UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2004

OR

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

For the transition period from ________to _________

Commission file number 0-20725

SIEBEL SYSTEMS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3187233**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

2207 Bridgepointe Parkway
San Mateo, CA 94404
(Address of Principal Executive Offices, Including Zip Code)

(650) 477-5000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES [X] NO [ ]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
YES [X] NO [ ]

The number of shares outstanding of the Registrant's common stock, par value $.001 per share, as of October 20, 2004, was 508,172,487.

SIEBEL SYSTEMS, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2004

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Part I. Financial Information

Item 1. Financial Statements

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

	December 31, 2003	September 30, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 583,532	$ 506,574
Short-term investments	1,439,674	1,647,162
Total cash, cash equivalents and short-term investments	2,023,206	2,153,736
Accounts receivable, net	259,834	208,805
Deferred income taxes	61,742	64,222
Prepaids and other	52,186	47,557
Total current assets	2,396,968	2,474,320
Property and equipment, net	157,391	93,730
Goodwill	140,957	202,488
Intangible assets, net	10,786	24,066
Other assets	42,406	37,300
Deferred income taxes	95,866	94,866
Total assets	$ 2,844,374	$ 2,926,770
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 18,907	$ 31,898
Accrued expenses	333,270	317,462
Restructuring obligations	53,676	36,397
Deferred revenue	282,217	288,869
Total current liabilities	688,070	674,626
Restructuring obligations, less current portion	97,919	78,474
Other long-term liabilities	8,159	3,035
Total liabilities	794,148	756,135
Commitments and contingencies		
Stockholders' equity:		
Common stock; $0.001 par value; 2,000,000 shares authorized; 498,305 and 507,596 shares issued and outstanding, respectively	498	508
Additional paid-in capital	1,550,834	1,622,821
Deferred compensation	(1,479)	(3,021)
Accumulated other comprehensive income	58,650	49,366
Retained earnings	441,723	500,961
Total stockholders' equity	2,050,226	2,170,635
Total liabilities and stockholders' equity	$ 2,844,374	$ 2,926,770

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Revenues:				
Software license	$ 110,003	$ 104,579	$ 331,989	$ 326,207
Professional services, maintenance and other	211,429	212,507	655,497	621,225
Total revenues	321,432	317,086	987,486	947,432
Cost of revenues:				
Software license	5,974	3,010	14,963	9,054
Professional services, maintenance and other	120,489	108,868	372,142	324,534
Total cost of revenues	126,463	111,878	387,105	333,588
Gross margin	194,969	205,208	600,381	613,844
Operating expenses:				
Product development	71,432	69,718	226,177	217,279
Sales and marketing	82,756	76,500	276,804	241,166
General and administrative	27,319	27,114	81,860	76,200
Restructuring and related expenses	104,767	6,151	105,041	5,743
Purchased in-process product development	--	--	--	6,000
Total operating expenses	286,274	179,483	689,882	546,388
Operating income (loss)	(91,305)	25,725	(89,501)	67,456
Other income (expense), net:				
Interest and other income, net	14,140	11,698	44,562	33,804
Loss on early extinguishment of debt	(10,711)	--	(10,711)	--
Interest expense	(4,827)	(174)	(14,575)	(728)
Total other income (expense), net	(1,398)	11,524	19,276	33,076
Income (loss) before income taxes	(92,703)	37,249	(70,225)	100,532
Income taxes (benefit)	(33,373)	17,879	(25,281)	41,294
Net income (loss)	$ (59,330)	$ 19,370	$ (44,944)	$ 59,238
Diluted net income (loss) per share	$ (0.12)	$ 0.04	$ (0.09)	$ 0.11
Basic net income (loss) per share	$ (0.12)	$ 0.04	$ (0.09)	$ 0.12
Shares used in diluted share computation	493,933	533,303	490,049	540,416
Shares used in basic share computation	493,933	506,706	490,049	503,983
Comprehensive income (loss):				
Net income (loss)	$ (59,330)	$ 19,370	$ (44,944)	$ 59,238
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments	(2,586)	4,354	16,130	(2,305)
Realized (gain) loss on marketable investments previously recognized in other comprehensive income	(633)	(88)	(2,856)	(1,198)
Unrealized gain (loss) on investments, net	(3,131)	3,690	2,568	(5,781)
Other comprehensive income (loss)	(6,350)	7,956	15,842	(9,284)
Total comprehensive income (loss)	$ (65,680)	$ 27,326	$ (29,102)	$ 49,954

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ (44,944)	$ 59,238
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Write-off of property and equipment abandoned in restructuring	17,506	1,908
Write-off of purchased in-process product development	--	6,000
Write-off of acquired technology	2,449	--
Loss on early extnguishment of debt	10,711	--
Depreciation and amortization	116,189	84,356
Amortization of identifiable intangible assets	5,051	7,219
Stock-based compensation, net	1,326	2,494
Provision for (recovery of) doubtful accounts and sales returns	7,434	(939)
Tax benefit from exercise of stock options	--	10,400
Deferred income taxes	(25,423)	16
Write-down of cost-method investments to fair value	675	1,820
Net realized gains on marketable investments	(4,760)	(1,997)
Changes in operating assets and liabilities:		
Accounts receivable	79,728	54,439
Prepaids and other	(1,062)	9,279
Accounts payable and accrued expenses	(26,353)	(5,604)
Restructuring obligations	25,209	(38,354)
Deferred revenue	(10,552)	4,802
Net cash provided by operating activities	153,184	195,077
Cash flows from investing activities:		
Purchases of property and equipment, net	(14,021)	(7,790)
Purchases of short-term investments	(1,521,990)	(1,398,049)
Sales and maturities of short-term investments	1,522,069	1,167,923
Proceeds from sale of marketable equity securities	5,593	505
Purchase consideration for acquired businesses, net of cash received	(1,680)	(76,556)
Other non-operating assets and non-marketable securities	(324)	--
Net cash used in investing activities	(10,353)	(313,967)
Cash flows from financing activities:		
Proceeds from issuance of common stock	41,127	57,368
Repurchase of convertible subordinated debentures	(307,080)	--
Repayments of capital lease obligations	(9,549)	(9,398)
Net cash provided by (used in) financing activities	(275,502)	47,970
Effect of exchange rate fluctuations	10,161	(6,038)
Change in cash and cash equivalents	(122,510)	(76,958)
Cash and cash equivalents, beginning of period	667,511	583,532
Cash and cash equivalents, end of period	$ 545,001	$ 506,574
Supplemental disclosures of non-cash activities:		
Fair value of common stock and stock options issued for acquisitions	$ 1,670	$ --

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Siebel Systems, Inc. and its wholly owned subsidiaries (the "Company"). The accompanying unaudited consolidated financial statements have been prepared on substantially the same basis as the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations regarding interim financial statements. All amounts included herein related to the consolidated financial statements as of September 30, 2004 and the three and nine months ended September 30, 2003 and 2004 are unaudited. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

In the opinion of management, these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for their fair presentation. The interim results presented are not necessarily indicative of results for any subsequent quarter or for the year ending December 31, 2004. Certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates

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

Stock-Based Compensation

The Company accounts for its employee stock-based compensation plans using the intrinsic value method, as prescribed by APB No. 25 "Accounting for Stock Issued to Employees" and interpretations thereof (collectively referred to as "APB 25"). Accordingly, the Company records deferred compensation costs related to its employee stock options when the market price of the underlying stock on the date of grant exceeds the exercise price of the stock option on the date of grant. Deferred compensation is expensed on a straight-line basis over the vesting period of the related stock option, which is generally five years. The Company did not grant any stock options at exercise prices below the fair market value of the Company's common stock on the date of grant during any period presented.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Net income (loss):				
As reported	$ (59,330)	$ 19,370	$ (44,944)	$ 59,238
Compensation expense related to:				
Stock options dilutive to stockholders:				
Stock-based compensation accounted for under APB 25	346	386	1,326	2,494
In-the-money stock options and restricted stock units	(7,109)	(584)	(20,853)	(3,140)
Stock purchase rights under the Purchase Plan	(1,904)	(2,554)	(3,973)	(8,071)
Subtotal	(8,667)	(2,752)	(23,500)	(8,717)
Stock options not dilutive to stockholders:				
Out-of-the-money stock options	(35,738)	(35,109)	(108,320)	(120,002)
Stock options cancelled for no consideration	--	--	(251,821)	--
Stock options forfeited in connection with terminations	(6,390)	--	(29,337)	(1,940)
Subtotal	(42,128)	(35,109)	(389,478)	(121,942)
Total pro forma expense giving effect to SFAS 123	(50,795)	(37,861)	(412,978)	(130,659)
Pro forma net loss giving effect to SFAS 123	$ (110,125)	$ (18,491)	$ (457,922)	$ (71,421)
Diluted net income (loss) per share:				
As reported	$ (0.12)	$ 0.04	$ (0.09)	$ 0.11
Pro forma giving effect to SFAS 123	$ (0.22)	$ (0.04)	$ (0.93)	$ (0.14)
Basic net income (loss) per share:				
As reported	$ (0.12)	$ 0.04	$ (0.09)	$ 0.12
Pro forma giving effect to SFAS 123	$ (0.22)	$ (0.04)	$ (0.93)	$ (0.14)

Consistent with the Company's accounting for deferred tax assets resulting from the exercise of employee stock options in the accompanying consolidated financial statements, the Company has not provided a tax benefit on the pro forma expense in the above table.

In-the-money stock options in the above table have exercise prices below the closing price of the Company's common stock as of the end of each of the respective periods, and out-of-the-money stock options have exercise prices equal to or greater than the closing price of the Company's common stock as of the end of each of the respective periods. The closing prices as of September 30, 2003 and 2004 were $9.76 and $7.54, respectively.

As the table above illustrates, total pro forma expense for stock options includes $42,128,000 and $389,478,000 of expense during the three and nine months ended September 30, 2003, respectively, and $35,109,000 and $121,942,000 of expense during the three and nine months ended September 30, 2004, respectively, related to (i) stock options that were cancelled by the Company's Chairman for no consideration, (ii) stock options forfeited by employees upon termination for no consideration, and (iii) stock options that are significantly out of the money (e.g., the weighted-average exercise price of the out-of-the-money stock options was $17.77 per share compared to a closing price of $7.54 per share as of September 30, 2004). These items represented 83% and 94% of the pro forma expense for the three and nine months ended September 30, 2003, respectively, and 93% of the pro forma expense for both the three and nine months ended September 30, 2004.

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

Expected Life

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

Company estimated the expected useful lives for each of these categories giving consideration to the vesting and purchase periods, contractual lives, expected employee turnover, the relationship between the exercise price and the fair market value of the Company's common stock, and past and expected exercise behavior within each of the individual categories, among other factors.

During the three months ended September 30, 2004, the Company increased its expected life assumption, both on a year-over-year and sequential basis, related to each of the above categories primarily due to the continued low levels of volatility of its common stock (i.e., lower volatility historically results in a longer stock option life).

Volatility

The Company estimated expected volatility giving consideration to the expected useful lives of the stock options, the Company's current expected growth rate, implied expected volatility in traded options for the Company's common stock, and recent volatility of the Company's common stock, among other factors. In considering these factors, the Company notes that (i) the stock market in general, and its common stock in particular, have continued to become less volatile over the last two years; and (ii) implied volatility in traded options for the Company's common stock has continued to decrease during the third quarter of 2004 relative to previous periods.

Risk-Free Interest Rate

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Risk-free interest rate	2.02 %	3.06 %	1.69 %	3.00 %
Expected life (in years)	3.3	3.7	3.1	3.4
Expected volatility	46 %	41 %	47 %	41 %

Using the Black-Scholes option valuation model, stock options granted during the three and nine months ended September 30, 2003 had weighted average fair values of $3.21 and $2.92 per share, respectively, as compared to weighted average fair values of $2.60 and $3.20 per share during the three and nine months ended September 30, 2004, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Risk-free interest rate	1.01 %	1.71 %	1.05 %	1.40 %
Expected life (in years)	0.6	0.5	0.6	0.5
Expected volatility	38 %	46 %	47 %	46 %

The weighted average fair value of the common stock purchase rights granted under the Purchase Plan during the three and nine months ended September 30, 2003 was $2.48 and $2.40 per share, respectively, as compared to a weighted average fair value of $2.22 and $2.85 per share during the three and nine months ended September 30, 2004, respectively.

