2004 to \$75.0 million in the first quarter of 2005. While there are numerous factors that we believe may have contributed to the shortfall in our license revenues in the first quarter, we recognize that our execution was the primary factor.

We intend to improve our revenue generation capabilities and are committed to improving our execution and delivering more consistent growth. Some of the challenges that we faced during the first quarter of 2005—challenges we must address and are addressing—include:

- We experienced an increase in the number of approvals required by our customers prior to their execution of a software license and service agreement, possibly due to our customers’ efforts regarding Section 404 of the Sarbanes-Oxley Act of 2002, or SOX. These more stringent governance and purchasing requirements lengthened the purchasing cycle. Accordingly, our close ratio in the first quarter of 2005 was lower than we have typically achieved and anticipated.
- Many of our customers’ and potential customers’ budgeting processes were delayed during the first quarter of 2005, resulting in a delay of our customers’ purchasing decisions. As a result, we believe the first quarter of 2005 was more seasonal than we had expected.
- Several transactions slipped into the second quarter and second half of the year. It is important to note that we have since closed some of this business.
- We have added many new members to our management team in recent months who are still learning our business processes and products, while simultaneously engaging new and existing customers. Despite this initial learning curve, we believe our new leadership team has put the right plan in place to grow our business and we expect to see tangible benefits from their expertise in the near future.

We are taking immediate steps to remedy the setback that we experienced in the first quarter of 2005 and we are confident that we will be successful in our endeavors. For example, we have or intend to:

- Implement a new account planning and customer engagement model. The focus of this model is on growing the size and quality of our pipeline for the second half of the year and beyond.
- Ensure that our entire executive management team's primary focus is on monitoring and closing business.
- Revitalize our partners and alliance program. Historically, we have found these relationships to be enormously important in building the size and quality of our pipeline.
- Launch a new marketing campaign and message—"it's all about the customer"—which communicates our commitment to customer value.
- Simplify our sales management and organization structure to promote clarity, responsiveness and accountability.

Notwithstanding the setback in our quest to improve our revenue generation capabilities, we believe the underlying demand for our products exists. The shortfall in our results was largely a result of addressable execution issues. We intend to address our execution issues and will take action to improve our profitability until we see improving core software license revenue or sufficient offsetting growth in other areas of our business. Specifically to improve our profitability at the current revenue levels and to allow for expansion of margins as revenues improve, we intend to implement additional cost control measures. In the first phase of our new cost control initiatives, we intend to reduce discretionary sales, marketing and general and administrative spending, including selective reductions in personnel. In the second phase of our cost control initiatives, we plan to optimize and reprioritize our development projects and resources such that we focus on areas that represent growth opportunities and have shown growth in the last few quarters. Likewise, we are going to review our investments in some of the less promising geographic areas that are not showing positive results. We expect that these actions will improve operating margins in the second quarter and beyond.

Despite the shortfall in our software license revenues, there were a number of positive areas in our business during the first quarter of 2005. Professional services and other revenues increased by \$13.8 million or 16%, from \$87.6 million during the first quarter of 2004 to \$101.4 million during the first quarter of 2005. Maintenance renewals remained very solid during the quarter at nearly 90%, with maintenance revenues growing by 7% from \$114.9 million in the first quarter of 2004 to \$122.6 million in the first quarter of 2005. Our OnDemand total contract value was approximately \$11.2 million as of March 31, 2005, up over 250% compared to the same period in 2004, and the number of subscribers increased on a year-over-year basis by 16,600, nearly doubling. Our latest version of CRM OnDemand has recently been recognized by a leading research firm as a leader in hosted CRM capability. Our small and medium-sized business ("SMB") initiative—introduced in the second half of 2004 as part of our Improvement Plan—exceeded our goals. Finally, the number of live users of our software increased by nearly 300,000 during the first quarter of 2005 to 3.2 million users.

## Summary of Our Operating Results for 2004 and Certain Key Financial Metrics

The following is a brief summary of our key financial metrics and operating results for the three months ended March 31, 2004 and 2005 (in thousands, except EPS, percentages and DSO):

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2005</b>
<b>Revenues:</b>		
Software license.....	\$ 126,799	\$ 74,978
Maintenance.....	114,877	122,578
Professional services and other.....	87,611	101,382
Total revenues.....	<u>\$ 329,287</u>	<u>\$ 298,938</u>
Annualized total revenue per employee.....	<u>\$ 269</u>	<u>\$ 232</u>
<b>Cost and expenses:</b>		
Restructuring and acquisition-related expenses (1).....	\$ 571	\$ 11,382
All other costs and expenses, on-going (2).....	292,151	309,471
Total costs and expenses.....	<u>\$ 292,722</u>	<u>\$ 320,853</u>
<b>Other key operating statistics:</b>		
Operating income (loss).....	\$ 36,565	\$ (21,915)
Operating margin.....	11 %	(7)%
Earnings (loss) per share, diluted ("EPS").....	\$ 0.06	\$ (0.01)
Cash flows from operations.....	\$ 89,799	\$ 47,917
	<b>December 31,</b>	<b>March 31,</b>
	<b>2004</b>	<b>2005</b>
<b>Balance sheet statistics:</b>		
Cash and short-term investments.....	\$ 2,246,488	\$ 2,196,276
Deferred revenue.....	\$ 357,223	\$ 365,979
Days sales outstanding ("DSO").....	67	77
Working capital.....	\$ 1,866,869	\$ 1,827,059
Total stockholders' equity.....	\$ 2,246,644	\$ 2,293,590

- (1) Please refer to "Restructuring and Related Expenses" and "Purchased In-Process Product Development" in the following pages for a further discussion of these expenses.
- (2) Represents the sum of (i) total cost of revenues, (ii) product development expense, (iii) sales and marketing expense and (iv) general and administrative expense. We believe these expenses are more representative of our on-going operations.

- **Software license revenues** decreased on a year-over-year basis during the three months ended March 31, 2005 by 41%, primarily due to our inability to properly close on our sales pipeline for the quarter. Also contributing to this decline were (i) a weaker information technology spending environment—particularly spending on enterprise application software and (ii) an increase in the seasonality of our results between the fourth quarter and first quarter.

To illustrate this increase in seasonality, our software license revenues declined sequentially by 53% in the first quarter of 2005 from the fourth quarter of 2004, compared to a 16% sequential decline in the first quarter of 2004. We believe the decline from the fourth quarter of 2004 to the first quarter of 2005 is comparable to the historical trends of our competitors and more mature software companies.

- **Maintenance revenues** increased on a year-over-year basis during the three months ended March 31, 2005 by 7%, primarily due to new maintenance agreements entered into in connection with new software licenses. In addition, the renewal rates among our existing customer base remains strong, with a renewal rate of approximately 90% during the first quarter of 2005.
- **Professional services and other revenues**, which primarily relate to implementation and training services performed in connection with new software licenses, increased on a year-over-year basis during the three months ended March 31, 2005 by 16%. Our professional services and other revenues increased on year-over-year basis primarily due to growth in new service offerings, including (i) additional service offerings associated with the



products of edocs, Inc. (“edocs”), which we acquired on January 14, 2005, and (ii) growth of our CRM OnDemand hosted service offering.

- **Annualized total revenue per employee** decreased from \$269,000 per employee during the three months ended March 31, 2004 to \$232,000 per employee during the three months ended March 31, 2005. The decrease was primarily due to the year-over-year decreases in our software license revenues for the reasons discussed previously, coupled with a year-over-year increase in our employee base that occurred as a result of (i) our acquisitions of edocs and Eontec Limited (“Eontec”) and (ii) additions in anticipation of an improvement in our operating performance that did not materialize.
- **Total costs and expenses** increased by \$17.3 million, or 6%, during the three months ended March 31, 2005 as compared to the respective period in 2004 primarily due to an increase of (i) \$21.6 million related to the expansion of our employee base as a result of our acquisitions of edocs and Eontec, coupled with additions in anticipation of an improvement in our operating performance that did not materialize, (ii) \$10.7 million associated with costs that vary directly or indirectly with our professional services revenues and (iii) \$1.3 million associated with legal and tax-related expenses. Partially offsetting these increases were further cost savings of \$16.3 million from our costs controls, including reductions in depreciation expense and travel and entertainment (“T&E”) expenses.
- **Operating income** decreased from \$36.6 million, representing an operating margin of 11%, during the three months ended March 31, 2004 to an operating loss of \$21.9 million, representing a negative operating margin of 7%, during the three months ended March 31, 2005. Our operating income and margin decreased on a year-over-year basis primarily due to (i) the decline in our software license revenues discussed above, (ii) a purchased in-process product development expense of \$10.9 million associated with our acquisition of edocs and (iii) a net increase in our total costs and expenses for the reasons described above.
- **Cash and short-term investments** decreased by \$50.2 million, or 2%, from \$2,246.5 million as of December 31, 2004 to \$2,196.3 million as of March 31, 2005, primarily due to net acquisition-related expenditures of \$93.1 million (\$103.2 million of consideration paid, net of cash received of \$10.1 million) associated with our acquisition of edocs on January 14, 2005, partially offset by our continued positive cash flows from operations of \$47.9 million.
- **Accounts receivable**—Days sales outstanding (“DSO”) were 67 days and 77 days as of December 31, 2004 and March 31, 2005, respectively.
- **Deferred revenues**, which tend to be seasonal based on calendar year end renewals, increased by \$8.8 million, or 2%, from \$357.2 million as of December 31, 2004 to \$366.0 million as of March 31, 2005, primarily due to our expanded base of customers receiving maintenance.
- **Working capital** decreased from \$1,866.9 million as of December 31, 2004 to \$1,827.1 million as of March 31, 2005 primarily due to acquisition-related expenditures of \$93.1 million, partially offset by our continued positive cash flows from operations of \$47.9 million. With virtually no debt and a strong working capital position, we believe that we have the flexibility to continue to invest in revenue generation capabilities and, when prudent, selectively acquire technologies or companies to strengthen our product portfolio.
- **Stockholders’ equity** was \$2,246.6 million and \$2,293.6 million as of December 31, 2004 and March 31, 2005, respectively.

## **Outlook**

Our outlook for the second quarter of 2005 discussed below is based, in part, on our review of our current sales pipeline, internal sales forecasts, recent surveys among information technology executives and current economic indicators. For the second quarter of 2005, we currently anticipate that our total revenues will be between \$310 million and \$330 million. We expect the individual components of our total revenues to be within the following ranges:

- software license revenues—between \$90 million and \$100 million;
- maintenance revenues—between \$121 million and \$123 million; and
- professional services and other revenues—between \$100 million and \$105 million.

Our expectations regarding our revenues and ability to execute against those expectations may be negatively impacted by many factors, including (i) a deterioration in global economic conditions and/or information technology spending; (ii) a continued lengthening of our sales cycle and/or reduction in our sales pipeline; (iii) additional terrorist attacks or threats of terrorist attacks; (iv) geopolitical uncertainties, including continued hostilities involving the United States; (v) corporate and consumer confidence in the economy, as evidenced, in part, by the levels of the stock market; (vi) continued intense competition, including new technological innovations within our industry; (vii) the uncertainty in the application software industry and resulting reductions in capital expenditures; (viii) the loss of or inability to hire enough key employees and attrition in general; and (ix) other factors, including those described under “Risk Factors” below.

We expect total costs and expenses in the second quarter of 2005 to approximate the levels in the first quarter, primarily due to the additional cost controls discussed previously. Our expectations regarding our total costs and expenses are prior to costs associated with employee separations, including the costs discussed in Note 8 to the accompanying unaudited consolidated financial statements, and any other restructuring-related costs that may be incurred, if any. We expect these cost savings to be offset by (i) an increase in expenses that vary directly with revenues, such as “cost of professional services revenues,” incentive compensation and commissions, and (ii) increases in personnel-related costs (i.e., salaries) associated with merit increases that were effective April 1, 2005.

As discussed further in Note 3 to the accompanying consolidated financial statements, certain of our U.S. payroll tax returns, U.S. sales and use tax returns and international sales and valued added tax returns are currently under examination and/or review by the applicable taxing authorities. While we believe that we have made adequate provisions related to the audits of these tax returns, the final determination of our obligations may exceed the amounts provided for by us. Specifically, we may receive assessments related to the audits and/or reviews of these tax returns that exceed amounts provided for by us. In the event we are unsuccessful in reducing the amount of such assessments, our estimates related to our total costs and expenses could be adversely affected.

As a result of the anticipated increases in our total revenue levels, we currently expect operating income and margin to increase in the second quarter of 2005 from levels obtained in first quarter. Our expectations regarding operating income depend in large part on our ability to grow our software license and professional services revenues.

Uncertainty with respect to the timing and amount of our future revenues could significantly impact the above expectations and our future operations. Our sales personnel monitor the status of all potential transactions, including the estimated closing date and potential dollar amount of each transaction. We aggregate these estimates periodically to generate a sales pipeline and then evaluate the pipeline to identify trends in our business. This pipeline analysis and related estimates of revenue may differ significantly from actual revenues in a particular reporting period. A variation in the pipeline or in the conversion rate of the pipeline into contracts could cause us to plan or budget inaccurately and thereby could adversely affect our business, financial condition or results of operations. In addition, because we expect that a substantial portion of our software license contracts will continue to close in the latter part of a quarter, management would not be able to adjust our cost structure to respond to a variation in the conversion of the pipeline, which may adversely and materially affect our business, financial condition or results of operations.

We expect other income, net for the second quarter of 2005 to be between approximately \$13.0 million and \$15.0 million.

We currently expect our effective tax rate for the second quarter of 2005 to be approximately 35%. The estimated effective tax rate is based on current tax law and our expected annual income and may be affected by the jurisdictions in which profits are determined to be earned and taxed and our ability to realize deferred tax assets.

As discussed in Note 3 to the accompanying consolidated financial statements, our U.S. Federal income tax returns for 2001 through 2003 are currently under examination by the Internal Revenue Service (“IRS”). While the final resolution of the IRS’s on-going examination is uncertain, we believe that we have made adequate provision in the accompanying consolidated financial statements for any adjustments that the IRS has or may propose with respect to our U.S. Federal income tax returns. The final determination of our tax obligations may exceed the amounts provided for by us in the accompanying consolidated financial statements. We will continually review our estimates related to our income tax obligations, including potential assessments from the IRS of additional taxes, penalties and/or interest, and revise our estimates, if deemed necessary. A revision in our estimates of our tax obligations will be reflected as an adjustment to our income tax provision at the time of the change in our estimates. Such a revision could materially impact our effective tax rate, income tax provision and net income.

