GOSSETT ROBERT L
Form 4
November 22, 2005

FORM 4

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

(Print or Type Responses)

1. Name and Address of Reporting Person *
GOSSETT ROBERT L

(Last) (First) (Middle)

WINNEBAGO INDUSTRIES, INC.,, P.O. BOX 152

(Street)

FOREST CITY, IA 50436

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
WINNEBAGO INDUSTRIES INC [WGO]

3. Date of Earliest Transaction (Month/Day/Year)
11/21/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
VP-Administration

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock, $.50 par value	11/21/2005		M		3,000	A	$ 6.2188	12,999	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. D Der Sec (Ins
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Stock Options (rights to buy) [(1)]	$ 6.2188	11/21/2005		M			3,000 [(1)]	[(1)]	10/11/2010	Common Stock	5,984 [(1)]	$ 0

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director			Expected to be February 4, 2013

Pricing Date:	Expected to be February 4, 2013
Original Issue Date:	Expected to be February 7, 2013 (to be determined on the Trade Date and expected to be the 3rd Business Day after the Trade Date)
Maturity Date:	February 7, 2028
Business Day:	Any day which is neither a legal holiday nor a day on which banking institutions are authorized or obligated by law, regulation or executive order to close in New York and Toronto.
	With respect to each Interest Payment Date, for each $1,000 Principal Amount of Notes, the Interest Payment will be calculated as $1,000 × 1/2 × Interest Rate.
Interest Payment:	Each Interest Payment is paid semi-annually and is calculated on a 30/360 unadjusted basis; (i)“30/360” means that Interest Payment is calculated on the basis of twelve 30-day months and (ii) “unadjusted” means that an Interest Payment Date may be delayed if it falls on a Saturday, Sunday or other non Business Day. As a result, each Interest Payment period will consist of 180 days (six 30-day months) and Interest Payments will accrue based on 180 days of a 360-day year or ½. See "Payment at Maturity” and “Interest” on page P-6 of this pricing supplement.
Interest Rate:	3.50% per annum
Interest Payment Dates:	

	The 7th calendar day of each February and August commencing on August 7, 2013 and ending on the Maturity Date. If these days are not Business Days, Interest Payments will actually be paid on the dates determined as described below.
Day Count Fraction:	30/360, unadjusted, following business day convention (all as more fully described below).
First Call Date:	February 7, 2014
Call Provision:	The Notes are redeemable at our option, in whole, but not in part, on each stated Call Payment Date, from and including the First Call Date, upon notice by us to DTC on or before the corresponding Call Notice Date, at an amount that will equal the Principal Amount of your Notes plus the Interest Payment applicable to such Interest Payment Date. If the Notes are called prior to the Maturity Date, you will be entitled to receive only the Principal Amount of the Notes and

	any accrued and unpaid Interest Payment in respect of Interest Payment Dates occurring on or before the Call Payment Date. In this case, you will lose the opportunity to continue to be paid Interest Payments in respect of Interest Payment Dates ending after the Call Payment Date.
Call Notice Date:	10 Business Days prior to the corresponding Call Payment Date.
Call Payment Date:	The 7th calendar day of each February and August, commencing on the First Call Date, if any, for which we have given a call notice for the Notes, on or before the corresponding Call Notice Date.
CUSIP/ISIN:	CUSIP 064159 BN5 / ISIN US064159BN56
Form of Notes:	Book-entry
Type of Note:	Callable Fixed Rate Notes, Series A
Calculation Agent:	Scotia Capital Inc., an affiliate of the Bank
Status:	The Notes will constitute direct, unsubordinated and unsecured obligations of the Bank ranking *pari passu* with all other direct, unsecured and unsubordinated indebtedness of the Bank from time to time outstanding (except as otherwise prescribed by law). Holders will not have the benefit of any insurance under the provisions of the *Canada Deposit Insurance Corporation Act*, the U.S. *Federal Deposit Insurance Act* or under any other deposit insurance regime.
Tax Redemption:	The Bank (or its successor) may redeem the Notes, in whole but not in part, at a redemption price equal to the principal amount thereof together with accrued and unpaid interest to the date fixed for redemption, if it is determined that changes in tax laws or their interpretation will result in the Bank (or its successor) becoming obligated to pay, on the next Interest Payment Date, additional amounts with respect to the Notes. See "Tax Redemption" in this pricing supplement.
Listing:	The Notes will not be listed on any securities exchange or quotation system.
Use of Proceeds:	General corporate purposes
Clearance and Settlement:	Depository Trust Company
Terms Incorporated:	All of the terms appearing under the caption "General Terms of the Notes" beginning on page PS-10 in the accompanying product prospectus supplement, as modified by this pricing supplement.

ADDITIONAL TERMS OF YOUR NOTES

You should read this pricing supplement together with the prospectus dated December 28, 2012, as supplemented by the prospectus supplement dated December 28, 2012 and the product prospectus supplement (Rate Linked Notes, Series A) dated December 28, 2012, relating to our Senior Note Program, Series A, of which these Notes are a part. Capitalized terms used but not defined in this pricing supplement will have the meanings given to them in the product prospectus supplement. In the event of any conflict, this pricing supplement will control. ***The Notes may vary from the terms described in the accompanying product prospectus supplement in several important ways. You should read this pricing supplement carefully.***

This pricing supplement, together with the documents listed below, contains the terms of the Notes and supersedes all prior or contemporaneous oral statements as well as any other written materials including preliminary or indicative pricing terms, correspondence, trade ideas, structures for implementation, sample structures, brochures or other educational materials of ours. You should carefully consider, among other things, the matters set forth in "Additional Risk Factors Specific to the Notes" in the accompanying product prospectus supplement, as the Notes involve risks not associated with conventional debt securities. We urge you to consult your investment, legal, tax, accounting and other advisors before you invest in the Notes. You may access these documents on the SEC website at www.sec.gov as follows (or if that address has changed, by reviewing our filings for the relevant date on the SEC website at http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0000009631):

Prospectus dated December 28, 2012:

http://www.sec.gov/Archives/edgar/data/9631/000119312512518291/d459446d424b3.htm

Prospectus Supplement dated December 28, 2012:

http://www.sec.gov/Archives/edgar/data/9631/000119312512518324/d457877d424b3.htm

Product Prospectus Supplement (Rate Linked Notes, Series A), dated December 28, 2012

http://www.sec.gov/Archives/edgar/data/9631/000119312512518374/d457891d424b5.htm

The Bank of Nova Scotia has filed a registration statement (including a prospectus, a prospectus supplement, and a product prospectus supplement) with the SEC for the offering to which this pricing supplement relates. Before you invest, you should read those documents and the other documents relating to this offering that we have filed with the SEC for more complete information about us and this offering. You may obtain these documents without cost by visiting EDGAR on the SEC Website at www.sec.gov. Alternatively, The Bank of Nova Scotia, any agent or any dealer participating in this offering will arrange to send you the prospectus, the prospectus supplement and the product prospectus supplement if you so request by calling 1-416-866-3672.

PAYMENT AT MATURITY

If the Notes have not been called by us, as described elsewhere in this pricing supplement, we will pay you the principal amount of your Notes on the Maturity Date, plus the final interest payment.

In the event that the stated Maturity Date is not a Business Day, then relevant repayment of principal will be made on the next Business Day ("Following Business Day Convention").

Interest

We describe payments as being based on a “day count fraction” of “30/360, unadjusted, Following Business Day Convention”.

P-4

This means that the number of days in the Interest Payment period will be based on a 360-day year of twelve 30-day months ("30/360") and that the number of days in the Interest Payment period will be based on the days on which interest would have been paid if each such day was a Business Day, not on the actual days on which payment is made ("unadjusted").

If any Interest Payment Date falls on a day that is not a Business Day (including any Interest Payment Date that is also the Maturity Date), the relevant Interest Payment will be made on the next Business Day under the Following Business Day Convention.

EVENTS OF DEFAULT AND ACCELERATION

If the Notes have become immediately due and payable following an Event of Default (as defined in the accompanying prospectus) with respect to the Notes, the Calculation Agent will determine (i) your principal amount and (ii) any accrued but unpaid interest payable based upon the then applicable Interest Rate calculated on the basis of a 360-day year consisting of twelve 30-day months.

If the Notes have become immediately due and payable following an Event of Default, you will not be entitled to any additional payments with respect to the Notes. For more information, see "Description of the Debt Securities We May Offer—Events of Default" beginning on page 21 of the accompanying prospectus.

TAX REDEMPTION

The Bank (or its successor) may redeem the Notes, in whole but not in part, at a redemption price equal to the principal amount thereof together with accrued and unpaid interest to the date fixed for redemption, upon the giving of a notice as described below, if:

- as a result of any change (including any announced prospective change) in or amendment to the laws (or any regulations or rulings promulgated thereunder) of Canada (or the jurisdiction of organization of the successor to the Bank) or of any political subdivision or taxing authority thereof or therein affecting taxation, or any change in official position regarding the application or interpretation of such laws, regulations or rulings (including a holding by a court of competent jurisdiction), which change or amendment is announced or becomes effective on or after the Pricing Date (or, in the case of a successor to the Bank, after the date of succession), and which in the written opinion to the Bank (or its successor) of legal counsel of recognized standing has resulted or will result (assuming, in the case of any announced prospective change, that such announced change will become effective as of the date specified in such announcement and in the form announced) in the Bank (or its successor) becoming obligated to pay, on the next succeeding date on which interest is due, additional amounts with respect to the Notes; or
- on or after the Pricing Date (or, in the case of a successor to the Bank, after the date of succession), any action has been taken by any taxing authority of, or any decision has been rendered by a court of competent jurisdiction in Canada (or the jurisdiction of organization of the successor to the Bank) or any political subdivision or taxing authority thereof or therein, including any of those actions specified in the paragraph immediately above, whether or not such action was taken or decision was rendered with respect to the Bank (or its successor), or any change, amendment, application or interpretation shall be officially proposed, which, in any such case, in the written opinion to the Bank (or its successor) of legal counsel of recognized standing, will result (assuming, in the case of any announced prospective change, that such change, amendment, application, interpretation or action is applied to the Notes by the taxing authority and that such announced change will become effective as of the date specified in such announcement and in the form announced) in the Bank (or its successor) becoming obligated to pay, on the next succeeding date on which interest is due, additional amounts with respect to the Notes;

and, in any such case, the Bank (or its successor), in its business judgment, determines that such obligation cannot be avoided by the use of reasonable measures available to it (or its successor).

P-5

In the event the Bank elects to redeem the Notes pursuant to the provisions set forth in the preceding paragraph, it shall deliver to the Trustees a certificate, signed by an authorized officer, stating (i) that the Bank is entitled to redeem such Notes pursuant to their terms and (ii) the principal amount of the Notes to be redeemed.

Notice of intention to redeem such Notes will be given to holders of the Notes not more than 45 nor less than 30 days prior to the date fixed for redemption and such notice will specify, among other things, the date fixed for redemption and the redemption price.

ADDITIONAL RISK FACTORS

An investment in the Notes involves significant risks. In addition to the following risks included in this pricing supplement, we urge you to read “Additional Risk Factors Specific to the Notes” beginning on page PS-5 of the accompanying product prospectus supplement and “Risk Factors” beginning on page S-2 of the accompanying prospectus supplement and on page 6 of the accompanying prospectus.

You should understand the risks of investing in the Notes and should reach an investment decision only after careful consideration, with your advisers, of the suitability of the Notes in light of your particular financial circumstances and the information set forth in this pricing supplement and the accompanying prospectus, prospectus supplement and product prospectus supplement.

Your Investment is Subject to a Reinvestment Risk in the Event We Elect to Call the Notes.

We have the ability to call the Notes prior to the Maturity Date. In the event we decide to exercise the Call Provision, the amount of interest payable would be less than the amount of interest payable if you held the Notes until the Maturity Date. There is no guarantee that you would be able to reinvest the proceeds from an investment in the Notes at a comparable return for a similar level of risk following our exercise of the Call Provision. We may choose to call the Notes early or choose not to call the Notes early, in our sole discretion. In addition, it is more likely that we will call the Notes prior to maturity if a significant decrease in U.S. interest rates or a significant decrease in the volatility of U.S. interest rates would result in greater interest payments on the Notes than on instruments of comparable maturity, terms and credit worthiness then trading in the market.

Interest Rate Risk.

The Notes are an investment in a fixed interest rate. Fixed interest rate instruments are generally more sensitive to market interest rate changes. The prices of long-term debt obligations generally fluctuate more than prices of short-term debt obligations as interest rates change. Generally, when market interest rates rise, the prices of debt obligations fall, and vice versa. This risk may be particularly acute because market interest rates are currently at historically low levels. Therefore, an increase in market interest rates will adversely affect the value of your Notes.

The Notes are Not Ordinary Debt Securities.

The Notes have certain investment characteristics that differ from traditional fixed income securities. Specifically, the performance of the Notes will not track the same price movements as traditional interest rate products. A person should reach a decision to invest in the Notes after carefully considering, with his or her advisors, the suitability of the Notes in light of his or her investment objectives and the information set out in the above terms of the offering. The Issuer does not make any recommendation as to whether the Notes are a suitable investment for any person.

Your Investment is Subject to the Credit Risk of The Bank of Nova Scotia.

The Notes are senior unsecured debt obligations of The Bank of Nova Scotia and are not, either directly or indirectly, an obligation of any third party. As further described in the accompanying prospectus, prospectus supplement and

product prospectus supplement, the Notes will rank on par with all of the other unsecured and unsubordinated debt obligations of The

Bank of Nova Scotia, except such obligations as may be preferred by operation of law. Any payment to be made on the Notes, including the return of the principal amount at maturity or on the Call Payment Date, as applicable, depends on the ability of The Bank of Nova Scotia to satisfy its obligations as they come due. As a result, the actual and perceived creditworthiness of The Bank of Nova Scotia may affect the market value of the Notes and, in the event The Bank of Nova Scotia were to default on its obligations, you may not receive the amounts owed to you under the terms of the Notes.

The Price at Which the Notes May Be Sold Prior to Maturity will Depend on a Number of Factors and May Be Substantially Less Than the Amount for Which They Were Originally Purchased.

The price at which the Notes may be sold prior to maturity will depend on a number of factors. Some of these factors include, but are not limited to: (i) volatility of the level of interest rates and the market's perception of future volatility of the level of interest rates, (ii) changes in interest rates generally, (iii) any actual or anticipated changes in our credit ratings or credit spreads, and (iv) time remaining to maturity. In particular, because the terms of the Notes permit us to redeem the Notes prior to maturity, the price of the Notes may be impacted by the call feature of the Notes. Additionally, the interest rates of the Notes reflect not only our credit spread generally but also the call feature of the Notes and thus may not reflect the rate at which a note without a call feature and increasing interest rate might be issued and sold.

Depending on the actual or anticipated level of interest rates, the market value of the Notes may decrease and you may receive substantially less than 100% of the issue price if you sell your Notes prior to maturity.

The Inclusion of Dealer Spread and Projected Profit from Hedging in the Original Issue Price is Likely to Adversely Affect Secondary Market Prices.

Assuming no change in market conditions or any other relevant factors, the price, if any, at which Scotia Capital (USA) Inc. or any other party is willing to purchase the Notes at any time in secondary market transactions will likely be significantly lower than the original issue price, since secondary market prices are likely to exclude underwriting commissions paid with respect to the Notes and the cost of hedging our obligations under the Notes that are included in the original issue price. The cost of hedging includes the projected profit that we and/or our subsidiaries may realize in consideration for assuming the risks inherent in managing the hedging transactions. These secondary market prices are also likely to be reduced by the costs of unwinding the related hedging transactions. In addition, any secondary market prices may differ from values determined by pricing models used by Scotia Capital (USA) Inc. as a result of dealer discounts, mark-ups or other transaction costs.

The Notes Lack Liquidity.

The Notes will not be listed on any securities exchange or automated quotation system. Therefore, there may be little or no secondary market for the Notes. Scotia Capital (USA) Inc. or any other dealer may, but is not obligated to, make a market in the Notes. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the Notes easily. Because we do not expect that other broker-dealers will participate significantly in the secondary market for the Notes, the price at which you may be able to trade your Notes is likely to depend on the price, if any, at which Scotia Capital (USA) Inc. is willing to purchase the Notes from you. If at any time Scotia Capital (USA) Inc. or any other dealer were not to make a market in the Notes, it is likely that there would be no secondary market for the Notes. Accordingly, you should be willing to hold your Notes to maturity.

SUPPLEMENTAL PLAN OF DISTRIBUTION (CONFLICTS OF INTEREST)

Pursuant to the terms of a distribution agreement, Scotia Capital (USA) Inc., an affiliate of The Bank of Nova Scotia, will purchase the Notes from The Bank of Nova Scotia for distribution to other registered broker-dealers or will offer the Notes directly to investors.

Scotia Capital (USA) Inc. or one of our affiliates will purchase the Notes at the Principal Amount and as part of the distribution, if the Notes priced today, would pay varying discounts and underwriting commissions of 0.45% per $1,000 principal amount of the Notes in connection with the distribution of the Notes. The actual discounts and underwriting

commissions that Scotia Capital (USA) Inc. or one of our affiliates will pay may be more or less than 0.45% and will depend on market conditions. In no event will Scotia Capital (USA) Inc. or one of our affiliates pay varying discounts and underwriting commissions in excess of 0.90% per $1,000 principal amount of the Notes in connection with the distribution of the Notes.Scotia Capital (USA) Inc. may also receive a structuring and development fee of up to 0.37% per $1,000 Principal Amount of the Notes.

In addition, Scotia Capital (USA) Inc. or another of its affiliates or agents may use the product prospectus supplement to which this pricing supplement relates in market-making transactions after the initial sale of the Notes. While Scotia Capital (USA) Inc. may make markets in the Notes, it is under no obligation to do so and may discontinue any market-making activities at any time without notice. See the sections titled “Supplemental Plan of Distribution” in the accompanying prospectus supplement and product prospectus supplement.

The price at which you purchase the Notes includes costs that the Bank or its affiliates expect to incur and profits that the Bank or its affiliates expect to realize in connection with hedging activities related to the Notes, as set forth above. These costs and profits will likely reduce the secondary market price, if any secondary market develops, for the Notes. As a result, you may experience an immediate and substantial decline in the market value of your Notes on the Issue Date.

Conflicts of Interest

Each of Scotia Capital (USA) Inc. and Scotia Capital Inc. is an affiliate of the Bank and, as such, has a ‘‘conflict of interest’’ in this offering within the meaning of FINRA Rule 5121. In addition, the Bank will receive the gross proceeds from the initial public offering of the Notes, thus creating an additional conflict of interest within the meaning of Rule 5121. Consequently, the offering is being conducted in compliance with the provisions of Rule 5121. Neither Scotia Capital (USA) Inc. nor Scotia Capital Inc. is permitted to sell the Notes in this offering to an account over which it exercises discretionary authority without the prior specific written approval of the account holder.

Scotia Capital (USA) Inc. and its affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. Scotia Capital (USA) Inc. and its affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the Bank, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, Scotia Capital (USA) Inc. and its affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities and/or instruments of the Bank. Scotia Capital (USA) Inc. and its affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

CERTAIN CANADIAN INCOME TAX CONSEQUENCES

See “Canadian Taxation ” at page 37 of the accompanying prospectus.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

We intend to treat all of the stated interest on the Notes as qualified stated interest for purposes of applying the original issue discount rules as a result our ability to call the Notes prior to any scheduled interest rate increases. If we do not call the Notes prior to an interest rate increase, the Notes will be considered to be reissued on the interest rate increase date at their then adjusted issue price solely for purposes of applying the original issue discount rules to the

Notes.

P-8

You should carefully consider the discussion set forth in “Supplemental Discussion of U.S. Federal Income Tax Consequences” in the accompanying product prospectus supplement. In particular, U.S. holders (as defined in the prospectus) should review the discussion under “—Fixed Rate Notes, Floating Rate Notes, Inverse Floating Rate Notes, Step Up Notes, Leveraged Notes, Range Accrual Notes, Dual Range Accrual Notes and Non-Inversion Range Accrual Notes” and “—Sale, Redemption or Maturity of Notes that Are Not Treated as Contingent Payment Debt Instruments” under “Supplemental Discussion of U.S. Federal Income Tax Consequences—Supplemental U.S. Tax Considerations—U.S. Holders—Where the term of your Notes exceeds one year” in the product prospectus supplement. In particular, U.S. holders (as defined in the prospectus) should review the discussion set forth in “Supplemental Discussion of U.S. Federal Income Tax Consequences—Supplemental U.S. Tax Considerations—U.S. Holders” in the product prospectus supplement and non-U.S. holders (as defined in the prospectus) should review the discussion set forth in “Supplemental Discussion of U.S. Federal Income Tax Consequences—Supplemental U.S. Tax Considerations—Non-U.S. Holders” in the product prospectus supplement. U.S. holders should also review the discussion under “—Treasury Regulations Requiring Disclosure of Reportable Transactions”, “—Information With Respect to Foreign Financial Assets” and “—Information Reporting and Backup Withholding” under “United States Taxation” in the prospectus.

Foreign Account Tax Compliance Act. Sections 1471 through 1474 of the Internal Revenue Code (which are commonly referred to as “FATCA”) generally impose a 30% withholding tax on certain payments, including “pass-thru” payments to certain persons if the payments are attributable to assets that give rise to U.S.-source income or gain. However, the IRS has expressed the intention to issue final regulations extending the FATCA “grandfathering” date such that FATCA withholding tax would not apply to any payment made under obligations outstanding on January 1, 2014 (and not materially modified after December 31, 2013). If these final regulations are issued and the Notes are not materially modified, FATCA withholding generally is not expected to be required on the Notes. If, however, withholding is required as a result of future guidance, we (and any paying agent) will not be required to pay additional amounts with respect to the amounts so withheld.

Significant aspects of the application of FATCA are not currently clear and the above description is based on proposed regulations and interim guidance. Investors should consult their own advisors about the application of FATCA, in particular if they may be classified as financial institutions under the FATCA rules.

Prospective purchasers of the Notes should consult their tax advisors as to the federal, state, local and other tax consequences to them of acquiring, holding and disposing of the Notes and receiving payments under the Notes.

eft" style="font-size: 10pt; margin-top: 12pt">**RESEARCH AND DEVELOPMENT EXPENSES**

Research and development expenses consist of costs incurred for Company-sponsored as well as collaborative research and development activities. These costs include direct and research-related overhead expenses, which include salaries and other personnel-related expenses, stock-based compensation, facility costs, supplies and depreciation of facilities and laboratory equipment, as well as the cost of funding research at universities and other research institutions, and are expensed as incurred. Costs to acquire technologies that are utilized in research and development and that have no alternative future use are expensed as incurred.

STOCK-BASED COMPENSATION

Prior to January 1, 2006, the Company accounted for our stock-based employee compensation arrangements under the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), as allowed by SFAS No. 123, *Accounting for Stock-based Compensation* (SFAS No. 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS No. 148). As a result, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant and no expense was recognized in connection with purchases under our employee stock purchase plan for the years ended December 31, 2005 or 2004. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004)

Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB No. 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. Subsequent to the effective date, the pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition. Effective January 1, 2006, the Company has adopted SFAS No. 123R using the modified prospective method. Under this method, compensation cost recognized includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized on an accelerated basis over the options vesting period, and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the options vesting period. Results for prior periods have not been restated. As a result of adopting SFAS No. 123R on January 1, 2006, the net loss is greater by $ 494,000 and $924,000 for the three-month period and six-month period ended June 30, 2006, respectively than had the Company continued to account for stock-based employee compensation under APB No. 25. Basic and diluted net loss per share for the three-month period and six-month period ended June 30, 2006 are $0.02 and $0.03 greater, respectively, than if the Company had continued to account for stock-based compensation under APB No. 25. The adoption of SFAS No. 123R had no impact on cash flows from operations or financing.

Stock Option Plan

Sangamo s 2004 Stock Option Plan (the 2004 Option Plan), which supersedes the 2000 Stock Option Plan, provides for the issuance of common stock and grants of options for common stock to employees, officers, directors and consultants. The exercise price per share will be no less than 85 percent of the fair value per share of common stock on the option grant date, and the option term will not exceed ten years. If the person to whom the option is granted is a 10 percent stockholder, and the option granted qualifies as an Incentive Stock Option Grant, then the exercise price per share will not be less than 110 percent of the fair value per share of common stock on the option grant date, and the option term will not exceed five years. Options granted under the 2004 Option Plan generally vest over four years at a rate of 25 percent one year from the grant date and one thirty-sixth per month thereafter and expire ten years after the grant, or earlier upon employment termination. Options granted pursuant to the 2004 Option Plan may be exercised prior to vesting, with the related shares subject to Sangamo s right to repurchase the shares that have not vested at the issue price if the option

Table of Contents

holder terminates employment. The right of repurchase lapses over the original option vesting period, as described above. A total of 6.5 million shares are reserved for issuance pursuant to the 2004 Option Plan. The number of shares authorized for issuance automatically increases on the first trading day of the fiscal year by an amount equal to 3.0 percent of the total number of shares of our common stock outstanding on the last trading day of the preceding fiscal year.

Employee Stock Purchase Plan

The Board of Directors adopted the 2000 Employee Stock Purchase Plan in February 2000, effective upon the completion of Sangamo s initial public offering of its common stock. Sangamo reserved a total of 400,000 shares of common stock for issuance under the plan. Eligible employees may purchase common stock at 85 percent of the lesser of the fair market value of Sangamo s common stock on the first day of the applicable two-year offering period or the last day of the applicable six-month purchase period. The reserve for shares available under the plan will automatically increase on the first trading day of the second fiscal quarter each year, beginning in 2001, by an amount equal to 1 percent of the total number of outstanding shares of our common stock on the last trading day of the immediately preceding first fiscal quarter.

As of June 30, 2006, total shares reserved for future awards under all plans were 8,274,664.

Adoption of FAS 123R

Employee stock-based compensation expense recognized in 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. A forfeiture rate of 10% is applied to the stock-based compensation expense, determined through historical experience of employee stock option exercises. The following table shows total stock-based employee compensation expense (see above for types of stock-based employee arrangements) included in the condensed consolidated statement of operations for the three-month and six-month periods ended June 30, 2006 (in thousands):

	Three months ended June 30, 2006	Six months ended June 30, 2006
Costs and expenses:		
Research and development	$ 310	$ 627
General and administrative	184	297
Total stock-based compensation expense	$ 494	$ 924

There was no capitalized stock-based employee compensation cost as of June 30, 2006. There were no recognized tax benefits during the six months ended June 30, 2006.

As of June 30, 2006, total compensation cost related to nonvested stock options to be recognized in future periods was $3.47 million, which is expected to be expensed over a weighted average period of 48 months.

Pro Forma Information for Period Prior to Adoption of FAS 123R

The following table illustrates the effect on net loss and net loss per share had we applied the fair value recognition provisions of SFAS No. 123 to account for our employee stock option and employee stock purchase plans for the three-month and six-month period ended June 30, 2005 because stock-based employee compensation was not accounted for using the fair value recognition method during that period. For purposes of pro forma disclosure, the estimated fair value of the stock awards, as prescribed by SFAS No. 123, is amortized to expense over the vesting period of such awards (in thousands, except per share data).

	Three months ended June 30, 2005	Six months ended June 30, 2005 (1)

Net loss, as reported	$	(3,380)	$	(6,933)
Deduct: Total stock-based employee compensation expense determined under fair value method		(667)		(1,214)
Pro forma net loss	$	(4,047)	$	(8,147)
Basic and diluted net loss per share:				
As reported	$	(0.13)	$	(0.27)
Pro forma	$	(0.16)	$	(0.32)

Table of Contents

(1) During the preparation of footnotes to the condensed consolidated financial statements for our quarterly filings during fiscal year 2006, we determined that the calculation of our net loss pro forma reported under SFAS No. 123 for fiscal year 2005, as reported in that year, did not appropriately reflect the effect of SFAS No. 123 for certain options granted prior to January 1, 2006. Accordingly, the amount of net loss pro forma reported under SFAS No. 123 for the first quarter of fiscal 2005 presented in the table above has been revised, resulting in an increase in the previously reported amount of pro forma net loss of $296,000 or $0.01 per basic and diluted share for

three-months period ended June 30, 2005 and $ 635,000 or $ 0.02 per basic and diluted share for six-months period ended June 30, 2005, respectively. This revision had no effect on our previously reported condensed consolidated results of operations or financial condition.