Recent Accounting Pronouncements

In June 2004, the Emerging Issues Task Force ("EITF") issued EITF No. 03-01 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-01"). EITF 03-01 provides guidance with respect to determining the meaning of other-than-temporary impairment and its application to debt and equity securities within the scope of SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), including investments accounted for under the cost method.

The Company expects to apply the recognition and measurement guidance in EITF 03-01 to other-than-temporary impairment evaluations beginning in the fourth quarter of 2004. The Company adopted the disclosure provisions of EITF 03-01 for marketable investments as of December 31, 2003 and will adopt the disclosure requirements for cost method investments as of December 31, 2004. The Company does not expect the adoption of EITF 03-01 to have a material effect on its financial position, results of operations or cash flows.

2. Restructuring Obligations

During 2002, 2003 and 2004, the Company initiated a series of restructurings designed to better align its operating structure with expected revenue levels. The Company initiated and completed the first restructuring of its operations during 2002 (the "2002 Restructuring"), resulting in a charge to its operations of $205,305,000 during 2002. Due in part to the continued weakening in the global economy and reduced revenue expectations, the Company initiated a further restructuring of its operations in the second quarter of 2003, which was completed in September 2003 (the "2003 Restructuring"). The Company recorded charges to its operations during 2003 totaling $104,391,000, which consisted of $89,500,000 associated with the 2003 Restructuring and $14,891,000 associated with changes in estimates related primarily to the 2002 Restructuring.

The 2002 and 2003 Restructurings included the following key measures: (i) the reduction of the Company's workforce across all functional areas; (ii) the consolidation of its excess facilities; (iii) the abandonment of certain long-lived assets, including leasehold improvements, furniture and fixtures; and (iv) the transfer of certain technical support, quality assurance and other product development positions to labor markets with lower cost structures.

In order to continue to reduce expense levels and to further improve the Company's operating margins, the Company initiated an additional restructuring of its operations during the third quarter of 2004 (the "2004 Restructuring," and collectively with the 2002 Restructuring and 2003 Restructuring, the "Restructurings"). The 2004 Restructuring consisted primarily of the consolidation of additional facilities (located primarily in North America and Asia Pacific) and the abandonment of the related leasehold improvements and furniture and fixtures.

The following table summarizes the restructuring and related expenses incurred during the nine months ended September 30, 2004, and the remaining obligations related to the Restructurings as of December 31, 2003 and September 30, 2004 (in thousands):

	Employee Termination Costs (1)	Facility-Related Costs (2)	Asset Abandonment Costs (3)	Total
Restructuring obligations, December 31, 2003	$ 3,805	$ 147,790	$ --	$ 151,595
Restructuring and related expenses:				
Recognized related to the 2004 Restructuring (4)	--	2,833	1,703	4,536
Recognized related to changes in estimates (5)	(1,465)	837	205	(423)
Accretion related to the Restructurings (6)	--	1,630	--	1,630
Total (7)	(1,465)	5,300	1,908	5,743
Cash payments	(1,557)	(39,002)	--	(40,559)
Non-cash charges	--	--	(1,908)	(1,908)
Restructuring obligations, September 30, 2004	$ 783	$ 114,088	$ --	$ 114,871
Less: Restructuring obligations, short-term				36,397
Restructuring obligations, long-term				$ 78,474

(1) The costs associated with the Company's workforce reductions consist primarily of severance payments, COBRA benefits, payroll taxes and other associated termination costs incurred in connection with the 2003 Restructuring. The remaining obligations as of September 30, 2004 relate to less than 10 terminations that have yet to be completed, primarily due to regulatory requirements in certain countries outside the U.S. The Company expects to complete these terminations within the next six months.

(2) The costs associated with the Company's facilities consolidation primarily relate to lease termination costs, costs associated with satisfying remaining lease commitments, and expected brokerage and other re-letting costs, partially offset by estimated sublease income.

(3) As part of the consolidation of the Company's facilities, certain leasehold improvements, furniture and fixtures were abandoned. As a result, the Company recorded a non-cash charge equal to the net book value of these abandoned assets in restructuring and related expenses.

(4) In accordance with SFAS 146, the Company recorded the facility-related expenses incurred in the 2004 Restructuring after giving effect to the net present value of the related obligations.

(5) The Company revised its estimated obligations with respect to the 2003 Restructuring during the nine months ended September 30, 2004 as follows:

- Employee termination costs—Due primarily to higher than expected voluntary terminations associated with positions included in the 2003 Restructuring, the Company reduced its remaining obligations for employee termination costs during the second quarter of 2004.

- Facility-related costs—Due primarily to the real estate markets in which the Company operates remaining at depressed levels longer than originally anticipated, the Company extended the estimated sublease commencement dates and/or reduced the estimated sublease rates on certain restructured properties. Partially offsetting these reductions in estimated sublease income were favorable changes in estimates that resulted from the Company entering into subleases sooner and/or at higher sublease rates than originally anticipated on certain other restructured properties.

(6) Represents the accretion of the 2003 and 2004 Restructuring obligations. The Company will continue to accrete its obligations related to the 2003 and 2004 Restructurings to the then present value and, accordingly, will recognize additional accretion expense as a restructuring and related expense in future periods.

(7) The following is a summary of the net restructuring and related expenses recognized during the three and nine months ended September 30, 2004 (in thousands):

	Six Months Ended June 30, 2004	Third Quarter	Nine Months Ended September 30, 2004
Restructuring and related expenses:			
2004 Restructuring-related	$ --	$ 4,536	$ 4,536
Changes in estimates	(1,579)	1,156	(423)
Accretion	1,171	459	1,630
Total restructuring and related expenses	$ (408)	$ 6,151	$ 5,743

The following table summarizes the time period in which the Company anticipates settling its remaining restructuring obligations as of September 30, 2004 (in thousands):

	Leases in the Restructurings (1)	Other Restructuring-Related Costs (2)	Estimated Sublease Income (3)	Total Restructuring Obligations
Three months ending December 31, 2004	$ 7,581	$ 6,752	$ (2,647)	$ 11,686
Year ending December 31, 2005	42,068	11,862	(19,777)	34,153
Year ending December 31, 2006	32,199	9,240	(19,944)	21,495
Year ending December 31, 2007	27,394	5,810	(20,010)	13,194
Year ending December 31, 2008	26,450	7,286	(18,531)	15,205
Year ending December 31, 2009, and thereafter	120,485	36,509	(129,363)	27,631
Total restructuring obligations, gross	$ 256,177	$ 77,459	$ (210,272)	123,364
Future accretion (4)				(8,493)
Present value of minimum lease payments				114,871
Less: restructuring obligations, short-term				36,397
Restructuring obligations, long-term portion				$ 78,474

(1) Represents the Company's remaining lease commitments related to properties included in the Restructurings.

(2) Consists primarily of (i) estimated operating costs (i.e., common area maintenance and property taxes) associated with restructured properties, (ii) estimated commissions associated with anticipated subleases of the restructured properties, and (iii) the remaining obligations related to employee termination cost.

(3) The Company estimated sublease income and the related timing thereof based upon the opinions of independent real estate consultants, current market conditions, the status of negotiations with potential subtenants, and the location of the respective facility, among other factors. The Company's estimates of sublease income may vary significantly from actual amounts realized depending, in part, on factors which may be beyond the Company's control, such as the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases.

(4) The Company has reduced the facility-related obligations associated with the 2003 and 2004 Restructurings to their net present value. Future accretion represents the interest component of these obligations and will be recognized in future periods by the Company as an additional restructuring and related expense and as an increase in the carrying amount of the 2003 and 2004 Restructuring obligations.

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

3. Convertible Subordinated Debentures

In September 1999, the Company issued $300,000,000 of convertible subordinated debentures (the "Debentures") and in connection therewith incurred $8,684,000 of issuance costs (the "Issuance Costs"). On September 30, 2003, the Company redeemed all of the Debentures in accordance with their terms for $307,080,000, plus accrued interest of $688,000. In connection with this redemption, the Company incurred a pre-tax charge to operations of $10,711,000, consisting of a $7,080,000 redemption premium and the write-off of the remaining unamortized Issuance Costs of $3,631,000. The Company has reflected the $10,711,000 loss on the early extinguishment of the debt in "Other income, net" during the three and nine months ended September 30, 2003.

Prior to redemption, the Debentures bore interest at a rate of 5.50% per annum, had a maturity date of September 15, 2006, and were convertible at the option of the holder into an aggregate of 12,867,000 shares of the Company's common stock at a conversion price of $23.32 per share.

4. Commitments and Contingencies

Legal Proceedings

On May 6, 2003, the Enforcement Division staff ("Staff") of the Securities & Exchange Commission ("SEC") contacted the Company and indicated that a May 1, 2003 article on CBS MarketWatch had raised questions regarding the Company's compliance with Regulation FD. In August 2003, the Staff notified the Company and two of its officers of the Staff's preliminary decision to recommend that the SEC take enforcement action against the Company and these officers in regard to statements allegedly made prior to and during an April 30, 2003 dinner. The Company and its officers have filed submissions with the SEC in response to the SEC notices that the Company believes contained numerous meritorious defenses to these allegations. Despite these submissions, on June 29, 2004, the SEC filed a lawsuit in the United States District Court of the Southern District of New York against the Company and two of its officers alleging, among other things, that the Company and its officers violated Regulation FD in connection with the statements described above. In September 2004, the Company filed a motion to dismiss the complaint. A hearing on the motion has been scheduled for December 2004. The Company believes the allegations in this action are without merit and it intends to defend itself vigorously.

On March 10, 2004, William Wollrab, on behalf of himself and purportedly on behalf of a class of the Company's stockholders, filed an action in the United States District Court for the Northern District of California against the Company and certain of its officers. This complaint was consolidated and amended on August 27, 2004, with the Policemen's Annuity and Benefit Fund of Chicago being appointed to serve as lead plaintiff. In October 2004, the Company filed a motion for dismissal of the consolidated complaint in this case. On April 12, 2004, Pamela Plotkin, on behalf of herself and purportedly on behalf of a class of the Company's stockholders, filed an action in the Superior Court of California (the "Superior Court") against the Company and certain members of the Company's Board of Directors. These actions allege claims in connection with various public statements made by the Company and seek damages together with interest and reimbursement of costs and expenses of litigation. The Superior Court dismissed the complaint by Ms. Plotkin on September 23, 2004, but gave Ms. Plotkin leave to file a new, amended complaint. The Company believes the allegations in these actions are without merit and it intends to defend vigorously against these claims.

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

Income, Payroll and Sales and Use Tax Audits

Income Tax Audits

The Company's U.S. Federal income tax returns for 1998 through 2003 are currently under examination by the Internal Revenue Service ("IRS"). During 2003 and 2004, the Company received notices from the IRS of proposed adjustments to certain of these tax returns. In August 2004, the Company reached a tentative settlement with the IRS with respect to the IRS's examination of the Company's income tax returns for 1998 through 2000, which the Company believes resolves all significant matters outstanding with respect to the Company's income tax returns for 1998 through 2000. Please refer to Note 5 below for a discussion of the impact on the Company's effective tax rate for the third quarter of 2004 due to this tentative settlement.

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

Payroll Tax Audits

The Company's U.S. payroll tax returns for 1999 through 2001 are currently under examination by the IRS, primarily related to taxes associated with stock option exercises. While to date the Company has not received any notices of proposed adjustments with respect to this examination, the Company expects that the IRS may issue a notice of proposed adjustment to its payroll tax returns in the fourth quarter of 2004. While the final resolution of this on-going examination of the Company's payroll tax returns is uncertain, based on currently available information, the Company believes it has made adequate provision in the accompanying consolidated financial statements for any adjustments that may result from the IRS audit of the Company's U.S. payroll tax returns for 1999 through 2001.

Sales and Use Tax Audits

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

Summary

The Company may receive assessments related to the audits and/or reviews of its U.S. income tax returns, U.S. payroll tax returns, U.S. sales and use tax returns, and international sales and value added tax returns that exceed amounts provided for by the Company. In the event of such an assessment, there exists the possibility of a material adverse impact on the Company's results of operations for the period in which the matter is ultimately resolved or an unfavorable outcome becomes probable and reasonably estimable.

Indemnifications

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

The Company believes its internal development processes and other policies and practices are designed to limit its exposure related to the indemnification provisions of the SLSA. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which, with limited exception, assigns the rights to its employees' development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions and no material claims are outstanding as of September 30, 2004. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement claims under the SLSA, the Company cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions.