## **Discussion of the Results of Operations for the Three Months Ended March 31, 2004 and 2005**

### ***Revenues***

Our total revenues decreased from \$329.3 million during the three months ended March 31, 2004 to \$298.9 million during the three months ended March 31, 2005, representing a year-over-year decline of 9%. Our total revenues decreased during 2005 primarily due to a \$51.8 million decrease in our software license revenues, partially offset by an increase of \$21.5 million in our professional services, maintenance and other revenues. In order to provide a better understanding of the year-over-year changes and underlying trends in our revenues, we have provided the following discussion of each of the individual components of our total revenues:

### ***Software***

The following table sets forth our software license revenues, both in absolute dollars and as a percentage of total revenues, for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Software license revenues.....	\$ 126,799	\$ 74,978	\$ (51,821)	(41)%
Percentage of total revenues.....	38 %	25 %		

Software license revenues decreased by 41% from the three months ended March 31, 2004 to the three months ended March 31, 2005 primarily due to our inability to properly execute in building and closing an adequate sales pipeline for the quarter. Also contributing to this decline were (i) increases in the seasonality of our results between the fourth quarter and first quarter and (ii) a weaker information technology spending environment—particularly spending on enterprise application software.

The year-over-year decline in our software license revenues during the three months ended March 31, 2005 was across all of our product lines, with our core sales, marketing and service automation product line declining by 44%, our analytics product line declining by 31% and our customer data integration product line declining by 19%. The following is a summary of our software license revenues, by front-office product, for the three months ended March 31, 2004 and 2005 (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Sales, marketing and service automation.....	\$ 98,008	\$ 54,686
Customer and business analytics.....	25,268	17,448
Customer data integration.....	3,523	2,844
Total.....	<u>\$ 126,799</u>	<u>\$ 74,978</u>

To provide further insight into current trends within our software license revenues, we have included the following summary of certain key operating metrics that we use to track the progress of our on-premise software license revenues:

<b>Other key software license metrics:</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Transactions equal to or greater than \$5 million.....	3	1
Transactions between \$1 million and \$5 million.....	26	21
Total number of transactions.....	306	244
Average transaction size (in thousands).....	\$ 414	\$ 307

As the above table indicates, the declines in our revenues were primarily associated with our largest transactions—those generating revenue of \$1 million and over—which decreased on a year-over-year basis from a total of 29 transactions during the first quarter of 2004 to 22 transactions during the first quarter of 2005. Further, our average transaction size decreased from \$414,000 in the first quarter of 2004 to \$307,000 in the first quarter of 2005 due primarily to the decline in these larger transactions (particularly the transactions generating revenue in excess of \$5.0 million). The total number of transactions declined from 306 transactions in the 2004 period to 244 transactions in the 2005 period, primarily due to our inability to close our pipeline as discussed previously. As further outlined above under “Improvement of Our Operating Performance,” we have taken and will continue to take the necessary steps to improve our revenue generation capabilities and overall execution across all product lines, geographic regions and transaction sizes.

We market our products through our direct sales force, and to a limited extent through distributors primarily in Europe, Asia Pacific, Japan and Latin America. International license revenues accounted for 45% and 43% of software license revenues during the three months ended March 31, 2004 and 2005, respectively. We expect international software license revenues will continue to account for a significant portion of our overall software license revenues in the foreseeable future. Because the majority of our software license arrangements and related operating activities are denominated in U.S. dollars, foreign currency exchange rates did not have a significant impact on software license revenues, total revenues or net income for any period presented.

Professional Services, Maintenance and Other

Professional services, maintenance and other revenues are primarily composed of implementation services and training services (i.e., professional services) and technical support and product updates (i.e., maintenance). Our professional services are typically initiated and provided over a period of three to nine months subsequent to the licensing of our software and depend in large part upon our software license revenues in the immediate preceding periods. Substantially all of our professional services arrangements are billed on a time and materials basis and, accordingly, are recognized as the services are performed.

Our maintenance revenues depend upon both our software license revenues and renewals of maintenance agreements by our existing customer base. Our customers typically prepay maintenance for the first year in connection with a new software license and may renew on an annual basis thereafter. We reflect the prepayment of the maintenance contract in deferred revenue and recognize the revenue ratably over the term of the maintenance contract based on the number of days the contract is outstanding during each period.

Also included in professional services, maintenance and other revenues is revenue from our newest service offerings, Siebel CRM OnDemand and Siebel Contact OnDemand. Our customers typically prepay for these subscription services, which we defer and recognize ratably over the term of the customer contract based on the number of days the contract is outstanding during each period.

Professional services, maintenance and other revenues increased by \$21.5 million, or 11%, from \$202.5 million for the three months ended March 31, 2004 to \$224.0 million for the three months ended March 31, 2005 primarily due to (i) growth in our professional service and other revenues, including increases associated with additional service offerings from the products of edocs and growth of our CRM OnDemand hosted service offering, and (ii) an increase in our installed base of customers receiving maintenance.

In order to better understand the changes within our professional services, maintenance and other revenues, we have provided the following table, which sets forth the individual components of these revenues in terms of absolute dollars and as a percentage of total revenues (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
<b>Maintenance:</b>				
Absolute dollars.....	\$ 114,877	\$ 122,578	\$ 7,701	7 %
Percentage of total revenues.....	35 %	41 %		
<b>Professional services and other:</b>				
Absolute dollars.....	\$ 87,611	\$ 101,382	\$ 13,771	16 %
Percentage of total revenues.....	27 %	34 %		

Our maintenance revenues, in absolute dollars and as a percentage of total revenues, increased during the first quarter of 2005 compared to the first quarter of 2004, primarily due to new maintenance agreements entered into in connection with the license of our software to new and existing customers. In addition to expanding our customer base receiving maintenance, we continue to maintain strong renewal rates within our existing customer base, with renewal rates of approximately 90%.

Our professional services and maintenance revenues increased sequentially for the fourth consecutive quarter, growth we attribute primarily to the Improvement Plan we implemented in July 2004. Specifically, professional services and other revenues, both in absolute dollars and as a percentage of total revenues, increased during the three months ended March 31, 2005 from the respective period in 2004, primarily due to (i) growth of our CRM OnDemand hosted service offering and continued improvement of our existing service offerings, representing increases aggregating \$8.5 million, (ii) additional service offerings associated with the products of edocs, representing an increase of \$3.6 million and (iii) an increase in our revenue from billable T&E expenses of \$1.7 million.

While we are pleased with this continued improvement in our professional services revenues, due to the dependency of our professional services on previous software license revenues, we recognize that we must return our software license revenues to positive sequential growth in order to continue this positive trend. Specifically, because our professional services are initiated and performed over a three- to nine-month period subsequent to signing the software license, trends in these revenues generally follow trends in our software license revenues by three to nine months.

### ***Cost of Revenues***

The following table sets forth our cost of revenues, both in absolute dollars and as a percentage of total revenues, for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Cost of revenues.....	\$ 111,421	\$ 116,862	\$ 5,441	5 %
Percentage of total revenues.....	34 %	39 %		
Gross Margin.....	66 %	61 %		

The increase in our cost of revenues during the first quarter of 2005 compared to the first quarter of 2004 was primarily due to an increase in the demand for our professional services and maintenance services, which in turn resulted in an increase in the corresponding cost of revenues. Cost of revenues increased as a percentage of our total revenues primarily due to a higher percentage of our revenues being derived from our professional services, which are at lower margins than our software license revenues.

In order to better understand the changes within our cost of revenues and resulting gross margins, we have provided the following discussion of the individual components of our cost of revenues:

### **Software**

Cost of software license revenues includes amortization of acquired technology, third-party software royalties and product packaging, production and documentation. All costs incurred in the research and development of software products and enhancements to existing products have been expensed as incurred. The following table sets forth our cost of software license revenues in terms of absolute dollars and as a percentage of software license revenues for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Cost of software license revenues.....	\$ 3,207	\$ 3,898	\$ 691	22 %
Percentage of software license revenues.....	3 %	5 %		

Cost of software license revenues increased in absolute dollars and as a percentage of software license revenues from the first quarter of 2004 to the first quarter of 2005 primarily due to increases in amortization expense of \$1.0 million associated with our acquisitions of Eontec in April 2004 and edocs on January 14, 2005. Partially offsetting these increases were net declines in costs that vary directly with software license revenues such as third-party royalties and product packaging and shipping costs.

Professional Services, Maintenance and Other

Cost of professional services, maintenance and other revenues consist primarily of personnel, facilities and systems costs incurred to provide training, consulting, technical support and other professional services. The following table sets forth our cost of professional services, maintenance and other revenues in terms of absolute dollars and as a percentage of these revenues for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	Three Months Ended March 31,			
	2004	2005	Change	%
Cost of professional services, maintenance, and other revenues.....	\$ 108,214	\$ 112,964	\$ 4,750	4 %
Percentage of professional services, maintenance, and other revenues.....	53 %	50 %		

The following is a summary of the year-over-year changes of our cost of professional services, maintenance and other revenues during the three months ended March 31, 2005 from the respective period in 2004 (in thousands):

<u>Cost component:</u>	<u>Year-Over- Year Change</u>
Outside consulting and cost of training.....	\$ 8,680
Personnel-related costs (compensation, benefits, etc.)....	3,250
Rebillable T&E expenses.....	1,690
Amortization of intangibles.....	354
Depreciation expense.....	(5,250)
Facility-related costs (rent, utilities, etc.).....	(2,588)
Non-billable T&E expenses.....	(1,386)
Total year-over-year change.....	<u>\$ 4,750</u>

Cost of professional services, maintenance and other revenues increased on a year-over-year basis during the three months ended March 31, 2005 primarily due to an increase in the demand for our professional services and maintenance offerings. Specifically, as a result of the increase in the demand for these services we increased the use of outside consultants commensurate with the increase in demand for our services in order to supplement customer engagements in lieu of hiring additional personnel. Accordingly, outside consulting and cost of training increased on year-over-year basis in the first quarter of 2005.

Personnel-related costs also increased on a year-over-year basis during 2005, primarily due to additional incentive compensation earned as a result of the continued improvement in our professional services revenues and margins. Specifically, while the demand for our professional services increased during the first quarter of 2005 compared to the first quarter of 2004, we were able to meet this increased demand with a smaller workforce (average headcount of 2,020 in the three months ended March 31, 2004 compared to 1,980 in the three months ended March 31, 2005) through the improvement in our utilization rates (i.e., utilization rates increased on a year-over-year basis by nearly 15%).

Similarly, as a result of the increased demand for these services, rebillable T&E expenses increased commensurate with the increases in our professional services revenues. Also contributing to the increase in our cost of professional services, maintenance and other revenues during the first quarter of 2005 compared to the first quarter of 2004 was an increase of \$0.4 million related to amortization expense that resulted from intangible assets obtained in our acquisitions of edocs and Eontec.

Partially offsetting the above increases in cost of professional services revenues were further reductions in these costs due to our cost control initiatives (e.g., the Restructurings, as described more fully in Note 2 to the accompanying unaudited consolidated financial statements and our continued attention to expense reduction). For example, previous reductions in our capital expenditures resulted in further declines in depreciation expense and previous consolidations of our facilities have resulted in further reductions in our facility-related expenses. In addition, we continue to monitor discretionary expenditures, such as non-billable T&E expenses, resulting in further reductions in our cost of professional services, maintenance and other revenues.

Cost of professional services, maintenance and other revenues as a percentage of the corresponding revenues decreased from 53% during the three months ended March 31, 2004 to 50% during the three months ended March 31, 2005, primarily due to the higher utilization rate of our professional services staff. Accordingly, our gross margin related to our professional services, maintenance and other revenues improved from 47% during the three months ended March 31, 2004 to 50% during the three months ended March 31, 2005.

## ***Operating Expenses***

### ***Product Development***

Product development expense includes costs associated with the development of new products, enhancements of existing products, quality assurance activities and vertical engineering. These costs consist primarily of employee salaries and benefits, occupancy costs, consulting costs and the cost of software development tools and equipment. The following table sets forth our product development expense in terms of absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Product development expense.....	\$ 72,633	\$ 74,717	\$ 2,084	3 %
Percentage of total revenues.....	22 %	25 %		

The following is a summary of the year-over-year changes of our product development expenses during the three months ended March 31, 2005 from the respective period in 2004 (in thousands):

<b>Cost component:</b>	<b>Year-Over- Year Change</b>
Personnel-related costs (compensation, benefits, etc.)....	\$ 6,175
Outside consulting and other costs, net.....	990
Depreciation expense.....	(4,008)
T&E expenses.....	(1,073)
Total year-over-year change.....	<u>\$ 2,084</u>

Personnel-related costs increased on a year-over-year basis during the three months ended March 31, 2005, primarily due to an increase in the number of personnel devoted to our product development efforts, including additional personnel obtained in our acquisitions of edocs and Eontec. Specifically, the average headcount in our product development organization increased from 1,315 in the three months ended March 31, 2004 to 1,450 in the three months ended March 31, 2005. Similarly, we continue to supplement our investment in product development with outside consultants performing a portion of our quality assurance and testing activities in labor markets with lower cost structures. The above headcount data does not include these outside consultants.

Partially offsetting these increases were further reductions in our product development costs due to our cost control initiatives (e.g., the Restructurings and our continued attention to expense reduction). For example, previous reductions in our capital expenditures resulted in further declines in depreciation expense and the continued close monitoring of discretionary expenditures resulted in further reductions in our T&E expenses.

As a percentage of total revenues, product development expense increased from 22% during the three months ended March 31, 2004 to 25% during the three months ended March 31, 2005, primarily due to our continued investment in product development despite declines in our revenues.

### ***Sales and Marketing***

We continue to place significant emphasis, both domestically and internationally, on direct sales through our sales force. Sales and marketing expense is composed primarily of costs associated with our sales and marketing personnel and includes (i) salaries, commissions and bonuses, (ii) facility-related (i.e., rent) and equipment-related (i.e., depreciation) expenses, (iii) T&E expenses and (iv) promotional and advertising expenses. The following table sets forth our sales and marketing expense in terms of absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Sales and marketing expense.....	\$ 86,398	\$ 92,274	\$ 5,876	7 %
Percentage of total revenues.....	26 %	31 %		

The following is a summary of the year-over-year changes of our sales and marketing expenses during the three months ended March 31, 2005 from the respective period in 2004 (in thousands):

<b>Cost component:</b>	<b>Year-Over- Year Change</b>
Personnel-related costs (compensation, benefits, etc.).....	\$ 9,059
Facility-related costs (rent, utilities, etc.).....	1,754
T&E expenses.....	800
Marketing and advertising.....	563
Depreciation expense.....	(2,805)
Sales commissions.....	(4,011)
Other, net.....	516
Total year-over-year change.....	<u>\$ 5,876</u>

Personnel-related costs increased on a year-over-year basis during the three months ended March 31, 2005 primarily due to an increase in the number of personnel in our sales and marketing organizations, including additional personnel obtained in our acquisitions of edocs and Eontec. Specifically, the average headcount in our sales and marketing organizations increased from 1,025 in the three months ended March 31, 2004 to 1,150 in the three months ended March 31, 2005. As a result of the increase in the number of personnel within these organizations, the facility-related and the T&E expense components of our sales and marketing expense increased on a year-over-year basis during the first quarter of 2005. In addition, we increased our investment in marketing and advertising during the first quarter of 2005 in order to better strengthen our sales pipeline for future periods.

Partially offsetting these increases were further reductions in our sales and marketing costs due to our cost control initiatives (e.g., the Restructurings and our continued attention to expense reduction). For example, previous reductions in our capital expenditures resulted in further declines in depreciation expense during the first quarter of 2005. Our sales commission expense declined by \$4.0 million during the three months ended March 31, 2005, primarily due to a decrease in our software license revenues.