The historical pro forma impact of applying the fair value method prescribed by SFAS No. 123 is not representative of the impact that may be expected in the future due to changes resulting from additional grants in future years and changes in assumptions such as volatility, interest rates and expected life used to estimate fair value of the grants in future years.

Valuation Assumptions

The employee stock-based compensation expense recognized under FAS123R and presented in the pro forma disclosure required under FAS123 was determined using the Black Scholes option valuation model. Option valuation models require the input of subjective assumptions and these assumptions can vary over time.

We primarily base our determination of expected volatility through our assessment of the historical volatility of our Common Stock. We do not believe that we are able to rely on our historical exercise and post-vested termination activity to provide accurate data for estimating our expected term for use in determining the fair value of these options. Therefore, as allowed by Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment* , we have opted to use the simplified method for estimating our expected term equal to the midpoint between the vesting period and the contractual term.

The weighted average assumptions used for estimating the fair value of the employee stock options are as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2006	**2005**	**2006**	**2005**
Risk-free interest rate	5.1%	3.7%	5.0-5.1%	3.8%
Expected life of option	6.25 years	5.0 years	6.25 years	4.5 years
Expected dividend yield of stock	0.0%	0.0%	0.0%	0.0%
Expected volatility	.97	1.0	.91-.97	1.0

The expected volatility reported in the quarter ended March 31, 2006 should be 0.91 instead of 0.82 as a result of a computational error. The impact of this change is not material to the net results of operations and basic and diluted loss per share for the three months and six months ended June 30, 2006.

The weighted average assumptions used for estimating the fair value of the employees purchase rights are as follows:

	Three months ended	**Six months ended**

	June 30,		June 30,	
	2006	**2005**	**2006**	**2005**
Risk-free interest rate	4.75-5.17%	1.25-3.61%	4.75-5.17%	1.25-3.61%
Expected life of option	0.5-2 years	0.5-2 yrs	.5-2 yrs	0.5-2 yrs
Expected dividend yield of stock	0.0%	0.0%	0.0%	0.0%
Expected volatility	.41-.98	.52-.78	.41-.98	.52-.78

Table of Contents

Stock Option Activity

A summary of Sangamo s stock option activity follows:

		Options Outstanding		
	Shares Available for Grant of Options	Number of Shares	Weighted-Average Exercise per Share Price	Weighted Average Remaining Contractual Term
Balance at January 1, 2006	3,256,505	3,874,097	$5.30	
Options granted	(157,500)	157,500	$6.74	
Options exercised		(223,122)	$1.57	
Options canceled	141,857	(141,857)	$7.58	
Balance at June 30, 2006	3,240,862	3,666,618	$5.50	6.36
Options exercisable at June 30, 2006		2,315,078	$6.00	5.06

There were no shares subject to Sangamo s right of repurchase as of June 30, 2006. The intrinsic value of options exercised were $ 269,000 and $36,000 for the three months ended June 30, 2006 and 2005 and $1,059,000 and $428,000 for the six months ended June 30, 2006 and 2005, respectively.

The weighted-average estimated fair value per share of options granted during the three months and six months ended June 30, 2006 and 2005 were $5.80 and $2.95, and $5.44 and $3.10, respectively, based upon the assumptions in the Black-Scholes valuation model described above.

The weighted-average estimated fair value per share of employee purchase rights during the three months and six months ended June 30, 2006 and 2005 were $2.23 and $1.16,and $2.17 and $1.24, respectively, based upon the assumptions in the Black-Scholes valuation model described above.

The following table summarizes information with respect to stock options outstanding at June 30, 2006:

	Options Outstanding	
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (In Years)
$0.05 - $ 0.15	61,583	1.62
$0.17 - $ 0.17	400,000	1.85
$0.23 - $ 3.61	443,976	7.25
$3.78 - $ 4.08	298,261	7.48
$4.11 - $ 4.11	390,000	9.45
$4.15 - $ 5.18	234,865	7.76
$5.19 - $ 5.19	487,733	7.80
$5.36 - $ 7.13	315,500	6.85
$7.49 - $ 7.49	415,000	5.25
$7.57 - $38.00	619,700	5.46

	3,666,618	6.36

At June 30, 2006, the aggregate intrinsic values of the outstanding and exercisable options were $5.8 million and 3.9 million, respectively.

Sangamo granted 15,000 nonqualified common stock options to consultants during the three months ended June 30, 2005. The Company did not grant any stock option to consultants during three-months and six-months ended June 30, 2006. The Company granted 15,000 and 10,000 nonqualified common stock options to consultants at exercise prices that range from $3.00 to $3.80 per share for services rendered in 2005 and 2004, respectively. Such options are included in the option tables disclosed above. The options generally vest over four years at a rate of 25 percent one year from grant date and one-thirty-sixth per month thereafter and expire ten years after the grant date. Total nonqualified stock-based compensation expense was $5,000 and $85,000 for the three months period

Table of Contents

ended June 30, 2006 and 2005 and $26,000 and $186,000 for the six months period ended June 30, 2006 and 2005, respectively. The fair value of these options was determined using the Black-Scholes Merton model.

NOTE 2-BASIC AND DILUTED NET LOSS PER SHARE

Basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period. Because we are in a net loss position, diluted earnings per share is also calculated using the weighted average number of common shares outstanding and excludes the effects of stock options which are all antidilutive.

NOTE 3-COMPREHENSIVE LOSS

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Other comprehensive loss includes certain changes in stockholders equity that are excluded from net loss, which includes unrealized gains and losses on our available-for-sale securities. Comprehensive loss and its components are as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net loss	$ (3,327)	$ (3,380)	$ (6,071)	$ (6,933)
Changes in unrealized gain (loss) on securities available-for-sale	(18)	5	(29)	63
Comprehensive loss	$ (3,345)	$ (3,375)	$ (6,100)	$ (6,870)

Table of Contents

NOTE 4-MAJOR CUSTOMERS, PARTNERSHIPS AND STRATEGIC ALLIANCES

Strategic Partnership with Edwards Lifesciences Corporation

In January 2000, we announced a therapeutic product development collaboration with Edwards Lifesciences Corporation (Edwards). Under the agreement, we have licensed to Edwards, on a worldwide, exclusive basis, ZFP Therapeutics for use in the activation of VEGFs and VEGF receptors in ischemic cardiovascular and vascular diseases. Edwards purchased a $5.0 million note that converted, together with accrued interest, into 333,333 shares of common stock at the time of our initial public offering (IPO) at the IPO price. In March 2000, Edwards purchased a $7.5 million convertible note in exchange for a right of first refusal for three years to negotiate a license for additional ZFP Therapeutics in cardiovascular and peripheral vascular diseases. That right of first refusal was not exercised and terminated in March 2003. Together with accrued interest, this note converted into common stock at the time of our initial public offering at the IPO price. Through 2001, we received $2 million in research funding from Edwards and a $1.4 million milestone payment for delivery of a lead ZFP Therapeutic product candidate. In November 2002, Edwards signed an amendment to the original agreement and agreed to provide up to $3.5 million in research and development funding, including $2.95 million for research and development activities performed in 2002 and 2003. The filing of the IND for PAD in 2004, and the achievement of other research-related milestones in 2003, triggered a total of $1.0 million in milestone payments from Edwards in the first quarter of 2004. There were no revenues attributable to milestone achievement and collaborative research and development performed under the Edwards agreements for both the three-month and six-month periods ended June 30, 2006 and 2005.

Our license agreement with Edwards Lifesciences provides Edwards with worldwide, exclusive rights for ZFP Therapeutics for the activation of VEGF and VEGF receptors for the treatment and prevention of ischemic cardiovascular and vascular disease in humans. We have retained all rights to use our technology for all therapeutic applications of VEGF activation outside of the treatment and prevention of ischemic cardiovascular and vascular disease in humans. During the first quarter of 2005, Sangamo commenced a Phase I clinical trial for the treatment of diabetic neuropathy using a ZFP Therapeutic for the activation of VEGF. Edwards has stated that its rights include diabetic neuropathy and consequently our activities relating to diabetic neuropathy constitute a breach of the agreement. We strongly disagree with the Edwards assertion because diabetic neuropathy is a neurological disease and not an ischemic vascular disease and therefore is outside the scope of the Edwards license. Sangamo and Edwards are in discussions regarding this issue.

In the future, Sangamo may receive milestone payments and royalties under this agreement. We have received $2.5 million in milestone payments to date and we could receive up to $27.0 million in additional milestone payments under the agreement if all future milestones are met for the first product developed under the agreement. Any subsequent products developed under the agreement may generate up to $15.0 million in milestone payments each. We would also receive royalties on any sales of products generated under the agreement and these royalty obligations would continue until the expiration of the last-to-expire patent covering products developed under the agreement on a country-by-country basis. Based on currently issued patents, these royalty obligations would last through January 12, 2019. The development of any products is subject to numerous risks and no assurance can be given that any products will successfully be developed under this agreement. See Risk Factors Our gene regulation technology is relatively new, and if we are unable to use this technology in all our intended applications, it would limit our revenue opportunities.

Under the Sangamo-Edwards agreement, we were responsible for advancing product candidates into preclinical animal testing. Edwards had responsibility for preclinical development, regulatory affairs, clinical development, and the sales and marketing of ZFP Therapeutic products developed under the agreement. Sangamo may receive milestone payments in connection with the development and commercialization of the first product under this agreement and may also receive royalties on product sales. As part of the November 2002 amendment to our original agreement, Edwards also entered into a joint collaboration with us to evaluate ZFP TFs for the regulation of a second therapeutic gene target, phospholamban (PLN), for the treatment of congestive heart failure. Under the amended agreement, Sangamo granted Edwards a right of first refusal to Sangamo s ZFP TFs for the regulation of PLN. This right of first refusal terminated on June 30, 2004. On August 14, 2003, Edwards and Sangamo entered into a Third Amendment to the original license agreement. Under this amendment, Sangamo received payment for research and development

milestones associated with the VEGF and PLN programs.

There is no assurance that the companies will achieve the development and commercialization milestones anticipated in these agreements. Edwards has the right to terminate the agreement at any time upon 90 days written notice. In the event of termination, we retain all payments previously received as well as the right to develop and commercialize all related products.

Table of Contents

Therapeutic Collaboration with LifeScan for Regenerative Medicine

In September 2004, we announced that we had entered into a research agreement with LifeScan, Inc., a Johnson & Johnson company. The agreement provides LifeScan with our ZFP TFs for use in a program to develop therapeutic cell lines as a potential treatment for diabetes. In December 2004, and again in September 2005, this agreement was expanded to include additional targets important in diabetes. The agreements represented our first collaboration in the field of regenerative medicine. During the three months ended June 30, 2006 and 2005, revenues attributable to collaborative research and development performed under the LifeScan agreements were $150,000 and $55,000, respectively. Revenues for the six-month periods ended June 30, 2006 and 2005 were $300,000 and $110,000, respectively. Related research and development costs and expenses performed under the LifeScan agreements were $24,000 and $19,000 during the three months ended June 30, 2006 and 2005, respectively. Research and development costs and expenses performed under the LifeScan agreements were $32,000 and $37,000 during the six months ended June 30, 2006 and 2005, respectively.

Enabling Technology Collaborations for Pharmaceutical Protein Production

We have established several research collaborations in this area. In December 2004, we announced a research collaboration agreement with Pfizer Inc to use our ZFP technology to develop enhanced cell lines for protein pharmaceutical production. The scope of this agreement was expanded in January 2006 and provided further research funding from Pfizer to develop additional cell lines for enhanced protein production. Under the terms of the agreement, Pfizer is funding research at Sangamo and Sangamo will provide our proprietary ZFP technology for Pfizer to assess its feasibility for use in mammalian cell-based protein production. We are generating novel cell lines and vector systems for enhanced protein production as well as novel technology for rapid creation of new production cell lines. Revenues attributable to collaborative research and development performed under the Pfizer agreement were $157,000 and $298,000 during the three months ended June 30, 2006 and 2005, respectively. Revenues for the six-month periods ended June 30, 2006 and 2005 were $307,000 and $423,000, respectively. Related research and development costs and expenses performed under the Pfizer agreement were $98,000 and $30,000 during the three months ended June 30, 2006 and 2005, respectively, and $155,000 and $52,000 during the six months ended June 30, 2006 and 2005, respectively.

Plant Agriculture Agreements

Sangamo scientists and collaborators have shown that ZFP TFs and ZFP nucleases (ZFNs) can be used to regulate and modify genes in plants with similar efficacy to that shown in various mammalian cells and organisms. The ability to regulate gene expression with engineered ZFP TFs may lead to the creation of new plants that increase crop yields, lower production costs, are more resistant to herbicides, pesticides, and plant pathogens; and permit the development of branded agricultural products with unique nutritional and processing characteristics. In addition, ZFNs may be used to facilitate the efficient and reproducible generation of transgenic plants. Effective as of October 1, 2005, we entered into a Research License and Commercial Option Agreement with Dow AgroSciences LLC (DAS), a wholly owned indirect subsidiary of Dow Chemical Corporation. Under this agreement, we will provide DAS with access to our proprietary ZFP technology and the exclusive right to use our ZFP technology to modify the genomes or alter the nucleic acid or protein expression of plant cells, plants, or plant cell cultures. We will retain rights to use plants or plant-derived products to deliver ZFP TFs or ZFNs into human or animals for diagnostic, therapeutic, or prophylactic purposes.

Our agreement with DAS provides for an initial three-year research term during which time we will work together to validate and optimize the application of our ZFP technology to plants, plant cells and plant cell cultures. A joint committee having equal representation from both companies will oversee this research. During the initial three-year research term, DAS will have the option to obtain a commercial license to sell products incorporating or derived from plant cells generated using our ZFP technology, including agricultural crops, industrial products and plant-derived biopharmaceuticals. This commercial license will be exclusive for all such products other than animal and human health products. In the event that DAS exercises this option, DAS may elect to extend the research program beyond the initial three-year term on a year-to-year basis.

Pursuant to the Research License and Commercial Option Agreement, DAS made an initial cash payment to us of $7.5 million and agreed to purchase up to $4.0 million of our common stock in the next financing transaction meeting

certain criteria. In November 2005, the Company sold approximately 1.0 million shares of common stock to DAS at a price of $3.85 per share, resulting in gross proceeds of $3.9 million. In addition, DAS will provide between $4.0 and $6.0 million in research funding over the initial three-year research term and may make an additional payment of up to $4.0 million in research milestone payments to us during this same period, depending on the success of the research program. In the event that DAS elects to extend the research program beyond the initial three-year term, DAS will provide additional research funding. If DAS exercises its option to obtain a commercial license, we will be entitled to full payment of the $4.0 million in research milestones, a one-time exercise fee of $6.0 million, minimum annual

Table of Contents

payments of up to $25.25 million, development and commercialization milestone payments for each product, and royalties on sales of products. Furthermore, DAS will have the right to sublicense our ZFP technology to third parties for use in plant cells, plants, or plant cell cultures, and we will be entitled to 25% of any cash consideration received by DAS under such sublicenses.

We have agreed to supply DAS and its sublicensees with ZFP TFs and/or ZFNs for both research and commercial use. If DAS exercises its option to obtain a commercial license, DAS may request that we transfer, at DAS s expense, the ZFP manufacturing technology to DAS or to a mutually agreed-upon contract manufacturer.

The Research License and Commercial Option Agreement will terminate automatically if DAS fails to exercise its option for a commercial license by the end of the initial three-year research term. DAS may also terminate the agreement at the end of the second year of the initial research term if the joint committee overseeing the research determines that disappointing research results have made it unlikely that DAS will exercise the option; we are guaranteed to receive $4.0 million in research funding from DAS prior to such a termination. Following DAS s exercise of the option and payment of the exercise fee, DAS may terminate the agreement at any time. In addition, each party may terminate the agreement upon an uncured material breach of the other party. In the event of any termination of the agreement, all rights to use our ZFP technology will revert to us, and DAS will no longer be permitted to practice our ZFP technology or to develop or, except in limited circumstances, commercialize any products derived from our ZFP technology. Revenues related to the research license under the DAS agreement are being recognized ratably over the initial three-year research term of the agreement and were $625,000 during the three months ended June 30, 2006 and $1.3 million during the six months ended June 30, 2006. Revenues attributable to collaborative research and development performed under the DAS agreement were $500,000 during the three months ended June 30, 2006 and $1.5 million during the six months ended June 30, 2006. Related costs and expenses incurred under the DAS agreement were $500,000 during the three months ended June 30, 2006 and $1.4 million during the six months ended June 30, 2006.

NOTE 5-STOCKHOLDERS EQUITY

In June 2006, in an underwritten public offering and pursuant to an effective registration statement, we sold 3,100,000 shares of common stock at a public offering price of $6.75 per share, resulting in net proceeds of approximately $20.15 million after deducting underwriter s discount.

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

The discussion in Management s Discussion and Analysis of Financial Condition and Results of Operations contains trend analysis, estimates and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include, without limitation, statements containing the words believes, anticipates, expects, continue, and other words of similar import or the negative of those terms or expressions. Such forward-looking statements are subject to known and unknown risks, uncertainties, estimates and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual results could differ materially from those set forth in such forward-looking statements as a result of, but not limited to, the Risk Factors described below. You should read the following discussion and analysis along with the financial statements and notes attached to those statements included elsewhere in this report and in our annual report on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on March 13, 2006.

Overview

We were incorporated in June 1995. From our inception through June 30, 2006, our activities related primarily to establishing and operating a biotechnology research and development organization and developing relationships with our corporate collaborators. Our scientific and business development endeavors currently focus on the engineering of novel zinc finger DNA binding proteins (ZFPs) for the regulation and modification of genes. We have incurred net losses since inception and expect to incur losses in the future as we continue our research and development activities. To date, we have funded our operations primarily through the issuance of equity securities, borrowings, payments

from federal government research grants and from corporate collaborators and strategic partners. As of June 30, 2006, we had an accumulated deficit of $116.5 million.

Our revenues have consisted primarily of revenues from our corporate partners for ZFP TFs and ZFNs, contractual payments from strategic partners for research programs and research milestones, and Federal government research grant funding. We expect revenues

Table of Contents

will continue to fluctuate from period to period and there can be no assurance that new collaborations or partner fundings will continue beyond their initial terms.

Commencing in 2005, we have placed more emphasis on higher-value therapeutic product development and related strategic partnerships and less emphasis on our Enabling Technology collaborations. We believe this shift in emphasis has the potential to increase the return on investment to our stockholders by allocating capital resources to higher value, therapeutic product development activities. At the same time, it may reduce our revenues over the next several years and it increases our financial risk by increasing expenses associated with product development. We have filed an Investigational New Drug (IND) application with the U.S. Food and Drug Administration (FDA) and have initiated a Phase 1 clinical trial of a ZFP Therapeutic in patients with diabetic neuropathy during the first quarter of 2005. Development of novel therapeutic products is costly and is subject to a lengthy and uncertain regulatory process by the FDA. Our future products are gene-based therapeutics. Adverse events in both our own clinical program and other programs in gene therapy may have a negative impact on regulatory approval, the willingness of potential commercial partners to enter into agreements and the perception of the public.

Research and development expenses consist primarily of salaries and related personnel expenses, including stock-based compensation, laboratory supplies, allocated facilities costs, subcontracted research expenses, trademark registration and technology licenses. Research and development costs incurred in connection with collaborator-funded activities are expensed as incurred. We believe that continued investment in research and development is critical to attaining our strategic objectives. We expect these expenses will increase significantly as we increase our focus on development of ZFP Therapeutics. The Company is also developing ZFNs for therapeutic gene correction and therapeutic gene modification as a treatment for certain monogenic and infectious diseases. Additionally, in order to develop ZFP TFs and ZFNs as commercially relevant therapeutics, we expect to expend additional resources for expertise in the manufacturing, regulatory affairs and clinical research aspects of biotherapeutic development.

General and administrative expenses consist primarily of salaries and related personnel expenses for executive, finance and administrative personnel, stock-based compensation, professional fees, patent prosecution expenses, allocated facilities costs and other general corporate expenses. As we pursue commercial development of our therapeutic leads we expect the business aspects of the Company to become more complex. We may be required in the future to add personnel and incur additional costs related to the maturity of our business.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates are described in Note 1, Basis of Presentation and Summary of Significant Accounting Policies to the Unaudited Notes to Condensed Financial Statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources, and evaluates our estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions. Sangamo believes the following critical accounting policies have significant effect in the preparation of our consolidated financial statements.

Revenue Recognition

In accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, revenue from research activities made under strategic partnering collaborations is recognized as the services are provided when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable, and collectibility is reasonably assured. Amounts received under such agreements are deferred until the above criteria are met and the research services are performed. Sangamo s federal government research grants are typically multi-year agreements and provide for the reimbursement of qualified expenses for research and development as defined under the terms of the grant agreement. Revenue under grant agreements is recognized when the related research expenses are incurred. Grant reimbursements are typically received on a quarterly basis and are subject to the issuing agency s right of audit.

Sangamo recognizes revenue from its Therapeutic and Enabling Technology collaborations when ZFP-based products are delivered to the collaborators, persuasive evidence of an agreement exists, there are no unfulfilled obligations, the price is fixed and determinable, and collectibility is reasonably assured. Generally, Sangamo receives partial payments from these collaborations prior to the delivery of ZFP-based products and the recognition of these revenues is deferred until the ZFP-based products are delivered, the

Table of Contents

risk of ownership has passed to the collaborator and all performance obligations have been satisfied. Upfront or signature payments received upon the signing of an Enabling Technology agreement are generally recognized ratably over the applicable period of the agreement, which currently ranges between 12 and 15 months, or as ZFP-based products are delivered.

Milestone payments under research, partnering, or licensing agreements are recognized as revenue upon the achievement of mutually agreed upon milestones, provided that (i) the milestone event is substantive and its achievement is not reasonably assured at the inception of the agreement, and (ii) there are no further significant performance obligations associated with the milestone payment.

In accordance with Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, revenue arrangements entered into after June 15, 2003, that include multiple deliverables, are divided into separate units of accounting if the deliverables meet certain criteria, including whether the fair value of the delivered items can be determined and whether there is evidence of fair value of the undelivered items. In addition, the consideration is allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criterion is considered separately for each of the separate units of accounting.

Table of Contents

Stock-Based Compensation

Prior to January 1, 2006, we accounted for our stock-based employee compensation arrangements under the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), as allowed by SFAS No. 123, *Accounting for Stock-based Compensation* (SFAS No. 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS No. 148). As a result, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant and no expense was recognized in connection with purchases under our employee stock purchase plan for the years ended December 31, 2005 or 2004. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004) *Share-Based Payment* (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB No. 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. Subsequent to the effective date, the pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition. Effective January 1, 2006, we have adopted SFAS No. 123R using the modified prospective method. Under this method, compensation cost recognized during the three-month and six-months period ended June 30, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized on an accelerated basis over the options vesting period, and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the options vesting period. Results for prior periods have not been restated. As a result of adopting SFAS No. 123R on January 1, 2006, our net loss is greater by $494,000 and $924,000 for the three-month and six month periods ended June 30, 2006, respectively, than had we continued to account for stock-based employee compensation under APB No. 25. Net loss per share for the three-month and six month periods ended June 30, 2006 is $0.02 and $0.03 greater, respectively, than if we has continued to account for stock-based compensation under APB No. 25. The adoption of SFAS No. 123R had no impact on cash flows from operations or financing.

As of June 30, 2006, total compensation cost related to nonvested stock options to be recognized in future periods was $3.47 million, which is expected to be expensed over a weighted average period of 48 months.

RESULTS OF OPERATIONS

Three and six months ended June 30, 2006 and 2005

Revenues

	Three months ended June 30, (in thousands, except percentage values)				Six months ended June 30, (in thousands, except percentage values)			
	2006	**2005**	**Change**	**%**	**2006**	**2005**	**Change**	**%**
Revenues:								
Collaboration agreements	$ 1,431	$ 353	$ 1,078	305%	$ 3,304	$ 533	$ 2,771	520%
Federal government research grants	346	65	281	432%	609	141	468	332%
Total revenues	$ 1,777	$ 418	$ 1,359	325%	$ 3,913	$ 674	$ 3,239	481%

We are increasing the emphasis of our research and development activities on ZFP Therapeutics and are moving away from our historic emphasis on Enabling Technology agreements. Over the next several years, this change in resource allocation will reduce our revenues.

Total revenues increased to $1.8 million for the three months ended June 30, 2006 from $418,000 in the corresponding period in 2005. The increase for the three months ended June 30, 2006 was principally due to revenues

in connection with our Research License and Commercial Option Agreement with Dow AgroSciences LLC (DAS), a wholly owned indirect subsidiary of Dow Chemical Corporation, of $1.1 million, which we entered in October 2005. The increase in revenues related to federal government research grants of $281,000 was due to increased revenues in connection with our Advanced Technical Program federal government research grant with the National Institute of Standards and Technologies of $180,000 and other federal government research grants of $100,000. Total revenues increased to $3.3 million for the six months ended June 30, 2006 from $533,000 in the corresponding period in 2005. The increase for the six months ended June 30, 2006 was principally due to revenues in connection with our Research

Table of Contents

License and Commercial Option Agreement with DAS of $2.7 million. The increase in revenues related to federal government research grants of $468,000 was due to increased revenues in connection with our Advanced Technical Program federal government research grant with the National Institute of Standards and Technologies of $360,000 and other federal government research grants of approximately $100,000. We anticipate continued revenues from collaboration agreements through the end of 2007, and we have applied for, and plan to continue to apply for, federal government research grants in the future to support the development of applications of our technology platform. Although we have negotiated collaboration agreements and received federal government research grants in the past, we cannot assure you that these efforts will be successful in the future.

Table of Contents

Operating Expenses

	Three months ended June 30, (in thousands, except percentage values)				Six months ended June 30, (in thousands, except percentage values)			
	2006	2005	Change	%	2006	2005	Change	%
Operating Expenses:								
Research and development	$ 4,028	$ 2,624	$ 1,404	54%	$ 7,617	$ 5,221	$ 2,396	46%
General and administrative	1,821	1,250	571	46%	3,576	2,489	1,087	44%
Total expenses	$ 5,849	$ 3,874	$ 1,975	51%	$ 11,193	$ 7,710	$ 3,483	45%

Research and development

Over the past three fiscal years, research and development expenses have consisted primarily of salaries and related personnel expenses including stock-based compensation as well as laboratory supplies, allocated facilities costs, subcontracted research expenses, trademark registration and technology licenses. We expect to continue to devote substantial resources to research and development in the future and expect research and development expenses to increase in the next several years if we are successful in advancing our ZFP Therapeutic product candidates into clinical trials. To the extent we collaborate with others with respect to clinical trials, increases in research and development expenses may be reduced or avoided.

Research and development expenses for the second quarter of 2006 increased to $4.0 million compared to $2.6 million for the second quarter of 2005. The increase in research and development expenses for the three months ended June 30, 2006 was primarily attributable to increased external development expenses of $734,000, primarily associated with our diabetic neuropathy program, increased personnel and lab supply expenses of $287,000 and $286,000, respectively, due to increased headcount and recognition of $310,000 in stock-based employee compensation expense due to adoption of SFAS No. 123R. These increases were partially offset by decreased expenses of $108,000 associated with Pre-clinical efficacy expense as the company completed the pre-clinical research during the second quarter of 2006, Research and development expenses for the first six months of 2006 increased to $7.6 million compared to $5.2 million for the corresponding period of 2005. The increase in research and development expenses for the six months ended June 30, 2006 was primarily attributable to increased external development expenses of $1.0 million primarily associated with our diabetic neuropathy program, increased personnel and lab supply expenses of $515,000 and $444,000, respectively, due to increased headcount and recognition of $627,000 in stock-based employee compensation expense due to adoption of SFAS No. 123R. These increases were partially offset by decreased expenses of $100,000 facility overhead expense and $25,000 associated with Pre-clinical efficacy expenses

General and administrative

General and administrative expenses consist primarily of salaries and related personnel expenses for executive, finance and administrative personnel, stock-based compensation, professional fees, patent prosecution expenses, allocated facilities costs, other general corporate expenses and stock-based compensation. As we pursue commercial development of our therapeutic leads, we expect the business aspects of the Company to become more complex. We may be required in the future to add personnel and incur additional costs related to the maturity of our business.