Lease Obligations

As of September 30, 2004, the Company leases facilities and certain equipment under non-cancelable operating leases expiring between 2004 and 2022. The Company also leases certain assets, primarily computer equipment, under capital leases expiring between 2004 and 2005. Future minimum lease payments under both operating and capital leases as of September 30, 2004 are as follows (in thousands):

	Capital Leases	Operating Leases
Three months ending December 31, 2004	$ 2,620	$ 21,070
Year ending December 31, 2005	6,500	65,993
Year ending December 31, 2006	--	63,858
Year ending December 31, 2007	--	61,945
Year ending December 31, 2008	--	61,865
Year ending December 31, 2009, and thereafter	--	371,151
Total minimum lease payments	9,120	$ 645,882
Amounts representing interest	(342)	
Present value of minimum lease payments	8,778	
Less: capital lease obligations, short-term portion (included in accrued expenses)	1,169	
Capital lease obligations, long-term portion (included in other long-term liabilities)	$ 7,609	

Operating lease commitments related to properties included in the Restructurings are not reflected in the above table, as the Company has reflected the fair value of these obligations in the accompanying consolidated balance sheet under the caption "Restructuring obligations." Please refer to Note 2 for further discussion of the Company's restructuring obligations, including a five-year summary of anticipated settlement dates of such obligations.

5. Income Taxes

The Company's income tax expense computed at the federal statutory rate of 35% differed from the Company's actual income tax expense for the three and nine months September 30, 2004 primarily due to (i) additional tax expense associated with the tentative settlement of certain IRS income tax examinations, as discussed further in Note 4, and (ii) certain expenses that are not deductible for income tax purposes. The following is a reconciliation of the Company's federal statutory rate to the Company's effective tax rate for the three and nine months ended September 30, 2004 (in thousands):

	Period Ended September 30, 2004	
	Three Months	Nine Months
Expected income tax expense	35.0 %	35.0 %
State income taxes, net of federal tax benefit	2.6 %	3.1 %
Tentative settlement of income tax audit	9.9 %	3.7 %
Non-deductible expenses	5.7 %	4.6 %
Purchased in-process product development	-- %	2.1 %
Foreign rate differential	(6.5)%	(6.2)%
Research and development credit	-- %	(1.0)%
Other, net	1.3 %	(0.2)%
Total income tax expense	48.0 %	41.1 %

6. Acquisitions, Goodwill and Intangible Assets

The following is a summary of the Company's acquisitions during 2003 and 2004, each of which has been accounted for as a purchase:

2004 Acquisitions

Acquisition of Eontec Limited

On April 20, 2004, the Company acquired all of the outstanding issued share capital of Eontec Limited ("Eontec"), a global provider of multichannel retail banking solutions, for initial cash consideration of $73,586,000 (the "Initial Consideration"). The Initial Consideration consists of the following: (i) the payment of cash consideration of $70,000,000 for all of the outstanding securities of Eontec and (ii) transaction costs of $3,586,000, consisting primarily of professional fees incurred related to investment bankers, attorneys, accountants and valuation advisors.

In the event certain revenue targets defined in the purchase agreement are met for the period from April 20, 2004 to March 31, 2005, the Company could be required to pay up to an additional $37,500,000 in cash to the former shareholders of Eontec and up to an additional $22,500,000 in cash to the former employees of Eontec who are employees of the Company at the time of payment. Any amounts paid by the Company to the Eontec shareholders will be recorded as an increase to goodwill and amounts paid to the former employees of Eontec will be recorded as compensation expense when earned.

The Company believes that Eontec's technology and certain products and functionality under development by Eontec at the time of purchase will enhance the Company's current offerings in the retail banking market. With the acquisition of Eontec, the Company expanded its solutions offering for banking to include branch teller and Internet banking systems, creating one of the first retail banking solutions that enables banks to increase branch profitability using an integrated suite of financial transactions, marketing, sales, service and business intelligence capabilities. The Company expects that its fully integrated solution will offer a standards-based, service-oriented architecture to handle a wide range of customer interactions through multiple channels, including the branch, call center, Internet and ATM.

In accordance with the purchase method of accounting prescribed by SFAS No. 141 "Business Combinations" ("SFAS 141"), the Company allocated the Initial Consideration to the tangible net assets and liabilities and intangible assets acquired, based on their estimated fair values. Under the purchase method of accounting, the Initial Consideration does not include the contingent earnout amounts described above. The Initial Consideration has been allocated as follows (in thousands):

Tangible assets:	
Cash and cash equivalents	$ 2,507
Accounts receivable and other current assets	3,169
Property and equipment	473
Other assets, long-term	88
Total tangible assets	6,237
Intangible assets:	
Identifiable intangibles	17,300
Acquired in-process research and development ("IPR&D")	6,000
Goodwill	53,686
Total intangible assets	76,986
Liabilities assumed:	
Accounts payable and accrued liabilities	(4,898)
Deferred revenue	(1,827)
Deferred tax liability	(2,912)
Total liabilities assumed	(9,637)
Net assets acquired	$ 73,586

The purchase price allocation is preliminary and a final determination of the purchase accounting adjustments will be made upon the completion of a final analysis of the total purchase cost. The items pending completion by the Company include an analysis of (i) estimated involuntary termination and related costs and (ii) certain commitments under customer contracts assumed in connection with the acquisition. The Company expects to finalize these matters by the end of 2004.

In performing this preliminary purchase price allocation of acquired intangible assets, the Company considered its intention for future use of the assets, analyses of historical financial performance and estimates of future performance of Eontec's products, among other factors. Acquired identifiable intangible assets obtained in the Company's acquisition of Eontec and the associated estimated useful lives are as follows (in thousands, except for years):

Intangible assets:		**Amount**	**Wtd. Avg. Life (in Years)**	**Range of Lives (in Years)**
Acquired technology	$	10,700	5.0 years	5 years
Customer relationships		4,100	4.5 years	3 to 6 years
Customer contracts		2,500	3.6 years	1 to 5 years
Total intangible assets	$	17,300		

In addition to the identifiable intangible assets in the above table, the Company also purchased certain technologies under development, primarily related to Eontec's internet banking and teller products. The Company estimated the fair value of this in-process research and development ("IPR&D") to be $6,000,000, which the Company has reflected in "purchased in-process product development" expense in the accompanying statement of operations. The Company estimated that the technologies under development relating to the Internet banking and teller products were approximately 25% and 75% complete, respectively, at the date of acquisition. As of the acquisition date, the Company estimated it would incur up to an additional $2,500,000 to complete this development, with completion expected in late 2004 or early 2005.

The Company determined the fair values of each of the above identifiable intangible assets and the IPR&D using the "income" valuation approach and discount rates ranging from 23% to 25%. The discount rates selected were based in part on the Company's weighted average cost of capital and determined after consideration of the Company's rate of return on debt capital and equity, the weighted average return on invested capital and the risk associated with achieving forecasted cash flows. Further, the Company also considered risks associated with achieving anticipated levels of market acceptance and penetration, successful completion of various research and development efforts, market growth rates and risks related to the impact of potential changes in future target markets.

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

The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired of $53,686,000 was assigned to goodwill. In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill will not be amortized but will be tested for impairment at least annually. This amount is not expected to be deductible for tax purposes. The operating results of Eontec have been included in the Company's consolidated financial statements from the date of acquisition.

The following table presents unaudited summarized combined results of operations of the Company and Eontec, on a pro forma basis, as though the companies had been combined as of January 1, 2003. The operating results of Eontec have been included in the Company's consolidated financial statements from the date of acquisition and, accordingly, pro forma results for the three months ended September 30, 2004 have not been presented. The following amounts are in thousands, except per share amounts:

	Three Months Ended September 30, 2003		**Nine Months Ended September 30,**			
			2003		**2004**	
Total revenues	$	324,359	$	996,572	$	949,933
Net income (loss)	$	(62,945)	$	(54,406)	$	51,907
Diluted net income (loss) per share	$	(0.13)	$	(0.11)	$	0.10

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

Acquisition of Ineto Services

On January 29, 2004, the Company acquired all of the outstanding shares of Ineto Services, Inc. ("Ineto"), a provider of hosted call center services over the Internet, for a cash payment of $4,841,000. The Company has integrated Ineto's hosted telephony service, which the Company re-branded as Contact OnDemand, with its Siebel CRM OnDemand product offering. The Company expects the acquisition of Ineto to further accelerate its penetration of the hosted CRM market and expand customer choice in this market.

The Company allocated the purchase price of $4,841,000 to the tangible net assets and liabilities and intangible assets acquired, based on their estimated fair values as follows (in thousands):

Tangible assets:	
Cash and cash equivalents	$ 20
Accounts receivable and other current assets	507
Property and equipment	40
Other assets, long-term	5
Total tangible assets	572
Intangible assets:	
Acquired technology	500
Customer relationships	1,250
Non-compete agreements	750
Goodwill	3,842
Total intangible assets	6,342
Liabilities assumed:	
Accounts payable and accrued liabilities	(1,006)
Deferred revenue	(23)
Deferred tax liability	(1,000)
Other liabilities, long-term	(44)
Total liabilities assumed	(2,073)
Net assets acquired	$ 4,841

The customer relationship intangible assets are being amortized over a period of six years based on the estimated customer attrition rates, currently estimated based on Ineto's historical attrition rate of approximately 30% per year of the remaining acquired customers. The non-compete agreements and acquired technology intangible assets are being amortized over their estimated lives of two and three years, respectively, using the straight-line method. In performing this purchase price allocation, the Company considered, among other factors, its intention for future use of the acquired assets, analyses of historical financial performance and estimates of the future performance of the acquired business.

The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired of $3,842,000 was assigned to goodwill. In accordance with SFAS 142, goodwill will not be amortized but will be tested for impairment at least annually. This amount is not expected to be deductible for tax purposes. The operating results of Ineto have been included in the Company's consolidated financial statements from the date of acquisition. Pro forma information giving effect to this acquisition has not been presented because the pro forma information would not differ materially from the historical results of the Company.

2003 Acquisitions

<u>*Acquisition of UpShot Corporation*</u>

On November 3, 2003, the Company acquired all of the outstanding shares of UpShot Corporation ("UpShot"), a leading provider of a hosted CRM service, for initial cash consideration of $55,984,000 (the "Initial Purchase Price"). The Company expects the acquisition of UpShot to accelerate its penetration of the hosted CRM market and expand customer choice in this market. Further, the Company believes the acquisition of UpShot will allow it to capitalize on the expertise of the UpShot management team in the hosted CRM market and their ability to develop new products using the Company's existing technology.

In the event certain revenue, revenue-related and product delivery targets defined in the merger agreement are met during 2004, the Company could be required to pay up to an additional $9,000,000 to the former holders of UpShot common stock and an additional $9,000,000 to the former employees of UpShot who are employees of the Company at the time of payment. All amounts paid by the Company to the UpShot shareholders will be recorded as an increase to goodwill and amounts paid to the former employees of UpShot will be recorded as compensation expense when earned.

In accordance with the purchase method of accounting prescribed by SFAS 141, the Company allocated the Initial Purchase Price to the tangible net assets and liabilities and intangible assets acquired, based on their estimated fair values, as follows: (i) $3,199,000 to tangible assets, (ii) $6,700,000 to a "customer relationship" intangible asset, (iii) $1,200,000 to an "acquired technology" intangible asset and (iv) $13,502,000 to assumed liabilities. The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired of $58,387,000 was assigned to goodwill.

The acquired technology intangible asset is currently being amortized over a period of 14 months using the straight-line method and the customer relationship intangible asset is being amortized over a period of six years based on the estimated customer attrition rates, currently estimated based on UpShot's historical attrition rate of approximately 30% per year of the remaining acquired customers. In accordance with SFAS 142, goodwill will not be amortized but will be tested for impairment at least annually. This amount is not deductible for tax purposes.

The following table presents unaudited summarized combined results of operations of the Company and UpShot, on a pro forma basis, as though the companies had been combined as of January 1, 2002. The operating results of UpShot have been included in the Company's consolidated financial statements from the date of acquisition and, accordingly, pro forma results for the three and nine months ended September 30, 2004 have not been presented. The following amounts are in thousands, except per share amounts:

	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2003
Total revenues	$ 323,234	$ 992,403
Net loss	$ (63,900)	$ (53,768)
Diluted net loss per share	$ (0.13)	$ (0.11)

The above unaudited pro forma summarized results of operations are intended for informational purposes only and, in the opinion of management, are neither indicative of the financial position or results of operations of the Company had the acquisition actually taken place as of January 1, 2002, nor indicative of the Company's future results of operations. In addition, the above unaudited pro forma summarized results of operations do not include potential cost savings from operating efficiencies or synergies that may result from the Company's acquisition of UpShot.