Sales and marketing expenses increased as a percentage of total revenues from 26% during the three months ended March 31, 2004 to 31% for the three months ended March 31, 2005, primarily due to our increased investment in our sales and marketing activities during a period in which our revenues declined.

#### General and Administrative

General and administrative expense is composed primarily of costs associated with our executive and administrative personnel (e.g., the CEO and legal, finance, information technology, human resources and facilities personnel) and consists primarily of (i) salaries and occupancy costs, (ii) provision for doubtful accounts (i.e., bad debt expense), (iii) professional services expenses (e.g., audit fees and costs associated with compliance with the Sarbanes-Oxley Act of 2002, or SOX) and (iv) legal expenses. The following table sets forth our general and administrative expense in terms of absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
General and administrative expense.....	\$ 21,699	\$ 25,618	\$ 3,919	18 %
Percentage of total revenues.....	7 %	9 %		

The following is a summary of the year-over-year changes of our general and administrative expenses during the three months ended March 31, 2005 from the respective period in 2004 (in thousands):

<b>Cost component:</b>	<b>Year-Over- Year Change</b>
Personnel-related costs (compensation, benefits, etc.).....	\$ 3,082
Legal and tax-related expenses.....	1,223
Bad debt expense.....	1,000
Professional services and other costs, net.....	314
Depreciation expense.....	(918)
T&E expenses.....	(782)
Total year-over-year change.....	<u>\$ 3,919</u>



The personnel-related cost component of general and administrative expenses increased on a year-over-year basis during the three months ended March 31, 2005 primarily due to (i) our continued investment in additional executive personnel as outlined above under the section entitled “Improvement of Our Operating Performance,” and (ii) continued investment in additional financial and administrative personnel as part of our on-going commitment to strong internal controls. Specifically, our average headcount in our administrative organization increased from 540 in the three months ended March 31, 2004 to 570 in the three months ended March 31, 2005.

General and administrative expenses also increased on a year-over-year basis due to further increases in legal and tax-related expenditures. Please refer to Note 3 to the accompanying unaudited consolidated financial statements for a further discussion of these legal and tax-related matters. Bad debt expense increased on a year-over-year basis during the first quarter of 2005, primarily due to a higher recovery rate of amounts previously written-off during the 2004 period compared to the level of recoveries during the 2005 period. We continue to maintain strong collection efforts, including further reductions in accounts receivable levels and an improved accounts receivable aging.

Partially offsetting these increases were further reductions in our general and administrative costs due to our cost control initiatives (e.g., the Restructurings and our continued attention to expense reduction). For example, previous reductions in our capital expenditures resulted in further declines in depreciation expense and the continued close monitoring of discretionary expenditures resulted in further reductions in our T&E expenses.

General and administrative expense increased as a percentage of total revenues from 7% during the three months ended March 31, 2004 to 9% for the three months ended March 31, 2005, primarily due to our increased investment in our general and administrative organization during a period in which our revenues declined.

### Restructuring and Related Expenses

As further described in Note 2 to the accompanying unaudited financial statements, we initiated a series of restructurings of our operations designed to better align our operating structure with expected revenue levels (the “Restructurings”). The Restructurings included the following key measures: (i) the reduction of our workforce across all functional areas; (ii) the consolidation of our excess facilities; (iii) the abandonment of certain long-lived assets, including leasehold improvements, furniture and fixtures; and (iv) the transfer of certain technical support, quality assurance and other product development positions to labor markets with lower cost structures.

The following table summarizes the restructuring and related expenses incurred during the three months ended March 31, 2005, and the remaining obligations related to the Restructurings as of December 31, 2004 and March 31, 2005 (in thousands):

	<b>Employee Termination Costs (1)</b>	<b>Facility- Related Costs (2)</b>	<b>Total</b>
Restructuring obligations, December 31, 2004.....	\$ 265	\$ 105,601	\$ 105,866
Restructuring and related expenses:			
Accretion related to the Restructurings (3).....	--	492	492
Total.....	--	492	492
Cash payments.....	(24)	(9,027)	(9,051)
Restructuring obligations, March 31, 2005.....	<u>\$ 241</u>	<u>\$ 97,066</u>	<u>\$ 97,307</u>
Less: Restructuring obligations, short-term.....			29,953
Restructuring obligations, long-term.....			<u>\$ 67,354</u>

- (1) The costs associated with our workforce reductions consist primarily of severance payments, COBRA benefits, payroll taxes and other associated termination costs. The remaining obligations as of March 31, 2005 relate to less than five terminations that have yet to be completed, primarily due to regulatory requirements in certain countries outside the U.S. We expect to complete these terminations within 2005.
- (2) The costs associated with our facilities consolidation primarily relate to lease termination costs, costs associated with satisfying remaining lease commitments, and expected brokerage and other re-letting costs, partially offset by estimated sublease income.
- (3) We will continue to accrete our obligations related to the Restructurings to the then present value and, accordingly, will recognize additional accretion expense as a restructuring and related expense in future periods.

The total restructuring charge and related cash outlay are based on management's current estimates, which may change materially if further consolidations are required or if actual lease-related expenditures or sublease income differ from amounts currently expected. We will review the status of our restructuring activities quarterly and, if appropriate, record changes to its restructuring obligations in current operations based on management's most current estimates. Please refer to Note 2 to the accompanying unaudited consolidated financial statements for a further discussion of our Restructurings.

Purchased In-Process Product Development

On January 14, 2005, we acquired all of the issued and outstanding shares of edocs, a leading provider of electronic bill presentment and customer self-service software solutions. edocs' solutions enable companies to improve customer service and increase customer loyalty while reducing the cost of serving their customers. Companies use edocs' solutions to move the most common customer inquiries and transactions—such as billing, account management and service order issues—from expensive channels such as paper correspondence and contact center calls to lower-cost self-service and assisted care channels such as the web, email and chat. We believe that edocs' existing technology and certain products and functionality under development by edocs at the time of purchase will enhance our current self-service offerings.

The technology being developed by edocs at the time of our acquisition, which is commonly referred to as IPR&D, primarily related to edocs' products designed specifically for the telecommunications, healthcare and credit card industries. We estimated the fair value of the IPR&D acquired in our acquisition of edocs to be \$10.9 million. Because the IPR&D had not yet reached technological feasibility and had no alternative future use, we reflected a \$10.9 million expense under the heading "purchased in-process product development" in the accompanying unaudited statements of operations for the three months ended March 31, 2005.

At the date of our acquisition of edocs, there were six products under development, with percentage completion for each of the IPR&D products ranging from approximately 50% to 75%. We expect to incur between \$1.5 and \$2.5 million to complete the development of these products. We expect to complete these products at various dates in 2005. We determined the fair values of the IPR&D using the "income" valuation approach and discount rates ranging from 20% to 32%. The discount rates selected were based in part on considerations of the rate of return implied by the purchase price and the risk associated with achieving forecasted cash flows for edocs.

Further, in calculating the value of amounts assigned to IPR&D, we also considered the relevant market sizes and growth factors of the technologies, our intended use of the products, expected industry trends, the anticipated nature and timing of new product introductions by us and our competitors, individual product sales cycles, and the estimated lives of each of the products' underlying technologies. We also gave consideration to the technologies' stage of completion, the complexity of the work completed to date, the difficulty of completing the remaining development, costs already incurred, and the expected cost to complete the project. The value assigned reflects the relative value and contribution of the IPR&D.

Given the uncertainties of the commercialization process, we cannot give assurances that deviations from our estimates will not occur. There is risk associated with the realization of benefits related to commercialization of an in-process project due to rapidly changing customer needs, the complexity of the technology and growing competitive pressures. There can be no assurance that any project will meet commercial success. Failure to successfully commercialize an in-process project would result in the loss of the expected economic return inherent in the fair value allocation. In addition, we will periodically evaluate our product development timeline and modify our overall business plan in response to various factors. Modifications to our business plan may include the reallocation of resources among various alternative development projects.

**Operating Income (Loss) and Operating Margin**

The following table sets forth our operating income (loss) and operating margin for the three months ended March 31, 2004 and 2005 (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Operating income (loss).....	\$ 36,565	\$ (21,915)	\$ (58,480)	(160)%
Operating margin.....	11.1 %	(7.3)%		

Our operating income (loss) and operating margin decreased on a year-over-year basis during the three months ended March 31, 2005 primarily due to (i) a year-over-year increase of \$10.9 million related to the IPR&D charges associated with our acquisition of edocs, (ii) declines in our total revenues of \$30.3 million during the three months ended March 31, 2005, and (iii) increases in total costs and expenses of \$17.3 million, primarily due to increases in personnel-related costs associated with an expanded workforce.

### ***Other Income (Expense), Net***

For the three months ended March 31, 2004 and 2005, other income, net was comprised of the following (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Interest income.....	\$ 11,699	\$ 14,773
Interest expense.....	(320)	(231)
Net gain (loss) on marketable investments.....	1,872	(238)
Gain on (write-down of) cost-method investments.....	(1,083)	2,059
Other, net.....	(413)	(600)
	<u>\$ 11,755</u>	<u>\$ 15,763</u>

Interest income represents earnings on our cash and short-term investments. Interest income increased on a year-over-year basis during the first quarter of 2005 primarily due to an increase in interest rates. Interest expense primarily represents interest associated with our capital lease obligations.

Net gain (loss) on marketable investments represents realized gains or losses recognized upon the sale of certain short-term debt instruments. During the first quarter of 2005, we sold substantially all of our venture investment portfolio for approximately \$5.0 million resulting in a gain on these cost-method investments of \$2.1 million. Write-down of cost-method investments in the above table during the three months ended March 31, 2004 represents adjustments to certain of these investments to the estimated fair value as the decline in these investments was deemed to be other-than-temporary. Other, net for all periods presented is primarily comprised of banking fees and foreign currency transaction gains or losses.

### ***Provision for Income Taxes and Income Tax Benefit***

During the three months ended March 31, 2004, we recognized a provision for income taxes of \$17.3 million, compared to an income tax benefit of \$2.2 million during the three months ended March 31, 2005. Income taxes (benefit) as a percentage of pretax income (loss) (the "Effective Rate") decreased from 36% during the three months ended March 31, 2004 to (35%) for the three months ended March 31, 2005, primarily due to higher percentage of our earnings being derived from jurisdictions with lower tax rates.

As part of the process of preparing unaudited consolidated financial statements, we are required to estimate our full-year income and the related income tax expense in each jurisdiction in which we operate. Changes in the geographical mix or estimated level of annual pretax income can impact our Effective Rate. This process involves estimating our current tax liabilities in each jurisdiction in which we operate, including the impact, if any, of additional taxes resulting from tax examinations, as well as making judgments regarding the recoverability of deferred tax assets. To the extent recovery of deferred tax assets is not likely based on our estimation of future taxable income in each jurisdiction, a valuation allowance is established. Tax liabilities can involve complex issues and may require an extended period to resolve. While we have considered future taxable income and the existence of prudent and feasible tax planning strategies in assessing our valuation allowance, in the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, we would charge to income an adjustment to the valuation allowance in the period such determination was made.

### **Liquidity and Capital Resources**

#### ***Overview***

We derive our liquidity and capital resources primarily from our cash flows from operations and from our working capital. Our working capital was \$1,866.9 million and \$1,827.1 million as of December 31, 2004 and March 31, 2005, respectively. With virtually no debt and a strong working capital position, we believe that we have the flexibility to continue to invest in further development of our technology and, when necessary or appropriate, make selective acquisitions to continue to strengthen our product portfolio.

The significant components of our working capital are liquid assets such as cash, short-term investments and trade accounts receivable, reduced by accounts payable, accrued expenses, restructuring obligations and deferred revenue. We continue to operate a cash-positive business and, accordingly, we have been able to eliminate substantially all of our long-term debt and maintain our cash and short-term investment balances at over \$2.0 billion.

We believe our current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for at least the next 12 months. Our liquidity could be negatively impacted by a decrease in revenues resulting from a decline in demand for our products, which are subject to rapid technological changes, or a reduction of capital expenditures by our customers as a result of a downturn in the global economy, among other factors. We did not repurchase any of our common stock during 2004 or 2005.

### ***Commitments***

Our future fixed commitments have not changed significantly since December 31, 2004. Please refer to “Liquidity and Capital Resources” in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2004 for a further discussion of our future fixed commitments, including a five-year schedule of future cash payments under these obligations.

### ***Cash Flows***

As discussed above, one of the primary sources of our liquidity is our ability to generate positive cash flows from operations. The following is a discussion of our primary sources and uses of cash in our operating, investing and financing activities:

#### *Operations*

Net cash provided by operating activities was \$89.8 million and \$47.9 million during the three months ended March 31, 2004 and 2005, respectively. Cash provided by operating activities decreased on a year-over-year basis during 2005 primarily as the result of decreases in revenues and earnings.

During each of these periods, our cash flows from operations were primarily derived from (i) our earnings from on-going operations prior to non-cash expenses such as depreciation, amortization and bad debt; (ii) the tax benefit related to the exercise of employee stock options, which reduces our cash outlay for income tax expense; and (iii) changes in our working capital, which is primarily composed of net collections of accounts receivable and increases in deferred revenue (collectively representing net cash inflows of \$59.4 million and \$52.0 million in the 2004 and 2005 periods, respectively), partially offset by payments of accounts payable, accrued expenses and restructuring obligations.

Because the majority of our restructuring obligations will be paid over time, cash provided by operating activities for the three months ended March 31, 2004 and 2005 was reduced by \$13.6 million and \$9.1 million, respectively, of cash payments made during these periods related to these obligations. As we settle our remaining restructuring obligations (\$97.3 million of remaining obligations, net of estimated sublease income, as of March 31, 2005), our future operating cash flows will be reduced from what they otherwise would have been in the period of settlement. We currently estimate that we will settle \$30.0 million of these obligations in the next 12 months.

We currently anticipate that we will continue to operate a cash-positive business in the second quarter of 2005. Our ability to meet these expectations depends on our ability to achieve positive earnings and maintain or increase the level of our software license revenues, including maintaining or improving the linearity of our revenues compared to our historical levels. In addition, our ability to generate future cash flows from operations could be negatively impacted by a decrease in demand for our products, which are subject to rapid technological changes, or a reduction of capital expenditures by our customers as a result of a downturn in the global economy, among other factors.

#### *Investing*

Net cash used in investing activities was \$36.0 million and \$72.4 million for the three months ended March 31, 2004 and 2005, respectively. During each of these periods, our investment activities primarily related to transactions within our short-term investments. For the three months ended March 31, 2004, we reinvested our cash into short-term investments in net amounts of \$30.9 million compared to net sales of short-term investments of \$18.8 million during the three months ended March 31, 2005. The decrease in our purchases of short-term investments on a year-over-year basis during the first quarter of 2005 was primarily due to our purchase of edocs, as discussed further below.