General and administrative expenses were $1.8 million in the three months ended June 30, 2006, as compared to $1.3 million during the corresponding period in 2005. This increase is primarily related to increased professional service-related expenses of $322,000 and $184,000 related to recognition of stock-based employee compensation expense due to adoption of SFAS No. 123R. General and administrative expenses were $3.6 million in the six months ended June 30, 2006, as compared to $2.5 million during the corresponding period in 2005. This increase is primarily related to increased professional service-related expenses of $674,000 and $297,000 related to recognition of

stock-based employee compensation expense due to adoption of SFAS No. 123R.

Interest income, net

Table of Contents

	Three months ended June 30, (in thousands, except percentage values)				Six months ended June 30, (in thousands, except percentage values)			
	2006	2005	Change	%	2006	2005	Change	%
Interest and other income, net	$745	$76	$669	880%	$1,208	$103	$1,105	1,073%

Interest and other income, net, increased to $745,000 for the three months ended June 30, 2006 from $76,000 in the corresponding period in 2005. The increase was primarily related to higher interest income of $391,000 related to higher average investment balances during the quarter ended June 30, 2006. In addition, a foreign currency translation gain of $142,000 was recorded during the quarter ended June 30, 2006 versus a foreign currency translation loss of $135,000 during the corresponding quarter in 2005. Interest and other income, net, increased to $1.2 million for the six months ended June 30, 2006 from $103,000 in the corresponding period in 2005. The increase was primarily related to higher interest income of $634,000 related to higher average investment balances during the six months ended June 30, 2006. In addition, a foreign currency translation gain of $175,000 was recorded during the six months ended June 30, 2006 versus a foreign currency translation loss of $221,000 during the corresponding quarter in 2005.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through the sale of equity securities, payments from corporate collaborators, federal government research grants and financing activities such as a bank line of credit. As of June 30, 2006, we had cash, cash equivalents, investments and interest receivable totaling $59.3 million. Net cash used for operating activities was $8.2 million for the six months ended June 30, 2006. Net cash used consisted primarily of the net loss for the six-month period of $6.1 million and a net change of $3.1 million in operating assets and liabilities. This was partially offset by stock-based compensation charges of $950,000 and depreciation and amortization of $92,000. Net cash used for operating activities was $7.3 million for the six months ended June 30, 2005. Net cash used consisted primarily of the net loss for the three-month period of $6.9 million and a net change of $976,000 in operating assets and liabilities. This was partially offset by amortization of premium / discount on investment of $191,000, stock-based compensation charges of $186,000, depreciation and amortization of $149,000 and realized losses on investments of $41,000.

Net cash used in investing activities was $1.9 million for the six months ended June 30, 2006 and was primarily comprised of cash used to purchase investments and fixed assets of $16.0 million and $136,000, respectively, partially offset by cash proceeds associated with maturities of investments of $14.2 million. Net cash provided by investing activities was $6.2 million for the six months ended June 30, 2005 and was primarily comprised of proceeds associated with maturities of investments and fixed assets $15.2 million and $181,000, respectively, partially offset by cash used to purchase investments of $8.9 million.

Net cash provided by financing activities for the six-month period ended June 30, 2006 was $20.5 million. In June 2006, in an underwritten public offering and pursuant to an effective registration statement, we sold 3,100,000 shares of common stock at a public offering price of $6.75 per share, resulting in net proceeds of approximately $20.15 million after deducting underwriter s discount. All other cash provided by financing activities for the first six months of 2006 and 2005 was solely related to proceeds from issuance of common stock related to stock options exercises.

While we expect our rate of cash usage to increase in the future, in particular, in support of our product development endeavors, we believe that the available cash resources, funds received from corporate collaborators, strategic partners and federal government research grants will be sufficient to finance our operations through 2008. We may need to raise additional capital to fund our ZFP Therapeutic development activities. Additional capital may not be available in terms acceptable to us, or at all. If adequate funds are not available, our business and our ability to develop our technology and our ZFP Therapeutic products would be harmed.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk for changes in interest rates relates primarily to our cash equivalents and investments. The investments are available-for-sale. We do not use derivative financial instruments in our investment portfolio. We attempt to ensure the safety and preservation of our invested funds by limiting default and market risks. Our cash and

investments policy emphasizes liquidity and preservation of principal over other portfolio considerations. We select investments that maximize interest income to the extent possible within these guidelines. We satisfy liquidity requirements by investing excess cash in securities with different maturities to match projected cash needs and limit concentration of credit risk by diversifying our investments among a variety of high credit-quality issuers. We mitigate default risk by investing in only investment-grade securities. The portfolio includes marketable securities with active secondary or resale markets to ensure portfolio liquidity. All investments have a fixed interest rate and are carried at market value, which approximates cost.

Table of Contents

Our market risks at June 30, 2006 have not changed materially from those discussed in Item 7A of our Form 10-K for the year ended December 31, 2005 on file with the Securities and Exchange Commission.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company s management, with the participation of the Company s Chief Executive Officer and Principal Financial Officer, evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) or 15d-15(e)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Principal Financial Officer concluded that the Company s disclosure controls and procedures as of the end of the period covered by this report are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

(b) Change in Internal Control over Financial Reporting

No change in the Company s internal control over financial reporting occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not party to any material pending legal proceedings, other than routine litigation incidental to our business.

ITEM 1A. RISKS FACTORS

This Form 10-Q contains forward-looking information based on our current expectations. Because our actual results may differ materially from any forward-looking statements made by or on behalf of Sangamo, this section includes a discussion of important factors that could affect our actual future results, including, but not limited to, our revenues, expenses, net loss and loss per share.

We have increased the focus of our research and development programs on human therapeutics, which may increase operating expenditures and the uncertainty of our business. We are increasing the emphasis and focus of our research and development activities on ZFP Therapeutics and have relatively fewer resources invested in our Enabling Technology programs. In the short term, this change in resource allocation may reduce our revenues and increase operating expenditures due to larger financial outlays to fund preclinical studies, manufacturing, and clinical research. The transition will also increase the visibility of our lead therapeutic programs and the potential impact on the stock price of news releases relating to these programs.

We, and our partner, Edwards Lifesciences, have initiated Phase 1 clinical trials in our respective lead ZFP Therapeutic programs, and ZFP Therapeutics have never before been tested in humans. We have completed enrollment and treatment of the patients in the first of these trials of SB-509 for diabetic neuropathy and thus far have not observed any drug-related adverse events. However if our lead ZFP Therapeutic fails its initial safety study, it could reduce our ability to attract new investors and corporate partners. In January 2005, Sangamo filed an IND with the FDA for SB-509, a ZFP TF activator of VEGF-A, for the treatment of mild to moderate diabetic neuropathy. We have completed enrollment and treatment of a Phase 1, single blind, dose-escalation trial to measure the laboratory and clinical safety of SB-509 and reported that we did not observe dose-limiting toxicity or any severe adverse drug-related events. We presented in April 2006 safety data and preliminary findings from our Phase 1 clinical trial and expect to initiate a Phase 2 clinical trial of SB-509 in the second half of 2006. Edwards Lifesciences also filed an investigational new drug (IND) application with the U.S. Food and Drug Administration (FDA) on February 10, 2004 and initiated a Phase 1 clinical trial in humans in August, 2004 and a second in the first half of 2005. The first Phase 1 studies of a ZFP Therapeutic will be a highly visible test of the Company s ZFP Therapeutic approach. Since we have increased our focus on ZFP Therapeutic research and development, investors will increasingly assess the value of the Company s technology based on the continued progress of ZFP Therapeutic products into and through clinical trials. If the initial safety study of our lead therapeutic was halted due to safety concerns, this would negatively affect the value of the Company s stock.

We are conducting proprietary research to discover ZFP Therapeutic product candidates. These programs increase our financial risk of product failure, will significantly increase our research expenditures, and may involve conflicts with our collaborators and strategic partners. Our proprietary research programs consist of research which is funded solely by the Company and where the Company retains exclusive rights to therapeutic products generated by the research. This is in contrast to certain of our research programs that may be funded by corporate partners and in which we may share rights to any resulting products. We have conducted proprietary research since inception, however, we are placing greater emphasis on proprietary research and therapeutic development and we expect this trend will continue in 2006 as we initiate our first Phase 2 clinical trial and bring new ZFP Therapeutics into clinical trials. Conducting proprietary research programs may not generate corresponding revenue and may create conflicts with our collaborators or strategic partners. The implementation of this strategy will involve substantially greater business risks, the expenditure of significantly greater funds than our historic research activities and will require substantial commitments of time from our management and staff.

In addition, disagreements with our collaborators or strategic partners could develop over rights to our intellectual property with respect to our proprietary research activities. Any conflict with our collaborators or strategic partners could reduce our ability to enter into future collaboration or strategic partnering agreements and negatively impact our relationship with existing collaborators and strategic partners, which could reduce our revenue and delay or terminate our product development.

If conflicts arise between us and our collaborators, strategic partners, scientific advisors, or directors, these parties may act in their self-interest, which may limit our ability to implement our strategies. If conflicts arise between our corporate or academic collaborators, strategic partners, or scientific advisors or directors and us, the other party may act in its self-interest, which may limit our ability to implement our strategies. Our license agreement with Edwards Lifesciences provides Edwards with worldwide,

Table of Contents

exclusive rights for ZFP Therapeutics for the activation of VEGF and VEGF receptors for the treatment and prevention of ischemic cardiovascular and vascular disease in humans. We have retained all rights to use our technology for all therapeutic applications of VEGF activation outside of the treatment and prevention of ischemic cardiovascular and vascular disease in humans. During the first quarter of 2005, Sangamo commenced a Phase 1 clinical trial for the treatment of diabetic neuropathy using a ZFP Therapeutic for the activation of VEGF. Edwards has stated that its rights include diabetic neuropathy and consequently our activities relating to diabetic neuropathy constitute a breach of the agreement. We strongly disagree with the Edwards assertion because diabetic neuropathy is a neurological disease and not an ischemic vascular disease and therefore is outside the scope of the Edwards license. Sangamo and Edwards are in discussions regarding this issue. Some of our academic collaborators and strategic partners are conducting multiple product development efforts within each area that is the subject of the collaboration with us. Our collaborators or strategic partners, however, may develop, either alone or with others, products in related fields that are competitive with the products or potential products that are the subject of these collaborations. Competing products, either developed by the collaborators or strategic partners or to which the collaborators or strategic partners have rights, may result in the withdrawal of partner support for our product candidates.

Some of our collaborators or strategic partners could also become competitors in the future. Our collaborators or strategic partners could develop competing products, preclude us from entering into collaborations with their competitors, fail to obtain timely regulatory approvals, terminate their agreements with us prematurely, or fail to devote sufficient resources to the development and commercialization of products. Any of these developments could harm our product development efforts.

Our collaborators may control aspects of our clinical trials, which could result in delays and other obstacles in the commercialization of our proposed products. For some programs we are dependent on third party collaborators to design and conduct our clinical trials. As a result, we may not be able to conduct these programs in the manner or on the time schedule we currently contemplate. In addition, if any of these collaborative partners withdraw support for our programs or proposed products or otherwise impair their development, our business could be negatively affected.

We have limited experience in conducting clinical trials, and we may encounter unanticipated toxicity or adverse events or fail to demonstrate the efficacy, causing us to delay, suspend or terminate the development of our ZFP Therapeutics. Our ZFP Therapeutics may fail to show the desired safety and efficacy in initial clinical trials. Even if we successfully complete Phase 1 trials, the FDA will require additional Phase 2 and Phase 3 clinical testing which involves significantly greater resources, commitments and expertise that may require us to enter into a collaborative relationship with a pharmaceutical company that would assume responsibility for late-stage development and commercialization.

Our potential therapeutic products are subject to a lengthy and uncertain regulatory process, and we may encounter unanticipated toxicity or adverse events or fail to demonstrate efficacy, causing us to delay, suspend or terminate the development of a ZFP

Therapeutics and if these potential products are not approved, we will not be able to commercialize those products. The FDA must approve any human therapeutic products before they can be marketed in the United States. The process for receiving regulatory approval is long and uncertain, and a potential product may not withstand the rigors of testing under the regulatory approval processes.

Before commencing clinical trials in humans, we or our commercial partner must submit an Investigational New Drug (IND) application to the FDA. The FDA has 30 days to comment on the IND. If the FDA does not comment on the IND, we or our commercial partner may begin clinical trials.

Clinical trials are subject to oversight by institutional review boards and the FDA. In addition, our proposed clinical studies will require review from the Recombinant DNA Advisory Committee, or RAC, which is the advisory board to the National Institutes of Health, or NIH, focusing on clinical trials involving gene transfer. We will typically submit a proposed clinical protocol and other product-related information to the RAC three to six months prior to the expected IND filing date.

Clinical trials:

- must be conducted in conformance with the FDA s good clinical practices ICH guidelines and other applicable regulations;

must meet requirements for institutional review board oversight;

must follow Institutional Biosafety Committee (IBC) and NIH RAC guidelines where applicable;

must meet requirements for informed consent;

Table of Contents

are subject to continuing FDA oversight;

may require large numbers of test subjects; and

may be suspended by our commercial partner, the FDA, or us at any time if it is believed that the subjects participating in these trials are being exposed to unacceptable health risks or if the FDA finds deficiencies in the IND or the conduct of these trials.

Clinical trials are lengthy and are typically conducted in three sequential phases, but the phases may overlap or be combined. Each trial must be reviewed and approved by an independent ethics committee or institutional review board before it can begin. Phase 1 usually involves the initial introduction of the investigational drug into healthy volunteers or patients to evaluate certain factors, including its safety, dosage tolerance and, if possible, to gain an early indication of its effectiveness. Phase 2 usually involves trials in a limited patient population to evaluate dosage tolerance and appropriate dosage, identify possible adverse effects and safety risks, and evaluate preliminarily the efficacy of the drug for specific indications. Phase 3 trials usually further evaluate clinical efficacy and test further for safety by using the drug in its final form in an expanded patient population. Later clinical trials may fail to support the findings of earlier trials, which would delay, limit or prevent regulatory approvals.

While we have stated our intention to file an additional IND applications during the next several years, this is only a statement of intent, and we may not be able to do so because the associated product candidates may not meet the necessary preclinical requirements. In addition, there can be no assurance that, once filed, an IND application will result in the actual initiation of clinical trials.

We may not be able to find acceptable patients or may experience delays in enrolling patients for our clinical trials. The FDA or we may suspend our clinical trials at any time if either believes that we are exposing the subjects participating in these trials to unacceptable health risks. The FDA or institutional review boards and/or institutional biosafety committees at the medical institutions and healthcare facilities where we sponsor clinical trials may suspend any trial indefinitely if they find deficiencies in the conduct of these trials. The FDA and institutional review boards may also require large numbers of patients, and the FDA may require that we repeat a clinical trial.

The results of early Phase 1 trials are based on a small number of patients over a short period of time, and our success may not be indicative of results in a large number of patients or of long-term efficacy. The results in early phases of clinical testing are based upon limited numbers of patients and a limited follow-up period. For example, the initial results from the Phase 1 clinical trial of our ZFP Therapeutic, SB-509 product, we presented in April 2006. The primary end point of the trial is clinical and laboratory safety, however we also collected some preliminary efficacy data. Typically, our Phase 1 clinical trials for indications of safety enroll less than 50 patients. We anticipate that our Phase 2 clinical trials for efficacy would typically enroll approximately 100 patients. Actual results with more data points may not confirm favorable results from our earlier stage trials. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in late stage clinical trials even after achieving promising results in earlier stage clinical trials. In addition, we do not yet know if early results will have a lasting effect. If a larger population of patients does not experience positive results, or if these results do not have a lasting effect, our products may not receive approval from the FDA. Failure to demonstrate the safety and effectiveness of our gene based products in larger patient populations could have a material adverse effect on our business that would cause our stock price to decline significantly.

We cannot predict whether or when we will obtain regulatory approval to commercialize our product candidates, therefore we cannot predict the timing of any future revenue from these product candidates. We cannot commercialize any of our product candidates to generate revenue until the appropriate regulatory authorities have reviewed and approved the applications for the product candidates. We cannot assure you that the regulatory agencies will complete their review processes in a timely manner or that we will obtain regulatory approval for any product candidate that we, or our collaborators, develop. Satisfaction of regulatory requirements typically takes many years, is dependent upon the type, complexity and novelty of the product and requires the expenditure of substantial resources. Regulatory approval processes outside the United States include all of the risks associated with the FDA approval process. In addition, we may experience delays or rejections based upon additional government regulation from future legislation

or administrative action or changes in FDA policy during the period of product development, clinical trials and FDA regulatory review.

Our gene regulation and gene modification technology is relatively new, and if we are unable to use this technology in all our intended applications, it would limit our revenue opportunities. Our technology involves a relatively new approach to gene regulation and gene modification. Although we have generated ZFP TFs for hundreds of gene sequences, we have not created ZFP TFs for all gene sequences and may not be able do so, which could limit the usefulness of our technology. In addition, while we have

Table of Contents

demonstrated the function of engineered ZFP TFs in mammalian cell culture, yeast, insects, plants, and animals, we have not yet done so in humans, and the failure to do so could restrict our ability to develop commercially viable products. If we, and our collaborators or strategic partners, are unable to extend our results to new commercially important genes, experimental animal models, and human clinical studies, we may be unable to use our technology in all its intended applications. Also, delivery of ZFP TFs and ZFNs into cells and organisms, including humans, in these and other environments is limited by a number of technical hurdles, which we may be unable to surmount. This is a particular challenge for therapeutic applications of our technology that will require the use of gene transfer systems that may not be effective for the delivery of our ZFP TFs or ZFNs in a particular therapeutic application.

The expected value and utility of our ZFP TFs and ZFNs is in part based on our belief that the targeted or specific regulation of gene expression and targeted gene modification may enable us to develop a new therapeutic approach as well as to help scientists better understand the role of human, animal, and other genes in disease and to aid their efforts in drug discovery and development. We also believe that the regulation of gene expression and targeted gene insertion will have utility in agricultural applications. There is only a limited understanding of the role of specific genes in all these fields. Life sciences companies have developed or commercialized only a few products in any of these fields based on results from genomic research or the ability to regulate gene expression. We, our collaborators, or our strategic partners may not be able to use our technology to identify and validate drug targets or to develop commercial products in the intended markets.

We are currently engaged in the research and development of a new application of our technology platform: ZFP-mediated gene modification using ZFNs to effect either gene correction or gene disruption. Using this technique, Sangamo scientists have engineered ZFNs to cut DNA at a specific site within a target gene, and to then to either correct the adjacent sequences with newly synthesized DNA copied from an introduced DNA template, gene correction, or to rejoin the two ends of the break which frequently results in the disruption of the gene s function. In so doing, we are attempting to correct an abnormal or disease-related mutation or DNA sequence or to disrupt a gene that is involved in disease pathology. ZFP-mediated gene modification is at an early research stage. Our scientists have shown ZFP-mediated gene modification to work in isolated cells; however, a significant amount of additional research will be needed before this technique can be evaluated in animals or plants and subsequently tested for applications in human healthcare and plant agriculture.

We may be unable to license gene transfer technologies that we may need to commercialize our ZFP TF technology. In order to regulate a gene in a cell, the ZFP TF or ZFN must be efficiently delivered to the cell. We have licensed certain gene transfer technologies for use with our Enabling Technologies, which are ZFP TFs and ZFNs used in pharmaceutical discovery research and protein production. We are evaluating these systems and other technologies, which may need to be used in the delivery of ZFP TFs or ZFNs into cells for in vitro and in vivo applications, including ZFP Therapeutics. However, we may not be able to license the gene transfer technologies required to develop and commercialize our ZFP Therapeutics. We have not developed our own gene transfer technologies, and we rely on our ability to enter into license agreements to provide us with rights to the necessary gene transfer technology. The inability to obtain a license to use gene transfer technologies with entities which own such technology on reasonable commercial terms, if at all, could delay or prevent the preclinical evaluation, clinical testing, and/or commercialization of our therapeutic product candidates.

We do not currently have the infrastructure or capability to manufacture therapeutic products on a commercial scale. In order for us to commercialize these products directly, we would need to develop, or obtain through outsourcing arrangements, the capability to execute all of these functions. If we are unable to develop or otherwise obtain the requisite preclinical, clinical, regulatory, manufacturing, marketing, and sales capabilities, we would be unable to directly commercialize our therapeutics products which would limit our future growth.

Even if our technology proves to be effective, it still may not lead to commercially viable products. Even if our collaborators or strategic partners are successful in using our ZFP technology in drug discovery, protein production, therapeutic development, or plant agriculture, they may not be able to commercialize the resulting products or may decide to use other methods competitive with our technology. To date, no company has received marketing approval or has developed or commercialized any therapeutic or agricultural products based on our technology. The failure of our technology to provide safe, effective, useful, or commercially viable approaches to the discovery and development

of these products would significantly limit our business and future growth and would adversely affect our value. *Even if our product development efforts are successful and even if the requisite regulatory approvals are obtained, our ZFP Therapeutics may not gain market acceptance among physicians, patients, healthcare payers and the medical community*. A number of additional factors may limit the market acceptance of products including the following:

Table of Contents

likelihood and rate of adoption by healthcare practitioners;

likelihood and rate of a product s acceptance by the target population;

timing of market entry relative to competitive products;

availability of alternative therapies;

price of our product relative to alternative therapies;

availability of third-party reimbursement;

extent of marketing efforts by us and third-party distributors or agents retained by us; and

side effects or unfavorable publicity concerning our products or similar products.

Adverse events in the field of gene therapy may negatively impact regulatory approval or public perception of our potential products. Our potential therapeutic products are delivered to patients as gene-based drugs, or gene therapy. The clinical and commercial success of our potential products will depend in part on public acceptance of the use of gene therapy for the prevention or treatment of human diseases. Public attitudes may be influenced by claims that gene therapy is unsafe, and, consequently, our products may not gain the acceptance of the public or the medical community. Negative public reaction to gene therapy in general could result in greater government regulation and stricter labeling requirements of gene therapy products, including any of our products, and could cause a decrease in the demand for any products we may develop.

Our stock price is also influenced by public perception. Reports of serious adverse events in a retroviral gene transfer trial for infants with X-linked severe combined immunodeficiency (X-linked SCID) in France and subsequent FDA actions putting related trials on hold in the United States had a significant negative impact on the public perception and stock price of certain companies involved in gene therapy. Stock prices of these companies declined whether or not the specific company was involved with retroviral gene transfer for the treatment of infants with SCID, or whether the specific company s clinical trials were placed on hold in connection with these events.

Other potential adverse events in the field of gene therapy may occur in the future that could result in greater governmental regulation of our potential products and potential regulatory delays relating to the testing or approval of our potential products.

We are at the development phase of operations and may not succeed or become profitable. We began operations in 1995 and are in the early phases of ZFP Therapeutic product development. We have incurred significant losses and our net losses to date and our revenues have been generated from Enabling Technology collaborations, strategic partners, and federal government research grants. In 2005, we have placed more emphasis on higher-value therapeutic product development and related strategic partnerships. This shift in emphasis has the potential to increase the return on investment to our stockholders by allocating capital resources to higher value, therapeutic product development activities. At the same time, it increases our financial risk by increasing expenses associated with product development. In addition, the preclinical or clinical failure of any single product may have a significant effect on the actual or perceived value of our shares. Our business is subject to all of the risks inherent in the development of a new technology, which include the need to:

attract and retain qualified scientific and technical staff and management, particularly scientific staff with expertise to develop our early-stage technology into therapeutic products;

obtain sufficient capital to support the expense of developing our technology platform and developing, testing, and commercializing products;

develop a market for our products;

successfully transition from a company with a research focus to a company capable of supporting commercial activities; and

attract and enter into research collaborations with research and academic institutions and scientists.

Table of Contents

Commercialization of our technologies will depend, in part, on strategic partnering with other companies. If we are not able to find strategic partners in the future or our strategic partners do not diligently pursue product development efforts, we may not be able to develop our technologies or products, which could slow our growth and decrease our value. We expect to rely, to some extent, on our strategic partners to provide funding in support of our research and to perform independent research and preclinical and clinical testing. Our technology is broad based, and we do not currently possess the resources necessary to fully develop and commercialize potential products that may result from our technologies or the resources or capabilities to complete the lengthy marketing approval processes that may be required for the products. Therefore, we plan to rely on strategic partnerships to help us develop and commercialize ZFP Therapeutic products. If those partners are unable or unwilling to advance our programs, or if they do not diligently pursue product approval, this may slow our progress and defer our revenues. Our partners may sublicense or abandon development programs or we may have disagreements with our partners, which would cause associated product development to slow or cease. There can be no assurance that we will be able to establish additional strategic collaborations for ZFP Therapeutic product development. We may require significant time to secure additional collaborations or strategic partners because we need to effectively market the benefits of our technology to these future collaborators and strategic partners, which use the time and efforts of research and development personnel and our management. Further, each collaboration or strategic partnering arrangement will involve the negotiation of terms that may be unique to each collaborator or strategic partner. These business development efforts may not result in a collaboration or strategic partnership.

The loss of our current or any future strategic partnering agreements would not only delay or terminate the potential development or commercialization of products we may derive from our technologies, but it may also delay or terminate our ability to test ZFP TFs for specific genes. If any strategic partner fails to conduct the collaborative activities successfully and in a timely manner, the preclinical or clinical development or commercialization of the affected product candidates or research programs could be delayed or terminated.

Our existing strategic partnering agreements are based on the achievement of milestones. Under the strategic partnering agreements, we expect to receive revenue for the research and development of a ZFP Therapeutic product and based on achievement of specific milestones. Achieving these milestones will depend, in part, on the efforts of our strategic partner as well as our own. In contrast, our historic Enabling Technology collaborations only pay us to supply ZFP TFs for the collaborator s independent use, rather than for future results of the collaborator s efforts. If we, or any strategic partner, fail to meet specific milestones, then the strategic partnership may be terminated, which could decrease our revenues.

If our competitors develop, acquire, or market technologies or products that are more effective than ours, this would reduce or eliminate our commercial opportunity. Any products that we or our collaborators or strategic partners develop by using our ZFP technology platform will enter into highly competitive markets. Even if we are able to generate ZFP Therapeutics that are safe and effective for their intended use, competing technologies may prove to be more effective or less expensive, which, to the extent these competing technologies achieve market acceptance, will limit our revenue opportunities. In some cases, competing technologies have proven to be satisfactorily effective and less expensive, as has been the case with technologies competitive with our Enabling Technology(R). The effectiveness of these competing products has reduced the revenues generated by our Enabling Technology. Competing technologies may include other methods of regulating gene expression or modifying genes. ZFP TFs and ZFNs have broad application in the life sciences and compete with a broad array of new technologies and approaches being applied to genetic research by many companies. Competing proprietary technologies with our product development focus include:

For ZFP Therapeutics:

- small molecule drugs;
- monoclonal antibodies;
- recombinant proteins;

gene therapy / cDNAs;

antisense; and

siRNA approaches

For our Enabling Technology Applications:

Table of Contents

For protein production: gene amplification, meganucleases, insulator technology;

For target validation: antisense, siRNA; and

For plant agriculture: recombination approaches, mutagenesis approaches, meganucleases;

In addition to possessing competing technologies, our competitors include biotechnology companies with:

substantially greater capital resources than ours;

larger research and development staffs and facilities than ours; and

greater experience in product development and in obtaining regulatory approvals and patent protection;

These organizations also compete with us to:

attract qualified personnel;

attract parties for acquisitions, joint ventures or other collaborations; and

license the proprietary technologies of academic and research institutions that are competitive with our technology, which may preclude us from pursuing similar opportunities.

Accordingly, our competitors may succeed in obtaining patent protection or commercializing products before us. In addition, any products that we develop may compete with existing products or services that are well established in the marketplace.

Our collaborators or strategic partners may decide to adopt alternative technologies or may be unable to develop commercially viable products with our technology, which would negatively impact our revenues and our strategy to develop these products. Our collaborators or strategic partners may adopt alternative technologies, which could decrease the marketability of ZFP technology. Additionally, because many of our collaborators or strategic partners are likely to be working on more than one development project, they could choose to shift their resources to projects other than those they are working on with us. If they do so, that would delay our ability to test our technology and would delay or terminate the development of potential products based on our ZFP technology. Further, our collaborators and strategic partners may elect not to develop products arising out of our collaborative and strategic partnering arrangements or to devote sufficient resources to the development, manufacturing, marketing, or sale of these products. If any of these events occur, we may not be able to develop our technologies or commercialize our products.