Goodwill

The changes in the carrying amount of goodwill during the nine months ended September 30, 2004 were as follows (in thousands):

Balance as of December 31, 2003	$	140,957
Purchase of Ineto		3,842
Purchase of Eontec		53,686
Payment of earnout consideration		656
Foreign currency fluctuation and other		3,347
Balance as of September 30, 2004	$	202,488

As required by SFAS 142, the Company does not amortize its goodwill balances, but instead tests its goodwill for impairment annually on July 1 and more frequently upon the occurrence of certain events in accordance with the provisions of SFAS 142. The Company's annual goodwill impairment test performed in the third quarter of 2004 indicated no impairment of goodwill as of July 1, 2004.

Intangible Assets

Intangible assets as of December 31, 2003 and September 30, 2004, along with the weighted average useful lives as of September 30, 2004, are as follows (in thousands, except years):

	December 31, 2003	September 30, 2004	Wtd. Avg. Life (in Years)
Gross assets:			
Acquired technology	$ 9,977	$ 21,624	3.9
Customer relationships	6,700	12,221	5.5
Customer contracts	--	2,605	3.6
Non-compete agreements	--	750	2.0
Intangible assets, gross	16,677	37,200	
Accumulated amortization:			
Acquired technology	(5,549)	(9,777)	
Customer relationships	(342)	(2,578)	
Customer contracts	--	(529)	
Non-compete agreements	--	(250)	
Total accumulated amortization	(5,891)	(13,134)	
Intangible assets, net	$ 10,786	$ 24,066	

The Company is amortizing its intangible assets as follows: (i) acquired technology, customer contracts and non-compete agreements are currently being amortized over their estimated useful lives using the straight-line method and (ii) customer relationship intangible assets are currently being amortized over their estimated useful lives based on the greater of the straight-line method or the estimated customer attrition rates. Based on identified intangible assets recorded as of September 30, 2004 and assuming no subsequent impairment of the underlying assets, amortization expense is expected to be as follows (in thousands):

Period		
Three months ending December 31, 2004	$	2,645
Year ending December 31, 2005		6,416
Year ending December 31, 2006		5,065
Year ending December 31, 2007		4,046
Year ending December 31, 2008		3,800
Year ending December 31, 2009, and thereafter		2,094
Total	$	24,066

7. Net Income (Loss) per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Shares used in basic net income (loss) per share computation	493,933	506,706	490,049	503,983
Effect of dilutive potential common shares resulting from stock options	--	26,592	--	36,388
Effect of dilutive potential common shares resulting from restricted stock units and common stock subject to repurchase	--	5	--	45
Shares used in diluted net income (loss) per share computation	493,933	533,303	490,049	540,416

Because the Company reported a net loss during the three and nine months ended September 30, 2003, the Company excluded the impact of its common stock equivalents in the computation of dilutive earnings per share for these periods, as their effect would be anti-dilutive. The dilutive impact of the Company's stock options for the three and nine months ended September 30, 2004 is calculated using the treasury stock method, based on the average share price of the Company's common stock. The average share prices of the Company's common stock during the three and nine months ended September 30, 2004 were $7.84 and $10.65 per share, respectively. Under the treasury stock method, the proceeds that would be hypothetically received from the exercise of all stock options with exercise prices below the average share price of the Company's common stock are assumed to be used to repurchase shares of the Company's common stock.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Stock options excluded due to the exercise price exceeding the average fair value of the Company's common stock during the period	73,028	85,856	74,955	60,430
Weighted average stock options and restricted stock, calculated using the treasury stock method, that were excluded due to the Company reporting a net loss during the period	38,195	--	36,603	--
Total common stock equivalents excluded from diluted net income (loss) per share computation	111,223	85,856	111,558	60,430

Under the treasury stock method, stock options with exercise prices exceeding the average share price of the Company's common stock during the applicable period are excluded from the diluted earnings per share computation. These stock options had weighted average exercise prices of $22.32 and $21.99 per share during the three and nine months ended September 30, 2003, respectively, compared to weighted average exercise prices of $18.14 and $21.93 per share during the three and nine months ended September 30, 2004, respectively.

8. Restricted Stock Units

On May 5, 2004, the Company amended its 1996 Equity Incentive Plan and its 1998 Equity Incentive Plan (collectively, the "Plans") to allow the Company to issue restricted stock units ("RSUs"). RSUs are similar to restricted stock in that they are issued for no, or nominal, consideration; however, the holder generally is not entitled to the underlying shares of common stock until the RSU vests.

On May 5, 2004, the Company granted to its Chief Executive Officer, J. Michael Lawrie, an RSU for 350,000 shares of its common stock in connection with his commencement of employment. The terms of this RSU provide that 150,000 of the underlying shares of common stock vested during the second quarter of 2004 and the remaining 200,000 shares vest two years from his commencement of employment. On August 31, 2004, the Company granted two additional RSUs for an aggregate of 105,000 shares of its common stock to an employee upon commencement of employment. As of September 30, 2004, RSUs for a total of 305,000 shares of the Company's common stock were unvested and remain outstanding.

The Company recorded an aggregate of $4,533,000 of deferred compensation during the nine months ended September 30, 2004 in connection with the issuance of these RSUs, which the Company is amortizing on a straight-line basis over the respective vesting periods. The Company has reflected $325,000 and $2,103,000 of compensation expense associated with the RSUs in the accompanying unaudited statements of operations during the three and nine months ended September 30, 2004, respectively.

9. Segment and Geographic Information

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

The Company evaluates the performance of its geographic regions based only on revenues. The Company does not assess the performance of its geographic regions on other measures of income or expense, such as depreciation and amortization, operating income or net income. In addition, the Company's assets are primarily located in the United States and not allocated to any specific region. The Company does not produce reports for, or measure the performance of, its geographic regions using any asset-based metrics. Therefore, geographic information is presented only for revenues. The following geographic information for total revenues is presented for the three and nine months ended September 30, 2003 and 2004 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
United States	$ 193,239	$ 200,612	$ 586,622	$ 583,803
Europe	95,323	93,550	301,034	286,654
Asia Pacific	25,734	15,342	68,511	56,139
Canada and Latin America	7,136	7,582	31,319	20,836
	$ 321,432	$ 317,086	$ 987,486	$ 947,432

International software license revenues for the three and nine months ended September 30, 2003 were $50,433,000 and $157,308,000, respectively, representing 46% and 47% of software license revenues, respectively. International software license revenues for the three and nine months ended September 30, 2004 were $34,810,000 and $126,572,000, respectively, representing 33% and 39% of software license revenues, respectively.

The following is a summary of the Company's software license revenues, by CRM product, for the three and nine months ended September 30, 2003 and 2004 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Sales, marketing and service automation	$ 81,176	$ 67,397	$ 255,848	$ 227,163
Analytics	22,176	27,429	50,927	76,139
Business integration applications	5,364	8,333	11,725	17,900
Employee relationship management	1,287	1,420	13,489	5,005
Total	$ 110,003	$ 104,579	$ 331,989	$ 326,207

At times the Company licenses a combination of its products to its customers, with the actual product selection and number of licensed users determined subsequent to the initial license. The Company refers to these licenses as "Enterprise Licenses." The Company recognizes revenue from its Enterprise Licenses upon delivery of the first copy, or product master, for all of the products within the license, as all products have been licensed and delivered, and the customer has the right of use. During the three and nine months ended September 30, 2003, software license revenues from Enterprise Licenses were $19,969,000 and $44,796,000, respectively. During the three and nine months ended September 30, 2004, software license revenues from Enterprise Licenses were $11,810,000 and $48,847,000, respectively. The Company estimates the allocation of the revenue from these Enterprise Licenses to individual software products based upon the expected usage by its customers and in a manner consistent with its determination of compensation for its sales personnel. The actual deployment of Enterprise Licenses by the Company's customers may differ from the revenue allocated in the above table.

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

The following is a summary of the Company's professional services, maintenance and other revenues, by service offering, for the three and nine months ended September 30, 2003 and 2004 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Maintenance	$ 110,046	$ 118,059	$ 331,839	$ 347,350
Professional services and other	101,383	94,448	323,658	273,875
Total	$ 211,429	$ 212,507	$ 655,497	$ 621,225

No single customer accounted for 10% or more of total revenues during the three and nine months ended September 30, 2003 and 2004.

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

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

Executive Summary

Our consolidated financial statements are included in Item 1 of this Quarterly Report on Form 10-Q. The following discussion is designed to provide a better understanding of these financial statements, including (i) a brief discussion of our business and products, (ii) key factors that impacted our performance, (iii) a summary of our operating results and certain key financial metrics, and (iv) our outlook for the fourth quarter of 2004, including certain risks that may impact our operations. This executive summary should be read in connection with the more detailed discussion and analysis of our financial condition and results of operations in this Item 2, the section below entitled "Risk Factors," and our consolidated financial statements, which are included in Item 1 of this quarterly report.

Overview of Our Business and Products

We are a leading provider of business applications software for the customer relationship management, or CRM, market. Substantially all of our revenues are derived directly or indirectly from perpetual licenses of our software products. Specifically, we license our software solutions in multi-element arrangements that include a combination of our software, customer support and/or professional services (e.g., training or implementation services). Payment terms for our customer arrangements are negotiated with the individual customer and determined based on a variety of factors, including the customer's credit standing and our history with the customer.

Our CRM applications enable an organization to better manage its relationships with its customers, partners and employees. A substantial portion of our software license revenue is derived from our sales, marketing and service automation solutions, which provide organizations with an integrated approach to identifying, acquiring and retaining customers. For example, these applications assist (i) sales organizations with creating a comprehensive view into the sales pipeline, thereby enabling sales professionals to better manage opportunities; (ii) marketing organizations with increasing campaign response rates and reducing customer-acquisition costs; and (iii) service organizations with reducing response times with customers, thereby improving customer satisfaction.

We also provide CRM software solutions that help organizations better analyze corporate and customer data, lower the cost of integrating software applications and manage their employee relationships. Specifically, our business intelligence (otherwise known as analytics) applications assist organizations in analyzing large volumes of corporate data quickly and easily, while our integration applications allow organizations to share data and processes among different software applications. Our employee relationship management applications enable an organization to increase employee and organizational performance and improve employee satisfaction by aligning employee performance with corporate objectives and providing employees with the information resources they need to be successful.

In addition to licensing our CRM applications on a per-user basis, we introduced Siebel CRM OnDemand in the fourth quarter of 2003. Siebel CRM OnDemand is a hosted software solution that provides CRM functionality over the Internet. We provide Siebel CRM OnDemand to our customers for a monthly per-user subscription fee, with a typical contractual period of one year. Siebel CRM OnDemand allows our customers to implement CRM software solutions quickly, easily and cost effectively. Siebel CRM OnDemand integrates with our on-premise licensed suite of products, enabling organizations to deploy our solutions in any combination of online hosted or on-premise delivery models.

Our Global Services Organization, which is comprised of our professional services and technical support organizations, provides (i) implementation services (i.e., assistance with the integration of our software with the customers' other software and hardware applications), (ii) training services for our customers regarding how to use our software, and (iii) customer support services, otherwise known as maintenance, which include technical support for the related software products and future product updates.

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

Internal Controls and Corporate Governance

We consider our internal controls over financial reporting a high priority and will continue to do so through a continual review of and resulting improvement in our internal controls. Further, we have formed an Internal Controls Committee, comprised primarily of senior financial and legal personnel, which helps ensure our internal controls over financial reporting are complete, accurate and appropriately documented. As of September 30, 2004, our Internal Controls Committee and internal audit department have completed their review and testing of the majority of the individual processes that make up our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002, or SOX, and we believe that we are on schedule to complete the review of the remaining processes by the end of the year. Based on the testing performed to date, we have not identified any material weaknesses in our internal controls. In addition, we believe that our internal controls are functioning as designed and provide reasonable assurance that transactions are recorded as necessary to permit preparation of our financial statements in accordance with accounting principles generally accepted in the United States. With the work we have completed to date and planned, we believe that we are well-positioned for our independent auditors to issue their audit report on our internal controls for the year ended December 31, 2004.