We also utilize our cash position to invest in new property and equipment, with net purchases of property and equipment of \$0.2 million and \$3.1 million during the three months ended March 31, 2004 and 2005, respectively. Capital expenditures were unusually low in the 2004 period primarily due to (i) the reduction/delay of our capital spending where possible; (ii) the consolidation of our data centers, resulting in a decrease in our information technology requirements for servers and other equipment; and (iii) the reduction in the number of offices we are occupying, which allowed us to reduce our purchases of tenant improvements, furniture and fixtures.

We intend to continue to closely monitor our capital expenditures, while making selective investments in additional information technology for (i) our CRM OnDemand product line, (ii) certain product development efforts and (iii) the replacement of certain older computer and information technology infrastructure. Accordingly, we expect our total capital expenditures to be between \$25.0 million and \$35.0 million for 2005.

The remaining cash flows used in investing activities for the three months ended March 31, 2004 and 2005 consisted primarily of the acquisition of Ineto Services, Inc. for net cash consideration of \$4.8 million in 2004 and the acquisition of edocs for net cash consideration of approximately \$93.1 million in 2005. Please refer to Note 4 to the accompanying unaudited consolidated financial statements for a further discussion of our acquisition of edocs.

### *Financing*

Net cash provided by financing activities was \$26.1 million and \$22.7 million for the three months ended March 31, 2004 and 2005, respectively. Our financing activities consisted primarily of net proceeds of \$29.4 million and \$24.7 million during the three months ended March 31, 2004 and 2005, respectively, from the issuance of common stock pursuant to the exercise of stock options and our employee stock purchase plan (the "Purchase Plan"). Our cash inflows from financing activities were partially offset by our repayment of capital lease obligations, with payments of \$3.3 million and \$2.0 million during the three months ended March 31, 2004 and 2005, respectively.

### **Off-Balance Sheet Arrangements**

We do not use off-balance sheet arrangements with unconsolidated entities or related parties. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of March 31, 2005, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases, expiring between 2005 and 2022, for most U.S. and international sales and support offices and certain equipment in the normal course of business. While these arrangements are often referred to as a form of off-balance sheet financing, these arrangements are not considered off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K. Please refer to Note 3 to the accompanying unaudited consolidated financial statements for detail of our future minimum lease payments under our operating leases as of March 31, 2005.

### **Application of Critical Accounting Policies and Use of Estimates**

#### *Use of Estimates*

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and the application of GAAP requires management to make estimates that affect our reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. In many instances, we could have reasonably used different accounting estimates. In other instances, changes in the accounting estimates from period to period are reasonably likely to occur. Accordingly, actual results could differ significantly from the estimates made by management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations may be affected.

On an on-going basis, we evaluate our estimates, including those related to revenue recognition, provision for doubtful accounts and sales returns, fair value of investments, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, restructuring obligations, and contingencies and litigation, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We refer to accounting estimates of this type as "critical accounting estimates."

## ***Critical Accounting Policies***

In addition to making critical accounting estimates, we must ensure that our financial statements are properly stated in accordance with GAAP. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, management's judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions (e.g., stock-based compensation, restructuring activities, depreciation methodology, etc.). We believe that the following accounting policies are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgments and estimates:

- Revenue recognition,
- Restructuring and related expenses,
- Impairment of long-lived assets,
- Provision for doubtful accounts,
- Acquired intangible assets,
- Stock-based compensation,
- Legal and tax contingencies, and
- Income taxes.

Our management has reviewed our critical accounting policies, our critical accounting estimates, and the related disclosures with our Disclosure and Audit Committees. These policies and our procedures related to these policies are described further in our Annual Report on Form 10-K for the year ended December 31, 2004 in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the heading "Application of Critical Accounting Policies and Use of Estimates."

## **Recent Accounting Pronouncements**

### **Stock-Based Compensation**

In December 2004, the FASB issued SFAS 123R. SFAS 123R addresses all forms of SBP awards, including shares issued under the Purchase Plan, stock options, restricted stock, restricted stock units, and stock appreciation rights. SFAS 123R will require us to record compensation expense for SBP awards based on the fair value of the SBP awards. Under SFAS 123R, restricted stock and restricted stock units will generally be valued by reference to the market value of freely tradable shares of our common stock. Stock options, stock appreciation rights and shares issued under the Purchase Plan will generally be valued at fair value determined through an option valuation model, such as a lattice model or the Black-Scholes model (the model which we currently use for our footnote disclosure). SFAS 123R is effective for annual periods beginning after June 15, 2005 and, accordingly, we must adopt the new accounting provisions effective January 1, 2006.

Upon adoption of SFAS 123R on January 1, 2006, we expect that the on-going application of SFAS 123R subsequent to adoption will result in a reduction to our quarterly earnings for 2006 by up to \$35.0 million per quarter. This estimate is based solely on the expense associated with stock options outstanding as of March 31, 2005 (including stock-based compensation under the Purchase Plan) and therefore does not take into consideration new stock option grants, which would increase this estimate, or forfeitures of stock options, which would reduce this estimate.

### **Income Taxes**

In December 2004, the FASB issued two FASB Staff Positions ("FSP") related to the American Jobs Creation Act of 2004 (the "AJCA"). FSP No. 109-1 "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities" ("FSP 109-1") requires companies that qualify for a deduction for domestic production activities under the AJCA to account for the deduction as a special deduction under FASB Statement No. 109.

FSP No. 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2") allows companies additional time to evaluate whether foreign earnings will be repatriated under the repatriation provisions of the AJCA and requires specified disclosures for companies needing the additional time to complete the evaluation. Once a decision is made to repatriate the foreign earnings, companies must reflect the deferred tax liabilities attributable to foreign earnings in the period that the decision is made to remit those earnings.

## Seasonality

Our first quarter revenues have typically been lower than the revenues in the immediately preceding fourth quarter because (i) many of our customers utilize a significant portion of their capital budgets at the end of their fiscal year, (ii) the majority of our customers begin a new fiscal year on January 1, and (iii) capital expenditures tend to be lower in an organization's first quarter than in its fourth quarter. We anticipate that this seasonality will continue. The seasonality between the fourth quarter and first quarter may be impacted by a variety of factors, including changes in the global economy, renewed terrorist attacks and other factors. Please refer to "Risk Factors—Our Operating Results May Fluctuate" for a further discussion of these factors.

## Employee Stock Options

### *Section I. Description of Plans*

Since our inception, our stock option program has been instrumental in attracting and retaining talented employees and aligning their interests with the interests of stockholders. Our stock option program consists primarily of two plans: the Siebel Systems, Inc. 1996 Equity Incentive Plan (the "1996 Plan"), and the Siebel Systems, Inc. 1998 Equity Incentive Plan (the "1998 Plan" and together with the 1996 Plan, the "Plans"). Stock options granted to executive officers, key employees and non-employee members of our Board of Directors are made under the 1996 Plan and stock options granted to non-officer employees are made under the 1998 Plan. Our Board of Directors and stockholders have approved the 1996 Plan, and our Board of Directors has approved the 1998 Plan.

On May 5, 2004, we amended the Plans to allow us to issue restricted stock units ("RSUs"). RSUs are similar to restricted stock in that they are issued for no, or nominal, consideration; however, the holder is generally not entitled to the underlying shares of common stock until the RSU vests.

All stock-based compensation grants are made after a review by, and with the approval of, the Compensation Committee of the Board of Directors or the full Board of Directors or, for director equity grants, the Nominating and Corporate Governance Committee of the Board of Directors. All members of our Compensation Committee are independent directors, as defined in the applicable rules for issuers traded on the NASDAQ stock market. Substantially all of our employees participate in one of the above Plans. Stock options granted under the Plans expire no later than ten years from the grant date and generally vest over five years.

On January 5, 2005, the Compensation Committee of our Board of Directors established a performance stock program for 2005 (the "Performance Stock Plan"), pursuant to which our executive officers and select other employees were granted RSUs under the Plans. A similar performance-based plan for 2005 through which stock options, rather than RSUs, were granted was also adopted on January 5, 2005 (the "Performance Option Plan" and collectively with the Performance Stock Plan, the "Performance Plans") for employees not covered by the Performance Stock Plan.

Shares granted under the Performance Stock Plan and Performance Option Plan generally vest on the fourth and third anniversaries of the date of grant, respectively; provided, however that a portion of the shares will accelerate and become vested upon achievement of all or a specified portion of certain defined objective financial performance goals. Specifically, the Compensation Committee has approved the following four performance goals for 2005 and 2006:

- **2005:** revenue growth of approximately 15% compared to actual revenue achieved in 2004 and operating margin of 15%.
- **2006:** revenue growth of 15% compared to actual revenue achieved in 2005 and operating margin of 17%.

The revenue-based targets set forth above will be adjusted upward to incorporate any revenue from companies acquired during the relevant year (excluding the acquisition of edocs, Inc. in 2005) and the operating margin-based targets will be adjusted for the impact of any acquisitions and certain unusual charges (e.g., stock-based compensation, restructuring expenses, etc.).

These performance goals have been established for vesting purposes only and in no way are intended to estimate the actual levels of revenue or operating margin that we expect to achieve. Accordingly, these goals should not be interpreted to update or supersede our previously disclosed guidance on revenue and operating margins or any guidance that we may provide in the future. Rather, these performance goals are meant to incentivize our employees to outperform our publicly disclosed guidance.

For each goal that is fully achieved, vesting will be accelerated for 25% of the total shares granted, such that half of such accelerated shares will vest on January 31 of the year in which the Compensation Committee determines that a goal has been met and the remaining half will vest on January 31 of the following year.

## Section II. Summary of Stock Option Activity during the First Quarter of 2005

Combined activity under the Plans for the three months ended March 31, 2005 is summarized as follows:

	<b>Shares Available for Grant</b>	<b>Number of Options</b>	<b>Wtd. Avg. Exercise Price per Share</b>
Balances as of December 31, 2004.....	195,942,345	132,712,132	\$ 12.78
Issuances of restricted stock and/or units, net.....	(1,288,211)	--	
Options granted to employees.....	(6,960,796)	6,960,796	\$ 8.68
Options granted to officers and directors.....	(150,000)	150,000	\$ 8.67
Options exercised.....	--	(5,010,399)	\$ 2.40
Options canceled due to employee termination.....	3,834,979	(3,836,087)	\$ 19.38
Balances as of March 31, 2005.....	<u>191,378,317</u>	<u>130,976,442</u>	\$ 12.75

The following table details the “in-the-money” and “out-of-the-money” status of our stock options outstanding as of March 31, 2005:

<b>Options</b>	<b>Options Outstanding</b>			<b>Options Exercisable</b>	
	<b>Number of Shares</b>	<b>Wtd. Avg. Remaining Life (Years)</b>	<b>Wtd. Avg. Exercise Price</b>	<b>Number of Shares</b>	<b>Wtd. Avg. Exercise Price</b>
In-the-money	66,132,224	3.2	\$ 5.46	46,618,532	\$ 4.26
Out-of-the-money	64,844,218	5.7	\$ 20.20	43,002,481	\$ 21.73
	<u>130,976,442</u>	4.4	\$ 12.75	<u>89,621,013</u>	\$ 12.64

In-the-money stock options in the above table have exercise prices below the closing price of our common stock as of March 31, 2005 of \$9.13 and out-of-the money stock options have exercise prices equal to or greater than \$9.13.

## Section III. Dilution

### Summary

Historically, equity ownership has been an important component of total compensation for our employees. Accordingly, substantially all employees are granted stock options upon commencement of employment. We have also granted RSUs to existing and new employees, and we will likely continue to do so in the future. In addition, we have on occasion assumed stock options of acquired businesses and rewarded existing employees for high levels of performance with additional grants of stock options (consideration of additional grants is typically scheduled to occur by the end of the second quarter of each year).

In order to maintain the proper balance between the need to attract and retain employees and minimize the dilution to existing stockholders, effective January 1, 2003 we adjusted our equity guidelines to reduce the size of stock option grants to new and existing employees. In addition, commencing in February 2003, we began granting stock options with a contractual life of six years, as opposed to ten years for stock options granted prior to that time. In 2004 and 2005, in addition to maintaining these guidelines for new employees, we further reduced the size of our renewal grants to existing employees.

Immediately upon voluntary or involuntary termination, an employee forfeits all unvested equity instruments, unless the applicable agreement provides otherwise. Any vested equity instruments that are not exercised within three months from the termination date are forfeited at the expiration of the three months, unless the applicable agreement provides otherwise.



Summarized below is the net dilution to our stockholders during the years ended December 31, 2003 and 2004 and the three months ended March 31, 2005, along with our option overhang as of the end of each of these respective periods (in thousands, except percentages):

	<u>Year Ended December 31,</u>		<u>Three Months</u>
	<u>2003</u>	<u>2004</u>	<u>Ended</u> <u>March 31,</u> <u>2005</u>
<b>Net options granted:</b>			
Stock options granted.....	22,787	11,995	7,111
Stock options forfeited upon termination.....	(27,660)	(16,143)	(3,836)
Net granted (forfeited).....	<u>(4,873)</u>	<u>(4,148)</u>	<u>3,275</u>
<b>Dilution percentage (1).....</b>	<u>(1)%</u>	<u>(1)%</u>	<u>1 %</u>
<b>Option overhang (2).....</b>	<u>29 %</u>	<u>26 %</u>	<u>25 %</u>

- (1) The potential dilution to stockholders from stock options (the “Dilution Percentage”) is calculated as new stock options granted during the period, net of forfeitures by employees terminating employment, divided by the total outstanding shares of common stock at the beginning of the respective period.
- (2) Stock option overhang is calculated by dividing total stock options outstanding by the total outstanding shares of common stock at the end of each period.

#### Distribution of Grants

As the table below indicates, we have continued to allocate the majority of our stock options to employees who are not officers and directors. “Named Executive Officers” in the below table and the remainder of this annual report represent our then-CEO and the four most highly compensated executive officers for the respective year. Information for Named Executive Officers for the first quarter of 2005 were identified using 2004 compensation information and include Thomas M. Siebel, J. Michael Lawrie, R. David Schmaier, Kenneth A. Goldman, Edward Y. Abbo and Neil M. Weston. Summarized below is the distribution of our stock options for the years ended December 31, 2003 and 2004 and the three months ended March 31, 2005:

	<u>Year Ended December 31,</u>		<u>Three Months</u>
	<u>2003</u>	<u>2004</u>	<u>Ended</u> <u>March 31,</u> <u>2005</u>
<b>Grants during the period as a percentage of total granted:</b>			
Named Executive Officers.....	4.6 %	23.3 %	-- %
All other officers and directors as a group.....	3.3	5.7	2.1
Total for all officers and directors.....	7.9	29.0	2.1
All other employees as a group.....	92.1	71.0	97.9
Total all grants.....	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

During the first quarter of 2005, our Named Executive Officers and members of our board of directors received RSUs or restricted stock in addition to or in place of stock options. Please refer to section entitled “Section V. Executive and Director Stock-Based Compensation” below for a further discussion of these grants.