We anticipate continuing to incur operating losses for the next several years. If material losses continue for a significant period, we may be unable to continue our operations. We have generated operating losses since we began operations in 1995. The extent of our future losses and the timing of profitability are uncertain, and we expect to incur losses for the foreseeable future. We have been engaged in developing our ZFP TF technology since inception, which has and will continue to require significant research and development expenditures. In November 2005, we announced that we had completed a registered direct offering to institutional and strategic investors for a total of 5,080,000 shares of common stock at a price of $3.85 per share to the investors, resulting in net proceeds to Sangamo of approximately $18.2 million. In June 2006, in an underwritten public offering and pursuant to an effective registration statement, we sold 3,100,000 shares of common stock at a public offering price of $6.75 per share, resulting in net proceeds of approximately $20.15 million after deducting underwriter s discount. To date, we have generated all other revenue from Enabling Technology collaborations, strategic partnering agreements, and federal government research grants. As of June 30, 2006, we had an accumulated deficit of approximately $116.5 million. We expect to incur losses for the foreseeable future. These losses will increase as we expand and extend our research and development activities into human therapeutic product development. If the time required to generate significant product revenues and achieve profitability is longer than we currently anticipate, we may not be able to sustain our operations.

We may be unable to raise additional capital, which would harm our ability to develop our technology and products. We have incurred significant operating losses and negative operating cash flows since inception and have not achieved

profitability. We expect capital outlays and operating expenditures to increase over the next several years as we expand our infrastructure and research and ZFP Therapeutic product development activities. While we believe our financial resources will be adequate to sustain our current operations at least through 2007, we may seek additional sources of capital through equity or debt financing. In addition, as we focus our efforts on proprietary human therapeutics, we will need to seek FDA approval of potential products, a process that could cost in excess of $100 million per product. We cannot be certain that we will be able to obtain financing on terms acceptable to us, or at all. If

Table of Contents

adequate funds are not available, our business and our ability to develop our technology and ZFP Therapeutic products would be harmed.

Our stock price has been volatile and may continue to be volatile, which could result in substantial losses for investors. During the quarter ended June 30, 2006, our stock price ranged from a low of $4.10 to high of $7.73. During the past two years, our common stock price has fluctuated significantly, ranging from a low of $3.46 to a high of $7.73 during the year ended December 31, 2005, and a low of $3.00 to a high of $8.02 during the year ended December 31, 2004. Volatility in our common stock could cause stockholders to incur substantial losses. An active public market for our common stock may not be sustained, and the market price of our common stock may continue to be highly volatile. The market price of our common stock has fluctuated significantly in response to the following factors, some of which are beyond our control:

announcements by us or our partners providing updates on the progress or development status of ZFP Therapeutics;

changes in market valuations of similar companies;

deviations in our results of operations from the guidance given by us or estimates of securities analysts;

announcements by us or our competitors of new or enhanced products, technologies or services or significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;

regulatory developments;

additions or departures of key personnel;

future sales of our common stock or other securities by the company, management or directors, liquidation of institutional funds that comprised large holdings of Sangamo stock;

decreases in our cash balances; and

general stock market trends.

Our common stock is thinly traded, which means large transactions in our common stock may be difficult to conduct in a short time frame. We have a low volume of daily trades in our common stock on the Nasdaq National Market. For example, the average daily trading volume in our common stock on the Nasdaq National Market over the ten-day trading period prior to August 1, 2006 was approximately 133,000 shares per day. Any large transactions in our common stock may be difficult to conduct and may cause significant fluctuations in the price of our common stock.

Failure to attract, retain, and motivate skilled personnel and cultivate key academic collaborations will delay our product development programs and our research and development efforts. We are a small company with 68 full-time employees as of May 8, 2006 and our success depends on our continued ability to attract, retain, and motivate highly qualified management and scientific personnel and our ability to develop and maintain important relationships with leading research and academic institutions and scientists. Competition for personnel and academic and other research collaborations is intense. The success of our technology development programs depends on our ability to attract and retain highly trained personnel and we have experienced a rate of employee turnover that we believe is typical of emerging biotechnology companies. If we lose the services of personnel with the necessary skills, it could significantly impede the achievement of our research and development objectives. We are not presently aware of any plans of specific employees to retire or otherwise leave the company. If we fail to negotiate additional acceptable collaborations with academic and other research institutions and scientists, or if our existing collaborations are unsuccessful, our ZFP Therapeutic development programs may be delayed or may not succeed.

Because it is difficult and costly to protect our proprietary rights, and third parties have filed patent applications that are similar to ours, we cannot ensure the proprietary protection of our technologies and products. Our commercial

success will depend in part on obtaining patent protection of our technology and successfully defending any of our patents which may be challenged. The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and can involve complex legal and factual questions. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged to date. Accordingly, we cannot predict the breadth of claims allowed in patents we own or license.

Table of Contents

We are a party to various license agreements that give us rights under specified patents and patent applications. Our current licenses, as our future licenses frequently will, contain performance obligations. If we fail to meet those obligations, the licenses could be terminated. If we are unable to continue to license these technologies on commercially reasonable terms, or at all, we may be forced to delay or terminate our product development and research activities.

With respect to our present and any future sublicenses, since our rights derive from those granted to our sublicensor, we are subject to the risk that our sublicensor may fail to perform its obligations under the master license or fail to inform us of useful improvements in, or additions to, the underlying intellectual property owned by the original licensor.

We are unable to exercise the same degree of control over intellectual property that we license from third parties as we exercise over our internally developed intellectual property. We do not control the prosecution of certain of the patent applications that we license from third parties; therefore, the patent applications may not be prosecuted exactly as we desire or in a timely manner.

The degree of future protection for our proprietary rights is uncertain, and we cannot ensure that:

- we or our licensors were the first to make the inventions covered by each of our pending patent applications;
- we or our licensors were the first to file patent applications for these inventions;
- the patents of others will not have an adverse effect on our ability to do business;
- others will not independently develop similar or alternative technologies or reverse engineer any of our products, processes or technologies;
- any of our pending patent applications will result in issued patents;
- any patents issued or licensed to us or our collaborators or strategic partners will provide a basis for commercially viable products or will provide us with any competitive advantages;
- any patents issued or licensed to us will not be challenged and invalidated by third parties; or
- we will develop additional products, processes or technologies that are patentable.

Others have filed and in the future are likely to file patent applications that are similar to ours. We are aware that there are academic groups and other companies that are attempting to develop technology that is based on the use of zinc finger and other DNA binding proteins, and that these groups and companies have filed patent applications. Several patents have been issued, although we have no current plans to use the associated inventions. If these or other patents issue, it is possible that the holder of any patent or patents granted on these applications may bring an infringement action against our collaborators, strategic partners, or us claiming damages and seeking to enjoin commercial activities relating to the affected products and processes. The costs of litigating the claim could be substantial. Moreover, we cannot predict whether we, our collaborators, or strategic partners would prevail in any actions. In addition, if the relevant patent claims were upheld as valid and enforceable and our products or processes were found to infringe the patent or patents, we could be prevented from making, using, or selling the relevant product or process unless we could obtain a license or were able to design around the patent claims. We can give no assurance that such a license would be available on commercially reasonable terms, or at all, or that we would be able to successfully design around the relevant patent claims. There may be significant litigation in the genomics industry regarding patent and other intellectual property rights, which could subject us to litigation. If we become involved in litigation, it could consume a substantial portion of our managerial and financial resources.

We cannot guarantee that third parties will not challenge our intellectual property. One of our licensed patents, European Patent No. 0 682 699, entitled Functional Domains in *Flavobacterium Okeanokoites* Restriction Endonuclease was granted on May 7, 2003 and forms the basis of Regional Phase patents in France, Germany, Great

Britain, Ireland and Switzerland. The granted claims of the patent cover technologies used in our programs in targeted recombination and gene correction. On December 1, 2005 an interlocutory decision revoking this patent was issued by the European Patent Office. We have appealed this decision. If our appeal is ultimately unsuccessful, our ability to exclude potential competitors in the field of targeted recombination and gene correction in Europe may be limited. These developments apply only to Europe and do not affect our ability to practice our targeted recombination and gene correction programs in Europe. Moreover, we also hold licenses to six US patents to the technology covered by the opposed European patent, and hold licenses to related applications pending in Canada and Japan. Accordingly, any effects of the opposition, up to and

Table of Contents

including invalidation of the European patent, would be restricted to Europe and would have little, if any, material adverse effect on our business.

We rely on trade secrets to protect technology where we believe patent protection is not appropriate or obtainable. Trade secrets, however, are difficult to protect. While we require employees, academic collaborators, and consultants to enter into confidentiality agreements, we may not be able to adequately protect our trade secrets or other proprietary information or enforce these confidentiality agreements.

Our collaborators, strategic partners, and scientific advisors have rights to publish data and information in which we may have rights. If we cannot maintain the confidentiality of our technology and other confidential information in connection with our collaborations and strategic partnerships, then we may not be able to receive patent protection or protect our proprietary information.

Regulatory approval, if granted, may be limited to specific uses or geographic areas, which could limit our ability to generate revenues. Regulatory approval will be limited to the indicated use for which we can market a product. Further, once regulatory approval for a product is obtained, the product and its manufacturer are subject to continual review. Discovery of previously unknown problems with a product or manufacturer may result in restrictions on the product, manufacturer, and manufacturing facility, including withdrawal of the product from the market. In Japan and Europe, regulatory agencies also set or approve prices.

Even if regulatory clearance of a product is granted, this clearance is limited to those specific states and conditions for which the product is useful, as demonstrated through clinical trials. We cannot ensure that any ZFP Therapeutic product developed by us, alone or with others, will prove to be safe and effective in clinical trials and will meet all of the applicable regulatory requirements needed to receive marketing clearance in a given country.

Outside the United States, our ability to market a product is contingent upon receiving a marketing authorization from the appropriate regulatory authorities, so we cannot predict whether or when we would be permitted to commercialize our product. These foreign regulatory approval processes include all of the risks associated with FDA clearance described above.

Our collaborations with outside scientists may be subject to change, which could limit our access to their expertise. We work with scientific advisors and collaborators at academic research institutions. These scientists are not our employees and may have other commitments that would limit their availability to us. Although our scientific advisors generally agree not to do competing work, if a conflict of interest between their work for us and their work for another entity arises, we may lose their services. Although our scientific advisors and academic collaborators sign agreements not to disclose our confidential information, it is possible that some of our valuable proprietary knowledge may become publicly known through them.

Laws or public sentiment may limit the production of genetically modified agricultural products in the future, and these laws could reduce our partner s ability to sell these products. Genetically modified products are currently subject to public debate and heightened regulatory scrutiny, either of which could prevent or delay production of agricultural products. Effective as of October 1, 2005, we entered into a Research License and Commercial Option Agreement with Dow AgroSciences LLC (DAS), a wholly owned indirect subsidiary of Dow Chemical Corporation. Under this agreement, we will provide DAS with access to our proprietary ZFP technology and the exclusive right to use our ZFP technology to modify the genomes or alter the nucleic acid or protein expression of plant cells, plants, or plant cell cultures. The field-testing, production, and marketing of genetically modified plants and plant products are subject to federal, state, local, and foreign governmental regulation. Regulatory agencies administering existing or future regulations or legislation may not allow production and marketing of our genetically modified products in a timely manner or under technically or commercially feasible conditions. In addition, regulatory action or private litigation could result in expenses, delays, or other impediments to our product development programs or the commercialization of resulting products.

The FDA currently applies the same regulatory standards to foods developed through genetic engineering as those applied to foods developed through traditional plant breeding. Genetically engineered food products, however, will be subject to pre-market review if these products raise safety questions or are deemed to be food additives. Governmental authorities could also, for social or other purposes, limit the use of genetically modified products created with our gene regulation technology.

Even if we are able to obtain regulatory approval for genetically modified products, our success will also depend on public acceptance of the use of genetically modified products including drugs, plants, and plant products. Claims that genetically modified products are unsafe for consumption or pose a danger to the environment may influence public attitudes. Our genetically modified products may not gain public acceptance. The subject of genetically modified organisms has received negative publicity in the United States and particularly in Europe, and such publicity has aroused public debate. The adverse publicity in Europe could lead to greater regulation and trade restrictions on imports of genetically altered products. Similar adverse public reaction in the United States to genetic

Table of Contents

research and its resulting products could result in greater domestic regulation and could decrease the demand for our technology and products.

If we use biological and hazardous materials in a manner that causes injury or violates laws, we may be liable for damages. Our research and development activities involve the controlled use of potentially harmful biological materials as well as hazardous materials, chemicals, and various radioactive compounds typically employed in molecular and cellular biology. We routinely use cells in culture and gene delivery vectors, and we employ small amounts of radioisotopes in trace experiments. Although we maintain up-to-date licensing and training programs, we cannot completely eliminate the risk of accidental contamination or injury from the use, storage, handling, or disposal of these materials. In the event of contamination or injury, we could be held liable for damages that result, and any liability could exceed our resources. We currently carry insurance covering claims arising from our use of these materials. However, if we are unable to maintain our insurance coverage at a reasonable cost and with adequate coverage, our insurance may not cover any liability that may arise. We are subject to federal, state, and local laws and regulations governing the use, storage, handling, and disposal of these materials and specified waste products. To date, we have not experienced significant costs in complying with regulations regarding the use of these materials.

Anti-takeover provisions in our certificate of incorporation and Delaware law could make an acquisition of the Company more difficult and could prevent attempts by our stockholders to remove or replace current management. Anti-takeover provisions of Delaware law, our certificate of incorporation and our bylaws and may discourage, delay or prevent a change in control of our company, even if a change in control would be beneficial to our stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors. In particular, under our certificate of incorporation our board of directors may issue up to 5,000,000 shares of preferred stock with rights and privileges that might be senior to our common stock, without the consent of the holders of the common stock. Moreover, without any further vote or action on the part of the stockholders, the board of directors would have the authority to determine the price, rights, preferences, privileges, and restrictions of the preferred stock. This preferred stock, if it is ever issued, may have preference over, and harm the rights of, the holders of common stock. Although the issuance of this preferred stock would provide us with flexibility in connection with possible acquisitions and other corporate purposes, this issuance may make it more difficult for a third party to acquire a majority of our outstanding voting stock. Similarly, our authorized but unissued common stock is available for future issuance without stockholder approval.

In addition, our certificate of incorporation:

- states that stockholders may not act by written consent but only at a stockholders meeting;
- establishes advance notice requirements for nominations for election to the board of directors or proposing matters that can be acted upon at stockholders meetings; and
- limits who may call a special meeting of stockholders.

We are also subject to Section 203 of the Delaware General Corporation Law, which provides, subject to certain exceptions, that if a person acquires 15% of our voting stock, the person is an interested stockholder and may not engage in business combinations with us for a period of three years from the time the person acquired 15% or more or our voting stock.

Insiders have substantial control over Sangamo and could delay or prevent a change in corporate control. The interest of management could conflict with the interest of our other stockholders. Our executive officers and directors beneficially own, in the aggregate, approximately 18% of our outstanding common stock. As a result, these stockholders, if they choose to act together, will be able to have a material impact on all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This could have the effect of delaying or preventing a change of control of Sangamo, which in turn could reduce the market price of our stock.

Accounting pronouncements may affect our future financial position and results of operations On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (or FAS 123R).

As a result, we have included employee stock-based compensation costs in our results of operations for the quarter and six months ended June 30, 2006, as discussed in Note 2, Employee Stock-Based Compensation, in the Notes to Condensed Consolidated Financial Statements of Part I, Item I of this Form 10-Q. Our adoption of FAS 123R is expected to result in compensation expense that will increase basic and diluted net loss per share by approximately $0.08 per share for 2006. However, our estimate of future employee stock-based compensation expense is affected by our stock price, the number of stock-based awards our board of directors may grant in 2006, as well as a

Table of Contents

number of complex and subjective valuation assumptions. These valuation assumptions include, but are not limited to, the volatility of our stock price and employee stock option exercise behaviors.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The effective date of our first Registration Statement on Form S-1 filed under the Securities Act of 1933, as amended, relating to the initial public offering of our common stock was April 6, 2000. On the same date, we signed an underwriting agreement with Lehman Brothers, Chase H&Q, ING Barings LLC, and William Blair & Co., the managing underwriters for the initial public offering and the representatives of the underwriters named in the underwriting agreement, for the initial public offering of 3,500,000 shares of our common stock at an initial public offering price of $15 per share. The offering commenced on April 6, 2000 and was closed on April 11, 2000. The initial public offering resulted in gross proceeds of $52.5 million. We received net proceeds of $48.8 million after deducting underwriting discounts of $3.7 million. Expenses related to the offering totaled approximately $1.4 million. None of Sangamo s net proceeds from the initial public offering were paid directly or indirectly to any director, officer, general partner of Sangamo or their associates, persons owning 10% or more of any class of equity securities of Sangamo, or an affiliate.

In November 2005, we completed a registered direct offering to institutional and strategic investors for a total of 5,080,000 shares of common stock at a price of $3.85 per share to the investors, resulting in net proceeds to Sangamo of approximately $18.2 million.

In June 2006, in an underwritten public offering and pursuant to an effective registration statement, we sold 3,100,000 shares of common stock at a public offering price of $6.75 per share, resulting in net proceeds of approximately $20.15 million after deducting underwriter s discount.

From the time of receipt through June 30, 2006, Sangamo has used the net proceeds from its initial public offering, registered direct offering and underwritten public offering of common stock to invest in short-term and long-term, interest bearing, investment-grade securities and has used its existing cash balances to fund general operations. The proceeds are being used for general corporate purposes, including working capital and product development. A portion of the net proceeds will also be used to acquire or invest in complementary businesses or products or to obtain the right to use complementary technologies. Sangamo has no agreements or commitments with respect to any such acquisition and is not currently engaged in any material negotiations with respect to any such transaction.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of shareholders was held on June 7, 2006. Two matters were voted on and each was approved. The results are as follows:

PROPOSAL I

The following directors were elected at the meeting to serve until our annual meeting following the end of fiscal year 2006 or until their successors are duly elected and qualified:

NOMINEE	VOTES FOR	VOTES WITHHELD
Edward O. Lanphier, II	27,350,816	110,133
William G. Gerber, M.D.	27,397,785	63,164
John W. Larson	25,317,245	2,143,704
Margaret A. Liu, M.D.	27,396,935	64,014
Steven J. Mento, Ph.D.	27,391,485	69,464
H. Ward Wolff	27,398,935	62,014
Michael C. Wood	27,198,067	262,882

PROPOSAL II

Table of Contents

The proposal to ratify the selection of Ernst & Young LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2006 was approved.

FOR	AGAINST	ABSTAINED	NON VOTES
27,331,648	90,083	39,218	0

ITEM 6. EXHIBITS

(a) Exhibits:

31.1 Form of Rule 13a 14(a) Certification

31.2 Form of Rule 13a 14(a) Certification

32.1 Certification Pursuant to 18 U.S.C. Section 1350.

Table of Contents

SIGNATURES

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

SANGAMO BIOSCIENCES, INC. Dated: August 4, 2006

/s/ Greg S. Zante

Greg S. Zante
Senior Director, Finance and Administration
(Principal Financial and Accounting Officer)
35

ign="bottom" bgcolor="#EEEEEE">

Developed technology
$4,753 $5,420 $13,387 $31,512
Distribution channels
24,458
Trademarks
288 288 863 2,825
Other intangible assets
1,958 2,329 6,746 5,872

Total amortization expense
$6,999 $8,037 $20,996 $64,667

Total amortization expense for developed technology and other intangibles includes approximately $1.2 million and $0.5 million, respectively, for the three months ended September 30, 2004 and 2003 and approximately $2.5 million and $1.4 million, respectively, for the nine months ended September 30, 2004 and 2003 that is included in cost of user license fees.

The total expected future annual amortization of intangible assets related to acquisitions is set forth in the table below:

	Future Amortization

	(In thousands)
2004	$ 11,167
2005	43,046
2006	40,719
2007	28,896
2008	17,929
2009	11,316
Total	$153,073

7. Strategic Investments

The Company holds investments in capital stock of several privately-held companies. The total carrying amount of these strategic investments was $2.7 million at September 30, 2004 and $5.4 million at December 31, 2003. These strategic investments are included in other non-current assets. For the nine months ended September 30, 2004, the Company realized a gain of $7.5 million on the sale of a strategic investment. The Company recorded no impairment losses on strategic investments for the three and nine months ended September 30, 2004 and for the three months ended September 30, 2003. The Company recorded $3.5 million of impairment losses for the nine months ended September 30, 2003. The losses realized represent other-than-temporary declines in the fair value of the investments and were determined based on the value of the investee s stock, its inability to obtain additional private financing, its cash position and current cash burn rate, the status and competitive position of the investee s products and the uncertainty of its financial condition, among other factors.

8. Accrued Acquisition and Restructuring Costs

In the fourth quarter of 2002, the Company s board of directors approved a facility restructuring plan to exit and consolidate certain of the Company s facilities located in 17 metropolitan areas worldwide. The facility restructuring plan was adopted to address overcapacity in its facilities as a result of lower than planned

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

headcount growth in these metropolitan areas. In connection with this facility restructuring plan, the Company recorded a net restructuring charge (the 2002 Facility Accrual) to operating expenses of $96.1 million in the fourth quarter of 2002. The 2002 Facility Accrual was originally comprised of (i) $86.9 million associated with terminating and satisfying remaining lease commitments, partially offset by sublease income net of related sublease costs and (ii) write-offs of $9.2 million for net assets.

In the third quarter of 2004, the Company acquired KVS and, as a result, reversed $9.6 million of the 2002 Facility Accrual related to previously restructured facilities to be occupied by KVS personnel. In addition, cash outlays of $4.0 million and the impact of foreign exchange rates of $0.4 million were recognized in the third quarter of 2004. As of September 30, 2004, the remaining balance of the 2002 Facility Accrual was $55.0 million. Restructuring costs will generally be paid over the remaining lease terms, ending at various dates through 2022, or over a shorter period as the Company may negotiate with its lessors. The majority of costs are expected to be paid by the year ending December 31, 2010.

The Company is in the process of seeking suitable subtenants for these facilities. The estimates related to the 2002 Facility Accrual may vary significantly depending, in part, on factors that are beyond the Company s control, including the commercial real estate market in the applicable metropolitan areas, its ability to obtain subleases related to these facilities and the time period to do so, the sublease rental market rates and the outcome of negotiations with lessors regarding terminations of some of the leases. Adjustments to the 2002 Facility Accrual will be made if actual lease exit costs or sublease income differ from amounts currently expected. Because a portion of the 2002 Facility Accrual relates to international locations, the accrual will be affected by exchange rate fluctuations.

As of September 30, 2004, accrued acquisition and restructuring costs consisted of the 2002 Facility Accrual discussed above, acquisition related costs discussed in Note 5 and other accrued acquisition and restructuring charges incurred from 1999 through 2003, net of cash payments made.

The components of accrued acquisition and restructuring costs and movements within these components through September 30, 2004 were as follows:

	Direct Transaction Costs	Involuntary Termination Benefits	Facilities Related Costs	Asset Write-offs	Total
			(In millions)		
Balance at December 31, 2003	$ 0.6	$	$91.4	$ 2.1	$ 94.1
Additions	2.1	11.5			13.6
Cash payments	(1.8)	(11.4)	(5.1)		(18.3)
Non-cash charges				(2.1)	(2.1)
Impact of exchange rates			0.7		0.7
Balance at March 31, 2004	0.9	0.1	87.0		88.0
Cash payments	(0.4)		(5.0)		(5.4)
Impact of exchange rates			0.3		0.3
Balance at June 30, 2004	0.5	0.1	82.3		82.9
Additions	4.2	0.1	2.1		6.4
Cash payments	(0.8)		(5.1)		(5.9)
Restructuring reversals, net			(9.6)		(9.6)
Other			(0.4)		(0.4)
Impact of exchange rates			(0.5)		(0.5)
Balance at September 30, 2004	$ 3.9	$ 0.2	$68.8	$	$ 72.9

14

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Convertible Subordinated Notes

In August 2003, the Company issued $520.0 million of 0.25% convertible subordinated notes due August 1, 2013 (the 0.25% Notes), to several initial purchasers in a private offering, for which the Company received net proceeds of approximately $508.2 million. The 0.25% Notes were issued at their face value and provide for semi-annual interest payments of $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of the Company s registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue such additional interest until April 27, 2004, the 90th day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will continue to accrue such additional interest until the date on which the registration statement is declared effective. The 0.25% Notes are convertible, under specified circumstances, into shares of the Company s common stock at a conversion rate of 21.6802 shares per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $46.13 per share; provided that, pursuant to the terms of a supplemental indenture dated as of October 25, 2004, the Company will be required to deliver cash to holders upon conversion, except to the extent that the Company s conversion obligation exceeds the principal amount of the notes converted, in which case the Company will have the option to satisfy the excess (and only the excess) in cash and/or shares of common stock.

10. Long-Term Debt

In 1999 and 2000, the Company entered into three build-to-suit lease agreements for office buildings in Mountain View, California, Roseville, Minnesota and Milpitas, California. The Company began occupying the Roseville and Mountain View facilities in May and June 2001, respectively, and began occupying the Milpitas facility in April 2003. The Mountain View facility includes 425,000 square feet and serves as the Company s corporate headquarters and for research and development functions. The Milpitas facility includes 466,000 square feet and is primarily used for technical support, sales and general corporate functions. The Roseville facility includes 204,000 square feet and provides space for technical support and research and development functions. A syndicate of financial institutions financed the acquisition and development of these properties. Prior to July 1, 2003, the Company accounted for these properties as operating leases in accordance with SFAS No. 13, *Accounting for Leases,* as amended. On July 1, 2003, the Company adopted Financial Accounting Standards Board (FASB) Interpretation Number (FIN) 46. Under FIN 46, the lessors of the facilities are considered variable interest entities, and the Company is considered the primary beneficiary. Accordingly, the Company began consolidating these variable interest entities on July 1, 2003 and has included the property and equipment and long-term debt on its balance sheet at September 30, 2004 and December 31, 2003 and the results of their operations in its consolidated statement of operations for the three and nine months ended September 30, 2004. As of September 30, 2004, $380.6 million of debt has been classified as current as the lease terms for the Mountain View and Roseville facilities expire in March 2005 and the lease term for the Milpitas facility expires in July 2005.

Interest only payments under the debt agreements relating to the facilities are generally paid quarterly and are equal to the termination value of the outstanding debt obligations multiplied by the Company s cost of funds, which is based on London Inter Bank Offered Rate (LIBOR) using 30-day to 180-day LIBOR contracts and adjusted for the Company s credit spread. The termination values of the debt agreements are approximately $145.2 million, $41.2 million and $194.2 million for the Mountain View, Roseville and Milpitas leases, respectively. The terms of these debt agreements are five years with an option to extend the lease terms for two successive periods of one year each, if agreed to by the financial institutions that financed the facilities. The terms of these debt agreements began March 2000 for the Mountain View and Roseville facilities and July 2000 for the Milpitas facility. The Company has the option to purchase the three facilities for the aggregate termination value of $380.6 million or, at the end of the term, to arrange for the sale of the

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

properties to third parties while the Company retains an obligation to the financial institutions that financed the facilities in an amount equal to the difference between the sales price and the guaranteed residual value up to an aggregate $344.6 million if the sales price is less than this amount, subject to the specific terms of the debt agreements. In addition, the Company is entitled to any proceeds from a sale of the facilities in excess of the termination values.

In January 2002, the Company entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging the cash payments related to the Mountain View, California and Roseville, Minnesota agreements (see Note 13). Under the terms of these interest rate swaps, the Company makes payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR rate. For the three months ended September 30, 2004 and 2003, the aggregate payments, including the net payments on the interest rate swaps, were $4.3 million and for the nine months ended September 30, 2004 and 2003, the aggregate payments, including the net payments on the interest rate swaps, were $12.3 million and $12.5 million, respectively. The payments for the three months ended September 30, 2004 and 2003 and the nine months ended September 30, 2004 were included in interest expense in the consolidated statement of operations in accordance with FIN 46. The payments made for the six months ended June 30, 2003 were classified as rent expense and included in cost of revenue and operating expenses, in accordance with SFAS No. 13.