In addition to maintaining robust internal controls, we follow high professional standards in measuring and reporting our financial performance. Specifically, we have adopted a code of conduct for all of our employees and directors that requires a high level of professionalism and ethical behavior. We believe that our accounting policies are prudent and provide a clear view of our financial performance. We utilize our internal audit function to help ensure that we follow these accounting policies and maintain our internal controls. Further, our Disclosure Committee, comprised primarily of senior financial and legal personnel, helps ensure the completeness and accuracy of our financial results and disclosures. In addition, prior to the release of our financial results, key members of our management review our operating results and key accounting policies and estimates with our Audit Committee, which is comprised solely of independent members of our Board of Directors. Please refer to the section entitled “Item 10. Directors and Executive Officers of the Registrant” of our Annual Report on Form 10-K for the year ended December 31, 2003 for a further discussion of our policies regarding corporate governance and our code of conduct.

Operating Environment during the Three and Nine Months Ended September 30, 2004

From the first quarter of 2001 to the third quarter of 2003, macro-economic conditions generally deteriorated or stabilized at depressed levels, with the information technology industry in which we operate disproportionately impacted. Beginning in the latter part of 2003, many key economic indicators, such as the U.S. gross domestic product, or GDP, and certain labor statistics, began to strengthen. Many of these same economic indicators continued to strengthen, albeit at slower growth rates, in the first nine months of 2004. Capital spending also moderately increased in the first nine months of 2004; however, spending on information technology—particularly business applications software—appears to continue to lag the overall improvements in macro-economic indicators and capital spending.

Further, many of our customers remain cautious in completing their software purchases. We attribute much of this cautiousness to our customers’ concerns regarding (i) the sustainability of the current economic recovery, (ii) the current geopolitical environment (i.e., continued concerns regarding future terrorist attacks and geopolitical conflicts) and (iii) heightened uncertainty within the business application software industry, due in part to the on-going unsolicited bid by Oracle Corporation for PeopleSoft, Inc. We have also recently experienced an increase in the number of approvals required by our customers prior to their execution of a software license and service agreement, possibly due to our customers’ efforts regarding the Sarbanes-Oxley Act of 2002. We believe these factors, among others, have led to a lengthening of our sales cycle.

We believe the above factors have also impacted the broader technology and software sectors, as a number of companies in these sectors showed year-over-year declines in revenues during the nine months ended September 30, 2004. Despite these trends in our operating environment, we also recognize that our performance during the first nine months of 2004—particularly the second quarter of 2004—did not meet our expectations and, as announced in July 2004, we developed and began executing on a plan to improve our execution and overall operating performance. Our progress to date against this plan is discussed further below.

Focus on Future Improvement in Our Operating Performance

In accordance with the plan announced in July 2004, we have been reviewing and continue to review our business thoroughly, with our primary focus in the following three areas: (i) revenue generation, (ii) financial structure and (iii) leadership. We are pleased with our progress to date, as many of our key financial metrics improved sequentially during the third quarter of 2004.

We believe the actions completed to date and our continued execution against this plan will provide a strong foundation for accelerated growth of our revenues, operating income and many other key financial metrics in the future. The following is a summary of our progress to date:

Revenue Generation

As a result of our execution against the above mentioned plan, our revenue performance during the third quarter of 2004 reflected improved execution and sequential quarterly growth from the second quarter. License, maintenance and professional services revenues increased sequentially from the second quarter of 2004, despite a typically seasonally weak third quarter. The following is a summary of the growth on a sequential quarterly basis:

- *Total revenue* was $317.1 million, increasing 5% from the second quarter;
- *License revenue* was $104.6 million, increasing 10% from the second quarter;
- *Maintenance revenue* was $118.1 million, increasing 3% from the second quarter;
- *Services and other revenue* was $94.4 million, increasing 3% from the second quarter; and
- *Total contract value for OnDemand* increased by 32% from the second quarter.

As outlined in July 2004, in order to improve our revenue generation capability, we are focusing on the following areas:

- **Small and medium-sized business ("SMB") initiative** – During the third quarter of 2004 we established a sales division focused on the SMB market to further extend our CRM leadership to companies of all sizes. We also joined forces with T-Systems, which will market and deliver a hosted CRM solution powered by Siebel CRM OnDemand in Germany, Austria, Switzerland, the Czech Republic, Hungary, Poland, Slovakia, Croatia and Russia.

- **Accelerate new growth initiatives** – In addition to our SMB and OnDemand initiatives, we have and will continue to invest in key growth areas, which include:

    - *New markets* – During the third quarter of 2004, we leveraged our expertise in providing industry-specific software solutions by introducing Siebel CRM OnDemand Industry Editions for the financial services, high tech, life sciences and automotive industries. Siebel CRM OnDemand is the first hosted CRM solution to provide industry-specific capabilities at the user-interface, data model and process levels.

    - *Analytics* – Software license revenues from analytics grew 17% sequentially from the second quarter of 2004 and increased on a year-over-year basis by 24% and 50% during the three and nine months ended September 30, 2004, respectively.

      During the third quarter of 2004 we expanded our business analytics product line with new enterprise analytic applications organized into four main application areas–customer analytics, financial analytics, workforce/employee performance management and supply chain and supplier analytics. These pre-built, end-to-end business intelligence solutions enable organizations to gain new levels of actionable intelligence across multiple business functions.

    - *Business Integration Applications* – Software license revenues from business integration applications (i.e., our Universal Customer Master, or UCM, and Universal Application Network, or UAN, products) increased 38% sequentially from the second quarter of 2004 and increased on a year-over-year basis by 55% and 53% during the three and nine months ended September 30, 2004, respectively.

    - *Global Services Organization* – Our professional services revenues increased sequentially from the second quarter of 2004 by 3%, representing the second consecutive quarter of sequential quarterly growth. We continue to evaluate ways to add to our recurring revenue businesses by investing, where appropriate, in other outsourced services and recurring revenue offerings originated in-house or delivered with partners.

- **Better aligning our selling model** – We more than doubled the number of transactions generating revenues equal to or greater than $1 million, with a total of 32 transactions in the third quarter of 2004 compared to 15 transactions during the second quarter of 2004. In addition, as discussed above, during the third quarter of 2004 we established a sales division focused on the SMB market to further extend our CRM leadership to companies of all sizes.

- **Investing in critical customer facing positions** – During the third quarter of 2004 we added or redeployed nearly 100 sales and marketing professionals in our on-going efforts to increase our revenue generation capability.

Financial Structure

As outlined in our quarterly report on Form 10-Q for the second quarter of 2004, we identified certain measures that we intended to pursue in order to better align our costs with our revenues. Some of these measures included continuing to:

- reduce discretionary spending including, for example, travel and entertainment ("T&E");
- consolidate our facilities and reduce other facilities and related expenses;
- limit and closely monitor net capital expenditures;
- streamline our information technology spending;
- utilize outsourced services where appropriate and cost effective; and
- redeploy or, if appropriate, eliminate duplicative activities, extraneous layers of management or unproductive resources.

These measures and our on-going attention to cost controls reduced our total costs and expenses by approximately $14.8 million during the third quarter of 2004 compared to the second quarter of 2004. These cost savings were primarily derived from (i) $4.7 million in savings from depreciation, which resulted from our continued close monitoring of capital expenditures and streamlining of information technology spending, (ii) $3.8 million in savings in marketing-related expenditures, (iii) $3.4 million in net savings from reductions in personnel- and facility-related expenditures, and (iv) $2.9 million in savings related to T&E expenditures. Partially offsetting these cost savings were increases of (i) $4.3 million of additional costs associated with our reinvestment in outside services in labor markets with lower cost structures, (ii) a net $2.5 million from legal and professional fees (primarily tax-related accruals), and (iii) $1.0 million of costs that vary directly with revenues, such as commissions and "cost of license revenues." As a result of enacting the above measures, we were able to improve our profitability sequentially and on a year-over-year basis, even as we increased our investments in the key growth areas discussed above.

In addition, during the third quarter of 2004 we completed a small restructuring of operations, which we believe may reduce our on-going costs by an additional $2.6 million per year, or $650,000 per quarter. We intend to continue to closely monitor expenditures in the future and, when deemed prudent, continue to implement the above measures.

Leadership

We had previously announced the appointments of Mr. Bruce Cleveland as Senior Vice President and General Manger of our newly formed OnDemand/SMB unit and Ms. Eileen McPartland as Senior Vice President, Global Services. In addition to these appointments, we have added the following executives during the third quarter of 2004:

- Mr. Les Rechan, formerly the Senior Vice President and General Manager of Worldwide Field Operations in North America at Cadence Design Systems, Inc., joined us as Senior Vice President and General Manager for our Manufacturing and Automotive business unit. Mr. Rechan brings more than 20 years of information technology solutions experience from Cadence, IBM Corporation and Onyx Software.

- Mr. Reid Drucker joined us as Senior Vice President and General Manager for our Communications, Media and Energy business unit. Mr. Drucker brings more than 25 years of CRM and telecommunications industry experience from leading organizations including Accenture, Computer Sciences Corporation and Southern New England Telecommunications.

We intend to continue to expand our leadership capabilities throughout our organization.

Areas of Continued Focus

Notwithstanding the progress we made during the third quarter of 2004, we intend to continue to improve in the following areas:

Revenue Generation

We are committed to improving our revenue generating capability in underperforming areas, particularly our sales, marketing and service automation product line and intend to renew our focus on execution worldwide and continue to invest across our key products and verticals. In addition, we are focused on improving our revenue generation capability with respect to (i) geographic regions that underperformed, such as Asia Pacific and (ii) verticals that underperformed, such as communications and financial services.

Financial Structure, While Supporting Growth Priorities

We will continue to remix our deployment of capital by driving additional savings in non-revenue facing functions and investing in strategic growth areas including (i) products such as analytics and OnDemand/SMB, (ii) international geographies, particularly Japan, China, India and Europe, and (iii) investing in additional services offerings.

Leadership Capability

We remain committed to furthering the prior two goals by adding leadership talent in priority verticals and geographies.

Summary

While the environment remains challenging, we are encouraged by our performance in the third quarter and we are cautiously optimistic for the fourth quarter of 2004 and the future. Our third quarter results demonstrate positive early results across each of the above initiatives and our commitment to return value to our stockholders, employees, partners and customers.

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

As discussed above, we believe we are executing against our performance improvement plan and are beginning to realize the benefits in our operating results, as evidenced by our performance in the third quarter of 2004. Specifically, our operating results improved sequentially during the third quarter of 2004 compared to the second quarter of 2004, with software license revenues increasing by $9.8 million, or 10%; total revenues increasing by $16.0 million, or 5%; "total cost and expenses, on-going" decreasing by $6.8 million, or 2%; and operating income increasing by $21.7 million, or 539%. In addition, we continued to achieve encouraging results in our key growth initiatives. For example, our analytics and business integration product revenues increased sequentially by an aggregate of over 20% and the total contract value of our Siebel CRM OnDemand service offering increased sequentially by more than 30%.

In addition to improving our operating performance sequentially from the second quarter of 2004, we also improved many of our key financial metrics on a year-over-year basis during the third quarter of 2004. The following is a brief summary of our key financial metrics and operating results for the three and nine months ended September 30, 2003 and 2004 (in thousands, except EPS, percentages and DSO):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Revenues:				
Software license	$ 110,003	$ 104,579	$ 331,989	$ 326,207
Maintenance	110,046	118,059	331,839	347,350
Professional services and other	101,383	94,448	323,658	273,875
Total revenues	$ 321,432	$ 317,086	$ 987,486	$ 947,432
Annualized total revenue per employee	$ 243	$ 260	$ 234	$ 259
Cost and expenses:				
Restructuring and acquisition-related expenses (1)	$ 107,216	$ 6,151	$ 107,490	$ 11,743
All other costs and expenses, on-going (2)	305,521	285,210	969,497	868,233
Total costs and expenses	$ 412,737	$ 291,361	$ 1,076,987	$ 879,976
Other key operating statistics:				
Operating income (loss)	$ (91,305)	$ 25,725	$ (89,501)	$ 67,456
Operating margin	(28)%	8 %	(9)%	7 %
Earnings (loss) per share, diluted ("EPS")	$ (0.12)	$ 0.04	$ (0.09)	$ 0.11
Cash flows from operations	$ 37,473	$ 19,714	$ 153,184	$ 195,077

	December 31, 2003	March 31, 2004	June 30, 2004	September 30, 2004
Balance sheet statistics:				
Cash and short-term investments	$ 2,023,206	$ 2,132,927	$ 2,120,565	$ 2,153,736
Deferred revenue	$ 282,217	$ 311,375	$ 314,474	$ 288,869
Days sales outstanding ("DSO")	64	63	60	59
Working capital	$ 1,708,898	$ 1,788,076	$ 1,738,287	$ 1,799,694
Total stockholders' equity	$ 2,050,226	$ 2,112,214	$ 2,121,151	$ 2,170,635

(1) Please refer to "Cost of Revenues," "Restructuring and Related Expenses" and "Purchased In-Process Product Development" in the following pages for a further discussion of these expenses.