#### **Section IV. Accounting for Stock-Based Compensation**

We account for our employee stock-based compensation plans using the intrinsic value method, as prescribed by APB No. 25 “Accounting for Stock Issued to Employees” and interpretations thereof (collectively “APB 25”). Accordingly, we record deferred compensation costs, if any, related to our stock-based compensation as follows:

- Stock options—We record and measure deferred compensation for stock options granted to our employees and members of our Board of Directors when the market price of the underlying stock exceeds the exercise price of the stock option on the date of the grant. We record and measure deferred compensation for stock options granted to non-employees based on the fair value of the stock options.
- Restricted stock and RSUs—We record and measure deferred compensation for restricted stock and RSUs based on the market price of our common stock on the date of grant.

Deferred compensation is expensed on a straight-line basis over the respective vesting period of the equity instrument. The terms of our stock options and restricted stock vary, but generally provide for ratable vesting over five years, with 20% of the underlying shares vesting one year from grant and the remaining shares vesting 5% quarterly thereafter. The terms of our RSUs provide for vesting that ranges from approximately three months to five years. We did not grant any stock options at exercise prices below the fair market value of our common stock during any period presented.

An alternative to the intrinsic value method of accounting for stock-based compensation is the fair value approach prescribed by SFAS 123. If we followed the fair value approach, we would record deferred compensation based on the fair value of the stock option at the date of grant as determined using the Black-Scholes option valuation model. The deferred compensation calculated under the fair value method would then be amortized on a straight-line basis over the respective vesting period of the stock option.

We have continued to follow the intrinsic value method of APB 25, as we believe the accounting for stock options under SFAS 123 could be extremely confusing to investors, and perhaps may even misinform our stockholders. Specifically, we believe the expense associated with stock options under SFAS 123 has no relationship to (i) the value realized by our employees, (ii) the potential dilution to our stockholders, or (iii) the cost incurred by us. In addition, we believe the use of option valuation models as required by SFAS 123 is highly subjective.

As required by SFAS 123, we have prepared a reconciliation of our earnings as reported on our statement of operations to the earnings that we would have reported if we had followed SFAS 123 in accounting for our stock-based compensation arrangements. In accordance with SFAS 123, in preparing this reconciliation we must first add back all stock-based compensation expense reflected in our statement of operations, then deduct the stock-based employee compensation expense determined under SFAS 123. Summarized below are the pro forma effects on our earnings as if we had elected to use the fair value approach prescribed by SFAS 123 to account for our employee stock-based compensation plans (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
<b>Net income (loss):</b>		
As reported.....	\$ 30,980	\$ (3,999)
<b>Compensation expense related to:</b>		
<b>Stock options dilutive to stockholders:</b>		
Stock-based compensation accounted for under APB 25.....	195	1,012
In-the-money stock options and restricted stock units.....	(4,308)	(4,224)
Stock purchase rights under the Purchase Plan.....	(2,559)	(2,228)
Subtotal.....	<u>(6,672)</u>	<u>(5,440)</u>
<b>Stock options not dilutive to stockholders:</b>		
Out-of-the-money stock options.....	(37,336)	(23,355)
Stock options forfeited in connection with terminations.....	(3,135)	--
Subtotal.....	<u>(40,471)</u>	<u>(23,355)</u>
Total pro forma expense giving effect to SFAS 123.....	<u>(47,143)</u>	<u>(28,795)</u>
<b>Tax benefit related to SFAS 123 expense.....</b>	<u>--</u>	<u>2,287</u>
<b>Pro forma net loss giving effect to SFAS 123.....</b>	<u>\$ (16,163)</u>	<u>\$ (30,507)</u>

In-the-money stock options in the above table have exercise prices below the closing price of our common stock as of the end of each of the respective periods, and out-of-the-money stock options have exercise prices equal to or greater than the closing price of our common stock as of the end of each of the respective periods. The closing prices as of March 31, 2004 and 2005 were \$11.53 and \$9.13, respectively.

As the table above illustrates, total pro forma expense for stock options includes \$40.5 million and \$23.4 million of expense during the three months ended March 31, 2004 and 2005, respectively, related to (i) stock options forfeited by employees upon termination for no consideration and (ii) stock options that are significantly out of the money (e.g., the weighted-average exercise price of the out-of-the-money stock options was \$20.20 per share compared to a closing price of \$9.13 per share as of March 31, 2005). These items represented 86% and 81% of the pro forma expense for the three months ended March 31, 2004 and 2005, respectively.

Please refer to Note 1 to the accompanying consolidated financial statements for a further discussion of the fair value approach prescribed by SFAS 123, including the assumptions used to determine the fair value of and resulting SFAS 123 expense related to stock options, and the procedures followed by us in determining those assumptions.

## Section V. Executive and Director Stock-Based Compensation

### Executive Stock-Based Compensation

We did not grant any stock options to our Named Executive Officers during the three months ended March 31, 2005. Instead of granting stock options to our executive officers, we granted our Named Executive Officers an RSU under the Performance Stock Plan discussed above under Section I. The following table sets forth certain information regarding the RSUs options granted to the Named Executive Officers during the three months ended March 31, 2005:

<b>Officer Name</b>	<b>Number of Securities Underlying RSUs Granted</b>	<b>Percent of Total RSUs Granted to Employees in 2005 (4)</b>	<b>Fair Value at Grant Date (5)</b>	<b>Fair Value as of March 31, 2005 (6)</b>
Thomas M. Siebel	--	-- %	\$ --	\$ --
J. Michael Lawrie (1)	--	-- %	\$ --	\$ --
R. David Schmaier	--	-- %	\$ --	\$ --
Kenneth A. Goldman	100,000 (2)	7.8 %	\$ 867,000	\$ 913,000
Edward Y. Abbo	50,000 (3)	3.9 %	\$ 433,500	\$ 456,500
Neil M. Weston	30,000 (3)	2.4 %	\$ 260,100	\$ 273,900

- (1) Mr. Lawrie resigned as our CEO effective April 12, 2005.
- (2) Mr. Goldman received two RSUs for a total of 100,000 shares of our common stock (each RSU representing 50,000 shares of our common stock). The first RSU vests in full on January 31, 2006 and the second RSU vests based on certain defined objective financial performance goals, as described in note 3 below.
- (3) The RSUs vest upon achievement of all or a specified portion of certain defined objective financial performance goals, or if the goals are not met, on the fourth anniversary of the grant date. Specifically, the Compensation Committee has approved the following four performance goals for 2005 and 2006:
  - **2005:** revenue growth of approximately 15% compared to actual revenue achieved in 2004 and operating margin of 15%.
  - **2006:** revenue growth of 15% compared to actual revenue achieved in 2005 and operating margin of 17%.

For each goal that is fully achieved, vesting will be accelerated for 25% of the total shares granted, such that half of such accelerated shares will vest on January 31 of the year in which the Compensation Committee determines that a goal has been met and the remaining half will vest on January 31 of the following year.

- (4) Based on an aggregate of 1.3 million shares subject to RSUs granted to employees pursuant to the Plans during the three months ended March 31, 2005, including grants to the Named Executive Officers.
- (5) The fair value on the grant date is calculated as the product of the number of underlying shares and the fair value of our common stock on the date of grant.
- (6) Represents the aggregate fair value of the RSUs on March 31, 2005, calculated as the product of the number of underlying shares and the fair value of our common stock on March 31, 2005 of \$9.13.

The following summarizes the distribution and dilutive impact of the stock options held by our Named Executive Officers as of December 31, 2003 and 2004 and March 31, 2005:

	<b>Year Ended December 31,</b>		<b>March 31,</b>
	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Stock options held by Named Executive Officers as a percentage of:</b>			
Total options outstanding.....	<u>18.7 %</u>	<u>20.9 %</u>	<u>19.3 %</u>
Outstanding shares of common stock.....	<u>5.4 %</u>	<u>5.5 %</u>	<u>4.9 %</u>

The following table sets forth for each of the Named Executive Officers the shares acquired and the value realized on exercise of stock options during the three months ended March 31, 2005 and the number and value of securities underlying unexercised options held by the Named Executive Officers as of March 31, 2005:

Officer Name	Shares		Number of Securities Underlying Unexercised Options at March 31, 2005 (2)		Value of Unexercised In-the-Money Options at March 31, 2005 (3)	
	Acquired on Exercise	Value Realized (1)	Exercisable	Unexercisable	Exercisable	Unexercisable
	Thomas M. Siebel	2,500,000	\$ 21,272,007	16,186,134	--	\$ 112,464,639
J. Michael Lawrie (4)	--	\$ --	--	2,000,000	\$ --	\$ --
R. David Schmaier	--	\$ --	1,957,504	772,500	\$ 2,441,672	\$ 219,492
Kenneth A. Goldman	--	\$ --	2,170,000	800,000	\$ 41,125	\$ 76,375
Edward Y. Abbo	--	\$ --	560,000	350,000	\$ 1,181,538	\$ 76,375
Neil M. Weston	--	\$ --	100,000	400,000	\$ --	\$ --

- (1) Based on the fair market value of our common stock on the exercise date, minus the exercise price, multiplied by the number of shares exercised.
- (2) Represents the total number of shares of our common stock subject to stock options held by the Named Executive Officers as of March 31, 2005.
- (3) Based on the fair market value of our common stock as of March 31, 2005 (\$9.13 per share), minus the exercise price, multiplied by the number of shares underlying the stock options.
- (4) Mr. Lawrie resigned as our CEO effective April 12, 2005. As a result of Mr. Lawrie's resignation, 0.8 million of the 2.0 million stock options in the above table became immediately vested. Mr. Lawrie has until April 11, 2006 to exercise these stock options.

#### Director Stock-Based Compensation

Historically, our directors have not received any cash compensation for service on the Board of Directors or any committee thereof, but have been eligible for reimbursement for certain expenses incurred in attending Board of Directors' and committee meetings.

On January 31, 2005, the Nominating and Corporate Governance Committee of our Board of Directors approved 2005 compensation for our non-employee directors such that each non-employee director would receive compensation equivalent to the fair value of a stock option to purchase 20,000 shares of our common stock (based on the Black-Scholes valuation model and the fair market value of our common stock on the date of grant) to be allocated as follows: 50% in cash and 50% in shares of restricted stock that vest in full on January 31, 2006. Accordingly, in the first quarter of 2005 we awarded each of James C. Gaither, C. Scott Hartz, Marc F. Racicot, Eric E. Schmidt, George T. Shaheen and John W. White compensation of \$32,500 in cash and 3,750 shares of restricted stock that will vest in full on January 31, 2006 in consideration for their service as a director in 2005.

On April 12, 2005, Mr. Shaheen, a member of our Board of Directors, accepted an offer of employment from our Board of Directors to serve as our Chief Executive Officer, effective as of April 13, 2005. Per the terms of Mr. Shaheen's offer letter, all existing stock options and restricted stock granted to Mr. Shaheen in his capacity as a member of our Board of Directors ceased vesting as of the first day of his employment. Further, Mr. Shaheen has volunteered to reimburse us cash consideration of \$23,418, representing the pro rata portion of the \$32,500 paid to him in his capacity as a non-employee member of our Board of Directors for the period from April 13, 2005 to December 31, 2005.

We believe that these guidelines will motivate and reward our non-employee directors for their service in a manner that is consistent with good corporate practice and the independence requirements of the NASDAQ applicable to members of boards of directors and compensation committees. Notwithstanding the foregoing guidelines, from time to time, the Nominating and Corporate Governance Committee of the Board of Directors will review the appropriateness and adequacy of these compensation guidelines, taking into consideration actual performance by us and the non-employee director and such other factors and circumstances as deemed necessary and appropriate, and exercising such other power and authority as may be permitted or required under the 1996 Plan.

**Section VII. Equity Compensation Plan Information**

Information as of March 31, 2005 related to each of our stock option plans is summarized as follows:

Plan Category	Number of Shares to Be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Options Outstanding)
Equity compensation plans:			
Approved by stockholders (1).....	48,081,461	\$ 7.92	75,500,018
Not approved by stockholders (2).....	82,088,103	\$ 15.62	125,207,182
Acquired companies' plans (3).....	806,878	\$ 9.33	--
	130,976,442	\$ 12.75	200,707,200

- (1) Represents shares available under the 1996 Plan, which is used for grants to our officers and directors. The shares remaining available for future issuance amount also includes 9.3 million shares available under our 2003 Employee Stock Purchase Plan.
- (2) Represents shares available under the 1998 Plan, which is used for grants to our employees other than officers and directors.
- (3) We have assumed certain stock options granted to former employees of acquired companies (the "Acquired Options"). All of the Acquired Options have been adjusted to give effect to the conversion under the terms of the agreements between us and the companies acquired. The Acquired Options generally become exercisable over a four-year period and expire ten years from the date of grant. Additional stock options will not be granted under any of the acquired companies' plans, and these plans have not been approved by our stockholders.

## **Risk Factors**

*Set forth below and elsewhere in this quarterly report and in the other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this quarterly report. Prospective and existing investors are strongly urged to carefully consider the various cautionary statements and risks set forth in this quarterly report and our other public filings.*

### ***Our operating results may fluctuate.***

We have experienced in the past, and may experience in the future, a shortfall in revenue or earnings or otherwise fail to meet public market expectations, which could materially and adversely affect our business and the market price of our common stock. Our total revenue, expenses and operating results may fluctuate significantly because of a number of factors, many of which are outside of our control. These factors include:

- Corporate and consumer confidence in the economy, evidenced, in part, by stock market levels;
- Changes in the domestic and international economic, business and political conditions;
- Economic conditions within the information technology industry;
- Economic conditions within the key industries in which we derive our revenues, including the manufacturing and distribution, communications, financial services, life sciences and public sector industries;
- Legal and other costs relating to defending intellectual property, regulatory enforcement actions and other types of litigation;
- Level of product and price competition;
- Length of our sales cycle and the discretionary nature of our customers' purchase and budget cycles;
- Size and timing of individual license transactions;
- Levels of international license transactions;
- Delay or deferral of customer implementations of our products;
- Success in expanding our professional services organization, direct sales force and indirect distribution channels;
- Our ability to develop or acquire and market new products and services and control costs;
- Timing of new product introductions and product enhancements;
- Appropriate mix of products licensed and services sold;
- Activities of and acquisitions by competitors;
- Success of, and costs associated with, integrating and achieving the anticipated benefits of our acquisitions;
- Timing of new hires and the allocation of our resources;
- Increases in the cost of software and professional services;
- Variations in marketing expenditures and our success in generating additional sales pipeline from those expenditures;
- The size of and conversion rates of our sales pipeline;
- Changes in foreign currency exchange rates;
- Changes in domestic and foreign tax laws;
- Seasonal variations in operating results;
- Variations in the fiscal or quarterly cycles of our customers; and
- Changes in accounting principles generally accepted in the United States.

One or more of the foregoing factors, as well as other factors, may cause our operating expenses to be disproportionately high during any given period or may cause our net revenue and operating results to fluctuate significantly, which could materially and adversely affect our business, financial condition, results of operations and the market price of our common stock.

Further, each customer's decision to implement our products and services is discretionary, involves a significant commitment of resources and is subject to the customer's budget cycles. In addition, the timing of license revenue is difficult to predict because of the length of our sales cycle. We base our operating expenses on anticipated revenue trends. Because a high percentage of these expenses are relatively fixed, a delay in recognizing revenue from license transactions could cause significant variations in operating results from quarter to quarter and could result in operating losses. If these expenses precede, or are not subsequently followed by, increased revenues, our business, financial condition or results of operations could be materially and adversely affected.