The agreements for the facilities described above require that the Company maintain specified financial covenants, all of which the Company was in compliance with as of September 30, 2004. The specified financial covenants as of September 30, 2004 require the Company to maintain a minimum rolling four quarters earning before interest, taxes, depreciation and amortization (EBITDA) of $500.0 million, a minimum ratio of cash and cash equivalents and accounts receivable to current liabilities plus the debt consolidated under the build-to-suit lease agreements of 1.2 to 1, and a leverage ratio of total funded indebtedness to rolling four quarter EBITDA of not more than 2 to 1. For purposes of these financial covenants, EBITDA represents the Company s net income for the applicable period, plus interest expense, taxes, depreciation and amortization and all non-cash restructuring charges, less software development expenses classified as capital expenditures. In order to secure the obligation under each agreement, each of the facilities is subject to a deed of trust in favor of the financial institutions that financed the development and acquisition of the respective facility. Bank of America, N.A. was the agent for the syndicate of banks that funded the development of the Mountain View, California and Roseville, Minnesota facilities, and ABN AMRO Bank, N.V. was the agent for the syndicate of banks that funded the development of the Milpitas, California facility.

11. Common Stock

In July 2004, the Company s board of directors authorized a program by which the Company may repurchase up to $500.0 million of the Company s common stock over a 12 to 18 month period. In the third quarter of 2004, the Company repurchased 5.4 million shares of common stock for an aggregate purchase price of $94.3 million, of which $23.4 million was payable to the Company s agent as of September 30, 2004. Between October 1 and October 31, 2004, the Company repurchased an additional 7.6 million shares of common stock for an aggregate purchase price of $155.7 million.

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Comprehensive Income

The following are the components of comprehensive income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(In thousands)			
Net income	$ 96,199	$68,118	$282,717	$156,856
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	3,393	1,556	1,288	16,196
Derivative financial instrument adjustments	1,298	1,126	4,641	878
Unrealized gain (loss) on marketable securities	5,390	(884)	(4,525)	(999)
Comprehensive income	$106,280	$69,916	$284,121	$172,931

The components of accumulated other comprehensive income are:

	September 30, 2004	December 31, 2003
	(In thousands)	
Foreign currency translation adjustments	$14,744	$13,456
Derivative financial instrument adjustments	(3,141)	(7,782)
Unrealized gain (loss) on marketable securities	(4,027)	498
Accumulated other comprehensive income	$ 7,576	$ 6,172

13. Derivative Financial Instruments

In September 2000, the Company entered into a three-year cross currency cash flow hedge against foreign exchange fluctuations on foreign currency denominated cash flows under an intercompany loan receivable. Under the terms of this derivative financial instrument, Euro denominated fixed principal and interest payments to be received under the intercompany loan were swapped for U.S. dollar-fixed principal and interest payments. In September 2003, the intercompany loan was paid in full and the derivative financial instrument was settled.

In January 2002, the Company entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging cash flows on variable interest rate debt related to Mountain View, California and Roseville, Minnesota build-to-suit lease agreements. Under the terms of these interest rate swaps, the Company makes payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR. The Company s payments on its build-to-suit lease agreements are based upon a 3-month LIBOR plus a credit spread. If critical terms of the interest rate swap or the hedged item do not change, the interest rate swap will be considered to be highly effective with all changes in the fair value included in other comprehensive income. If critical terms of the interest rate swap or the hedged item change, the hedge may become partially or fully ineffective, which could result in all or a portion of the changes in fair value of the derivative recorded in the statement of

operations. The interest rate swaps settle the first day of January, April, July and October until expiration. As of September 30, 2004, the fair value of the interest rate swaps was $(3.1) million and was recorded in other long-term liabilities. As a result of entering into the interest rate swaps, the Company has mitigated its exposure to variable cash flows associated with interest rate fluctuations. Because the rental payments on the leases are based on the 3-month LIBOR and the Company receives 3-month LIBOR from the interest rate swap counter-party, the Company has eliminated any impact to raising interest rates related to its rent payments under the build-to-suit lease agreements. On July 1, 2003, the Company began accounting for its variable interest rate debt in accordance with FIN 46 (see Note 10). In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* the Company had designated the interest rate swap as a cash flow hedge of the variability embedded in the rent expense as it

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

was based on a 3-month LIBOR. However, with the adoption of FIN 46, the Company redesignated the interest rate swap as a cash flow hedge of variability in interest expense and it remains highly effective with all changes in the fair value included in other comprehensive income.

As of September 30, 2004, the total gross notional amount of the Company s forward contracts was approximately $132.5 million, all hedging intercompany accounts of certain of its international subsidiaries. The forward contracts had terms of 31 days or less and settled on October 29, 2004. All foreign currency transactions and all outstanding forward contracts are marked-to-market at the end of the period with unrealized gains and losses included in other income. The unrealized gain (loss) and fair market value of the outstanding forward contracts at September 30, 2004 were not material to the Company s consolidated financial statements.

14. Segment Information

The Company operates in one segment, storage and infrastructure software solutions. The Company s products and services are sold throughout the world, both directly to end-users and through a variety of indirect sales channels. The Company s chief operating decision maker, the chief executive officer, evaluates the performance of the Company based upon stand-alone revenue from product channels and the geographic regions of the segment and does not receive discrete financial information about asset allocation, expense allocation or profitability related to the Company s specific product categories or services.

Geographic Information

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(In thousands)			
User license fees(1):				
United States	$152,789	$166,346	$ 468,050	$ 476,614
Europe(2)	92,384	78,268	271,628	204,556
Other(3)	42,179	37,200	119,999	100,900
Total user license fees	287,352	281,814	859,677	782,070
Services(1):				
United States	139,106	118,487	410,851	332,142
Europe(2)	49,381	31,224	141,214	90,417
Other(3)	20,819	15,100	55,697	40,500
Total services	209,306	164,811	607,762	463,059
Total net revenue	$496,658	$446,625	$1,467,439	$1,245,129

	September 30, 2004	December 31, 2003
	(In thousands)	
Long-lived assets(4):		
United States	$1,997,417	$1,902,181

Europe(2)	701,690	483,315
Other(3)	11,822	13,723
Total	2,710,929	2,399,219
Other assets, including current	2,940,477	2,949,247
Total consolidated assets	$5,651,406	$5,348,466

(1) License and services revenues are attributed to geographic regions based on location of customers.

(2) Europe includes the Middle East and Africa.

(3) Other includes Canada, Latin America, Japan and the Asia Pacific region.

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Long-lived assets include all long-term assets except those specifically excluded under SFAS No. 131, such as deferred income taxes.

For the three and nine months ended September 30, 2004 and for the three months ended September 30, 2003, no customer represented 10% or more of the Company s net revenue. For the nine months ended September 30, 2003, a distributor that sells the Company s products and services through resellers, accounted for 10% of the Company s net revenue.

User License Fees Information

The Company markets and distributes its software products both as stand-alone software products and as integrated product suites, also referenced as application solutions. The Company derives its user license fees from the licensing of its technology, segregated into three product areas: Data Protection, which include its NetBackup and Backup Exec product families; Storage Management, which includes its Storage Foundation Suites, which includes File Systems, Volume Manager, replication, Database Editions and storage resource management product families; and Utility Computing Infrastructure, which includes its clustering, high-availability offerings, application performance management, OpForce and CommandCentral Service product families. User license fees by product area were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(In millions)			
User license fees:				
Data protection	$161.0	$154.0	$474.1	$440.5
Storage management	64.4	69.1	222.6	194.4
Utility computing infrastructure	62.0	58.7	163.0	147.2
Total user license fees	$287.4	$281.8	$859.7	$782.1

15. Credit Facility

During 2002, the Company s Japanese subsidiary entered into a short-term credit facility with a multinational Japanese bank in the amount of 1.0 billion Japanese yen ($9.0 million USD). At September 30, 2004, no amount was outstanding. The short-term credit facility was renewed in March 2004 and is due to expire in March 2005. Borrowings under the short-term credit facility bear interest at Tokyo Inter Bank Offered Rate plus 0.5%. There are no covenants on the short-term credit facility and the loan has been guaranteed by VERITAS Software Global LLC, a wholly-owned subsidiary of the Company.

16. Commitments and Contingencies

Acquired Technology

On October 1, 2002, the Company acquired volume replicator software technology for $6.0 million and contingent payments of up to another $6.0 million based on future revenues generated by the acquired technology. The contingent payments will be paid quarterly over 40 quarters, in amounts between $150,000 and $300,000. The Company issued a promissory note payable in the principal amount of $5.0 million, representing the present value of the Company s minimum payment obligations under the purchase agreement for the acquired technology, which are payable quarterly commencing in the first quarter of 2003 and ending in the fourth quarter of 2012. The contingent payments in excess of the quarterly minimum obligations will be paid as they may become due. The outstanding balance of the note payable was $4.3 million as of September 30, 2004 and $4.6 million as of December 31, 2003 and is included in other long-term liabilities.

SEC Related Matters

SEC Investigation. As previously disclosed, since the third quarter of 2002, the Company has received subpoenas issued by the Securities Exchange Commission in the investigation entitled *In the Matter of AOL/ Time Warner.* The SEC has requested information concerning the facts and circumstances surrounding the Company s transactions with AOL Time Warner (AOL) and related accounting and disclosure matters.

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s transactions with AOL, entered into in September 2000, involved a software and services purchase by AOL at a stated value of $50.0 million and the purchase by the Company of advertising services from AOL at a stated value of $20.0 million. In March 2003, the Company restated its financial statements for 2001 and 2000 to reflect a reduction in revenues and expenses of $20.0 million. The restatement included an additional reduction in revenues and expenses of $1.0 million related to two other contemporaneous transactions with other parties entered into in 2000 that involved software licenses and the purchase of on-line advertising services.

In March 2004, the Company announced its intention to restate its financial statements for 2002 and 2001 and revise its previously announced financial results for 2003. The decision resulted from the findings of an investigation into past accounting practices that concluded on March 12, 2004. The investigation resulted from concerns raised by an employee in late 2003, which led to a detailed review of the matter in accordance with the Company s corporate governance processes, including the reporting of the matter to the audit committee of the Company s board of directors, and to KPMG LLP, the Company s independent registered public accounting firm. The audit committee retained independent counsel to investigate issues relating to these past accounting practices, and the audit committee s counsel retained independent accountants to assist with the investigation. In the first quarter of 2004, the Company voluntarily disclosed to the staff of the SEC past accounting practices applicable to its 2002 and 2001 financial statements that were not in compliance with GAAP. For more information regarding the audit committee s investigation and the restatement of the Company s financial statements for 2002 and 2001, including the corresponding interim periods for 2002 and 2001 and the interim periods ended March, June and September 2003, see Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Financial Statements and Supplementary Data Selected Quarterly Results of Operations, Controls and Procedures and Note 2 of the Notes to Consolidated Financial Statements of the Company s annual report on Form 10-K for the year ended December 31, 2003.

The Company and its audit committee continue to cooperate with the SEC in its review of these matters. At this time, the Company cannot predict the outcome of the SEC s review.

Litigation

After the Company announced in January 2003 that it would restate its financial results as a result of transactions entered into with AOL in September 2000, numerous separate complaints purporting to be class actions were filed in the United States District Court for the Northern District of California alleging that the Company and some of its officers and directors violated provisions of the Securities Exchange Act of 1934. The complaints contain varying allegations, including that the Company made materially false and misleading statements with respect to its 2000, 2001 and 2002 financial results included in its filings with the SEC, press releases and other public disclosures. On May 2, 2003, a lead plaintiff and lead counsel were appointed. A consolidated complaint entitled *In Re VERITAS Software Corporation Securities Litigation* was filed by the lead plaintiff on July 18, 2003. On December 10, 2003, the District Court granted the defendants motion to dismiss the consolidated complaint, with leave to amend. On May 19, 2004, the District Court granted the defendants motion to dismiss the plaintiffs first amended complaint, with leave to amend. On June 30, 2004, a second amended complaint was filed with the Court in this matter and defendants have filed a motion to dismiss the second amended complaint. The second amended complaint seeks an unspecified amount of damages.

In addition, in 2003 several complaints purporting to be derivative actions were filed in California state court against some of the Company s directors and officers. These complaints are generally based on the same facts and circumstances alleged in *In Re VERITAS Software Corporation Securities Litigation*, referenced above, and allege that the named directors and officers breached their fiduciary duties by failing to oversee adequately the Company s financial reporting. The state court complaints have been consolidated into the action *In Re VERITAS Software Corporation Derivative Litigation*, which was filed on May 8, 2003 in the Superior Court of Santa Clara County. The consolidated complaint seeks an unspecified amount of damages.

Table of Contents

VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On August 2, 2004, the Company received a copy of an amended complaint in *Stichting Pensioenfonds ABP v. AOL Time Warner, et. al.* in which the Company was named as a defendant. The case was originally filed in the U.S. District Court for the Southern District of New York in July 2003 against Time Warner (formerly, AOL Time Warner), current and former officers and directors of Time Warner and AOL, and Time Warner s outside auditor, Ernst & Young LLP. In adding the Company as a defendant, the plaintiff alleges that the Company aided and abetted AOL in alleged common law fraud and also alleges that the Company itself engaged in common law fraud as part of a civil conspiracy. The allegations against the Company are based on the factual allegations in the second amended consolidated class action complaint and other filings in the matter entitled *In Re VERITAS Software Corporation Securities Litigation,* referenced above. The plaintiff seeks an unspecified amount of compensatory and punitive damages.

On July 7, 2004, a purported class action complaint entitled *Paul Kuck, et al. v. VERITAS Software Corporation, et al.* was filed in the United States District Court for the District of Delaware. The lawsuit alleges violations of federal securities laws in connection with the Company s announcement on July 6, 2004 that it expected its results of operations for the fiscal quarter ended June 30, 2004 to fall below estimates that were earlier provided by the Company. The complaint generally seeks an unspecified amount of damages. Subsequently, additional purported class action complaints have been filed in Delaware federal court against the same defendants named in the Kuck lawsuit. These complaints are based on the same facts and circumstances as the Kuck lawsuit.

The foregoing cases are still in the preliminary stages, and it is not possible for the Company to quantify the extent of its potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on the Company s business, financial condition, results of operations and cash flow. In addition, defending any litigation may be costly and divert management s attention from the day-to-day operations of the Company s business.

In addition to the legal proceedings listed above, the Company is also party to various other legal proceedings that have arisen in the ordinary course of its business. While the Company currently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not have a material adverse effect on its financial position or overall trends in results of operations, litigation is subject to inherent uncertainties. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on the Company s results of operations and cash flows for the period in which the ruling occurs. The estimate of the potential impact on the Company s financial position or overall results of operations for the above discussed legal proceedings could change in the future.

Table of Contents

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

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Securities Exchange Act of 1934 and the Securities Act of 1933 that involve risks and uncertainties. These forward-looking statements include statements about our revenue, revenue mix, gross margin, operating expense levels, financial outlook, commitments under existing leases, research and development initiatives, sales and marketing initiatives and competition. In some cases, forward-looking statements are identified by words such as believe, anticipate, expect, intend, plan, will, may and similar expressions. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this quarterly report on Form 10-Q. All of these forward-looking statements are based on information available to us at this time, and we assume no obligation to update any of these statements. Actual results could differ from those projected in these forward-looking statements as a result of many factors, including those identified in the section captioned Factors That May Affect Future Results below, and elsewhere in this quarterly report. We urge you to review and consider the various disclosures made by us in this report, and those detailed from time to time in our filings with the Securities and Exchange Commission, that attempt to advise you of the risks and factors that may affect our future results.

The following discussion should be read in conjunction with our financial statements and accompanying notes, which appear elsewhere in this quarterly report on Form 10-Q. Unless expressly stated or the context otherwise requires, the terms we , our , us and VERITAS refer to VERITAS Software Corporation and its subsidiaries.

Overview

The following Management s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, is intended to help the reader understand our company. MD&A is provided as a supplement to and should be read in conjunction with our condensed consolidated financial statements and the accompanying notes.

Our Business

VERITAS Software Corporation is a leading independent supplier of storage and infrastructure software products and services. Our software products operate across a variety of computing environments, from PCs and workgroup servers to enterprise servers and networking platforms in corporate data centers. Our products protect, archive and recover business-critical data, provide high levels of application availability, enhance and tune system and application performance and enable recovery from disasters. Our solutions enable businesses to reduce costs by efficiently and effectively managing their information technology, or IT, infrastructure as they seek to maximize value from their IT investments.

We generate revenues, income and cash flows by licensing software products and selling related services to our customers, which include many leading global corporations and small and medium-sized enterprises around the world operating in a wide variety of industries. We market our products and related services both directly and through a variety of indirect sales channels, which include value added resellers, or VARs, distributors, system integrators, or SIs, and original equipment manufacturers, or OEMs. Specifically, the channel mix for the three and nine months ended September 30, 2004 was 54% and 56%, respectively, from sales to end-users and through VARs, and 46% and 44%, respectively, from other indirect sales channels, which includes 12% from our OEM partners.

We invest significantly in research and development activities and for the three and nine months ended September 30, 2004, we spent $87.2 million and $250.7 million, respectively, on research and development. Our research and development efforts have been directed toward developing new products for UNIX, Linux and Windows, developing new features and functionality for existing products, integrating products across our existing product lines, porting new and existing products to different operating systems and expanding our product portfolio into new markets such as application performance management, server provisioning and centralized service level management.

Table of Contents

Our Strategy

Our strategy is to continue to compete in our current markets while expanding and integrating our product portfolio in the area of utility computing infrastructure, to continue to expand our product offering across key operating system platforms, including UNIX, Linux and Windows, and to continue to invest for growth in international markets.

We expect to continue to grow the company organically and through acquisitions. In January 2004, we completed the acquisition of Ejasent, Inc., or Ejasent, which added application migration technology to our utility computing infrastructure. In addition, in July 2004, we completed the acquisition of Invio Software, Inc., or Invio, which added IT process automation technology to our utility computing infrastructure portfolio. Then in September 2004, we completed the acquisition of KVault Software Limited, or KVS, which added e-mail archiving software to our Data Protection product line. Consistent with our strategy of growing revenue both organically and through acquisition, we will continue to evaluate new strategic acquisitions in the future.

Our revenue from international sales continues to increase primarily as a result of our increased investment in our international geographies, market strength in the emerging market areas in Europe and Asia and a favorable impact of changes in foreign currency exchange rates related to the weaker U.S. dollar. For the three and nine months ended September 30, 2004, revenue from international sales, consisting of sales of licenses and services to customers located outside the U.S., increased 27% and 35% from the three and nine months ended September, 2003, respectively, and represented 41% and 40% of our total revenue for the three and nine months ended September 30, 2004, respectively.

Our Financial Position

In the third quarter of 2004, our operating results were affected by several factors, including a challenging IT spending environment and a decrease in demand by the U.S. federal government offset by the growing need of enterprises to effectively manage storage and computing infrastructure, the strength of our product offerings and the contribution of our recent acquisitions. For the nine months ended September 30, 2004, we experienced stronger IT spending in our customer base internationally, resulting in stronger demand for our products and growth in our user license fees compared to the same period last year. In the U.S., our license revenue decreased 2% for the nine months ended September 30, 2004 over 2003, primarily due to a decrease in our government business. The acquisition of Precise and the integration of the acquired products into our product offerings contributed to our overall growth, as did our increased sales penetration in international markets and the favorable impact of changes in foreign currency exchange rates. Additionally, our services revenue grew significantly over last year due to new service contracts associated with user license fees as well as our success in increasing support contract renewals within our customer base.

For the three months ended September 30, 2004, total revenue from sales in the U.S., consisting of sales of licenses and services to customers located in the U.S., increased 2% from the three months ended September 30, 2003. License revenue decreased by 8% from $166.3 million for the three months ended September 30, 2003 to $152.8 million for the three months ended September 30, 2004 reflecting the decrease in our government business. U.S. services revenue increased by 17% from $118.5 million for the three months ended September 30, 2003 to $139.1 million for the three months ended September 30, 2004 primarily as a result of strong maintenance renewal rates.

For the nine months ended September 30, 2004, total revenue from sales in the U.S. increased 9% from the nine months ended September 30, 2003 and represented approximately 60% of our total revenue for the nine months ended September 30, 2004 compared to 65% for the same period in 2003.

For the three and nine months ended September 30, 2004, net revenue was $496.7 million and $1,467.4 million, respectively, an increase of 11% and 18%, respectively, from the three and nine months ended September 30, 2003. Revenue from user license fees for the three and nine months ended September 30, 2004 was $287.4 million and $859.7 million, respectively, an increase of 2% and 10%, respectively, from 2003, and representing 58% and 59% of total net revenue, respectively. Services revenue for the three and nine months ended September 30, 2004 was $209.3 million and $607.8 million, respectively, an increase of

Table of Contents

27% and 31% from 2003, and representing 42% and 41% of total net revenue, respectively. Diluted net income per share for the three months ended September 30, 2004 was $0.22, up from $0.15 for the three months ended September 30, 2003, primarily as a result of earnings leverage from revenue growth, the restructuring reversal in the third quarter of 2004, the loss on extinguishment of debt in the third quarter of 2003 and the cumulative effect of change in accounting principle in the third quarter of 2003 offset by the write-off of in-process research and development in the third quarter of 2004 in connection with the acquisition of KVS. Diluted net income per share for the nine months ended September 30, 2004 was $0.64, up from $0.36 for the nine months ended September 30, 2003, primarily as a result of earnings leverage from revenue growth, the restructuring reversal in 2004, gains on strategic investments in 2004, the loss on extinguishment of debt in 2003, the cumulative effect of change in accounting principle in 2003 and a reduction in acquisition-related expenses, such as amortization of intangibles and in-process research and development in 2004.

We continue to generate cash from operations and to retain a significant balance of cash and short-term investments. As of September 30, 2004, we had $2,539.2 million in cash, cash equivalents and short-term investments, which represented 72% of our tangible assets. We generated $427.5 million of cash from operating activities for the nine months ended September 30, 2004. We utilize cash in ways that management believes will provide an optimal return on investment. Principal uses of our cash include acquisitions of businesses and technologies, repurchases of our common stock and purchases of property and equipment.

Recent Acquisitions

In September 2004, we acquired all of the outstanding capital stock of KVS, a provider of e-mail archiving products. We acquired KVS in order to expand our product offerings in the storage software market to include products to store, manage, backup and archive corporate e-mail and data. The KVS acquisition included total purchase consideration of $249.6 million. We have included the results of operations of KVS in our consolidated financial statements beginning September 21, 2004. In connection with the acquisition of KVS, we allocated approximately $11.5 million of the purchase price to in-process research and development, or IPR&D, that had not yet reached technological feasibility and had no alternative future use. We have expensed this amount in our condensed consolidated statement of operations for the three months ended September 30, 2004.

In July 2004, we acquired all of the outstanding capital stock of Invio, a privately held supplier of IT process automation technology. We acquired Invio to extend the capability of software products that enable utility computing by offering customers a tool for standardizing and automating IT service delivery in key areas such as storage provisioning, server provisioning and data protection. The Invio acquisition included purchase consideration of approximately $35.4 million. We have included the results of operations of Invio in our condensed consolidated financial statements beginning July 14, 2004.

In January 2004, we acquired Ejasent, a privately held provider of application virtualization technology for utility computing. We acquired Ejasent to add important application migration technology, which allows IT personnel to move an application from one server to another without disrupting or terminating the application. The Ejasent acquisition included total purchase consideration of $61.4 million. We have included the results of operations of Ejasent in our consolidated financial statements beginning January 20, 2004. In connection with the acquisition of Ejasent, we allocated approximately $0.4 million of the purchase price to IPR&D that had not yet reached technological feasibility and had no alternative future use. We have expensed this amount in our condensed consolidated statement of operations for the nine months ended September 30, 2004.

In June 2003, we acquired Precise Software Solutions Ltd., or Precise, a provider of application performance management products. We acquired Precise to expand our product and service offerings across storage, databases and application performance management. The Precise acquisition included total purchase consideration of $714.7 million. We have included the results of operations of Precise in our consolidated financial statements beginning July 1, 2003. In connection with the acquisition of Precise, we allocated approximately $15.3 million of the purchase price to IPR&D that had not yet reached technological feasibility

Table of Contents

and had no alternative future use. We have expensed this amount in our condensed consolidated statement of operations for the nine months ended September 30, 2003.

In January 2003, we acquired Jareva Technologies, Inc., or Jareva, a privately held provider of automated server provisioning products that enable businesses to automatically deploy additional servers without manual intervention. We acquired Jareva to integrate its technology into our software products. This technology enables our customers to optimize their investments in server hardware by deploying new server resources on demand. The Jareva acquisition included total purchase consideration of $68.7 million. We have expensed the acquired IPR&D of $4.1 million in our condensed consolidated statement of operations for the nine months ended September 30, 2003.

Critical Accounting Policies and Estimates

We believe that there are several accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amounts of revenue and other significant areas that involve management s judgments and estimates. These critical accounting policies and estimates include:

revenue recognition;

restructuring expenses and related accruals;

impairment of long-lived assets; and

accounting for income taxes.

These policies and estimates and our procedures related to these policies and estimates are described in detail below and under specific areas within the discussion and analysis of our financial condition and results of operations. Please refer to the Notes to Consolidated Financial Statements in our annual report on Form 10-K for the year ended December 31, 2003 for further discussion of our accounting policies and estimates.

Revenue Recognition

We make significant judgments related to revenue recognition. For each arrangement, we make significant judgments regarding the fair value of multiple elements contained in our arrangements, judgments regarding whether our fees are fixed or determinable and judgments regarding whether collectibility is probable. We also make significant judgments when accounting for concurrent transactions with our suppliers and in our accounting for potential product returns and, in some cases, we also have discretion over the timing of product shipments. These decisions, and their effect on revenue recognition, are discussed below.

Multiple Element Arrangements

We typically enter into arrangements with customers that include perpetual software licenses, maintenance and technical support. Some arrangements may also include consulting and education services. Software licenses are sold as site licenses or on a per copy basis. Site licenses give customers the right to copy licensed software on either a limited or unlimited basis during a specified term. Per copy licenses give customers the right to use a single copy of licensed software. We make judgments regarding the fair value of each element in the arrangement and generally account for each element separately.

Assuming all other revenue recognition criteria are met, license revenue is recognized upon delivery using the residual method in accordance with Statement of Position, or SOP, No. 98-9, *Modification of SOP No. 97-2, Software Revenue Recognition, with Respect to Certain Transactions.* Under the residual method, we allocate and defer revenue for the undelivered elements based on vendor-specific objective evidence, or VSOE, of fair value, and recognize the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. Undelivered elements typically include maintenance and technical support, consulting and education services. The determination of fair value of each undelivered element in multiple element arrangements is based on the price charged when the same element is sold separately. If sufficient evidence of fair value cannot be determined for any undelivered item, all revenue from the arrangement will be deferred until VSOE of fair value can be established or until all elements of the

Table of Contents

arrangement have been delivered. If the only undelivered element is maintenance and technical support for which we cannot establish VSOE, we will recognize the entire arrangement fees ratably over the maintenance and support term.

Our VSOE of fair value for maintenance and technical support is based upon stated renewal rates for site licenses and historical renewal rates for per copy licenses. Maintenance and technical support revenue is recognized ratably over the maintenance term. Our VSOE of fair value for education services is based upon the price charged when sold separately. Revenue is recognized when the customer has completed the course. For annual education passes, revenue is recognized ratably over the one-year term. Our VSOE of fair value for consulting is based upon the price charged when sold separately. Consulting revenue is recognized as work is performed when reasonably dependable estimates can be made of the extent of progress toward completion, contract revenue and contract costs. Otherwise, consulting revenue is recognized when the services are complete.

The Fee is Fixed or Determinable

We make judgments, at the outset of an arrangement, regarding whether the fees are fixed or determinable. Our customary payment terms are generally within 30 days after invoice date. Arrangements with payment terms extending beyond 90 days after invoice date are not considered to be fixed or determinable, in which case revenue is recognized as the fees become due and payable.

Collection is Probable

We also make judgments at the outset of an arrangement regarding whether collection is probable. Probability of collection is assessed on a customer-by-customer basis. We typically sell to customers with whom we have a history of successful collections. New customers are subjected to a credit review process to evaluate the customer s financial position and ability to pay. If it is determined at the outset of an arrangement that collection is not probable, revenue is recognized upon receipt of payment.