(2) Represents the sum of (i) total cost of revenues, (ii) product development expense, (iii) sales and marketing expense and (iv) general and administrative expense. We believe these expenses are more representative of our on-going operations.

- **Software license revenues** decreased on a year-over-year basis during three and nine months ended September 30, 2004 by 5% and 2%, respectively, primarily due to the continued cautiousness of our customers and prospects. While our software license revenues declined on a year-over-year basis, we were able to grow software license revenues sequentially by 10%, primarily due to the actions taken by management discussed above. We are cautiously optimistic that the actions we have taken thus far, coupled with our continued execution against our operating performance plan, may result in continued improvement in our software license revenues in the fourth quarter of 2004 and beyond.

- **Maintenance revenues** increased on a year-over-year basis during three and nine months ended September 30, 2004 by 7% and 5%, respectively, primarily due to stable renewal rates among our existing customer base and maintenance agreements entered into in connection with new software licenses.

- **Professional services and other revenues,** which primarily relate to implementation and training services performed in connection with new software licenses, decreased on a year-over-year basis during the three and nine months ended September 30, 2004 by 7% and 15%, respectively, primarily due to previous declines in our software license revenues. Trends in our professional services and other revenues generally follow trends in our software license revenues by a three- to nine-month period because these services are generally initiated and performed over a similar period subsequent to the signing of the software license. Despite these year-over-year declines, professional services and other revenues have stabilized and have increased sequentially in each of the last two quarters.

- **Annualized total revenue per employee** increased from $243,000 and $234,000 per employee during the three and nine months ended September 30, 2003, respectively, to $260,000 and $259,000 per employee during the three and nine months ended September 30, 2004, respectively. The increases in each of these periods were primarily due to reductions in our employee base in connection with the Restructurings and our on-going attention to our cost structure. As we improve the performance of our worldwide sales organization, we anticipate that our annualized total revenue per employee will also improve.

- **Our Restructuring and cost control initiatives** reduced our total costs and expenses by approximately $20.3 million, or 7%, and approximately $101.3 million, or 10%, during the three and nine months ended September 30, 2004, respectively, as compared to the respective periods in 2003. Partially offsetting our cost savings were increases in expenses from (i) legal, tax-related and professional fees of $2.2 million and $5.9 million during the three and nine months ended September 30, 2004, respectively, and (ii) compensation expense due to merit increases.

- **Operating income** increased from an operating loss of $91.3 million and $89.5 million, representing negative operating margins of 28% and 9%, during the three and nine months ended September 30, 2003, respectively, to operating income of $25.7 million and $67.5 million, representing operating margins of 8% and 7%, during the three and nine months ended September 30, 2004, respectively. We were able to increase our operating income and margin on a year-over-year basis primarily due to the reduction in quarterly expenses that resulted from the Restructurings and our on-going attention to our cost structure.

- **Cash and short-term investments** increased by $130.5 million, or 6%, from $2,023.2 million as of December 31, 2003 to $2,153.7 million as of September 30, 2004, representing approximately 71% and 74% of total assets, respectively. The increase in cash and short-term investments was primarily due to our continued positive cash flows from operations ($195.1 million for the first nine months of 2004), partially offset by acquisition-related expenditures of $76.6 million (primarily related to our acquisition of Eontec on April 20, 2004).

- **Accounts receivable**—Days sales outstanding ("DSO") decreased from 64 days as of December 31, 2003 to 59 days as of September 30, 2004, primarily due to continued strong collections.

- **Deferred revenues** increased by $6.7 million, or 2%, from $282.2 million as of December 31, 2003 to $288.9 million as of September 30, 2004, primarily due to stable renewal rates among our existing customer base and new maintenance agreements entered into in connection with software licenses. Because our deferred revenues are historically at their lowest levels in the third quarter of each year, we believe a better reflection of the growth of our deferred revenues is a year-over-year comparison to September 30, 2003. On a year-over year basis we have increased our deferred revenues by $28.9 million, or 11%, from $260.0 million as of September 30, 2003 to $288.9 million as of September 30, 2004.

- **Working capital** increased from $1,708.9 million as of December 31, 2003 to $1,799.7 million as of September 30, 2004. With virtually no debt and a strong working capital position, we believe that we have the flexibility to continue to invest in further technology development and, when prudent, to selectively acquire technologies or companies to strengthen our product portfolio.

- **Stockholders' equity** increased from $2,050.2 million as of December 31, 2003 to $2,170.6 million as of September 30, 2004, primarily due to our positive earnings for the nine months ended September 30, 2004, which increased retained earnings, and proceeds from the exercise of stock options.

- **Stock option overhang**, which represents the number of stock options outstanding relative to the number of shares of common stock outstanding, continued to decrease in the first nine months of 2004 from 29% as of December 31, 2003 to 27% as of September 30, 2004. The decrease was due primarily to forfeitures of stock options by employees upon termination, coupled with reduced levels of new stock option grants.

Outlook

During our October 20, 2004 webcast discussion of our financial results for the third quarter of 2004, we publicly disclosed our guidance for the fourth quarter of 2004. Our outlook is based solely on our current expectations, which are based, in part, on our review of our current sales pipeline, internal sales forecasts, recent surveys among information technology executives, and current economic indicators. We are cautiously optimistic that our operating results may continue to improve on a sequential quarterly basis in the fourth quarter of 2004. For the fourth quarter of 2004, we currently anticipate that our total revenues will be between $330 million and $360 million. We expect the individual components of our total revenues to be within the following ranges:

- software license revenues—between $115 million and $145 million;
- maintenance revenues—between $116 million and $120 million; and
- professional services and other revenues—between $95 million and $103 million.

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

We expect total costs and expenses to increase in the fourth quarter of 2004 from the levels incurred in the third quarter of 2004, primarily due to (i) increases in expenses that vary directly with revenue levels, such as “cost of revenues,” incentive compensation and commissions, and (ii) increases in personnel-related costs (i.e., salaries and benefits) associated with increased investments in customer-facing and product development personnel. Partially offsetting these increases are continued cost savings from the Restructurings, additional cost savings from the cost control initiatives described previously and additional reductions in depreciation expense.

As discussed further in Note 4 to the accompanying unaudited consolidated financial statements, certain of our U.S. payroll tax returns, U.S. sales and use tax returns and international sales and valued added tax returns are currently under examination and/or review by the applicable taxing authorities. While we believe that we have made adequate provisions related to the audits of these tax returns, the final determination of our obligations may exceed the amounts provided for by us. Specifically, we may receive assessments related to the audits and/or reviews of these tax returns that exceed amounts provided for by us. In the event we are unsuccessful in reducing the amount of such assessments, our estimates related to our total costs and expenses could be adversely affected.

We expect that the anticipated increases in our total revenue levels will more than offset the anticipated modest increases in total costs and expenses and, accordingly, we currently expect operating income and margin for the fourth quarter of 2004 to increase from levels achieved in the third quarter of 2004. Our expectations regarding operating income depend on our ability to continue to grow our software license and professional services revenues.

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

We expect other income, net to remain comparable in the fourth quarter of 2004 to levels obtained in the third quarter of 2004.

We currently expect our effective tax rate for the fourth quarter of 2004 to be approximately 41%. The estimated effective tax rate is based on current tax law and our expected annual income and may be affected by the jurisdictions in which profits are determined to be earned and taxed and our ability to realize deferred tax assets. Further, our projected effective income tax rate for the remainder of 2004 does not take into account a new election that is available under the U.S. income tax rules regarding the allocation between U.S. and foreign jurisdictions of tax deductions attributable to employee stock option compensation. We have not yet determined the impact that this election would have on our effective tax rate and operating results.

As discussed in Note 4 to the accompanying unaudited consolidated financial statements, our U.S. Federal income tax returns for 1998 through 2003 are currently under examination by the Internal Revenue Service ("IRS"). While the final resolution of the IRS's on-going examination is uncertain, we believe that we have made adequate provision in the accompanying consolidated financial statements for any adjustments that the IRS has or may propose with respect to our U.S. Federal income tax returns. The final determination of our tax obligations may exceed the amounts provided by us in the accompanying consolidated financial statements. We will continually review our estimates related to our income tax obligations, including potential assessments from the IRS of additional taxes, penalties and/or interest, and revise our estimates if deemed necessary. A revision in our estimates of our tax obligations will be reflected as an adjustment to our income tax provision at the time of the change in our estimates. Such a revision could materially impact our effective tax rate, income tax provision and net income.

Discussion of the Results of Operations for the Three and Nine Months Ended September 30, 2003 and 2004

Revenues

Our total revenues decreased from $321.4 million and $987.5 million during the three and nine months ended September 30, 2003, respectively, to $317.1 million and $947.4 million during the three and nine months ended September 30, 2004, respectively, representing year-over-year declines of 1% and 4%, respectively. Our total revenues decreased during the third quarter of 2004 from the third quarter of 2003 primarily due to a $5.4 million decrease in our software license revenues, whereas the year-over-year decrease in our total revenues during the nine months ended September 30, 2004 was primarily due to a $34.3 million decrease in our professional services, maintenance and other revenues.

In order to provide a better understanding of the year-over-year changes and underlying trends in our revenues, we have provided the following discussion of each of the individual components of our total revenues:

Software

The following table sets forth our software license revenues, both in absolute dollars and as a percentage of total revenues, for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Software license revenues	$ 110,003	$ 104,579	$ (5,424)	(5)%	$ 331,989	$ 326,207	$ (5,782)	(2)%
Percentage of total revenues	34 %	33 %			34 %	34 %		

Software license revenues decreased from the three and nine months ended September 30, 2003 to the three and nine months ended September 30, 2004, respectively, primarily due to (i) the continued cautiousness on the part of our prospects and customers in setting and executing on their capital spending budgets; (ii) a lengthening of our customers' evaluation and approval time to complete a software purchase, possibly due to our customers' efforts regarding the Sarbanes-Oxley Act of 2002; (iii) reductions of the size of orders by our customers, possibly attributable to our customers' own cost control initiatives; (iv) increased competitive dynamics in the CRM application market; and (v) declines in revenues in certain of our geographic regions (primarily Asia Pacific), industries (e.g., telecom) and product lines (e.g., our core sales, marketing and service automation product line).

While our software license revenues declined on a year-over-year basis, we were able to grow software license revenues sequentially by $9.8 million, or 10%, from the second quarter of 2004, primarily due to the actions taken by management as described in the section above entitled "Focus on Future Improvement in Our Operating Performance." We are cautiously optimistic that the actions we have taken thus far, coupled with our continued execution against our operating performance plan, may result in continued improvement in our software license revenues in the fourth quarter of 2004 and beyond.

One of the primary reasons for our cautious optimism is the significant growth in our newest product lines, analytics and business integration applications. Specifically, analytics increased on a year-over-year basis by 24% and 50% during the three and nine months ended September 30, 2004, respectively, and business integration applications (primarily UCM) increased on a year-over-year basis by 55% and 53% during the three and nine months ended September 30, 2004, respectively. The growth within these product lines partially offset declines in our core sales, marketing and service automation product line, which declined on a year-over-year basis by 17% and 11% during the three and nine months ended September 30, 2004, respectively. We are cautiously optimistic that our continued execution against our operating performance plan will allow us to return our sales, marketing and service automation product line to sequential and year-over-year growth in the near future. The following is a summary of our software license revenues, by CRM product, for the three and nine months ended September 30, 2003 and 2004 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
Sales, marketing and service automation	$ 81,176	$ 67,397	$ 255,848	$ 227,163
Analytics	22,176	27,429	50,927	76,139
Business integration applications	5,364	8,333	11,725	17,900
Employee relationship management	1,287	1,420	13,489	5,005
Total	$ 110,003	$ 104,579	$ 331,989	$ 326,207

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Other key software license metrics:	**2003**	**2004**	**2003**	**2004**
Transactions equal to or greater than $5 million	3	2	7	8
Transactions between $1 million and $5 million	16	30	73	68
Total number of transactions	317	296	1,033	901
Average transaction size (in thousands)	$ 347	$ 353	$ 321	$ 362

As the above table indicates, we are beginning to see the benefits of our operating performance plan on a year-over-year basis in many of the above metrics. For example, the average transaction size increased on a year-over-year basis during both the three and nine months ended September 30, 2004 and our largest transactions—those generating revenue of $1 million and over—increased on a year-over-year basis from a total of 19 transactions during the third quarter of 2003 to 32 transactions during the third quarter of 2004. While the total number of transactions declined on year-over-year basis during both the three and nine months ended September 30, 2004, we are focused on driving revenue across customers of all sizes and intend to continue to work to increase both the total number of transactions and further increase our average transaction size. We are cautiously optimistic that we will achieve these objectives.