***A variation in the conversion of our revenue pipeline to contracts could adversely affect our revenues and ability to forecast operations.***

We use a “pipeline” system, a common industry practice, to forecast sales and trends in our business. Our sales personnel monitor the status of all potential transactions, including the estimated closing date and potential dollar amount of each transaction. We aggregate these estimates periodically to generate a sales pipeline and then evaluate the pipeline to identify trends in our business. This pipeline analysis and related estimates of revenue may differ significantly from actual revenues in a particular reporting period. A slowdown in the global economy, among other factors, has caused and may continue to cause customer purchasing decisions to be delayed, reduced in amount or cancelled, all of which have reduced and could continue to reduce the rate of conversion of the pipeline into contracts. In addition, because a substantial portion of our software license contracts close in the latter part of a quarter, management may not be able to adjust our cost structure to respond to a variation in the conversion of the pipeline into contracts in a timely manner. Our inability to respond to a variation in the pipeline or in the conversion of the pipeline into contracts in a timely manner, or at all, could cause us to plan or budget inaccurately and thereby could adversely affect our business, financial condition or results of operations.

***Increases in services revenues as a percentage of total revenues may decrease overall margins.***

We realize lower margins on our professional services and maintenance revenues than on our software license revenues. In addition, we may contract with certain third parties to supplement the services we provide to customers, which generally yields lower margins than our internal services business. As a result, if services revenues increase as a percentage of total revenues or if we increase our use of third parties to provide services, our margins would be negatively impacted.

***Hostilities involving the United States and/or terrorist attacks could harm our business.***

Our operations could be negatively impacted if there are additional terrorist attacks or threats of terrorist attacks, or if hostilities involving the United States escalate. In the past, terrorist attacks, including attacks on the United States and internationally, have had a significant impact on global economic conditions and our operations. Further, as a result of past terrorist attacks and hostilities involving the United States, we believe many of our customers and potential customers have been much more cautious in setting and spending against their capital expenditure budgets. Subsequent terrorist acts and/or the threat of future terrorist attacks or escalation of hostilities involving the United States or other countries could adversely affect the growth rate of our revenue and have an adverse effect on our business, financial condition or results of operations. In addition, any escalation in these events or similar future events may disrupt our operations or those of our customers, distributors and suppliers, which could adversely affect our business, financial condition or results of operations.

***The length of time required to engage a client and to implement our products may be lengthy and unpredictable.***

The timing of the sales and implementation of our products and services is lengthy and not predictable with any degree of accuracy. Prior sales and implementation cycles should not be relied upon as any indication of future cycles. The license of our software products is often an enterprise-wide decision by prospective customers and generally requires us to provide a significant level of education to prospective customers regarding the use and benefits of our products. In addition, the implementation of our software products involves a significant commitment of resources by prospective customers and may involve reengineering efforts performed by the customer or third-party systems integrators. The cost of our software product to the customer is typically only a portion of the related hardware, software, development, training and integration costs of implementing a large-scale business software system. For these and other reasons, the period between initial contact and the purchase and implementation of our software products is often lengthy and is subject to a number of factors, many of which we have little or no control over, and which can result in significant delays. These factors include the size and complexity of the overall project and delays in our customers’ implementation of web-based computing environments, among others. A delay in the sale or implementation of even a limited number of license transactions could have a material adverse effect on our business, financial condition or results of operations and cause our operating results to vary significantly from quarter to quarter.

***Our business is subject to changing regulation of corporate governance and public disclosure that has increased both our costs and the risk of noncompliance.***

We are subject to rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, or PCAOB, the SEC and NASDAQ, have recently issued new requirements and regulations and continue to develop additional regulations and requirements in response to recent laws enacted by Congress, most notably SOX. Our efforts to comply with these new regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

In particular, our efforts to comply with Section 404 of SOX and the related regulations regarding our required assessment of our internal control over financial reporting and our external auditors' audit of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. Moreover, because these laws, regulations and standards are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by on-going revisions to our disclosure and governance practices.

***An unfavorable government review of our income and payroll tax returns or changes in our effective tax rates could adversely affect our operating results.***

Our operations are subject to income, payroll and indirect taxes in the United States and in multiple foreign jurisdictions. We exercise judgment in determining our worldwide provision for these taxes, and in the ordinary course of our business there may be transactions and calculations where the ultimate tax determination is uncertain.

Our U.S. Federal income tax returns for 2001 through 2003 are currently under examination by the IRS. In addition, certain of our U.S. payroll tax returns (primarily related to taxes associated with stock option exercises), state sales and use tax returns, and international sales and value added tax returns are currently under examination and/or review by the applicable taxing authorities. While we believe that we have made adequate provisions related to the audits of these tax returns, the final determination of our obligations may exceed the amounts provided for by us in the accompanying consolidated financial statements.

Specifically, we may receive assessments related to the audits and/or reviews of our U.S. income, U.S. payroll, U.S. sales and use tax returns, or our international sales and value added tax returns that exceed amounts provided for by us. In the event we are unsuccessful in reducing the amount of such assessments, our business, financial condition or results of operations could be adversely affected. Further, if additional taxes and/or penalties are assessed as a result of these audits, there could be a material effect on our income tax provision, operating expenses and net income in the period or periods for which that determination is made.

***Because of our limited history with our OnDemand subscription model, we cannot predict our revenue or operating results.***

The market for on-demand or "hosted" application services is relatively new and unproven, and it is uncertain whether these services will achieve and sustain high levels of demand and market acceptance. Our success will depend in part on the willingness of enterprises to increase their use of on-demand application services in general and for front-office applications in particular. If enterprises do not perceive the benefits of on-demand application services, then the market for these services may not develop at all, or may develop more slowly than we expect, either of which could significantly and adversely affect our operating results. In addition, if the demand for our OnDemand services does not materialize as expected, our ability to recover our investments in UpShot Corporation and Ineto Services, Inc. ("Ineto") may be impaired.

We began offering Siebel CRM OnDemand, a hosted CRM application delivered as an online service, in the fourth quarter of 2003, and Siebel Contact OnDemand, a hosted contact center application, in the first quarter of 2004. These OnDemand solutions are offered on a subscription basis, rather than as a perpetual license. Our OnDemand customers have no obligation to renew their service subscriptions after the expiration of the initial subscription period, which is typically 12 months. Some former customers of acquired businesses which are now a part of our OnDemand business have elected not to renew their subscriptions. In addition, our customers may elect to renew their service for fewer users. Because the fee structure for our OnDemand solutions is based on the number of users, this could reduce our revenue generated from this service. We have limited historical data with respect to rates of customer subscription renewals, so we cannot predict with any degree of certainty customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, many of which are beyond our control, including their inability to continue their operations and/or spending levels. If our customers do not renew their subscriptions for our service, or if they renew our service for fewer users, our expectations regarding future revenues from this new product offering may be incorrect, which could adversely affect our business, financial condition or results of operations.

***Interruptions or delays in our OnDemand service from our third-party hosting providers could impair the delivery of our service and harm our business.***

We have entered into strategic relationships with hosting providers, including IBM and British Telecom, to provide our OnDemand service through computer hardware located at the facilities of these third parties. We do not control the operation of these facilities, which could be subject to damage or interruption from a variety of sources, including earthquakes, fires, power loss, telecommunications failures and similar events. The occurrence of one of these events or other unanticipated problems at these facilities could result in lengthy interruptions in our service. In addition, the failure by one of our hosting providers to provide the required data communications capacity could result in interruptions in our service. Interruptions in our service, among other things, may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate



their subscriptions and adversely affect our renewal rates.

***If our security measures are breached and an unauthorized party obtains access to a customer's data, our OnDemand service may be perceived as being insecure and customers may curtail or stop using our service.***

Our OnDemand service involves the storage and transmission of customers' proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and potential liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose existing customers and our ability to obtain new customers.

***We may not realize the anticipated benefits of past or future acquisitions, and integration of acquisitions may disrupt our business and management.***

We have in the past and may in the future acquire additional companies, products or technologies. Most recently, we acquired edocs, Inc. in January 2005, Eontec Limited in April 2004, and Ineto in January 2004. We may not realize the anticipated benefits of these or any other acquisition and each acquisition has numerous risks. These risks include:

- difficulty in assimilating the operations and personnel of the acquired company;
- difficulty in effectively integrating the acquired technologies or products with our current products and technologies;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- disruption of our on-going business and distraction of our management and employees due to integration issues;
- inability to retain key technical and managerial personnel from the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- incurrence of acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- impairment of our relationships with employees, customers, partners or third-party providers of technology or products;
- failure of the due diligence processes to identify significant issues with product quality, architecture and development, or legal and financial contingencies, among other things; and
- incurrence of significant exit charges if products acquired in business combinations are unsuccessful.

Ultimately, if we do not successfully complete the integration of acquired businesses in a timely manner, or at all, we may not realize the anticipated benefits of the acquisitions to the extent anticipated, which could adversely affect our business, financial condition or results of operations.

***We may incur future restructuring charges, which may adversely impact our operations.***

During 2002, 2003 and 2004, we initiated a series of restructurings of our operations involving, among other things, the reduction of our workforce and the consolidation of excess facilities (the "Restructurings"). As part of the Restructurings, we ceased to use certain of our leased facilities and, accordingly, we are negotiating certain lease terminations and/or subleases of our facilities. We cannot predict when or if we will be successful in negotiating lease termination agreements or subleases of our facilities on terms acceptable to us. If we are not successful negotiating terms acceptable to us, or at all, we may be required to materially increase our restructuring and related expenses in future periods. Further, if we consolidate additional facilities in the future, we may incur additional restructuring and related expenses, which could have a material adverse effect on our business, financial condition or results of operations.

We also cannot assure you that we will not reduce or otherwise adjust our workforce again in the future or that the related transition issues associated with such a reduction will not occur again. In addition, employees, whether or not directly affected by the reduction, may seek future employment with our business partners, customers or competitors. Although our employees are required to sign a confidentiality agreement at the time of hire, we cannot assure you that the confidential nature of certain proprietary information will be maintained in the course of such future employment. Further, we believe that our future success will depend in large part upon our ability to attract and retain highly skilled personnel. We may have difficulty attracting such personnel as a result of a perceived risk of future workforce reductions.

***If we do not successfully manage the size of our operations, our business may be negatively impacted.***

If we fail to manage the size of our operations effectively, our business, financial condition or results of operations could be materially and adversely affected. Since we began operations and continuing throughout early 2001, our business grew rapidly. Beginning in early 2001 and continuing through much of 2004, our revenues declined in part as a result of a deterioration of the overall economy and information technology industry. These changes in our business have placed a significant strain on our management systems and resources. In response to the deterioration in the information technology industry, management completed a series of Restructurings, as described more fully in Note 2 to the accompanying consolidated financial statements. The Restructurings have particular risks, many of which are discussed above under “We may incur future restructuring charges, which may adversely impact our operations.” In addition, if our operations return to positive growth we may need to implement new systems or upgrade current systems. The failure to successfully implement such new or improved systems could materially and adversely affect our business, financial condition or results of operations.

The majority of our expenses are personnel-related costs such as employee compensation and benefits, along with the cost of the infrastructure (occupancy and equipment) to support our employee base. The failure to adjust our employee base to the appropriate level to support our revenues could materially and adversely affect our business, operating results and financial condition. In addition, expanding the distribution of our products may place new and increased demands on our direct sales force, professional services staff, and technical and sales support staff. Although we currently believe that we invest sufficient resources in our direct sales force, professional services staff, and our technical and sales support staff, there are only a limited number of qualified personnel in these areas. Our ability to achieve expanded distribution and revenue growth in the future will depend, in part, on our success in recruiting and training sufficient direct sales, professional services, and technical and sales support personnel. If we are not be able to expand our direct sales force, professional services staff, and technical and sales support staff as necessary to support our operations, our business and operations could be harmed.

***Decreased effectiveness of equity compensation could negatively impact our ability to attract and retain employees, and a modification to our equity compensation strategy or recent changes in accounting for equity compensation could adversely affect our earnings.***

Accounting principles generally accepted in the United States are subject to interpretation by the Financial Accounting Standards Board, or FASB, the American Institute of Certified Public Accountants, the PCAOB, the SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the implementation of a new accounting principle.

We currently account for stock options under APB 25 and, accordingly, we record compensation expense related to stock options if the current market price of the underlying stock exceeds the exercise price of the stock option on the date of grant. On December 15, 2004, the FASB issued SFAS 123R, which will require us to expense stock options in our statement of operations no later than January 1, 2006. SFAS 123R applies to all outstanding stock options that are not vested at the effective date and grants of new stock options made subsequent to the effective date.

Upon adoption of SFAS 123R on January 1, 2006, we estimate that our earnings in 2006 could be reduced by up to approximately \$35.0 million per quarter. This estimate is based solely on the expense associated with stock options outstanding as of March 31, 2005 (including stock-based compensation under the Purchase Plan) and therefore does not take into consideration new stock option grants, which would increase this estimate, or forfeitures of stock options, which would reduce this estimate.

We have historically used stock options and other forms of equity compensation as key components of our employee compensation program in order to align employees’ interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The changing regulatory landscape could make it more difficult and expensive for us to grant stock options to employees in the future. In light of these changes, we have modified and anticipate that we may further modify our equity compensation strategy to emphasize equity incentives other than stock options, including increased use of certain performance-related features. If employees believe that the incentives that they would receive under a modified strategy are less attractive, we may find it difficult to attract, retain and motivate employees. In addition, the use of alternative equity incentives may increase our compensation expense and may negatively impact our earnings. To the extent that new regulations make it more difficult or expensive to grant equity instruments to employees, we may incur increased compensation costs, further change our equity compensation strategy or find it increasingly difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business, financial condition or results of operations.

***We rely on strategic relationships with systems integrators, distributors, resellers and technology vendors.***

We have established strategic relationships with a number of organizations that we believe are important to our sales, marketing and support activities and the implementation of our products. We believe that our relationships with these organizations provide marketing and sales opportunities for our direct sales force and expand the distribution of our products. These relationships allow us to keep pace with the technological and marketing developments of major software vendors and provide us with technical assistance for our product development efforts. Failure to maintain existing strategic relationships with systems integrators, distributors, resellers and technology vendors, or to establish new relationships in the future, could have a material adverse effect on our business, financial condition or results of operations.

In particular, we have established non-exclusive strategic relationships with Accenture, Capgemini, Deloitte Consulting, IBM and BearingPoint, among others. A significant portion of our revenues has historically been derived from customers that have engaged systems integrators with which we have a relationship. Any deterioration of our relationships with these significant systems integrators could have a material adverse effect on our business, financial condition or results of operations. Our current and potential customers may also rely on third-party systems integrators to develop, deploy or manage Siebel Business Applications. If we do not adequately train a sufficient number of systems integrators, or if these integrators do not have, or do not devote, the resources necessary to implement our products, our business, financial condition or results of operations could be materially and adversely affected.