Indirect Channel Sales

We generally recognize revenue from licensing of software products through our indirect sales channel upon sell-through or when evidence of an end-user exists. For certain types of customers, such as distributors, we recognize revenue upon receipt of a point of sales report, which is our evidence that the products have been sold through to an end-user. For resellers, we recognize revenue when we obtain evidence that an end-user exists, which is usually when the software is delivered. For licensing of our software to original equipment manufacturers, or OEMs, royalty revenue is recognized when the OEM reports the sale of software to an end-user customer, generally on a quarterly basis. In addition to license royalties, some OEMs pay an annual flat fee and/or support royalties for the right to sell maintenance and technical support to the end-user. We recognize revenue from OEM support royalties and fees ratably over the term of the support agreement.

Transactions with our Suppliers

Some of our customers are also our suppliers. Occasionally, in the normal course of business, we purchase goods or services for our operations from these suppliers at or about the same time we license our software to them. We also have multi-year agreements under which we receive sub-licensing royalty payments from OEMs from whom we may also purchase goods or services. We identify and review significant transactions to confirm that they are separately negotiated, settled in cash, and recorded at terms we consider to be arm s length. In addition, the goods or services have generally been budgeted in advance of the transaction, are necessary for our current operations and are expected to be placed in service shortly after purchase. In cases where the transactions are not separately negotiated, we apply the provisions of Accounting Principles Board, or APB, Opinion No. 29, *Accounting for Nonmonetary Transactions,* and Emerging Issues Task Force Issue, or EITF, No. 01-02, *Interpretations of APB Opinion 29.* If the fair values are reasonably determinable, revenue is recorded at the fair values of the products delivered or products or services received, whichever is more readily determinable. If we can not determine fair value of either of the goods or services involved within

Table of Contents

reasonable limits, we record the transaction on a net basis. License revenue associated with software licenses entered into with our suppliers at or about the same time we purchase goods or services from them is not material to our consolidated financial statements.

Product Returns

We estimate potential future product returns based on our analysis of historical return rates and reduce current period product revenue accordingly. Actual returns may vary from estimates if we experience a change from historical sales and returns patterns or if there are unanticipated changes in competitive or economic conditions that affect our actual returns.

Delivery of Software Products

Delivery of our software products is a prerequisite to the recognition of software license revenue. We consider delivery complete when the software products have been shipped and the customer has access to license keys. If arrangements include an acceptance provision, we defer revenue and recognize it upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.

Restructuring Expenses and Related Accruals

We monitor and regularly evaluate our organizational structure and associated operating expenses. Depending on events and circumstances, we may decide to restructure our operations to reduce operating costs.

We applied the provisions of EITF Issue No. 94-3, *Liability Recognized for Certain Employee Termination Benefits and other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)*, to all of our restructuring activities initiated before January 1, 2003. For exit or disposal activities initiated on or after January 1, 2003, we apply the provisions of Statement of Financial Accounting Standards, or SFAS, No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.*

Our restructuring costs and any resulting accruals involve significant estimates made by management using the best information available at the time the estimates are made, some of which may be provided by third parties. These estimates include facility exit costs, such as lease termination costs, and amount and timing of sublease income and related sublease expense costs, such as brokerage fees.

We regularly evaluate a number of factors to determine the appropriateness and reasonableness of our restructuring accruals. These factors include, but are not limited to, our ability to enter into sublease or lease termination agreements and market data about lease rates, timing and term of potential subleases and costs associated with terminating certain leases on vacated facilities.

Our estimates involve a number of risks and uncertainties, some of which are beyond our control, including future real estate market conditions and our ability to successfully enter into subleases or lease termination agreements upon terms as favorable as those assumed under our restructuring plan. Actual results may differ significantly from our estimates and may require adjustments to our restructuring accruals and operating results in future periods. For example, if the actual proceeds from our sublease agreements were to differ by 10% from the estimate we included in our facility restructuring plan, the facility restructuring charge recorded in operating expenses during the fourth quarter of 2002 would have been different by approximately $6 million.

Impairment of Long-Lived Assets

We review our goodwill for impairment annually or whenever events or changes in circumstances suggest that the carrying amount may not be recoverable. We are required to test our goodwill for impairment at the

Table of Contents

reporting unit level. We have determined that we have only one reporting unit. The test for goodwill impairment is a two-step process:

Step 1- We compare the carrying amount of our reporting unit, which is the book value of our entire company, to the fair value of our reporting unit, which corresponds to our market capitalization. If the carrying amount of our reporting unit exceeds its fair value, we have to perform the second step of the process. If not, no further work is required.

Step 2- We compare the implied fair value of our reporting unit s goodwill to its carrying amount. If the carrying amount of our reporting unit s goodwill exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess.

We completed this test during the fourth quarter of 2003 and were not required to record an impairment loss on goodwill.

We review our long-lived assets, including property and equipment and other intangibles, for impairment whenever events indicate that their carrying amount may not be recoverable. When we determine that one or more impairment indicators are present for an asset, we compare the carrying amount of the asset to net future undiscounted cash flows that the asset is expected to generate. If the carrying amount of the asset is greater than the net future undiscounted cash flows that the asset is expected to generate, we would compare the fair value to the book value of the asset. If the fair value is less than the book value, we would recognize an impairment loss. The impairment loss would be the excess of the carrying amount of the asset over its fair value.

Some of the events that we consider as impairment indicators for our long-lived assets, including goodwill, are:

significant underperformance of our company relative to expected operating results;

our net book value compared to our market capitalization;

significant adverse economic and industry trends;

significant decrease in the market value of the asset;

the extent to which we use an asset or changes in the manner in which we use it; and

significant changes to the asset since we acquired it.

Significant assumptions and estimates are made when determining if our goodwill or other long-lived assets have been impaired or if there are indicators of impairment. We base our estimates on assumptions that we believe to be reasonable, but actual future results may differ from those estimates as our assumptions are inherently unpredictable and uncertain. Our estimates include estimates of future market growth and trends, forecasted revenue and costs, expected periods of asset utilization, appropriate discount rates and other variables. Based on our assumptions and estimates, we do not expect to record an impairment loss on our long-lived assets in the near future.

Accounting for Income Taxes

We are required to estimate our income taxes in each federal, state and international jurisdiction in which we operate. This process requires that we estimate the current tax exposure as well as assess temporary differences between the accounting and tax treatment of assets and liabilities, including items such as accruals and allowances not currently deductible for tax purposes. The income tax effects of the differences we identify are classified as current or long-term deferred tax assets and liabilities in our consolidated balance sheets. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax laws or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our balance sheet and results of operations. We must also assess the likelihood that deferred tax assets

Table of Contents

will be realized from future taxable income and, based on this assessment, establish a valuation allowance, if required. As of September 30, 2004, we determined the valuation allowance to be $138.4 million based upon uncertainties related to our ability to recover certain deferred tax assets. These deferred tax assets are in specific geographical or jurisdictional locations or are related to losses on strategic investments that will only be realized with the generation of future capital gains within a limited time period. Our determination of our valuation allowance is based upon a number of assumptions, judgments and estimates, including forecasted earnings, future taxable income and the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. Future results may vary from these estimates, and at this time it is not practicable to determine if we will need to establish an additional valuation allowance and if it would have a material impact on our financial statements.

Results of Operations

Net Revenue

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Total net revenue	$496.7	$446.6	11%	$1,467.4	$1,245.1	18%

For the three and nine months ended September 30, 2004, our total net revenue increased by $50.1 million or 11% and $222.3 million or 18%, respectively, compared to the same periods in 2003 due primarily to the growth in user license fees, which grew by 2% and 10%, increased sales penetration of international markets which grew by 27% and 35% and the continued growth of our services businesses which grew by 27% and 31%, respectively. During 2003 and 2004, as part of our strategy to increase our net revenues, we continued expanding our product portfolio and offerings, increased the computer platforms supported by our software and continued to invest in sales and service capacity internationally. Net revenue increased by $11.6 million from the second to third quarter of 2004 primarily due to the growth in user license fees in all geographic areas. We expect net revenue to increase in the fourth quarter of 2004, consistent with historical seasonality and continued penetration of international markets, the benefit of new product offerings, growth in services revenue, the impact of our recent acquisitions and improved general economic conditions resulting in stronger IT spending.

For the three months ended September 30, 2004, we completed and recognized revenue for 11 direct transactions valued at over $1.0 million, including related services, and 231 direct transactions valued at over $100,000. For the three months ended September 30, 2003, we completed and recognized revenue for 15 direct transactions valued at over $1.0 million, including related services, and 239 direct transactions valued at over $100,000.

International Sales and Operations

We believe that a key component of our growth strategy is the continued expansion of our international operations. We currently have sales and services offices and resellers located in Europe, Asia-Pacific and Japan, Latin America, Canada, Africa and the Middle East, and research and development centers in India, the United Kingdom, Israel, China and Japan. Our international sales consist of sales of licenses and services to customer locations outside the U.S. and are generated primarily through our international sales subsidiaries. International revenue, a majority of which is collectible in foreign currencies, accounted for approximately 41% and 36% of our total revenue for the three months ended September 30, 2004 and 2003, respectively, and 40% and 35% for the nine months ended September 30, 2004 and 2003, respectively. Our international revenue increased 27% to $204.8 million and 35% to $588.5 million for the three and nine months ended September 30, 2004 over 2003. During 2003 and through the third quarter of 2004, we saw continued strength in the emerging markets in Europe, Asia-Pacific and Japan. Additionally, during 2004, our international sales benefited from favorable foreign currency exchange rate movements relative to the weaker U.S. dollar. Excluding the benefit from foreign currency movement, the increase in international sales would have been 21% from the three months ended September 30, 2003 to 2004 and 27% from the nine months ended

Table of Contents

September 30, 2003 to 2004. We expect that our international revenue will increase in absolute dollars and as a percent of total revenue for the remainder of 2004 because of the continued expansion of international markets and the focus and increased investment by our company in these markets.

User License Fees

We market and distribute our software products both as standalone software products and as integrated product suites. We derive our user license fees from the licensing of our technology, segregated into three product categories: Data Protection, which includes our NetBackup and Backup Exec product families; Storage Management, which includes our Storage Foundation Suite Products, Database Editions and storage resource management product families; and Utility Computing Infrastructure, which includes our clustering, high-availability offerings, application performance management, or APM, OpForce and CommandCentral Service product families.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
User license fees:						
Data protection	$161.0	$154.0	5%	$474.1	$440.5	8%
Storage management	64.4	69.1	(7)%	222.6	194.4	15%
Utility computing infrastructure	62.0	58.7	6%	163.0	147.2	11%
Total user license fees	$287.4	$281.8	2%	$859.7	$782.1	10%
As a percentage of user license fees:						
Data protection	56%	55%		55%	56%	
Storage management	22%	24%		26%	25%	
Utility computing infrastructure	22%	21%		19%	19%	
Total user license fees	100%	100%		100%	100%	
As a percentage of net revenue	58%	63%		59%	63%	

For the three and nine months ended September 30, 2004 compared to 2003, user license fees increased by $5.6 million or 2% and $77.6 million or 10%, respectively, due to increased user license fees in Europe and other international regions of 18% and 13%, respectively, for the three months ended September 30, 2004 over 2003 and 33% and 19% for the nine months ended September 30, 2004 over 2003. These increases were offset by an 8% decrease in U.S. user license fees for the three months ended September 30, 2004 over 2003 and a 2% decrease for the nine months ended September 30, 2004 over 2003, primarily reflecting a decrease in demand by the U.S. federal government and weaker than expected license revenue in the U.S. enterprise market in the second quarter of 2004. User license fees across our Data Protection product category increased by $7.0 million and $33.6 million for the three and nine months ended September 30, 2004, respectively, over 2003 due primarily to growth in our core backup family of products, including NetBackup 5.0 which was introduced during the fourth quarter of 2003. User license fees across our Storage Management product category decreased $4.7 million for the three months ended September 30, 2004 over 2003 as a result of a smaller number of large customer transactions in the quarter and a decrease in revenue from the U.S. federal government. For the nine months ended September 30, 2004 compared to 2003, user license fees across our Storage Management product category increased $28.2 million primarily due to increases in our storage foundation suite and storage resource management products, including the introduction of Storage Foundation Suite 4.0 during the first quarter of 2004. User license fees across our Utility Computing Infrastructure product category increased by $3.3 million and $15.8 million for the three and nine months ended

Table of Contents

September 30, 2004, respectively, due primarily to increases in clustering, Database Editions/ Advanced Cluster and APM products.

User license fees from OEMs accounted for 15% and 13% of user license fees for the three and nine months ended September 30, 2004 and 12% for the three and nine months ended September 30, 2003.

Unfilled license orders were approximately $36.9 million and $47.9 million at September 30, 2004 and 2003, respectively. Unfilled license orders represent cancelable and non-cancelable license orders that have been received from our customers for the license of our software products but have not been shipped as of the end of the applicable fiscal period. We generally ship our software products within 30 days after acceptance of customer orders. In some cases, we have discretion over the timing of product shipments, which affects the timing of revenue recognition for software license orders. In those cases, we consider a number of factors, including: the effect of the related license revenue on our business plan; the delivery dates requested by customers and resellers; the amount of software license orders received in the quarter; the amount of software license orders shipped in the quarter; the degree to which software license orders received are concentrated at the end of a quarter; and our operational capacity to fulfill software license orders at the end of a quarter. We do not believe that unfilled license orders are a consistent or reliable indicator of future results.

Deferred license revenue was approximately $10.2 million and $15.7 million at September 30, 2004 and 2003, respectively. Deferred license revenue represents license orders for our software products that have been billed to and paid by our customers and for which revenue will generally be earned within the next year. Deferred license revenue excludes license orders that have not been paid by our customers and that do not otherwise satisfy our revenue recognition criteria; these license orders were approximately $29.0 million and $6.7 million at September 30, 2004 and 2003, respectively.

Services Revenue

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Services revenue	$209.3	$164.8	27%	$607.8	$463.1	31%
As a percentage of net revenue	42%	37%		41%	37%	

We derive our services revenue primarily from contracts for software maintenance and technical support and, to a lesser extent, consulting and education and training services. The increase in services revenue for the three and nine months ended September 30, 2004 over 2003 was due primarily to the increase in software maintenance and technical support revenue of 30% and 34%, respectively, as a result of a larger installed base of customers, greater focus on renewing customer support contracts, particularly internationally. We expect our services revenue to increase in absolute dollars over time as we continue to grow our installed base of customers, continue our focus on renewing our software maintenance and technical support contracts, and increase demand for our consulting and education and training services.

Deferred services revenue was approximately $408.0 million and $297.3 million at September 30, 2004 and 2003, respectively. Maintenance and technical support is generally recognized over the maintenance and support period of twelve months. Training or consulting services is generally recognized over the period the specific services are delivered. The increase in deferred services revenue is the result of significant growth in our installed base of customers under software maintenance and technical support contracts and our continued focus on maintenance and technical support contract renewals.

Table of Contents

Cost of Revenue

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Cost of revenue	$78.3	$75.5	4%	$237.2	$231.6	2%
As a percentage of net revenue	16%	17%		16%	19%	

Gross margin on user license fees, excluding amortization of developed technology, is substantially higher than gross margin on services revenue, reflecting the low materials, packaging and other costs of software products compared with the relatively high personnel costs associated with providing maintenance and technical support, consulting and education services. Cost of services varies depending upon the mix of maintenance and technical support, consulting and education services. We expect gross margin to fluctuate in the future, reflecting changes in royalty rates on licensed technologies, the mix of license and services revenue and the timing of continued investment in our services organization and the recognition of revenue that we expect as a result of those investments.

Cost of User License Fees (including amortization of developed technology)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Cost of user license fees:						
User license fees	$5.1	$11.5	(56)%	$23.5	$35.1	(33)%
Amortization of developed technology	4.4	5.0	(13)%	12.3	30.4	(60)%
Total cost of user license fees	$9.5	$16.5	(43)%	$35.8	$65.5	(45)%
Gross margin:						
User license fees including amortization of developed technology	97%	94%		96%	92%	

Cost of user license fees consists primarily of amortization of developed technology, royalties, media, manuals and distribution costs. The amortization of developed technology is related primarily to acquisitions completed during 2003 and 2004. Excluding amortization of developed technology from the cost of user license fees, the gross margin on user license fees would have been 98% and 97% for the three and nine months ended September 30, 2004, respectively, and 96% for the three and nine months ended September 30, 2003. The increase is primarily the result of lower royalty rates in 2004. The gross margin on user license fees may vary from period to period based on the license revenue mix because some of our products carry higher royalty rates than others. Excluding the amortization of developed technology, we expect gross margins on user license fees to remain relatively constant.

The decrease in amortization of developed technology for the nine months ended September 30, 2004 over 2003 was primarily the result of the developed technology related to the 1999 acquisitions reaching full amortization in the second quarter of 2003. This decrease was partially offset by the amortization of developed technology related to the Precise, Ejasent and Invio acquisitions. We expect amortization of developed technology to be approximately $7 million in the fourth quarter of 2004 for our current intangible assets, including the amortization of developed technology acquired from KVS.

32

Table of Contents

Cost of Services

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Cost of services	$68.8	$58.9	17%	$201.4	$166.1	21%
Gross margin	67%	64%		67%	64%	

Cost of services consists primarily of personnel-related costs in providing maintenance and technical support, consulting and education to customers. The gross margin improvement for the three and nine months ended September 30, 2004 over 2003 was primarily the result of the increase in maintenance and support revenues of 30% and 34% for the three and nine months ended September 30, 2004 over 2003, respectively, while related expenses increased only 12% and 19% for the three and nine months ended September 30, 2004 over 2003, respectively, as we continued to take advantage of the larger installed customer base. We expect gross margin on services revenue to be relatively flat for the remainder of 2004.

Selling and Marketing

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Selling and marketing	$153.0	$136.2	12%	$447.7	$373.3	20%
As a percentage of net revenue	31%	30%		31%	30%	

Selling and marketing expenses consist primarily of salaries, related benefits, commissions, consultant fees and other costs associated with our sales and marketing efforts. The increase for the three and nine months ended September 30, 2004 over 2003 of $16.8 million and $74.4 million, respectively, was primarily the result of an increase in sales commissions, compensation and benefit costs due to an increase in personnel partially resulting from our 2003 and 2004 acquisitions, investments in sales capacity in our international markets and higher sales commissions resulting from the increase in total net revenues. Selling and marketing expenses remained relatively consistent with the same period in 2003 when measured as a percentage of total net revenue. We expect selling and marketing expenses to continue to grow in absolute dollars, and to remain relatively constant as a percentage of total net revenues, for the remainder of 2004.

Research and Development

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Research and development	$87.2	$77.4	13%	$250.7	$219.4	14%
As a percentage of net revenue	18%	17%		17%	18%	

Research and development expenses consist primarily of salaries, related benefits, third-party consultant fees and other engineering related costs. The increase of $9.8 million and $31.3 million for the three and nine months ended September 30, 2004 over 2003, respectively, was

primarily the result of increases in compensation costs from an increase in staffing levels and an increase in outside services used to supplement engineering personnel. We believe that a significant level of research and development investment is required to remain competitive and we expect to continue to invest in research and development for the remainder of 2004 at current levels as a percentage of revenue, including continued investments in our operations in India.

Table of Contents

General and Administrative

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
General and administrative	$49.5	$39.2	26%	$143.7	$117.0	23%
As a percentage of net revenue	10%	9%		10%	9%	

General and administrative expenses consist primarily of salaries, related benefits and fees for professional services, such as legal and accounting services. The increase of $10.3 million and $26.7 million for the three and nine months ended September 30, 2004 over 2003, respectively, was primarily the result of an increase in compensation and benefit costs, costs associated with our recent restatement and compliance with our corporate governance initiatives, including those required under the Sarbanes-Oxley Act of 2002. We expect general and administrative expenses to remain relatively constant as a percentage of revenue for the remainder of 2004.

Amortization of Other Intangibles

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Amortization of other intangibles	$1.4	$2.5	(43)%	$6.2	$32.9	(81)%
As a percentage of net revenue	0%	1%		0%	3%	

Amortization of other intangibles principally represents amortization of distribution channels, trademarks and other intangibles related to acquisitions. The decrease in amortization of other intangibles for the nine months ended September 30, 2004 over 2003 was primarily due to the intangibles related to 1999 acquisitions reaching full amortization during the second quarter of 2003. The amortization of other intangibles also includes intangibles from the acquisitions of Jareva, Precise, Ejasent and Invio, which are being amortized over the estimated useful lives of two to five years. We expect amortization of other intangibles to be approximately $3 million for the fourth quarter of 2004 for our current intangible assets, including the amortization of developed technology acquired from KVS.

In-Process Research and Development

In connection with our acquisition of Ejasent in January 2004 and KVS in September 2004, we allocated $0.4 million and $11.5 million, respectively, of the purchase price to IPR&D, which represents technology we identified as having not reached technological feasibility and having no alternative future use. In connection with our acquisition of Jareva in January 2003 and Precise in June 2003, we allocated $4.1 million and $15.3 million, respectively, of the purchase price to IPR&D.

Restructuring Reversals

In the third quarter of 2004, in connection with our acquisition of KVS, we reversed $9.6 million of accrued restructuring costs related to previously restructured facilities to be occupied by KVS personnel.

Interest and Other Income, Net

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Interest and other income, net	$13.7	$8.7	58%	$35.4	$33.6	6%
As a percentage of net revenue	3%	2%		2%	3%	

Table of Contents

Interest and other income, net, includes interest income and realized gains and losses on our cash equivalents and investments held and, to a lesser extent, foreign currency exchange gains or losses. The increase in interest and other income of $5.0 and $1.8 million for the three and nine months ended September 30, 2004 over 2003, respectively, is due primarily to an increase in interest income due to higher average cash equivalents and investments balances and an increase in interest rates.

Interest Expense

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Interest expense	$6.5	$9.2	(30)%	$18.2	$24.8	(27)%
As a percentage of net revenue	1%	2%		1%	2%	

Interest expense for the three and nine months ended September 30, 2004 consisted of interest recorded under the 0.25% convertible subordinated notes issued in August 2003 and interest of approximately $4 million per quarter, beginning in July 2003, as a result of our adoption of Financial Accounting Standards Board, or FASB, Interpretation Number, or FIN, 46, *Consolidation of Variable Interest Entities,* which required us to consolidate the properties from our build-to-suit lease agreements and related debt in our financial statements. Previously, interest on the build-to-suit lease agreements was recorded as rent expense in cost of revenue and operating expenses. Interest expense for the three and nine months ended September 30, 2003 also consisted of interest recorded under the 1.856% convertible subordinated notes issued in August 1999 that were partially redeemed for cash and partially converted to common stock in August 2003 and interest recorded under the 5.25% convertible subordinated notes issued in October 1997 that were converted to common stock in August 2003. We expect interest expense for the fourth quarter of 2004 to be approximately $6 million representing the interest on the 0.25% convertible subordinated notes and the interest on the build-to-suit lease agreements.

Loss on Extinguishment of Debt

In August 2003 we redeemed $391.7 million of our outstanding 1.856% convertible subordinated notes for cash. In connection with this cash redemption, we recorded a loss on extinguishment of debt of $4.7 million representing the unamortized portion of debt issuance costs at the time of redemption.

Gain (Loss) on Strategic Investments

For the nine months ended September 30, 2004, we recognized a gain on strategic investments of $7.5 million related to the sale of one of our investments. For the nine months ended September 30, 2003, we recognized impairment losses of $3.5 million on our strategic investments when we determined that there had been a decline in the fair value of these investments that was other than temporary. These losses represented write-downs of the carrying amount of our investments.

Provision for Income Taxes

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	% Change	2004	2003	% Change
	(In millions, except percentages)					
Income taxes	$36.4	$36.3	0%	$121.8	$88.9	37%
As a percentage of net revenue	7%	8%		8%	7%	
Effective tax rate	27%	33%		30%	35%	

Our effective tax rate for the third quarter of 2004 differed from the combined federal and state statutory rates due primarily to the tax effect of international operations. The decrease in our effective tax rates for the three and nine months ended September 30, 2004 over 2003 is primarily due to differences attributable to the

Table of Contents

restructuring reversals in 2004 and acquisition-related charges in 2003, including in-process research and development, that were non-deductible for tax purposes.

Cumulative Effect of Change in Accounting Principle, Net of Tax

We currently have three build-to-suit operating leases, commonly referred to as synthetic leases, which were entered into prior to February 1, 2003. Each synthetic lease is owned by a trust that has no voting rights, no employees, no financing activity other than the lease with us, no ability to absorb losses and no right to participate in gains realized on the sale of the related property. We have determined that the trusts under the leasing structures qualify as variable interest entities for purposes of FIN 46, *Consolidation of Variable Interest Entities.* Consequently, we are considered the primary beneficiary and consolidated the trusts into our financial statements beginning July 1, 2003. As a result of consolidating these entities in the third quarter of 2003, we reported a cumulative effect of change in accounting principle in accordance with Accounting Principles Board, or APB, Opinion No. 20, *Accounting Changes,* with a charge of $6.2 million which equals the amount of depreciation expense that would have been recorded had these trusts been consolidated from the date the properties were available for occupancy, net of tax.

Accrued Acquisition and Restructuring Costs

In the fourth quarter of 2002, our board of directors approved a facility restructuring plan to exit and consolidate certain of our facilities located in 17 metropolitan areas worldwide. The facility restructuring plan was adopted to address overcapacity in our facilities as a result of lower than planned headcount growth in these metropolitan areas. In connection with this facility restructuring plan, we recorded a net restructuring charge, or the 2002 Facility Accrual, to operating expenses of $96.1 million in the fourth quarter of 2002. The 2002 Facility Accrual was originally comprised of (i) $86.9 million associated with terminating and satisfying remaining lease commitments, partially offset by sublease income net of related sublease costs and (ii) write-offs of $9.2 million for net assets.

In the third quarter of 2004, we acquired KVS and, as a result, reversed $9.6 million of the 2002 Facility Accrual related to previously restructured facilities to be occupied by KVS personnel. In addition, cash outlays of $4.0 million and the impact of foreign exchange rates of $0.4 million were recognized in the third quarter of 2004. As of September 30, 2004, the remaining balance of the 2002 Facility Accrual was $55.0 million. Restructuring costs will generally be paid over the remaining lease terms, ending at various dates through 2022, or over a shorter period as we may negotiate with our lessors. The majority of costs are expected to be paid by the year ending December 31, 2010.

We are in the process of seeking suitable subtenants for these facilities. The estimates related to the 2002 Facility Accrual may vary significantly depending, in part, on factors that are beyond our control, including the commercial real estate market in the applicable metropolitan areas, our ability to obtain subleases related to these facilities and the time period to do so, the sublease rental market rates and the outcome of negotiations with lessors regarding terminations of some of the leases. Adjustments to the 2002 Facility Accrual will be made if actual lease exit costs or sublease income differ from amounts currently expected. Because a portion of the 2002 Facility Accrual relates to international locations, the accrual will be affected by exchange rate fluctuations.

As of September 30, 2004, accrued acquisition and restructuring costs consisted of the 2002 Facility Accrual discussed above, acquisition related costs discussed in Note 5 of the Notes to Condensed Consolidated Financial Statements and other accrued acquisition and restructuring charges incurred from 1999 through 2003, net of cash payments made.

Table of Contents

The components of the accrued acquisition and restructuring costs and movements within these components through September 30, 2004 were as follows:

	Direct Transaction Costs	Involuntary Termination Benefits	Facilities Related Costs	Asset Write-offs	Total
			(In millions)		
Balance at December 31, 2003	$ 0.6	$	$91.4	$ 2.1	$ 94.1
Additions	2.1	11.5			13.6
Cash payments	(1.8)	(11.4)	(5.1)		(18.3)
Non-cash charges				(2.1)	(2.1)
Impact of exchange rates			0.7		0.7
Balance at March 31, 2004	0.9	0.1	87.0		88.0
Cash payments	(0.4)		(5.0)		(5.4)
Impact of exchange rates			0.3		0.3
Balance at June 30, 2004	0.5	0.1	82.3		82.9
Additions	4.2	0.1	2.1		6.4
Cash payments	(0.8)		(5.1)		(5.9)
Restructuring reversals, net			(9.6)		(9.6)
Other			(0.4)		(0.4)
Impact of exchange rates			(0.5)		(0.5)
Balance at September 30, 2004	$ 3.9	$ 0.2	$68.8	$	$ 72.9

Recent Accounting Pronouncements

In September 2004, the EITF reached a consensus on EITF Issue No. 04-8, *The Effect of Contingently Convertible Debt on Diluted Earnings per Share,* that all issued securities that have embedded conversion features that are contingently exercisable upon occurrence of a market-price condition should be included in the calculation of diluted earnings per share, regardless of whether the market price trigger has been met. This consensus also applies to instruments with embedded conversion features that are contingently exercisable upon the occurrence of a market price condition or upon the occurrence of another contingency. The FASB is presently in the process of amending certain aspects of SFAS No. 128, Earnings per Share, and it is expected to require that share settlement be assumed in the diluted earnings per share calculation for contracts that can be settled in stock or cash. The consensus in EITF Issue No. 04-8 will become effective in the period when the proposed amendment to SFAS No. 128 becomes effective. We do not believe that EITF Issue No. 04-8 will have a material effect on the Company s diluted per share calculation and we will evaluate the impact of the amendments to SFAS No. 128 once issued.