We base this cautious optimism in part on our improved sequential quarterly performance in the third quarter of 2004 and other non-financial metrics that we believe may provide a solid foundation to grow our revenues. For example, our customers continue to increase the deployment of previous purchases of our software, which is evidenced by the increase in the number of deployed users from approximately 2.2 million as of December 31, 2003 to approximately 2.8 million as of September 30, 2004. In addition, we believe our leadership position in the CRM application market and our corresponding customer base provide us with a solid foundation to improve our performance. Further, we continue to build on this customer base—software license revenues from new customers or new projects at existing customers increased to approximately 54% and 58% of total software license revenues during the three and nine months ended September 30, 2004, respectively, compared to a range of 50% to 55% during each of the last three years. We believe increases in our customer base may provide increased future sales opportunities when and if corporate capital expenditures return to normalized levels.

We market our products through our direct sales force, and to a limited extent through distributors primarily in Europe, Asia Pacific, Japan and Latin America. International license revenues accounted for 46% and 47% of software license revenues during the three and nine months ended September 30, 2003, respectively, and 33% and 39% during the three and nine months ended September 30, 2004, respectively. The decline in our international software license revenues is primarily attributable to declines within Asia Pacific, which declined on a year-over-year basis by $13.1 million and $17.2 million during the three and nine months ended September 30, 2004, respectively, from the comparable periods in 2003. We expect international software license revenues will continue to account for a significant portion of our overall software license revenues in the foreseeable future. Because the majority of our software license arrangements and related operating activities are denominated in U.S. dollars, foreign currency exchange rates did not have a significant impact on software license revenues, total revenues or net income for any period presented.

Professional Services, Maintenance and Other

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

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

Also included in professional services, maintenance and other revenues for the three and nine months ended September 30, 2004 is revenue from our newest service offering, Siebel CRM OnDemand, which we introduced in the fourth quarter of 2003. Our customers typically pre-pay for this subscription service, which we defer and recognize ratably over the term of the customer contract based on the number of days the contract is outstanding in each period. While the revenues derived from Siebel CRM OnDemand were not significant for the three and nine months ended September 30, 2004, we believe that Siebel CRM OnDemand represents a significant growth opportunity for us. For example, Siebel CRM OnDemand continued to show growth during the third quarter of 2004, with sequential quarterly growth in the total contract value of our Siebel CRM OnDemand service offering of more than 30% compared to the second quarter of 2004. We intend to continue to devote an increasing amount of our resources to this service offering.

Professional services, maintenance and other revenues increased in aggregate by $1.1 million, or 1%, from $211.4 million for the three months ended September 30, 2003 to $212.5 million for the three months ended September 30, 2004, and decreased by $34.3 million, or 5%, from $655.5 million for the nine months ended September 30, 2003 to $621.2 million for the nine months ended September 30, 2004. This decrease was primarily due to a decline in revenues derived from our implementation and training services, partially offset by an increase in the installed base of customers receiving maintenance.

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Maintenance:								
Absolute dollars	$ 110,046	$ 118,059	$ 8,013	7 %	$ 331,839	$ 347,350	$ 15,511	5 %
Percentage of total revenues	34 %	37 %			34 %	37 %		
Professional services and other:								
Absolute dollars	$ 101,383	$ 94,448	$ (6,935)	(7)%	$ 323,658	$ 273,875	$ (49,783)	(15)%
Percentage of total revenues	32 %	30 %			32 %	29 %		

Our maintenance revenues, both in absolute dollars and as a percentage of total revenues, increased during the three and nine months ended September 30, 2004 from the respective periods in 2003 primarily due to (i) stable renewal rates among our existing customer base, which were approximately 90% in the first nine months of 2004, and (ii) new maintenance agreements associated with additional licenses of our software to new and existing customers.

While maintenance revenues have continued to increase on a year-over-year basis, professional services and other revenues, both in absolute dollars and as a percentage of total revenues, decreased during the three and nine months ended September 30, 2004 from the respective periods in 2003, primarily due to (i) a lag effect, as discussed further below and elsewhere in this quarterly report, related to our software license revenues; (ii) declines of $0.9 million and $4.1 million in our rebillable travel and entertainment ("T&E") expenses during the three and nine months ended September 30, 2004, respectively, primarily due to lower demand for our professional services; and (iii) the effect of the transition to new leadership in our Global Services Organization.

While each of these factors impacted our professional services and other revenues, we believe the primary reason for the decrease in our professional services revenues is a lag effect related to our software license revenues. Specifically, our implementation and training services are initiated and performed over a period of three to nine months subsequent to the initial software license and, as a result, our implementation and training services typically vary with the amount of software license revenues generated in the preceding three- to nine-month period. Accordingly, we believe a majority of the year-over-year declines in our professional services and other revenues is due to previous declines in our software license revenues.

We have taken and will continue to take steps to improve the performance of our Global Services Organization. We are beginning to realize the benefit of these efforts with modest sequential quarterly growth in the third quarter of 2004, the second consecutive quarter of sequential growth, and an improved pipeline of professional services contracts as we begin the fourth quarter of 2004. We are committed to realizing the benefits of these efforts in an expansion of our professional services' margins, including further cost controls, if necessary, to achieve our gross margin goals. Despite our focus to grow our professional service revenues, we expect to balance our growth initiatives with our desire to manage our professional services organization to ensure that it does not compete with our implementation partners.

Cost of Revenues

Total cost of revenues decreased by $14.6 million, or 12%, from $126.5 million during the three months ended September 30, 2003 to $111.9 million during the three months ended September 30, 2004. Total cost of revenues decreased by $53.5 million, or 14%, from $387.1 million during the nine months ended September 30, 2003 to $333.6 million during the nine months ended September 30, 2004. As a percentage of total revenues, cost of revenues decreased from 39% (a gross margin of 61%) in each of the 2003 periods to 35% (a gross margin of 65%) during each of the 2004 periods.

The decline of our total cost of revenues, both in absolute dollars and as a percentage of total revenues, during each of these periods was primarily due to cost savings from the Restructurings, our cost control initiatives and further reductions in our professional services staff commensurate with the decline in our professional services and other revenues.

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

Software

Cost of software license revenues includes amortization of acquired technology, third-party software royalties and product packaging, production and documentation. All costs incurred in the research and development of software products and enhancements to existing products have been expensed as incurred. The following table sets forth our cost of software license revenues in terms of absolute dollars and as a percentage of software license revenues for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Cost of software license revenues	$ 5,974	$ 3,010	$ (2,964)	(50)%	$ 14,963	$ 9,054	$ (5,909)	(39)%
Percentage of software license revenues	5 %	3 %			5 %	3 %		

Included in cost of software license revenues for the three and nine months ended September 30, 2003 is a charge of $2.4 million related to the abandonment in July 2003 of certain technology acquired from Sales.com, Inc. ("Sales.com"). There were no abandonment charges in any of the 2004 periods. In addition to the decline in cost of software license revenues due to this abandonment charge, cost of software license revenues decreased from the 2003 periods to the 2004 periods primarily due to (i) a further reduction of $0.4 million and $3.1 million, respectively, from the cessation of amortization expense related to the technology acquired from Sales.com, and (ii) reductions in third-party royalties resulting from reductions in software license revenues and a shift to products with lower royalties. Partially offsetting these declines were increases in amortization expense of $0.5 million and $0.9 million during the three and nine months ended September 30, 2004, respectively, associated with technology acquired in connection with our acquisition of Eontec on April 20, 2004.

Professional Services, Maintenance and Other

Cost of professional services, maintenance and other revenues consist primarily of personnel, facilities and systems costs incurred to provide training, consulting, technical support and other global services. The following table sets forth our cost of professional services, maintenance and other revenues in terms of absolute dollars and as a percentage of these revenues for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Cost of professional services, maintenance, and other revenues.....	$ 120,489	$ 108,868	$ (11,621)	(10)%	$ 372,142	$ 324,534	$ (47,608)	(13)%
Percentage of professional services, maintenance, and other revenues.....	57 %	51 %			57 %	52 %		

The following is a summary of the year-over-year changes of our cost of professional services, maintenance and other revenues during the three and nine months ended September 30, 2004 from the respective period in 2003 (in thousands):

	Year-Over-Year Change	
Cost component:	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Personnel-related costs (compensation, benefits, etc.).....	$ (807)	$ (11,158)
Outside consulting costs..	37	(4,575)
Facility-related costs (rent, maintenance, etc.)................	(3,684)	(11,834)
Depreciation expense..	(6,711)	(14,346)
Rebillable T&E expenses...	(859)	(4,117)
Non-billable T&E expenses...	(1,102)	(4,813)
Amortization of intangibles..	1,664	4,108
Cost of training and other costs, net...............................	(159)	(873)
Total year-over-year change................................	$ (11,621)	$ (47,608)

We were able to reduce our cost of professional services, maintenance and other revenues on a year-over-year basis during the three and nine months ended September 30, 2004 primarily due to (i) the Restructurings, (ii) our cost control initiatives and (iii) further cost reductions in response to declines in the demand for our professional services (i.e., implementation and training services). For example, personnel-related costs have declined as a result of our reduction of average headcount in our Global Services Organization from 2,185 and 2,305 in the three and nine months ended September 30, 2003, respectively, to 1,905 and 1,955 in the three and nine months ended September 30, 2004, respectively. On a year-to-date basis, we also reduced our use of third-party consultants commensurate with the decline in our implementation revenues and declines in the utilization rates of our personnel. Finally, we consolidated several of our facilities in connection with the Restructurings, resulting in reductions in the facility-related component of our cost of professional services, maintenance and other revenues.

In addition to the savings from the Restructurings, we have reduced our discretionary spending in areas such as (i) capital expenditures, resulting in declines in depreciation expense; (ii) non-billable T&E and rebillable T&E, both of which declined primarily due to reductions in professional services personnel commensurate with the declines in our professional services revenues; and (iii) cost of training commensurate with the declines in our training revenues.

Partially offsetting the above cost savings were the following: (i) increases of $1.7 million and $4.1 million during the three and nine months ended September 30, 2004, respectively, due to additional amortization expense of intangible assets obtained in our acquisitions of Eontec and UpShot, (ii) increases in compensation costs associated with additional personnel obtained in our acquisitions of Eontec and UpShot and (iii) increases in compensation costs associated with the renewal of merit increases and certain incentive compensation.

Cost of professional services, maintenance and other revenues as a percentage of the corresponding revenues decreased from 57% during both the three and nine months ended September 30, 2003 to 51% and 52% during the three and nine months ended September 30, 2004, respectively, primarily due to (i) a higher percentage of our professional services, maintenance and other revenues being derived from our higher-margin maintenance revenues in the 2004 periods compared to the 2003 periods and (ii) our reduction of personnel, facility and other costs as discussed above. Primarily as a result of these factors, our gross margin related to our professional services, maintenance and other revenues improved from 43% during both the three and nine months ended September 30, 2003 to 49% and 48% during the three and nine months ended September 30, 2004, respectively. This year-over-year improvement in our gross margin includes an offsetting impact of an increase in amortization expense associated with intangible assets obtained in our acquisitions of Eontec and UpShot.