We also have relationships with technology vendors such as Hewlett-Packard, Intel, Microsoft and Sun Microsystems, among others. Failure to maintain existing relationships with such vendors on acceptable terms, or to establish new relationships with technology vendors in the future, could have a material adverse effect on our business, financial condition or results of operations.

***If we do not maintain our relationships with third-party vendors, interruptions in the supply of our products may result.***

Portions of our products incorporate software that was developed and is maintained by third-party software developers. We may not be able to replace the functionality provided by the third-party software currently offered with our products if that software becomes obsolete or incompatible with future versions of our products or is not adequately maintained or updated. Although we believe there are other sources for these products, any significant interruption in the supply of these products could adversely impact our sales unless and until we can secure another source. We depend in part on these third parties' abilities to enhance their current products, to develop new products on a timely and cost-effective basis and to respond to emerging industry standards and other technological changes. The inability to replace, or any significant delay in the replacement of, functionality provided by third-party software in our products could materially and adversely affect our business, financial condition or results of operations.

***Our customers may not successfully implement our products.***

Our customers frequently deploy our products to large numbers of sales, marketing and customer service personnel. These end users may not accept our products. Our products are also being deployed on a variety of computer hardware platforms and used with a number of third-party software applications and programming tools. This use may present significant technical challenges, particularly as large numbers of personnel attempt to use our products concurrently. If existing customers have difficulty deploying Siebel Business Applications or our OnDemand solutions or for any other reason are not satisfied with Siebel Business Applications or our OnDemand solutions, our business, financial condition or results of operations could be materially and adversely affected.

***Our distribution channels may create additional risks.***

We have a number of relationships with third-party resellers that assist us in selling our products. We generally do not have exclusive relationships with these resellers. In an effort to minimize channel conflicts among our resellers, we have implemented certain policies and licensing programs with each of our resellers. These policies and programs may not effectively minimize or eliminate all channel conflicts. Failure to minimize channel conflicts could result in lost sales opportunities or impair our relationship with our third-party resellers or customers, among other consequences, which could materially and adversely affect our business, operating results and financial condition.

***Our continued success will require us to keep pace with technological developments, evolving industry standards and changing customer needs.***

The software market in which we compete is characterized by (i) rapid technological change, (ii) frequent introductions of new products, (iii) changing customer needs, and (iv) evolving industry standards. To keep pace with technological developments, evolving industry standards and changing customer needs, we must support existing products and develop new products. We may not be successful in developing, marketing and releasing new products or enhancements to Siebel Business

Applications or our OnDemand solutions that respond to technological developments, evolving industry standards or changing customer requirements. We may also experience difficulties that could delay or prevent the successful development, introduction and sale of these new products or enhancements. In addition, these new products or enhancements may not adequately meet the requirements of the marketplace and may not achieve any significant degree of market acceptance. If release dates of any future products or enhancements to Siebel Business Applications or our OnDemand solutions are delayed, or if these products or enhancements fail to achieve market acceptance when released, our business, operating results or financial condition could be materially and adversely affected. In addition, new products or enhancements by our competitors may cause customers to defer or forego purchases of our products, which could have a material adverse effect on our business, financial condition or results of operations.

***We cannot predict the demand for Internet-related products and services.***

Siebel Business Applications and our OnDemand solutions communicate through public and private networks over the Internet. The success of our products and services may depend, in part, on our ability to continue developing products and services that are compatible with the Internet. The increased commercial use of the Internet could require substantial modification and customization of our products and services and the introduction of new products and services. Further, critical issues concerning the commercial use of the Internet, including security, privacy, demand, reliability, cost, ease-of-use, accessibility, quality of service, the impact of “viruses,” “worms” and similar malicious programs, and potential tax or other government regulation remain unresolved and may affect the use of the Internet as a medium to support the functionality of our products and services and the distribution of our software. If these critical issues are not favorably resolved, our business, financial condition or results of operations could be materially and adversely affected.

If the web-based applications market fails to grow at the pace we expect or at all, our business, financial condition or results of operations could be materially and adversely affected. The market for web-based applications software is relatively new, highly competitive and rapidly changing. We market our products primarily to customers who have migrated or are in the process of migrating their enterprise computing systems to web-based computing environments. Our future financial performance will partly depend on the continued growth of organizations successfully adopting web-based computing environments.

***To be successful, we must effectively compete against others in the business applications market.***

Our products are designed for the front-office business applications software market. This market is highly competitive, rapidly changing, and significantly affected by new product introductions and the activities of other market participants. Our products are specifically targeted at the CRM market, as well as the markets for business analytics and customer data integration. We face competition primarily from our customers’ internal information technology departments and systems integrators, as well as other application software providers that offer a variety of products and services designed to address these markets. We may not be able to compete successfully against such internal development efforts.

Our customers and prospective customers are increasingly evaluating their software procurement needs with a focus on the long-term total cost of ownership, which includes the cost of the license and the related professional services, such as implementation, training and technical support. With significantly lower license costs from competitive solutions, and no license cost for internal projects, our success depends on our ability to adequately communicate our strengths in the relative capabilities of our products, the total cost of ownership of the various alternative solutions, and the total return on investment of each of these alternatives.

The following is a discussion of the competitive environments in which we operate:

**Internal Development**

We believe that our primary competition comes from custom-built applications. Specifically, many of our customers and potential customers have in the past developed CRM, customer and business intelligence and certain customer data integration solutions in-house, either alone or with the help of systems integrators. In some cases, these internal development projects have been successful in satisfying the needs of the organization. To compete successfully, our products must conform to the customer’s information technology standards, scale to meet the needs of growing enterprises, operate globally and cost less than an internal development effort. We may not be able to compete effectively against these internal development efforts.

### Systems Integrators

We also face competition from systems integrators engaged by companies to build custom applications. To successfully compete in this area, we must demonstrate and provide to the customer the cost savings and advantages of a configurable, upgradeable and commercially supported product developed by a dedicated professional software organization.

We frequently rely on a number of systems consulting and systems integration firms for a substantial portion of implementation and other professional services, as well as for recommendations of our products during the evaluation stage of the purchase process. Although we seek to maintain close relationships with these service providers, many of them have similar and often more established relationships with our competitors. If we are unable to develop and retain effective, long-term relationships with these third parties, our competitive position could be materially and adversely affected. Further, some of these third parties have significantly greater resources than we do and may market software products that compete with us and may otherwise reduce or discontinue their relationships with or support of us and our products.

### Other Competitors

Our competitors include a number of companies that compete with us primarily within a particular product line (e.g., analytics, interactive selling, etc.) and/or a particular industry (e.g., life sciences, financial services, etc.). These companies include Amdocs Limited; CAS GmbH; Chordiant Software, Inc.; Dendrite International, Inc.; E.piphany, Inc.; FrontRange Solutions, Inc.; Kana Software, Inc.; Microsoft Corporation; ONYX Software Corporation; Pivotal Corporation; The Sage Group; Salesforce.com, Inc.; SAS Institute, Inc.; and StayinFront, Inc., among many others. In addition, our competitors include several companies, such as Oracle Corporation and SAP AG, which compete in a majority of our product lines.

Some of these competitors have longer operating histories; significantly greater financial, technical, marketing and other resources; significantly greater name recognition; a broader product offering; and a larger installed base of customers than we do. In addition, many competitors have well-established relationships with our current and potential customers. As a result, these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion and sale of their products than we can.

There are many factors that may increase competition in the business applications software market, including (i) entry of new competitors, (ii) alliances among existing competitors, (iii) alliances between our competitors and systems integrators, (iv) consolidation in the software industry or among systems integrators, and (v) technological changes or changes in the use of the Internet. Increased competition may result in price reductions, reduced gross margins or loss of market share, any of which could materially and adversely affect our business, financial condition or results of operations. We may not be able to compete successfully against current and future competitors or competitive pressures faced by us may materially and adversely affect our business, financial condition or results of operations.

### ***Industry consolidation may lead to stronger competitors, which may harm our operating results.***

Many leading companies in the market for business applications software have been the subject of mergers, acquisitions and divestitures during the last several years. For example, Oracle Corporation completed its acquisition of PeopleSoft, Inc. during the fourth quarter of 2004. We expect this trend towards consolidation to continue as companies attempt to maintain or extend their market and competitive positions in the rapidly changing business applications software industry and as companies are acquired or are unable to continue operations. This industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results due to lengthening of the customer evaluation process and/or loss of business to these stronger competitors, which may materially and adversely affect our business, financial condition or results of operations.

### ***If we cannot hire enough qualified employees or if we lose key employees, it will adversely affect our ability to manage our business, develop our products and increase our revenues.***

Our performance depends on the continued service of our key technical, sales and senior management personnel. Our key employees have not entered into employment agreements with a specified term of employment with us. The loss of one or more of our senior management personnel could have a material adverse effect on our business, financial condition or results of operations. In particular, in April 2005, upon mutual agreement between ourselves and J. Michael Lawrie, Mr. Lawrie resigned as our Chief Executive Officer and our Board of Directors appointed George T. Shaheen as our Chief Executive Officer. In addition, in recent years, we have had members of our senior management announce their retirement or departure from our company. We replace these individuals with internal candidates and, if deemed appropriate, individuals from outside our organization. While our internal candidates understand our business model, they must learn a new position and take on additional or new responsibilities, which could take time and result in the disruption to our on-going operations. To integrate

into our company, new senior personnel must spend a significant amount of time learning our business model and management systems, in addition to performing their regular duties. Accordingly, until new senior personnel become familiar with our business model and systems, their integration may result in some disruption to our on-going operations. Additionally, we may need to hire additional personnel in general or to replace internal candidates who have been promoted and as a result, we may experience increased compensation costs that are not offset by either improved productivity or higher prices.

***We have restructured, and may in the future restructure, our sales force, which can be disruptive.***

We continue to rely heavily on our direct sales force. In recent years, we have restructured or made other adjustments to our sales force in response to factors such as management changes, product changes and other internal considerations. Changes in the structure of the sales force and sales force management have resulted in a temporary lack of focus and reduced productivity that may have affected revenues in one or more quarters. If we continue to restructure our sales force, then the transition issues associated with restructuring the sales force may recur. Such restructuring or associated transition issues can be disruptive and adversely impact our business and operating results.

***Software errors or defects in our products could reduce revenues.***

Software products frequently contain errors or failures, especially when first introduced or when new versions are released, and can be affected by viruses. We have in the past been, and may in the future be, forced to delay the commercial release of products until the software problems have been corrected. We could lose revenues as a result of software viruses, errors or defects, including defects in third-party products with which our products work. Our products are intended for use in applications that may be critical to a customer's business. As a result, we expect that our customers and potential customers will have a greater sensitivity to product defects than the market for software products generally. Testing errors may also be found in new products or releases after commencement of commercial shipments, resulting in loss of revenue or delay in market acceptance, damage to our reputation, or increased service and warranty costs, any of which could have a material adverse effect upon our business, financial condition or results of operations.

***We may not be able to protect our proprietary information.***

We rely primarily on a combination of patent, copyright, trade secret and trademark laws, confidentiality procedures and contractual provisions to protect our proprietary rights in our products. We also believe that the technological and creative skills of our personnel, new product developments, frequent product enhancements, name recognition and reliable product maintenance are essential to establishing and maintaining a technology leadership position. We seek to protect our software, documentation and other written materials under patent, trade secret and copyright laws, which afford only limited protection. Any patents issued to us may be invalidated, circumvented or challenged. Any of our pending or future patent applications, whether or not being currently challenged, may not be issued with the scope of the claims we seek, if at all. Furthermore, others may develop technologies that are similar or superior to our technology or design around our patents.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our proprietary rights is difficult. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate. We have entered into agreements with substantially all of our customers that require us to place Siebel Business Applications source code into escrow. Such agreements generally provide that such parties will have a limited, non-exclusive right to use such code if (i) there is a bankruptcy proceeding by or against us, (ii) we cease to do business, or (iii) we fail to meet our support obligations.

Although we do not believe that we are infringing any proprietary rights of others, third parties may claim that we have infringed their proprietary rights. Furthermore, former employers of our former, current or future employees may assert claims that such employees have improperly disclosed to us the confidential or proprietary information of such former employers. Any such claims, with or without merit, could (i) be time-consuming to defend, (ii) result in costly litigation, (iii) divert management's attention and resources, (iv) cause product shipment delays, and (v) require us to pay monetary damages or enter into royalty or licensing agreements. A successful claim of product infringement against us and our failure or inability to license or create a workaround for such infringed or similar technology may materially and adversely affect our business, financial condition or results of operations.

***Our international operations involve unique risks.***

Our revenues are primarily derived from large multinational companies. To service the needs of these companies, we must provide worldwide product support services. We have expanded and in the future may expand our international operations and enter additional international markets. This will require significant management attention and financial resources that could adversely affect our operating margins and earnings. We may not be able to maintain or increase international market demand

for Siebel Business Applications and our OnDemand solutions. If we do not, our international sales will be limited and our business, financial condition or results of operations could be materially and adversely affected.

Our international operations are subject to a variety of risks, including (i) foreign currency fluctuations, (ii) economic or political instability, (iii) shipping delays, and (iv) various trade restrictions. Any of these risks could have a significant impact on our ability to deliver products on a competitive and timely basis. Significant increases in the level of customs duties, export quotas or other trade restrictions could also have an adverse effect on our business, financial condition or results of operations. In situations where direct sales or purchases are denominated in foreign currency, any fluctuation in the exchange rate may adversely affect our business, financial condition or results of operations. Generally, we manage our foreign currency exchange rate risk by entering into contracts to sell or purchase foreign currency at the time a foreign currency receivable or payable is generated. When the foreign currency asset or liability is extinguished, the contract is liquidated, and the resulting gain or loss on the contract mitigates the exchange rate risk of the associated asset or liability. In certain instances, we have not hedged foreign currency receivables and payables when the forward contracts in the relevant currency were not readily available or were not cost-effective.

***Our stock price may continue to be volatile.***

The trading price of our common stock has fluctuated substantially since our initial public offering in June 1996. The trading price is subject to significant fluctuations in response to (i) variations in quarterly operating results; (ii) the gain or loss of significant orders; (iii) changes in earnings estimates by analysts; (iv) changes in our revenue and/or earnings expectations as announced in our earnings calls; (v) announcements of technological innovations or new products by us or our competitors; (vi) changes in domestic and international economic, political and business conditions; (vii) general conditions in the software and computer industries; (viii) the recent lack of public confidence in corporate governance and accounting practices; and (ix) other events or factors. In addition, the stock market in general has experienced extreme price and volume fluctuations that have affected the market prices for many companies in industries similar or related to ours and that have been unrelated to the operating performance of these companies. These market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock.

***Provisions in our charter documents may prevent, discourage or delay certain corporate actions.***

Our Board of Directors is authorized to issue up to 2,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further approval by our stockholders. One of these shares has been designated Series A1 Preferred Stock, which was issued in connection with the acquisition of Janna Systems Inc. in 2000, and 100,000 shares have been designated as Series A2 Junior Participating Preferred Stock, which were authorized in connection with a stockholders' rights plan that we implemented in 2003. Additional shares of preferred stock could be authorized or issued with voting, liquidation, dividend and other rights superior to those of the common stock.