In March 2004, FASB issued EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.* EITF Issue No. 03-1 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF Issue No. 03-1; however, the disclosure requirements are effective for our annual period ending December 31, 2004. We will evaluate the impact of EITF Issue No. 03-1 once final guidance is issued.

Liquidity and Capital Resources

Cash Flows

Our largest source of operating cash flows is cash collections from our customers for purchases of software licenses and maintenance and technical support. Our standard payment terms for both license and support invoices are net 30 days from the date of invoice. Our primary uses of cash for operating activities

37

Table of Contents

include personnel and facilities related expenditures, income tax payments and technology costs as well as costs associated with outside support and services.

Cash flows provided by operating activities for the nine months ended September 30, 2004 decreased $21.1 million compared to the same period a year ago. Our net income for the nine months ended September 30, 2004 was significantly higher than 2003; however, this was offset by lower non-cash charges such as amortization of developed technology and other intangibles and write-off of in-process research and development. In addition, there was a higher amount of cash paid for income taxes for the nine months ended September 30, 2004 compared to 2003.

Cash flows used for investing activities consist primarily of net purchases of investments, property and equipment and businesses and technology. Cash flows used for investing activities included net purchases of investments of $230.5 million for the nine months ended September 30, 2004 compared to net sales of $15.6 million for the nine months ended September 30, 2003 and an increase of $27.4 million for purchases of property and equipment for the nine months ended September 30, 2004 over 2003. In addition, purchases of businesses and technology were $325.1 million for the nine months ended September 30, 2004, primarily related to the acquisitions of Ejasent, Invio and KVS, compared to $402.4 million for the nine months ended September 30, 2003, primarily related to the acquisitions of Jareva and Precise.

Cash flows from financing activities consist primarily of proceeds related to the issuance of common stock under our employee stock plans of $80.2 million for the nine months ended September 30, 2004 and $132.5 million for the nine months ended September 30, 2003 offset by $70.9 million used for the repurchase of our common stock for the nine months ended September 30, 2004 and $316.2 million used for the repurchase of our common stock for the nine months ended September 30, 2003. In addition, in 2003 we generated $116.6 million of cash from the issuance of new convertible subordinated notes, net of the redemption of the then-outstanding convertible subordinated notes.

In July 2004, our board of directors authorized a program to repurchase our common stock in an amount of up to $500.0 million over the next 12 to 18 months. We expect to purchase these shares of common stock from time to time on the open market or in privately negotiated transactions. Depending on market conditions and other factors, these purchases may be commenced or suspended from time to time without prior notice. The stock repurchase program is primarily intended to reduce the dilution resulting from our employee stock plans. In the third quarter of 2004, we repurchased 5.4 million shares of common stock for an aggregate purchase price of $94.3 million, of which $23.4 million was paid to the Company s agent in October 2004. Between October 1 and October 31, 2004, the Company repurchased an additional 7.6 million shares of common stock for an aggregate purchase price of $155.7 million.

We continue to evaluate alternative uses of our cash including, but not limited to, exercising our purchase option for the properties subject to the build-to-suit lease arrangements, repurchasing additional amounts of our common stock and strategic acquisitions, any of which could reduce the amount of available cash and cash equivalents.

Convertible Subordinated Notes

In August 2003, we issued $520.0 million of 0.25% convertible subordinated notes due August 1, 2013, or 0.25% Notes, for which we received net proceeds of approximately $508.2 million, to several initial purchasers in a private offering. The 0.25% Notes were issued at their face value and provide for semi-annual interest payments of $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of our registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue additional interest at that rate until April 27, 2004, the 90th day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will continue to accrue such additional interest until the date on which the registration statement is declared effective. The 0.25% Notes are convertible, under specified circumstances, into shares of our common stock at a conversion rate of 21.6802 shares per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $46.13 per share;

Table of Contents

provided that, pursuant to the terms of a supplemental indenture dated as of October 25, 2004, we will be required to deliver cash to holders upon conversion, except to the extent that our conversion obligation exceeds the principal amount of the notes converted, in which case, we will have the option to satisfy the excess (and only the excess) in cash and/or shares of common stock.

At September 30, 2004, we had a ratio of long-term debt to total capitalization of approximately 12%. The degree to which we are leveraged could materially and adversely affect our ability to obtain financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. We will require substantial amounts of cash to fund scheduled payments of principal and interest on our indebtedness, future capital expenditures and any increased working capital requirements.

Long-Term Debt

In 1999 and 2000, we entered into three build-to-suit lease agreements for office buildings in Mountain View, California, Roseville, Minnesota and Milpitas, California. We began occupying the Roseville and Mountain View facilities in May and 2001, respectively, and began occupying the Milpitas facility in April 2003. A syndicate of financial institutions financed the acquisition and development of these properties. Prior to July 1, 2003, we accounted for these properties as operating leases in accordance with SFAS No. 13, *Accounting for Leases,* as amended. On July 1, 2003, we adopted FIN 46. Under FIN 46, the lessors of the facilities are considered variable interest entities, and we are considered the primary beneficiary. Accordingly, we began consolidating the variable interest entities on July 1, 2003 and have included the property and equipment and long-term debt on our balance sheet at September 30, 2004 and December 31, 2003 and the results of their operations in our consolidated statement of operations for the three and nine months ended September 30, 2004. As of September 30, 2004, approximately $380.6 million of debt has been classified as current as the lease terms for the Mountain View and Roseville facilities expire in March 2005 and lease terms for Milpitas facilities expire in July 2005.

Interest only payments under our debt agreements relating to the facilities are generally paid quarterly and are equal to the termination value of the outstanding debt obligations multiplied by our cost of funds, which is based on London Inter Bank Offered Rate, or LIBOR, using 30-day to 180-day LIBOR contracts and adjusted for our credit spread. The termination values of the debt agreements are approximately $145.2 million, $41.2 million and $194.2 million for the Mountain View, Roseville and Milpitas leases, respectively. The terms of these debt agreements are five years with an option to extend the lease terms for two successive periods of one year each, if agreed to by the financial institutions that financed the facilities. The terms of these debt agreements began March 2000 for the Mountain View and Roseville facilities and July 2000 for the Milpitas facility. We have the option to purchase the three facilities for the aggregate termination value of $380.6 million or, at the end of the term, to arrange for the sale of the properties to third parties while we retain an obligation to the financial institutions that financed the facilities in an amount equal to the difference between the sales price and the guaranteed residual value up to an aggregate $344.6 million if the sales price is less than this amount, subject to the specific terms of the debt agreements. In addition, we are entitled to any proceeds from a sale of the facilities in excess of the termination values. Payment of the purchase price for these properties would reduce the amount of cash, cash equivalents and short-term investments available for funding our research and development efforts, geographic expansion and strategic acquisitions in the future.

In January 2002, we entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging the cash payments related to the Mountain View, California and Roseville, Minnesota agreements. Under the terms of these interest rate swaps, we make payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR rate. For the three months ended September 30, 2004 and 2003, the aggregate payments, including the net payments on the interest rate swaps, were $4.3 million and for the nine months ended September 30, 2004 and 2003, the aggregate payments, including the net payments on the interest rate swaps, were $12.3 million and $12.5 million, respectively. The payments for the three months ended September 30, 2004 and 2003 and for the nine months ended September 30, 2004 were included in interest expense in the consolidated statements of operations in accordance with FIN 46. The payments made for the six months ended June 30, 2003 were classified as rent expense and included in cost of

Table of Contents

revenue and operating expenses, in accordance with SFAS No. 13. We expect future interest expense from the build-to-suit agreements to be approximately $4 million per quarter.

The agreements for each of the facilities described above require that we maintain specified financial covenants, all of which we were in compliance with as of September 30, 2004. The specified financial covenants as of September 30, 2004 require us to maintain a minimum rolling four quarter earnings before interest, taxes, depreciation and amortization of EBITDA of $500.0 million, a minimum ratio of cash and cash equivalents and accounts receivable to current liabilities plus the debt consolidated under the build-to-suit lease agreements of 1.2 to 1, and a leverage ratio of total funded indebtedness to rolling four quarter EBITDA of not more than 2 to 1. For purposes of these financial covenants, EBITDA represents our net income for the applicable period, plus interest expense, taxes, depreciation and amortization and all non-cash restructuring charges, less software development expenses classified as capital expenditures. In order to secure the obligation under each agreement, each of the facilities is subject to a deed of trust in favor of the financial institutions that financed the acquisition and development of the respective facility. Bank of America, N.A. was the agent for the syndicate of banks that funded the development of the Mountain View, California and Roseville, Minnesota facilities, and ABN AMRO Bank, N.V. was the agent for the syndicate of banks that funded the development of the Milpitas, California facility.

Credit Facility

During 2002, our Japanese subsidiary entered into a short-term credit facility with a multinational Japanese bank in the amount of 1.0 billion Japanese yen ($9.0 million USD). At September 30, 2004, no amount was outstanding. The short-term credit facility was renewed in March 2004 and is due to expire in March 2005. Borrowings under the short-term credit facility bear interest at Tokyo Inter Bank Offered Rate, plus 0.5%. There are no covenants on the short-term credit facility and the loan has been guaranteed by VERITAS Software Global LLC, one of our wholly-owned subsidiaries.

Acquired Technology Commitments

On October 1, 2002, we acquired volume replicator software technology for $6.0 million and contingent payments of up to another $6.0 million based on future revenues generated by the acquired technology. The contingent payments will be paid quarterly over 40 quarters, in amounts between $150,000 and $300,000, which includes interest. We issued a promissory note payable in the principal amount of $5.0 million, representing the present value of our minimum payment obligations under the purchase agreement for the acquired technology, which are payable quarterly commencing in the first quarter of 2003 and ending in the fourth quarter of 2012. The contingent payments in excess of the quarterly minimum obligations will be paid as they may become due. The outstanding balance of the note payable was $4.3 million as of September 30, 2004 and $4.6 million as of December 31, 2003 and is included in other long-term liabilities.

We believe that our current cash, cash equivalents and short-term investment balances and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. After that time, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financing or from other sources. We cannot assure you that additional financing will be available at all or that if available, we will be able to obtain it on terms favorable to us.

Factors That May Affect Future Results

In addition to the other information in this quarterly report on Form 10-Q, you should consider carefully the following factors in evaluating VERITAS and our business.

Table of Contents

If we experience lower-than-anticipated revenue in any particular quarter, or if we announce that we expect lower revenue or earnings than previously forecasted, the market price of our securities could decline.

Our revenue is difficult to forecast and is likely to fluctuate from quarter to quarter due to many factors outside of our control. Any significant revenue shortfall or lowered revenue or earnings forecast could cause the market price of our securities to decline substantially. Factors that could lower our revenue or affect our revenue and earnings forecast include:

- the possibility that our customers may cancel, defer or limit purchases as a result of reduced IT budgets or weak and uncertain economic and industry conditions;
- the possibility that our customers may defer purchases of our products in anticipation of new products or product updates from us or our competitors;
- changes in the competitive landscape due to mergers, acquisitions or strategic alliances that could allow our competitors to gain market share;
- the possibility that our strategic partners will introduce, market and sell products that compete with our products;
- the unpredictability of the timing and magnitude of our sales through direct sales channels and indirect sales channels, including value-added resellers, or VARs, and other distributors, which tend to occur later in a quarter than revenues received through our original equipment manufacturer, or OEM, partners;
- our operational capacity to fulfill software license orders received at the end of a quarter;
- the timing of new product introductions by us and the market acceptance of new products, which may be delayed as a result of weak and uncertain economic and industry conditions;
- the seasonal nature of our sales;
- the rate of adoption and long sales cycles for new solutions such as utility computing, storage resource management technology and replication;
- changes in our pricing and distribution terms or those of our competitors; and
- the possibility that our business will be adversely affected as a result of the threat of terrorism, terrorism or military actions taken by the United States or its allies.

You should not rely on the results of prior periods as an indication of our future performance. Our operating expense levels are based, in significant part, on our expectations of future revenue. If we have a shortfall in revenue or orders in any given quarter, we may not be able to reduce our operating expenses quickly in response. Therefore, any significant shortfall in revenue or orders could have an immediate adverse effect on our operating results for that quarter. In addition, if we fail to manage our business effectively, we may experience high operating expenses, and our operating results may fall below the expectations of securities analysts or investors.

Because we derive a majority of our license revenue from sales of a few product lines, any decline in demand for these products could severely harm our ability to generate revenue.

We derive a majority of our revenue from a small number of software products, including our NetBackup and Backup Exec data protection products. In addition, our software products are concentrated within the market for data storage. For example, for the nine months ended September 30, 2004, we derived approximately 55% of our user license fees from the NetBackup and Backup Exec products. As a result, we are particularly vulnerable to fluctuations in demand for these products, whether as a result of competition, product obsolescence, technological change, budget constraints of our potential customers or other factors. If our revenue derived from these software products were to decline significantly, our business and operating results would be adversely affected. In addition, because our software products are concentrated within the

Table of Contents

market for data storage, a decline in the demand for storage devices, storage software applications or storage capacity could result in a significant reduction in our revenue and adversely affect our business and operating results.

If we fail to manage our distribution channels effectively, or if our partners choose not to market and sell our products to their customers, our sales could decline.

We market our products and related services both directly to end-users and through a variety of indirect sales channels, which include VARs, distributors, system integrators and OEMs. If we fail to manage our distribution channels successfully, our distribution channels may conflict with one another or otherwise fail to perform as we anticipate which could reduce our sales and increase our expenses, as well as weaken our competitive position.

Direct Sales. A significant portion of our revenue is derived from sales by our direct sales force to end-users. This sales channel involves special risks, including:

- longer sales cycles associated with direct sales efforts;
- we may have difficulty hiring, training, retaining and motivating our direct sales force; and
- sales representatives require a substantial amount of training to become productive, and training must be updated to cover new and revised products.

Indirect Sales Channels. A significant portion of our revenue is also derived from sales through indirect sales channels, including distributors that sell our products to end-users and other resellers. This channel involves a number of special risks, including:

- our lack of control over the timing of delivery of our products to end-users;
- our resellers and distributors are not subject to minimum sales requirements or any obligation to market our products to their customers;
- our resellers and distributors may terminate their relationships with us at any time; and
- our resellers and distributors may market and distribute competing products.

OEMs. A portion of our revenue is derived from sales through our OEM partners that incorporate our products into their products. Our reliance on this sales channel involves many risks, including:

- our lack of control over the shipping dates or volume of systems shipped;
- our OEM partners are not subject to minimum sales requirements or any obligation to market our products to their customers;
- our OEM partners may terminate or renegotiate their arrangements with us and new terms may be less favorable in recognition of our increasingly competitive relationship with certain partners;
- the development work that we must generally undertake under our agreements with our OEM partners may require us to invest significant resources and incur significant costs with little or no associated revenue;
- the time and expense required for the sales and marketing organizations of our OEM partners to become familiar with our products may make it more difficult to introduce those products to the market; and
- our OEM partners may develop, market and distribute their own products and market and distribute products of our competitors, which could reduce our sales.

Table of Contents

We face intense competition, and our competitors may gain market share in the markets for our products, which could adversely affect the growth of our business and cause our revenues to decline.

We have many competitors in the markets for our products. If existing or new competitors gain market share in any of these markets, we may experience a decline in revenues, which could adversely affect our business and operating results. Our competitors include the internal development groups of our strategic partners. These groups develop storage management software and utility computing infrastructure for the storage and server hardware products marketed by the strategic partners. We also face competition from software vendors that offer products that directly compete with our products or bundle their software products with storage software offered by another vendor.

Many of our strategic partners and storage hardware vendors offer software products that compete with our products or have announced their intention to focus on developing or acquiring their own storage software products. Storage hardware companies may choose not to offer our products to their customers or limit our access to their hardware platforms. End-user customers may prefer to purchase storage software and hardware that is manufactured by the same company because of greater product breadth offered by the company, perceived advantages in price, technical support, compatibility or other issues. In addition, software vendors may choose to bundle their software, such as an operating system, with their own or other vendors storage software. They may also limit our access to standard product interfaces for their software and inhibit our ability to develop products for their platform.

Many of our competitors have greater financial, technical, sales, marketing and other resources than we do and consequentially may have an ability to influence customers to purchase their products that compete with ours. Our future and existing competitors could introduce products with superior features, scalability and functionality at lower prices than our products, and could also bundle existing or new products with other more established products in order to compete with us. Our competitors could also gain market share by acquiring or forming strategic alliances with our other competitors. Finally, because new distribution methods offered by the Internet and electronic commerce have removed many of the barriers to entry historically faced by start-up companies in the software industry, we may face additional sources of competition in the future.

If we are unable to develop new and enhanced products that achieve widespread market acceptance, we may be unable to recover product development costs, and our earnings and revenue may decline.

Our future success depends on our ability to address the rapidly changing needs of our customers by developing, acquiring and introducing new products, product updates and services on a timely basis. We must also extend the operation of our products to new platforms and keep pace with technological developments and emerging industry standards. We intend to commit substantial resources to developing new software products and services, including software products and services for the utility computing infrastructure, the storage area networking and the storage resource management markets. Each of these markets is new and unproven, and industry standards for these markets are evolving and changing. They also may require development of new channels. If these markets do not develop as anticipated, or if demand for our products and services in these markets does not materialize or occurs more slowly than we expect, we will have expended substantial resources and capital without realizing sufficient revenue, and our business and operating results could be adversely affected.

We have provided standards-setting organizations and various partners with access to our standard product interfaces through our VERITAS Enabled Program. If these standards-setting organizations or our partners do not accept our standard product interfaces for use with other products, or if our partners are able to use our standard product interfaces to improve their competitive position against us, then our business and operating results could be adversely affected.

Our international sales and operations involve special risks that could increase our expenses, adversely affect our operating results and require increased time and attention of our management.

We derive a substantial portion of our revenue from customers located outside of the U.S. and have significant operations outside of the U.S., including engineering, sales, customer support and production

Table of Contents

operations. We plan to expand our international operations and our planned growth is contingent upon the successful expansion of our international revenue. Our international operations are subject to risks in addition to those faced by our domestic operations, including:

- potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights;
- imposition of foreign laws and other governmental controls, including trade and employment restrictions;
- fluctuations in currency exchange rates and economic instability such as higher interest rates and inflation, which could reduce our customers ability to obtain financing for software products or which could make our products more expensive in those countries;
- limitations on future growth or inability to maintain current levels of revenue from international sales if we do not invest sufficiently in our international operations;
- difficulties in hedging foreign currency transaction exposures;
- longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;
- difficulties in staffing, managing and operating our international operations, including difficulties related to administering our stock plans in some foreign countries;
- difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations;
- seasonal reductions in business activity in the summer months in Europe and in other periods in other countries;
- costs and delays associated with developing software in multiple languages; and
- political unrest, war or terrorism, particularly in areas in which we have facilities.

In addition, we receive significant tax benefits from sales to our non-U.S. customers. These benefits are contingent upon existing tax regulations in both the U.S. and in the countries in which our international operations are located. Future changes in domestic or international tax regulations could adversely affect our ability to continue to realize these tax benefits.

Our products may contain significant defects, which may subject us to liability for damages suffered by end-users.

Software products frequently contain errors or failures, especially when first introduced or when new versions are released. Our end-user customers use our products in applications that are critical to their businesses, including for data backup and recovery, and may have a greater sensitivity to defects in our products than to defects in other, less critical software products. If a customer loses critical data as a result of an error in or failure of our software products or as a result of the customer s misuse of our software products, the customer could suffer significant damages and seek to recover those damages from us. Although our software licenses generally contain protective provisions limiting our liability, a court could rule that these provisions are unenforceable. If a customer is successful in proving its damages and a court does not enforce our protective provisions, we could be liable for the damages suffered by our customers and other related expenses, which could adversely affect our operating results.

In addition, product defects could cause delays in new product releases or product upgrades, or our products might not work in combination with other hardware or software, which could adversely affect market acceptance of our products. If our customers were dissatisfied with product functionality or performance, or if we were to experience significant delays in the release of new products or new versions of products, we could lose competitive position and revenue and our business and operating results could be adversely affected.

Table of Contents

If we lose key personnel or fail to integrate replacement personnel successfully, our ability to manage our business could be impaired.

Our future success depends upon the continued service of our key management, technical, sales and other critical personnel. Whether we are able to execute effectively on our business strategy will depend in large part on how well key management and other personnel perform in their positions and are integrated within our company. Our officers and other key personnel are employees-at-will, and we cannot assure you that we will be able to retain them. Key personnel have left our company over the years, and there may be additional departures of key personnel from time to time. The loss of any key employee could result in significant disruptions to our operations, including adversely affecting the timeliness of product releases, the successful implementation and completion of company initiatives and the results of our operations. In addition, the integration of replacement personnel could be time consuming, may cause additional disruptions to our operations and may be unsuccessful.

If we are unable to attract and retain qualified employees and manage our employee base effectively, we may be unable to develop new and enhanced products, expand our business or increase our revenue.

We believe that our success depends in part on our ability to hire and retain qualified employees. As our company grows, and our customers demand for our products and services increase, we will need to hire additional management, technical, sales and other personnel. However, competition for people with the specific skills that we require is significant. If we are unable to hire and retain qualified employees, or conversely, if we fail to manage employee performance or reduce staffing levels when required by market conditions, our business and operating results could be adversely affected.

Historically, we have provided stock-based compensation, such as stock option grants and the availability of discounted shares in our Employee Stock Purchase Plan, as an important incentive for our employees. The volatility in our stock price may from time to time adversely affect our ability to retain or attract key employees. In addition, if we are unable to obtain stockholder approval for anticipated future increases in the number of shares of common stock authorized under our stock plans, or if changes in accounting rules require us to treat all stock-based compensation as an expense, we may reduce the amount of stock-based compensation awarded to employees. Reductions in our stock-based compensation practices may make it more difficult for us to attract and retain employees, which may negatively affect our ability to manage and operate our business.

We incur considerable expenses to develop products for operating systems that are either owned by others or that are part of the Open Source Community. If we do not receive cooperation in our development efforts from others and access to operating system technologies, we may face higher expenses or fail to expand our product lines and revenues.

Many of our products operate primarily on the Windows, UNIX and Linux computer operating systems. As part of our efforts to develop products for operating systems that are part of the Open Source Community, we may have to license portions of our products on a royalty free basis or may have to expose our source code. We continue to develop new products for these operating systems. We may not accomplish our development efforts quickly or cost-effectively, and it is not clear what the relative growth rates of these operating systems will be. Our development efforts require substantial capital investment, the devotion of substantial employee resources and the cooperation of the owners of the operating systems to or for which the products are being ported or developed. If the market for a particular operating system does not develop as anticipated, or demand for our products and services in such market does not materialize or occurs more slowly than we expect, we may have expended substantial resources and capital without realizing sufficient revenue, and our business and operating results could be adversely affected.

In addition, for some operating systems, we must obtain from the owner of the operating system a source code license to portions of the operating system software to port some of our products to or develop products for the operating system. Operating system owners have no obligation to assist in these porting or development

Table of Contents

efforts. If they do not grant us a license or if they do not renew our license, we may not be able to expand our product line into other areas.

We derive a large amount of revenue from one of our distributors, the loss of which could cause our revenues to decline.

We derive a large amount of revenue from a distributor that sells our products and services through resellers. For the three and nine months ended September 30, 2004, this distributor accounted for less than 10% of our net revenue. If this distributor were to reduce purchases of our products or services, our revenues would decline unless we were able to increase sales through other distributors or direct sales to customers. Our contract does not require this distributor to purchase any specified amount of our product or services. Accordingly, we cannot be sure that this distributor will continue to market and sell our products and services at current levels.

Cooperating with the SEC in its investigation of our transactions with AOL Time Warner and its recent inquiries regarding our past accounting practices has required, and may continue to require, a large amount of management time and attention, as well as accounting and legal expense, which may reduce net income or interfere with our ability to manage our business.

Since the third quarter of 2002, we have received subpoenas and other requests for information issued by the SEC in the investigation entitled *In the Matter of AOL/ Time Warner.* We continue to furnish information requested by the SEC and otherwise cooperate with regard to this investigation. In addition, in the first quarter of 2004, we voluntarily disclosed to the staff of the SEC past accounting practices applicable to our 2002 and 2001 financial statements that were not in compliance with GAAP, and we subsequently restated our financial statements for 2002 and 2001, the interim periods for 2002 and 2001 and the interim periods ended March, June and September 2003. We and our audit committee continue to cooperate with the SEC in its review of these matters. The SEC s investigation and inquiries may continue to require significant management attention and accounting and legal resources, which could adversely affect our business, results of operations and cash flows.

We have been named as a party to several class action and derivative action lawsuits, and we may be named in additional litigation, all of which could require significant management time and attention and result in significant legal expenses. An unfavorable outcome in one or more of these lawsuits could have a material adverse effect on our business, financial condition, results of operations and cash flows.

After we announced in January 2003 that we would restate our financial results as a result of transactions entered into with AOL Time Warner in September 2000, numerous separate complaints purporting to be class actions were filed in federal court alleging that we and some of our officers and directors violated provisions of the Securities Exchange Act of 1934. Several similar complaints purporting to be derivative actions have been filed in state court against some of our directors and officers. In addition, after we announced in July 2004 that we expected our results of operations for the fiscal quarter ended June 30, 2004 to fall below guidance earlier provided by us, several separate complaints purporting to be class actions were filed in federal court alleging that we and some of our officers violated federal securities laws. The expense of defending such litigation may be costly and divert management s attention from the day-to-day operations of our business, which could adversely affect our business, results of operations and cash flows. In addition, an unfavorable outcome in such litigation could have a material adverse effect on our business, results of operations and cash flows.

We have received notification from The Nasdaq Stock Market that our securities may be delisted if we are unable to comply with certain filing deadlines, which delisting could materially and adversely affect the liquidity and trading price of our common stock.

Due to our delinquency in filing our annual report on Form 10-K for the year ended December 31, 2003, and our quarterly report on Form 10-Q for the quarter ended March 31, 2004, we have received a written determination from The Nasdaq Stock Market stating, among other things, that we must timely file all periodic reports with the SEC and Nasdaq for all reporting periods ending on or before June 30, 2005. Should

Table of Contents

we fail to comply with this requirement, our securities could be delisted, which would materially and adversely affect the liquidity and trading price of our common stock.

Our business strategy includes possible growth through business acquisitions, which involve special risks that could increase our expenses, cause our stock price to decline and divert the time and attention of management.

As part of our business strategy, we have in the past acquired and expect in the future to acquire other businesses, business units and technologies. Acquisitions involve a number of special risks and challenges, including:

diversion of management s attention from our business;

integration of acquired business operations and employees into our existing business, including coordination of geographically dispersed operations, which in the past has taken longer and has been more complex than initially expected;

incorporation of acquired products and business technology into our existing product lines, including consolidating technology with duplicative functionality or designed on different technological architecture, and our ability to sell the acquired products through our existing or acquired sales channels;

loss or termination of employees, including costly litigation resulting from the termination of those employees;

dilution of our then-current stockholders percentage ownership;

dilution of earnings if synergies with the acquired business are not achieved;

assumption of liabilities of the acquired business, including costly litigation related to alleged liabilities of the acquired business;

presentation of a unified corporate image to our customers and our employees; and

risk of impairment charges related to potential write-down of acquired assets in future acquisitions.

Acquisitions of businesses, business units and technologies are inherently risky and create many challenges. We cannot provide any assurance that our previous or any future acquisitions will achieve the desired objectives.

Our effective tax rate may increase or fluctuate, which could increase our income tax expense and reduce our net income.

Our effective tax rate could be adversely affected by several factors, many of which are outside of our control. Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. We are also subject to changing tax laws, regulations and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings. On October 22, 2004, the American Jobs Creation Act of 2004 (the Act) was signed into law. We are presently evaluating the impact of the Act on our future effective tax rate. We do not have a substantial history of audit activity from various taxing authorities and while we believe we are in compliance with all federal, state and international tax laws, there are various interpretations of their application that could result in additional tax assessments. Our effective tax rate is also influenced by the tax effects of purchase accounting for acquisitions and non-recurring charges, which may cause fluctuations between reporting periods, and may also be influenced by tax assessments against acquired entities with respect to tax periods prior to the acquisition, which may significantly affect our effective tax rate for the period in which the settlements take place.

Table of Contents

Changes to current accounting policies could have a significant effect on our reported financial results or the way in which we conduct our business.

We prepare our financial statements in conformity with accounting principles generally accepted in the U.S., which are subject to interpretation by the American Institute of Certified Public Accountants, the Public Company Accounting Oversight Board, the SEC and various other bodies formed to interpret and create appropriate accounting policies. A change in these policies could have a significant effect on our reported results and may even retroactively affect previously reported transactions. Our accounting policies that recently have been or may in the future be affected by changes in the accounting rules are as follows:

software revenue recognition;

accounting for stock-based compensation;

accounting for variable interest entities;

accounting for goodwill and other intangible assets; and

accounting issues related to certain features of contingently convertible debt instruments and their effect on diluted earnings per share.

Changes in these or other rules, or the questioning of current practices, may have a significant adverse effect on our reported financial results or in the way in which we conduct our business. See our discussion above under Critical Accounting Policies and Estimates for additional information about our critical accounting policies and estimates and associated risks.

If we do not protect our proprietary information and prevent third parties from making unauthorized use of our products and technology, our revenues could be harmed.

We rely on a combination of copyright, patent, trademark and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect our proprietary information. All of these measures afford only limited protection. These measures may be invalidated, circumvented or challenged, and others may develop technologies or processes that are similar or superior to our technology. We may not have the proprietary information controls and procedures in place that we need to protect our proprietary information adequately. In addition, because we license the source code for some of our products to third parties, there is a higher likelihood of misappropriation or other misuse of our intellectual property. We also license some of our products under shrink-wrap license agreements that are not signed by licensees and therefore may be unenforceable under the laws of some jurisdictions. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy our products or obtain or use information that we regard as proprietary, which could harm our revenues.

Third parties claiming that we infringe their proprietary rights could cause us to incur significant legal expenses and prevent us from selling our products.

From time to time, we receive claims that we have infringed the intellectual property rights of others. As the number of products in the software industry increases and the functionality of these products further overlap, we believe that we may become increasingly subject to infringement claims, including patent, copyright and trademark infringement claims. We have received several trademark claims in the past and may receive more claims in the future from third parties who may also be using the VERITAS name or another names that may be similar to one of our trademarks or service marks. We have also received patent infringement claims in the past and may receive more claims in the future based on allegations that our products infringe upon patents held by third parties. In addition, 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 these former employers. Any such claim, with or without merit, could:

be time consuming to defend;

result in costly litigation;

Table of Contents

divert management s attention from our core business;

require us to stop selling, to delay shipping or to redesign our product; and

require us to pay monetary amounts as damages, for royalty or licensing arrangements or to satisfy indemnification obligations that we have with some of our customers.

In addition, we license and use software from third parties in our business. These third party software licenses may not continue to be available to us on acceptable terms. Also, these third parties may from time to time receive claims that they have infringed the intellectual property rights of others, including patent and copyright infringement claims, which may affect our ability to continue licensing this software. Our inability to use any of this third party software could result in shipment delays or other disruptions in our business, which could materially and adversely affect our operating results.

Any disruption in our operations caused by a catastrophic natural disaster or other events outside of our control could have a material adverse effect on our business, resulting in a loss of revenue or in higher expenses.

Our business is highly automated and any disruptions or failures in our operations due to a catastrophic natural disaster, such as an earthquake or a flood, or to manmade problems, such as inadvertent errors, malicious software programs or terrorism, may result in a loss of revenue or in higher expenses, harming our operating results. Most of our primary operations, which include a significant portion of our research and development activities and other critical business operations, are located near San Francisco, California, an area known for seismic activity. A catastrophic event, such as a major earthquake, which results in the destruction or disruption of our primary operations, could severely and adversely affect our business, including both our primary data center and other internal operations and our ability to communicate with our customers or sell our products over the Internet.

In our highly automated environment, we have tightly integrated systems that support our enterprise, including our financial accounting and e-commerce systems. Maintaining the integrity and security of this enterprise is an issue of critical importance for VERITAS and our customers. Any hardware or software failure or breach in security due to inadvertent error, malicious software programs, such as viruses and worms, break-ins or unauthorized tampering with our computer systems could, if wide-spread and destructive, have a negative effect on our internal operations and could adversely affect our business. We take significant and costly measures which have been effective in protecting our enterprise from such events, however, there is no assurance that these measures will be equally as effective in the future. In addition, other events outside of our control, such as war or acts of terrorism, could have a material adverse and potentially devastating effect on our business, operating results and financial condition.

Some provisions in our charter documents and our stockholder rights plan may prevent or deter an acquisition of VERITAS.

Some of the provisions in our charter documents may deter or prevent certain corporate actions, such as a merger, tender offer or proxy contest, which could affect the market value of our securities. These provisions include:

our board of directors is authorized to issue preferred stock with any rights it may determine;

our board of directors is classified into three groups, with each group of directors to hold office for three years;

our stockholders are not entitled to cumulate votes for directors and may not take any action by written consent without a meeting; and

special meetings of our stockholders may be called only by our board of directors, by the chairman of the board or by our chief executive officer, and may not be called by our stockholders.

Table of Contents

We also have in place a stockholder rights plan that is designed to discourage coercive takeover offers. In general, our stockholder rights plan provides our existing stockholders (other than an existing stockholder that becomes an acquiring person) with rights to acquire shares of our common stock at 50% of its trading price if a person or entity acquires, or announces its intention to acquire, 15% or more of the outstanding shares of our common stock, unless our board of directors elects to redeem these rights.

Our board of directors could utilize the provisions of our charter documents and stockholder rights plan to resist an offer from a third party to acquire VERITAS, including an offer to acquire our common stock at a premium to its trading price or an offer that is otherwise considered favorable by our stockholders.

Our stock price may be volatile in the future, and you could lose the value of your investment.

The market price of our common stock has experienced significant fluctuations and may continue to fluctuate significantly, and you could lose the value of your investment. The market price of our common stock may be affected by a number of factors, including:

announcements of our quarterly operating results and revenue and earnings forecasts or those of our competitors or our customers;

rumors, announcements or press articles regarding changes in our management, organization, operations or prior financial statements;

inquiries by the SEC, Nasdaq, law enforcement or other regulatory bodies;

changes in revenues and earnings estimates by securities analysts;

announcements of planned acquisitions by us or by our competitors;

gain or loss of a significant customer;

announcements of new products by us, our competitors or our OEM customers; and

acts of terrorism, the threat of war and economic slowdowns in general.

The stock market in general, and the market prices of stocks of other technology companies in particular, have experienced extreme price volatility, which has adversely affected and may continue to adversely affect the market price of our common stock for reasons unrelated to our business or operating results.

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

We are subject to market risk associated with changes in foreign currency exchange rates, interest rates and our equity investments, as discussed more fully below. In order to manage the volatility relating to our more significant market risks, we enter into various hedging arrangements described below. We do not execute transactions or hold derivative financial instruments for speculative trading purposes. We do not anticipate any material changes in our primary market risk exposures for the remainder of fiscal 2004.

Foreign Currency Risk

We transact business in various foreign currencies and have established a foreign currency hedging program, utilizing foreign currency forward exchange contracts, or forward contracts, to hedge certain foreign currency transaction exposures. Under this program, increases or decreases in our foreign currency transactions are offset by gains and losses on the forward contracts, so as to mitigate the possibility of foreign currency transaction gains and losses. We do not use forward contracts for speculative or trading purposes. All foreign currency transactions and all outstanding forward contracts are marked-to-market at the end of the period with unrealized gains and losses included in other income (expense). The unrealized gain (loss) on the outstanding forward contracts at September 30, 2004 was immaterial to our consolidated financial statements.

Table of Contents

Our outstanding forward contracts as of September 30, 2004 are presented in the table below. All forward contract amounts are representative of the expected payments to be made under these instruments. As of September 30, 2004, all forward contracts mature in 31 days or less:

	Local Currency Contract Amount	Contract Amount	Fair Market Value at September 30, 2004 (US$)
		(In thousands)	
Contracts to Buy US $			
Argentine peso	2,000.0 ARS	662.3 USD	(8.7)
Brazilian real	8,550.0 BRL	2,933.1 USD	(55.6)
Canadian dollar	4,550.0 CAD	3,566.8 USD	(40.6)
Australian dollar	870.0 AUD	621.2 USD	(11.9)
Contracts to Sell US $			
Euro	29,000.0 EUR	35,668.3 USD	396.1
Israel shekel	9,025.0 ILS	2,015.1 USD	(0.6)
Mexican peso	7,200.0 MXN	627.5 USD	5.1
Singapore dollar	20,650.0 SGD	12,178.9 USD	83.5
Indian rupee	19,000.0 INR	408.2 USD	5.3
British pound	8,100.0 GBP	14,626.0 USD	51.2
Japanese yen	33,500.0 JPY	301.1 USD	3.3
Contracts to Buy Euro			
United Arab Emirates dirham	23,600.0 AED	5,214.9 EUR	58.3
Indian rupee	164,900.0 INR	2,874.8 EUR	(13.0)
Japanese yen	2,400,000.0 JPY	17,516.8 EUR	(24.8)
Contracts to Sell Euro			
Danish krona	3,880.0 DKK	521.4 EUR	0.0
Swedish krona	8,300.0 SEK	915.8 EUR	2.9
British pound	3,000.0 GBP	4,403.7 EUR	(39.1)
South African rand	8,550.0 ZAR	1,080.6 EUR	(17.9)
Swiss franc	950.0 CHF	613.1 EUR	0.0
Contracts to Buy SGD $			
Hong Kong dollar	13,780.0 HKD	2,995.3 SGD	10.9
New Zealand dollar	1,750.0 NZD	1,973.3 SGD	(14.2)
Contracts to Sell SGD $			
Indian rupee	61,000.0 INR	2,223.8 SGD	6.8
South Korean won	5,130,000.0 KRW	7,511.0 SGD	(6.4)
Taiwanese dollar	12,750.0 TWD	635.3 SGD	(2.0)
Euro	1,200.0 EUR	2,504.1 SGD	5.3
Contracts to Buy GBP £			
Australian dollar	1,850.0 AUD	732.3 GBP	(18.9)

Interest Rate Risk

We are exposed to interest rate risk primarily on our investment portfolio and the build-to-suit lease agreement for the facility located in Milpitas, California. Our primary investment objective is to preserve principal while at the same time maximizing yields without significantly increasing risk. Our portfolio primarily includes money market funds, commercial paper, corporate notes, government securities (taxable

Table of Contents

and non-taxable), asset-backed securities and auction market securities. The diversity of our portfolio helps us to achieve our investment objective.

Debt obligations consist of $520.0 million of our 0.25% convertible subordinated notes due August 1, 2013 and $380.6 million of our debt related to our build-to-suit lease agreements. The interest rate on the 0.25% Notes is fixed and the notes provide for semi-annual interest payments of approximately $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of our registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue such additional interest until April 27, 2004, the 90th day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will continue to accrue such additional interest until the date on which the registration statement is declared effective. The 0.25% Notes are convertible, under specified conditions, into shares of our common stock unless previously redeemed or repurchased and the conversion price is subject to adjustment under the terms of the notes; provided that, as a result of a supplemental indenture we entered into on October 25, 2004, we now have the obligation to satisfy our conversion obligations under the notes in cash, unless the value of our conversion obligation exceeds the principal amount of the notes being converted by a holder, in which case we shall have the option to deliver cash and/or shares of common stock to the extent (and only to the extent) of such excess. Long-term debt consists of the three build-to-suit agreements. The interest rates on the build-to-suit agreements are variable based on a 3-month LIBOR plus a credit spread and provide for quarterly interest payments in January, April, July and October (see Management s Discussion and Analysis of Financial Condition and Results of Operations Long-Term Debt for more information regarding debt payout).

In January 2002, we entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging cash flows on variable interest rate debt of two of our build-to-suit agreements. Under the terms of these interest rate swaps, we make payments based on the fixed rate and will receive interest payments based on the 3-month London Inter Bank Offered Rate, or LIBOR. The payments on our build-to-suit lease agreements are based upon a 3-month LIBOR plus a credit spread. If critical terms of the interest rate swaps or the hedged item do not change, the interest rate swaps will be considered to be highly effective with all changes in the fair value included in other comprehensive income. If critical terms of the interest rate swaps or the hedged item change, the hedge may become partially or fully ineffective, which could result in all or a portion of the changes in fair value of the derivative recorded in the statement of operations. The interest rate swaps settle the first day of January, April, July and October until expiration. As of September 30, 2004, the fair value of the interest rate swaps was $(3.1) million. As a result of entering into the interest rate swaps, we have mitigated our exposure to variable cash flows associated with interest rate fluctuations. Because the rental payments on the leases are based on the 3-month LIBOR and we receive 3-month LIBOR from the interest rate swap counter-party, we have eliminated any impact to raising interest rates related to our rent payments under the build-to-suit lease agreements. This hedge was deemed to be highly effective as of September 30, 2004. On July 1, 2003, we began accounting for our variable interest rate debt in accordance with FIN 46. In accordance with SFAS No. 133, we had designated the interest rate swap as a cash flow hedge of the variability embedded in the rent expense as it is based on the 3-month LIBOR. However, with the adoption of FIN 46, we redesignated the interest rate swap as a cash flow hedge of variability in interest expense and it remains highly effective with all changes in the fair value included in other comprehensive income.

Table of Contents

The following table presents the amounts of our cash equivalents, short-term investments and debt obligations, according to maturity date, that may be subject to interest rate risk and the average interest rates as of September 30, 2004 by year of maturity:

	Amortized Cost				
	Due in 2004	Due in 2005 and Thereafter	Total	2004 Fair Value	2003 Amortized Cost
	(In thousands, except percentages)				
Cash equivalents and short-term investments(1):					
Fixed rate	$290,797	$1,394,079	$1,684,876	$1,678,881	$1,235,767
Average fixed rate	1.78%	2.81%	2.63%	2.64%	2.11%
Variable rate	$242,033	$ 169,694	$ 411,727	$ 411,704	$ 509,727
Average variable rate	1.78%	1.77%	1.77%	1.77%	1.40%
Total cash equivalents and short-term investments	$532,830	$1,563,773	$2,096,603	$2,090,585	$1,745,494
Average rate	1.78%	2.70%	2.46%	2.47%	1.90%
Debt obligations:					
Fixed rate	$ 111	$ 524,141	$ 524,252	$ 524,252	$ 524,578
Average fixed rate(2)	3.68%	0.28%	0.28%	0.28%	0.28%
Variable rate(3)	$	$ 380,630	$ 380,630	$ 380,630	$ 380,630
Average variable rate		2.45%	2.45%	2.45%	2.45%

(1) For purposes of the above table, cash equivalents consist of commercial paper and government securities.

(2) Not included in the average fixed rate is the amortization of the underwriting and issuance costs for the $520.0 million convertible subordinated notes. If this was included, our average fixed rate for these notes would be 1.04% for 2005 and thereafter.

(3) $186.4 million of the variable rate long-term debt is, in effect, a fixed rate as the result of the interest rate swaps (see Note 13, Derivative Financial Instruments in the Notes to Condensed Consolidated Financial Statements) entered into by VERITAS. Including the effect of these interest rate swaps, the average fixed rate would be 6.14%.

Equity Price Risk

We have made investments in development-stage companies that we believe provide strategic opportunities for us. We intend that these investments will provide access to new technologies and emerging markets, and create opportunities for additional sales of our products and services. We recognize impairment losses on our strategic investments when we determine that there has been a decline in the fair value of the investment that is other than temporary. For the nine months ended September 30, 2004, we realized a gain of $7.5 million on the sale of a strategic investment. For the three and nine months ended September 30, 2004, we recorded no impairment losses and for the nine months ended September 30, 2003, we recognized impairment losses of $3.5 million on our strategic investments when we determined that there had been a decline in the fair value of the investments that was other-than-temporary. The losses realized represent other-than-temporary declines in the fair value of our investments and were determined based on the value of the investee s stock, its inability to obtain additional private financing, its cash position and current burn rate, the status and competitive position of the investee s products and the uncertainty of its financial condition, among other factors. As of September 30, 2004, our strategic investments had a carrying value of $2.7 million, and we determined that there was no further impairment in these investments at that date. We cannot assure you that our investments will have the above mentioned results, or that we will not lose all or any part of these investments.

Table of Contents

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

Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this quarterly report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Our disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosure. Our internal controls are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements in conformity with generally accepted accounting principles.

Our disclosure controls and procedures are not capable of preventing all instances of error or 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 will be attained. Our disclosure controls and procedures can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected on a timely basis.

Our chief executive officer and chief financial officer, with the assistance of our disclosure committee, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2004. Our evaluation process included the identification, review and evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2004. In addition, we sought to identify any changes to our internal controls during the quarter ended September 30, 2004 that had or could have a material effect on our internal controls, any significant deficiencies or material weaknesses in our internal controls and any acts of fraud involving personnel who had a significant role in our internal controls. We perform this type of evaluation on a quarterly basis so that the conclusions concerning the effectiveness of our disclosure controls can be reported in our quarterly reports on Form 10-Q and annual report on Form 10-K.

Based on an evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2004, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that material information required to be included in our Exchange Act reports, including this report on Form 10-Q, is made known to them on a timely basis. Although we regularly implement improvements to our internal controls systems, there have been no changes in our internal control over financial reporting during the quarter ended September 30, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Appearing as exhibits to this periodic report are the certifications of our chief executive officer and chief financial officer required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in internal control over financial reporting, referred to in paragraphs 4(b) and (c) of the certifications. This Item 4 should be read in conjunction with the certifications for a more complete understanding of the topics presented.

PART II: OTHER INFORMATION

Item 1. ***Legal Proceedings***
SEC Related Matters

SEC Investigation. As previously disclosed, since the third quarter of 2002, we have received subpoenas issued by the Securities Exchange Commission in the investigation entitled *In the Matter of AOL/ Time Warner.* The SEC has requested information concerning the facts and circumstances surrounding our transactions with AOL Time Warner, or AOL, and related accounting and disclosure matters. Our transactions with AOL, entered into in September 2000, involved a software and services purchase by AOL at a stated value of $50.0 million and the purchase by us of advertising services from AOL at a stated value of $20.0 million. In March 2003, we restated our financial statements for 2001 and 2000 to reflect a reduction in

Table of Contents

revenues and expenses of $20.0 million. The restatement included an additional reduction in revenues and expenses of $1.0 million related to two other contemporaneous transactions with other parties entered into in 2000 that involved software licenses and the purchase of on-line advertising services.

In March 2004, we announced our intention to restate our financial statements for 2002 and 2001 and revise our previously announced financial results for 2003. The decision resulted from the findings of an investigation into past accounting practices that concluded on March 12, 2004. The investigation resulted from concerns raised by an employee in late 2003, which led to a detailed review of the matter in accordance with our corporate governance processes, including the reporting of the matter to the audit committee of our board of directors, and to KPMG LLP, our independent registered public accounting firm. The audit committee retained independent counsel to investigate issues relating to these past accounting practices, and the audit committee s counsel retained independent accountants to assist with the investigation. In the first quarter of 2004, we voluntarily disclosed to the staff of the SEC past accounting practices applicable to our 2002 and 2001 financial statements that were not in compliance with GAAP. For more information regarding the audit committee s investigation and the restatement of our financial statements for 2002 and 2001, including the corresponding interim periods for 2002 and 2001 and the interim periods ended March, June and September 2003, see Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Financial Statements and Supplementary Data Selected Quarterly Results of Operations, Controls and Procedures and Note 2 of the Notes to Consolidated Financial Statements of our annual report on Form 10-K for the year ended December 31, 2003.

We and our audit committee continue to cooperate with the SEC in its review of these matters. At this time, we cannot predict the outcome of the SEC s review.

Litigation

After we announced in January 2003 that we would restate our financial results as a result of transactions entered into with AOL in September 2000, numerous separate complaints purporting to be class actions were filed in the United States District Court for the Northern District of California alleging that we and some of our officers and directors violated provisions of the Securities Exchange Act of 1934. The complaints contain varying allegations, including that we made materially false and misleading statements with respect to our 2000, 2001 and 2002 financial results included in our filings with the SEC, press releases and other public disclosures. On May 2, 2003, a lead plaintiff and lead counsel were appointed. A consolidated complaint entitled *In Re VERITAS Software Corporation Securities Litigation* was filed by the lead plaintiff on July 18, 2003. On December 10, 2003, the District Court granted the defendants motion to dismiss the consolidated complaint, with leave to amend. On May 19, 2004, the District Court granted the defendants motion to dismiss the plaintiffs first amended complaint, with leave to amend. On June 30, 2004, a second amended complaint was filed with the Court in this matter and defendants have filed a motion to dismiss the second amended complaint. The second amended complaint seeks an unspecified amount of damages.

In addition, in 2003 several complaints purporting to be derivative actions were filed in California state court against some of our directors and officers. These complaints are generally based on the same facts and circumstances alleged in *In Re VERITAS Software Corporation Securities Litigation,* referenced above, and allege that the named directors and officers breached their fiduciary duties by failing to oversee adequately our financial reporting. The state court complaints have been consolidated into the action *In Re VERITAS Software Corporation Derivative Litigation,* which was filed on May 8, 2003 in the Superior Court of Santa Clara County. The consolidated complaint seeks an unspecified amount of damages.

On August 2, 2004, we received a copy of an amended complaint in *Stichting Pensioenfonds ABP v. AOL Time Warner, et. al.* in which we were named as a defendant. The case was originally filed in the U.S. District Court for the Southern District of New York in July 2003 against Time Warner (formerly, AOL Time Warner), current and former officers and directors of Time Warner and AOL, and Time Warner s outside auditor, Ernst & Young LLP. In adding us as a defendant, the plaintiff alleges that we aided and abetted AOL in alleged common law fraud and also alleges that we engaged in common law fraud as part of a civil conspiracy. The allegations against us are based on the factual allegations in the second amended consolidated

Table of Contents

class action complaint and other filings in the matter entitled *In Re VERITAS Software Corporation Securities Litigation,* referenced above. The plaintiff seeks an unspecified amount of compensatory and punitive damages.

On July 7, 2004, a purported class action complaint entitled *Paul Kuck, et al. v. VERITAS Software Corporation, et al.* was filed in the United States District Court for the District of Delaware. The lawsuit alleges violations of federal securities laws in connection with our announcement on July 6, 2004 that we expected our results of operations for the fiscal quarter ended June 30, 2004 to fall below estimates that were earlier provided by us. The complaint generally seeks an unspecified amount of damages. Subsequently, additional purported class action complaints have been filed in Delaware federal court against the same defendants named in the Kuck lawsuit. These complaints are based on the same facts and circumstances as the Kuck lawsuit.

The foregoing cases are still in the preliminary stages, and it is not possible for us to quantify the extent of our potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on our business, financial condition, results of operations and cash flow. In addition, defending any litigation may be costly and divert management s attention from the day-to-day operations of our business.

In addition to the legal proceedings listed above, we are also party to various other legal proceedings that have arisen in the ordinary course of our business. While we currently believe that the ultimate outcome of these proceedings, individually and in the aggregate, will not have a material adverse effect on our financial position or overall trends in results of operations, litigation is subject to inherent uncertainties. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on our results of operations and cash flows for the period in which the ruling occurs. The estimate of the potential impact on our financial position or overall results of operations for the above discussed legal proceedings could change in the future.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

During the quarter ended September 30, 2004, we repurchased 5.4 million shares of our common stock for an aggregate purchase price of $94.3 million, of which $23.4 million was paid to our agent in October 2004. Between October 1 and October 31, 2004, we repurchased an additional 7.6 million shares of common stock for an aggregate purchase price of $155.7 million. The monthly repurchases of our common stock for the quarter ended September 30, 2004 are set forth below.

ISSUER PURCHASES OF EQUITY SECURITIES*

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) Shares That May Yet Be Purchased Under the Plans or Program
		(In thousands, except per share amounts)		
Month 1:				
July 1, 2004 through July 31, 2004		N/A		
Month 2:				
August 1, 2004 through August 31, 2004		N/A		$500,000
Month 3:				
September 1, 2004 through September 30, 2004	5,400	$17.46	5,400	$405,710
Total	5,400	$17.46	5,400	$405,710

* On July 27, 2004, the Company issued a press release announcing that in July 2004, the board of directors had approved a stock repurchase program. Under the stock repurchase program, we are authorized to repurchase up to $500 million of our common stock over a 12 to 18 month period.

Table of Contents

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

At our annual meeting of stockholders held on August 25, 2004, each of the individuals listed below was elected to our board of directors as a Class C director to hold office for a term of three years or until his successor is duly elected or qualified or until his resignation or removal. The following is a tabulation of votes with respect to each nominee:

Nominee	Votes For	Votes Withheld
Michael Brown	332,146,278	39,410,377
Kurt J. Lauk	354,860,251	16,696,404

In addition to Mr. Brown and Dr. Lauk, the Company s board of directors is currently comprised of: Gary L. Bloom; William Pade; David J. Roux; Geoffrey W. Squire; Carolyn M. Ticknor; and V. Paul Unruh.

The following proposals were also approved at our annual meeting:

	Votes For	Votes Against	Abstentions	Broker Non-Votes
Approve the Amendment and Restatement of the VERITAS Software Corporation 2003 Stock Incentive Plan	185,025,551	120,420,855	2,475,480	63,634,769
Ratify the appointment of KPMG LLP as independent accountants for the fiscal year ending December 31, 2004	368,700,564	567,865	2,288,226	0

Item 6. ***Exhibits***

Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
2.01	Share Purchase Agreement, dated as of August 30, 2004, by and among VERITAS Software Corporation, KVault Software Limited and certain shareholders named therein				X
3.01	Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation	8-A	06/02/99	3.01	
3.02	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation (changing name of corporation to VERITAS Software Corporation)	8-A	06/02/99	3.02	
3.03	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS	S-8	06/02/00	4.03	
3.04	Amended and Restated Bylaws of VERITAS	S-4/A	09/28/00	3.04	
4.01	First Supplemental Indenture, dated as of October 25, 2004, by and between VERITAS Software Corporation and U.S. Bank National Association Incorporated by reference	8-K	10/27/04	4.01	

10.01	VERITAS Software Corporation Amended and Restated 2003 Stock Incentive Plan	8-K	08/31/04	10.01	
10.02	Form of Stock Option Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
10.03	Form of Stock Option Agreement for Executive Officers under VERITAS Software Corporation 2003 Stock Incentive Plan				X

Table of Contents

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
10.04	Form of Restricted Stock Issuance Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
10.05	Form of RSU Award Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
31.01	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on November 5, 2004.

VERITAS SOFTWARE CORPORATION

BY: /s/ EDWIN J. GILLIS

EDWIN J. GILLIS
Executive Vice President, Finance
and Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
2.01	Share Purchase Agreement, dated as of August 30, 2004, by and among VERITAS Software Corporation, KVault Software Limited and certain shareholders named therein				X
3.01	Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation	8-A	06/02/99	3.01	
3.02	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation (changing name of corporation to VERITAS Software Corporation)	8-A	06/02/99	3.02	
3.03	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS	S-8	06/02/00	4.03	
3.04	Amended and Restated Bylaws of VERITAS	S-4/A	09/28/00	3.04	
4.01	First Supplemental Indenture, dated as of October 25, 2004, by and between VERITAS Software Corporation and U.S. Bank National Association Incorporated by reference	8-K	10/27/04	4.01	
10.01	VERITAS Software Corporation Amended and Restated 2003 Stock Incentive Plan Incorporated by reference	8-K	08/31/04	10.01	
10.02	Form of Stock Option Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
10.03	Form of Stock Option Agreement for Executive Officers under VERITAS Software Corporation 2003 Stock Incentive Plan				X
10.04	Form of Restricted Stock Issuance Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
10.05	Form of RSU Award Agreement under VERITAS Software Corporation 2003 Stock Incentive Plan				X
31.01	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X