The rights of the holders of common stock will be subject to and may be adversely affected by the rights of the holders of any preferred stock that has already been authorized or issued, or that may be issued in the future. The issuance of the Series A2 Junior Participating Preferred Stock or the authorization of additional classes of preferred stock by our Board of Directors in the future, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could make it more difficult for a third party to acquire a majority of our outstanding voting common stock. In addition, the following factors could also delay or make more difficult a merger, tender offer or proxy contest: (i) our classified Board of Directors, (ii) certain provisions of our certificate of incorporation, (iii) certain provisions of our bylaws, and (iv) certain provisions of Delaware law.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The tables below provide information about our derivative financial instruments and other financial instruments that are subject to market risk. The first table includes our foreign currency contracts used to minimize the impact of changes in currency rates on existing foreign currency receivables, payables and intercompany balances, which are subject to exchange rate risk. The second table includes our available-for-sale short-term investments, which are subject to interest rate risk.

We manage our foreign currency exchange rate risk by entering into contracts to sell or buy foreign currency at the time a foreign currency receivable or payable is generated. When the foreign currency asset or liability is extinguished, the contract is liquidated, and the resulting gain or loss on the contract mitigates the exchange rate risk of the associated asset or liability.

The following table summarizes as of March 31, 2005 our foreign currency forward contracts, by currency. All of our foreign currency forward contracts mature within one year. Contract amounts are representative of the expected payments to be made under these instruments (in thousands):

	<u>Contract Amount (Local Currency)</u>	<u>Contract Amount</u>	<u>Fair Value (US\$)</u>
Australian dollars ("AUD") (contracts to pay AUD/receive US\$).....	(AUD) 12,700	US\$9,722	\$ 20
Brazilian real ("BRL") (contracts to pay BRL/receive US\$).....	(BRL) 30,635	US\$11,082	\$ 249
British pounds ("GBP") (contracts to pay GBP/receive EUR).....	(GBP) 10,175	EUR 14,696	\$ 3
Canadian dollars ("CAD") (contracts to pay CAD/receive US\$).....	(CAD) 5,322	US\$4,417	\$ 21
Japanese yen ("JPY") (contracts to pay JPY/receive US\$).....	(JPY) 1,237,434	US\$11,815	\$ 218
Korean won ("KRW") (contracts to receive KRW/pay US\$).....	(KRW) 15,433	US\$8	\$ 7
Mexican pesos ("MXN") (contracts to pay MXN/receive US\$).....	(MXN) 21,132	US\$1,861	\$ 16
Singapore dollars ("SGD") (contracts to pay SGD/receive US\$).....	(SGD) 1,779	US\$1,078	\$ --
Czech Republic koruna ("CZK") (contracts to receive CZK/pay EUR).....	(CZK) 4,145	EUR 139	\$ 2
Euros ("EUR") (contracts to receive EUR/pay US\$).....	(EUR) 221,153	US\$289,250	\$ (3,993)
Swedish krona ("SEK") (contracts to receive SEK/pay EUR).....	(SEK) 7,639	EUR 846	\$ (6)
Swiss francs ("CHF") (contracts to receive CHF/pay EUR).....	(CHF) 4,666	EUR 3,003	\$ 18

The following table summarizes our short-term investments and the weighted average yields as of March 31, 2005 (in thousands, except percentages):

	<u>Expected Maturity Date</u>						
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Thereafter</u>	
US Treasury and Agency securities... \$	115,601	\$ 175,206	\$ 75,322	\$ 25,016	\$ 6,548	\$ --	\$ 397,693
Weighted average yield.....	3.09%	3.78%	4.12%	3.82%	4.30%	--	
Corporate bonds..... \$	110,869	\$ 263,310	\$ 258,056	\$ 83,764	\$ 78,064	\$ 10,570	\$ 804,633
Weighted average yield.....	3.38%	3.71%	4.04%	4.33%	4.57%	3.26%	
Asset-backed securities..... \$	70,161	\$ 224,647	\$ 94,633	\$ 39,159	\$ 16,233	\$ 3,777	\$ 448,610
Weighted average yield.....	3.53%	3.84%	4.04%	4.52%	4.82%	3.22%	
Total short-term investments.....	<u>\$ 296,631</u>	<u>\$ 663,163</u>	<u>\$ 428,011</u>	<u>\$ 147,939</u>	<u>\$ 100,845</u>	<u>\$ 14,347</u>	<u>\$ 1,650,936</u>

The securities in the above table, like all fixed income instruments, are subject to interest rate risk and, accordingly, if market interest rates increase, these investments will decline in value. If market interest rates were to increase immediately and uniformly by 100 basis points from levels as of March 31, 2005, the fair value of the above investments would decline by approximately \$23.6 million.

We manage our interest rate risk by maintaining an investment portfolio with debt instruments of high credit quality and relatively short average maturities. We also manage interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity, if necessary.



## **Item 4. Controls and Procedures**

We have historically made our internal control over financial reporting a high priority and we continue to do so. Our Internal Control Committee, comprised primarily of senior financial and legal personnel, assists us in ensuring that our internal control over financial reporting is complete, accurate and appropriately documented. In addition, our internal audit department reviews and tests our internal control in order to ensure that it is designed appropriately and is operating as designed. The Sarbanes-Oxley Act of 2002 (“SOX”) and resulting rules adopted by the Securities and Exchange Commission served as a catalyst for us to formalize many of our processes, controls and procedures that we have instituted to ensure proper financial reporting.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the “Exchange Act”). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

### **Responsibility for Disclosure and Internal Control**

Our management, including our CEO and CFO, has the responsibility of establishing and maintaining adequate Disclosure Control and Internal Control over our financial reporting. Disclosure Control is a set of procedures that is designed to ensure that information required to be disclosed in reports filed or furnished with the SEC, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Disclosure Control is also designed to ensure that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Internal Control is a set of processes designed by, or under the supervision of, our principal executive and financial officers, or persons performing similar functions, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States (“GAAP”). Internal Control includes those policies and procedures that:

- (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of our assets;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our CEO and CFO note that during the three months ended March 31, 2005, there have been no changes in our Internal Control or in other factors that materially affected or are reasonably likely to materially affect such controls, including any corrective actions with regard to material weaknesses. We have historically considered our Internal Control a high priority and strive to continually improve our Internal Control. Accordingly, we have taken and will continue to take corrective action if and as we discover deficiencies in our Internal Control.

### **Limitations on the Effectiveness of Controls**

Our management, including our CEO and CFO, does not expect that our Disclosure Control or our Internal Control will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

## Part II. Other Information

### **Item 1. Legal Proceedings**

#### *Regulation FD*

On May 6, 2003, the Enforcement Division staff (“Staff”) of the Securities & Exchange Commission (“SEC”) contacted us and indicated that a May 1, 2003 article on CBS MarketWatch had raised questions regarding our compliance with Regulation FD. In August 2003, the Staff notified us and two of our officers of the Staff’s preliminary decision to recommend that the SEC take enforcement action against us and these officers in regard to statements allegedly made prior to and during an April 30, 2003 dinner. We and the officers filed submissions with the SEC in response to the SEC notices that we believe contained numerous meritorious defenses to these allegations. Despite these submissions, on June 29, 2004, the SEC filed a lawsuit in the United States District Court of the Southern District of New York against us and the two officers alleging, among other things, that we and the officers violated Regulation FD in connection with the statements described above.

In September 2004, we filed a motion to dismiss the complaint. A hearing on the motion occurred on March 15, 2005. We believe the allegations in this action are without merit and we intend to defend vigorously against them. Due to the uncertainty surrounding the litigation process, there exists the possibility that we may incur costs in excess of amounts already recognized. We cannot currently estimate the amount of such additional costs, if any.

#### *Stock Option Grant Inquiry*

On March 7, 2005, the SEC provided us with a copy of an order of investigation regarding certain stock option grants by a number of companies, including us. The SEC has advised us that this is a confidential fact finding inquiry and has confirmed that the issuance of the order does not indicate that it has concluded that we have violated any securities laws. We intend to cooperate with the SEC as this investigation continues to develop. In accordance with the disclosures required by SFAS 5, we are unable to estimate the potential financial impact this matter could have on us.

#### *Shareholder Class Actions*

On March 10, 2004, William Wollrab, on behalf of himself and purportedly on behalf of a class of our stockholders, filed a complaint in the United States District Court for the Northern District of California against us and certain of our officers. This complaint was consolidated and amended on August 27, 2004, with the Policemen’s Annuity and Benefit Fund of Chicago being appointed to serve as lead plaintiff. In October 2004, we filed a motion for dismissal of this case, which was granted on January 28, 2005. Plaintiffs in this case filed a second amended complaint on February 28, 2005, and we intend to file a motion to dismiss as soon as practical.

On April 12, 2004, Pamela Plotkin, on behalf of herself and purportedly on behalf of a class of our stockholders, filed a complaint in the Superior Court of California (the “Superior Court”) against us and certain members of our Board of Directors. The Superior Court dismissed the complaint by Ms. Plotkin on September 23, 2004, but gave Ms. Plotkin leave to file a new, amended complaint, which was subsequently filed by Ms. Plotkin. The Superior Court dismissed the amended complaint on December 28, 2004, but again gave Ms. Plotkin leave to file a new, amended complaint. Ms. Plotkin filed a new amended complaint on January 14, 2005. On February 2, 2005, the parties to this complaint agreed to stay (i.e., place on hold) the entire case until June 1, 2005.

These complaints allege claims in connection with various public statements made by us and seek damages together with interest and reimbursement of costs and expenses of litigation. We believe the allegations in each of these actions are without merit and we intend to defend vigorously against these claims.

#### *General*

We are subject to legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these proceedings and claims cannot be predicted with certainty, management does not believe that the outcome of any pending legal matter will have a material adverse effect on our consolidated financial position, although results of operations or cash flows could be affected in a particular period.

## **Item 5. Other Information**

In recent weeks, a number of stories have been written concerning potential strategic opportunities for Siebel Systems. While it is our firm policy not to comment on such stories, we believe that their unusual intensity in this instance and the heavy trading volume of our stock over the past several days warrants clarification.

Over the past several years, we have from time to time considered a diverse range of strategic opportunities to maximize stockholder value, including but not limited to potential significant acquisitions by us, restructurings of our equity, equity repurchases, strategic alliances and offers to purchase us. In evaluating such opportunities, we regularly engage outside financial and legal experts and our independent directors as necessary to aid us in our analysis and consideration. Such activities are quite common and are regularly under various stages of consideration in the normal course of business.

Similarly, potential opportunities have recently been presented to us that continue to be evaluated and discussed in a manner that is consistent with our past practices and the fiduciary duties of our officers and directors, with the goal of determining what the Board of Directors believes is in our stockholders' best interests. These activities include the involvement of independent directors, outside experts and independent advisors. Such activities continue to be conducted in the normal course of business and should not be interpreted to suggest that any of these current potential opportunities will or will not be consummated. There are none under current consideration that have progressed to the point at which the full Board of Directors has met to consider them.

We undertake no obligation and do not intend to make any further announcement regarding the exploration of potential strategic opportunities, except as required by law. We continue to be entirely focused on growing our business, generating profit, adding customer value and serving the long-term interests of our customers, employees and stockholders.

## **Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description of Document</b>
3.1	Amended and Restated Certificate of Incorporation of the Registrant, as amended to date. (1)
3.2	Amended and Restated Bylaws of the Registrant. (2)
4.1	Reference is made to Exhibit 3.1 and Exhibit 3.2.
4.2	Specimen Stock Certificate. (3)
4.3	Certificate of Designation of Series A1 Preferred Stock of the Registrant. (4)
4.4	Indenture between the Registrant, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated September 15, 1999. (5)
4.5	Certificate of Designation of Series A2 Junior Participating Preferred Stock. (6)
4.6	Rights Agreement dated as of January 29, 2003, between the Registrant and Mellon Investors Services LLC, as Rights Agent. (6)
4.7	Form of Rights Certificate. (6)
10.1	Registrant's Performance Stock Plan. (7)
10.2	Non-Employee Director Compensation Arrangement. (8)
10.3	Registrant's Executive Bonus Plan. (7)
10.4	Registrant's Amended and Restated Nonqualified Deferred Compensation Plan. (9)
10.5	Form of Nonstatutory Stock Option Agreement and Notice. (10)
10.6	Form of Incentive Stock Option Agreement and Notice. (10)
10.7	2004 Executive Bonus Arrangement. (8)
10.8	Offer of Employment by and between the Registrant and George T. Shaheen, dated as of April 12, 2005. (11)
10.9	Separation and Consulting Agreement by and between the Registrant and J. Michael Lawrie, dated as of April 15, 2005. (12)
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (10)
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (10)
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (10)

- 
- (1) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.
  - (2) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002.
  - (3) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (No. 333-03751), as amended.
  - (4) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 27, 2000.
  - (5) Incorporated by reference to the Registrant's Registration Statement on Form S-3 (No. 333-91777) filed on November 30, 1999.
  - (6) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 29, 2003.
  - (7) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 11, 2005.
  - (8) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on February 24, 2005.
  - (9) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on March 8, 2005.
  - (10) Filed herewith.
  - (11) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 18, 2005.
  - (12) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 20, 2005.

### **Availability of this Report**

We intend to make this quarterly report on Form 10-Q publicly available on our website ([www.siebel.com](http://www.siebel.com)) without charge immediately following our filing with the Securities and Exchange Commission. We assume no obligation to update or revise any forward-looking statements in this quarterly report on Form 10-Q, whether as a result of new information, future events or otherwise, unless we are required to do so by law.

## **SIGNATURE**

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

**SIEBEL SYSTEMS, INC.**

Date: May 6, 2005

By: /s/ Kenneth A. Goldman

Kenneth A. Goldman

Senior Vice President, Finance and Administration  
and Chief Financial Officer

CERTIFICATION

I, George T. Shaheen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Siebel Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2005

By: /s/ George T. Shaheen

George T. Shaheen

Chief Executive Officer

CERTIFICATION

I, Kenneth A. Goldman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Siebel Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2005

By: /s/ Kenneth A. Goldman

Kenneth A. Goldman

Senior Vice President, Finance and  
Administration and Chief  
Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE  
OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, George T. Shaheen, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Siebel Systems, Inc. on Form 10-Q for the period ended March 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Siebel Systems, Inc.

**In Witness Whereof**, the undersigned has set his hand hereto as of the 6<sup>th</sup> day of May 2005.

/s/ George T. Shaheen  
Chief Executive Officer  
(Principal Executive Officer)

I, Kenneth A. Goldman, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Siebel Systems, Inc. on Form 10-Q for the period ended March 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Siebel Systems, Inc.

**In Witness Whereof**, the undersigned has set his hand hereto as of the 6<sup>th</sup> day of May 2005.

/s/ Kenneth A. Goldman  
Senior Vice President, Finance and  
Administration and Chief Financial Officer  
(Principal Financial Officer)

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Siebel Systems, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.