Operating Expenses

Product Development

Product development expense includes costs associated with the development of new products, enhancements of existing products, quality assurance activities and vertical engineering. These costs consist primarily of employee salaries and benefits, occupancy costs, consulting costs and the cost of software development tools and equipment. The following table sets forth our product development expense in terms of absolute dollars and as a percentage of total revenues for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Product development expense	$ 71,432	$ 69,718	$ (1,714)	(2)%	$ 226,177	$ 217,279	$ (8,898)	(4)%
Percentage of total revenues	22 %	22 %			23 %	23 %		

The following is a summary of the year-over-year changes of our product development expenses during the three and nine months ended September 30, 2004 from the respective period in 2003 (in thousands):

	Year-Over-Year Change	
Cost component:	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Personnel-related costs (compensation, benefits, etc.)	$ (2,902)	$ (9,009)
Facility-related costs (rent, maintenance, etc.)	(2,219)	(7,025)
Depreciation expense	(2,344)	(4,856)
Outside consulting costs	5,816	11,441
Other, net	(65)	551
Total year-over-year change	$ (1,714)	$ (8,898)

Our personnel-related costs decreased on a year-over-year basis during both the three and nine months ended September 30, 2004 primarily due to reductions of product development headcount in connection with the Restructurings, including the transition of a number of these positions to labor markets with lower cost structures. Specifically, the average headcount in our product development organization decreased from 1,455 and 1,545 in the three and nine months ended September 30, 2003, respectively, to 1,350 and 1,330 in the three and nine months ended September 30, 2004, respectively. In addition to the reductions in our personnel costs, we have reduced the facility-related cost component of product development expense, primarily as a result of the consolidation of facilities in connection with the Restructurings. Further, we have continued to reduce our discretionary spending in areas such as capital expenditures, resulting in declines in our depreciation expense.

While we have reduced the personnel, facility and depreciation components of our product development expense, we recognize that our continued development of new products and new versions of and additional modules for our existing products is critical to our revenue growth initiatives. Accordingly, we have reinvested a significant portion of the above cost savings in the following areas: (i) outside consultants performing a portion of our quality assurance and testing activities in labor markets with lower cost structures, (ii) additional personnel obtained in acquired companies (e.g., personnel obtained in our acquisitions of Eontec and UpShot), and (iii) increased investments in additional personnel and existing personnel through the renewal of merit increases and certain other incentive compensation. We expect to continue to devote substantial resources related to our product development efforts.

Sales and Marketing

We continue to place significant emphasis, both domestically and internationally, on direct sales through our sales force. Sales and marketing expense is comprised primarily of costs associated with our sales and marketing personnel and includes (i) salaries, commissions and bonuses; (ii) facility-related (i.e., rent) and equipment-related (i.e., depreciation) expenses; (iii) T&E expenses; and (iv) promotional and advertising expenses. The following table sets forth our sales and marketing expense in terms of absolute dollars and as a percentage of total revenues for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Sales and marketing expense...............	$ 82,756	$ 76,500	$ (6,256)	(8)%	$ 276,804	$ 241,166	$ (35,638)	(13)%
Percentage of total revenues..............	26 %	24 %			28 %	25 %		

The following is a summary of the year-over-year changes of our sales and marketing expenses during the three and nine months ended September 30, 2004 from the respective period in 2003 (in thousands):

	Year-Over-Year Change	
Cost component:	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Personnel-related costs (compensation, benefits, etc.).....	$ (600)	$ (14,057)
Facility-related costs (rent, maintenance, etc.).................	(375)	(4,565)
Depreciation expense..	(1,008)	(5,011)
Marketing and advertising..	(4,052)	(8,654)
T&E expenses...	569	(1,655)
Sales commissions...	(1,331)	(1,971)
Other, net..	541	275
Total year-over-year change.................................	$ (6,256)	$ (35,638)

Our personnel-related costs decreased on a year-over-year basis during both the three and nine months ended September 30, 2004 primarily due to reductions of sales and marketing headcount in connection with the Restructurings. Specifically, the average headcount in our sales and marketing organizations decreased from 1,100 and 1,200 in the three and nine months ended September 30, 2003, respectively, to 1,070 and 1,040 in the three and nine months ended September 30, 2004, respectively. These savings related to personnel-related costs include the offsetting impact of increases in compensation costs from the renewal of merit increases and certain other incentive compensation. In addition to the reductions in our personnel costs, we have reduced the facility-related cost component of sales and marketing expense, primarily as a result of the consolidation of facilities in connection with the Restructurings.

We have also achieved aggregate decreases of $4.5 million and $15.3 million related to depreciation expense, marketing and advertising expenses, and T&E expenses during the three and nine months ended September 30, 2004, respectively, primarily due to the further realization of savings from our cost control initiatives. Our sales commission expense declined by $1.3 million and $2.0 million during the three and nine months ended September 30, 2004, respectively, primarily due to a decrease in our software license revenues.

Sales and marketing expense decreased as a percentage of total revenues from 26% and 28% for the three and nine months ended September 30, 2003, respectively, to 24% and 25% for the three and nine months ended September 30, 2004, respectively, primarily due to the Restructurings and our continued attention to our cost structure.

General and Administrative

General and administrative expense is comprised primarily of costs associated with our executive and administrative personnel (e.g., the CEO and finance, information technology, human resources and facilities personnel) and consists primarily of salaries and occupancy costs, along with bad debt, professional services expenses (e.g., audit fees, costs associated with compliance with the Sarbanes-Oxley Act of 2002, or SOX, etc.) and legal expenses. The following table sets forth our general and administrative expense in terms of absolute dollars and as a percentage of total revenues for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
General and adminstrative expense.....	$ 27,319	$ 27,114	$ (205)	(1)%	$ 81,860	$ 76,200	$ (5,660)	(7)%
Percentage of total revenues..............	8 %	9 %			8 %	8 %		

The following is a summary of the year-over-year changes of our general and administrative expenses during the three and nine months ended September 30, 2004 from the respective period in 2003 (in thousands):

	Year-Over-Year Change	
Cost component:	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Facility-related costs (rent, maintenance, etc.)................	$ (512)	$ (2,551)
Depreciation expense...	(2,440)	(5,588)
Bad debt expense..	(1,542)	(8,369)
Personnel-related costs (compensation, benefits, etc.).....	822	632
Compensation related to restricted stock units ("RSUs")..	325	2,103
Legal and tax-related expense..	2,225	5,938
Professional services and other costs, net........................	917	2,175
Total year-over-year change.................................	$ (205)	$ (5,660)

General and administrative expenses decreased on a year-over-year basis primarily due to declines in our facilities-related costs, depreciation expense and bad debt expense. Our facility-related costs decreased on a year-over-year basis during both the three and nine months ended September 30, 2004 primarily due to the consolidation of facilities in connection with the Restructurings. We have also continued to reduce our discretionary spending in areas such as capital expenditures, resulting in declines in our depreciation expense. Bad debt expense decreased during the three and nine months ended September 30, 2004, respectively, primarily due to the continued improvement in our collection efforts, including further reductions in accounts receivable levels, an improved accounts receivable aging and the recovery of amounts previously written-off.

Partially offsetting these cost savings were increases in personnel-related costs, compensation related to RSUs, legal expense and costs of outside professional services. Personnel-related costs increased on a year-over-year basis during both the three and nine months ended September 30, 2004, primarily due to (i) our continued investment in additional executive personnel as outlined above under the section entitled "Focus on Future Improvement in Our Operating Performance," (ii) renewal of merit increases and certain incentive compensation and (iii) continued investment in additional financial personnel as part of our on-going commitment to strong internal controls. Our average headcount in our administrative organization was 545 and 580 in the three and nine months ended September 30, 2003, respectively, compared to 560 and 550 in the three and nine months ended September 30, 2004, respectively. The year-over-year growth in our administrative organization during the third quarter of 2004 compared to the third quarter of 2003 was primarily due to growth in our information technology support personnel.

Further offsetting the above cost savings were (i) increases in compensation costs of $0.3 million and $2.1 million during the three and nine months ended September 30, 2004, respectively, associated with the issuance of RSUs to certain executive officers in connection with their commencement of employment; (ii) increases of $2.2 million and $5.9 million during the three and nine months ended September 30, 2004, respectively, related to increases in legal and tax-related expenses (please refer to Note 4 to the accompanying unaudited consolidated financial statements for further discussion of legal proceedings); and (iii) increases in professional services and certain other costs of approximately $0.9 million and $2.2 million during the three and nine months ended September 30, 2004, respectively, a significant portion of which was associated with our compliance with SOX.

Restructuring and Related Expenses

As further described in Note 2 to the accompanying unaudited financial statements, we initiated a series of restructurings of our operations designed to better align our operating structure with expected revenue levels. We initiated and completed the first restructuring in 2002 (the "2002 Restructuring"), the second restructuring in 2003 (the "2003 Restructuring"), and the third restructuring in the third quarter of 2004 (the "2004 Restructuring" and collectively with the 2002 Restructuring and 2003 Restructuring, the "Restructurings").

The 2002 and 2003 Restructurings included the following key measures: (i) the reduction of our workforce across all functional areas; (ii) the consolidation of our excess facilities; (iii) the abandonment of certain long-lived assets, including leasehold improvements, furniture and fixtures; and (iv) the transfer of certain technical support, quality assurance and other product development positions to labor markets with lower cost structures. The 2004 Restructuring consisted primarily of the consolidation of additional facilities (located primarily in North America and Asia Pacific) and the abandonment of the related leasehold improvements and furniture and fixtures.

The following table summarizes the restructuring and related expenses incurred during the nine months ended September 30, 2004, and the remaining obligations related to the Restructurings as of December 31, 2003 and September 30, 2004 (in thousands):

	Employee Termination Costs (1)	Facility-Related Costs (2)	Asset Abandonment Costs (3)	Total
Restructuring obligations, December 31, 2003	$ 3,805	$ 147,790	$ --	$ 151,595
Restructuring and related expenses:				
Recognized related to the 2004 Restructuring (4)	--	2,833	1,703	4,536
Recognized related to changes in estimates (5)	(1,465)	837	205	(423)
Accretion related to the Restructurings (6)	--	1,630	--	1,630
Total (7)	(1,465)	5,300	1,908	5,743
Cash payments	(1,557)	(39,002)	--	(40,559)
Non-cash charges	--	--	(1,908)	(1,908)
Restructuring obligations, September 30, 2004	$ 783	$ 114,088	$ --	$ 114,871
Less: Restructuring obligations, short-term				36,397
Restructuring obligations, long-term				$ 78,474

(1) The costs associated with our workforce reductions consist primarily of severance payments, COBRA benefits, payroll taxes and other associated termination costs incurred in connection with the 2003 Restructuring. The remaining obligations as of September 30, 2004 relate to less than 10 terminations that have yet to be completed, primarily due to regulatory requirements in certain countries outside the U.S. We expect to complete these terminations within the next six months.

(2) The costs associated with our facilities consolidation primarily relate to lease termination costs, costs associated with satisfying remaining lease commitments, and expected brokerage and other re-letting costs, partially offset by estimated sublease income.

(3) As part of the consolidation of our facilities, certain leasehold improvements, furniture and fixtures were abandoned. As a result, we recorded a non-cash charge equal to the net book value of these abandoned assets in restructuring and related expenses.

(4) In accordance with SFAS 146, we recorded the facility-related expenses incurred in the 2004 Restructuring after giving effect to the net present value of the related obligations.

(5) We revised our estimated obligations with respect to the 2003 Restructuring during the nine months ended September 30, 2004 as follows:

- Employee termination costs—Due primarily to higher than expected voluntary terminations associated with positions included in the 2003 Restructuring, we reduced our remaining obligations for employee termination costs during the second quarter of 2004.

- Facility-related costs—Due primarily to the real estate markets in which we operate remaining at depressed levels longer than originally anticipated, we extended the estimated sublease commencement dates and/or reduced the estimated sublease rates on certain restructured properties. Partially offsetting these reductions in estimated sublease income were favorable changes in estimates that resulted from entering into subleases sooner and/or at higher sublease rates than originally anticipated on certain other restructured properties.

(6) Represents the accretion of the 2003 and 2004 Restructuring obligations. We will continue to accrete our obligations related to the 2003 and 2004 Restructurings to the then present value and, accordingly, will recognize additional accretion expense as a restructuring and related expense in future periods.

(7) The following is a summary of the net restructuring and related expenses recognized during the three and nine months ended September 30, 2004 (in thousands):

	Six Months Ended June 30, 2004	Third Quarter	Nine Months Ended September 30, 2004
Restructuring and related expenses:			
2004 Restructuring-related	$ --	$ 4,536	$ 4,536
Changes in estimates	(1,579)	1,156	(423)
Accretion	1,171	459	1,630
Total restructuring and related expenses	$ (408)	$ 6,151	$ 5,743

We incurred net restructuring and related expenses of $104.8 million and $105.0 million during the three and nine months ended September 30, 2003, respectively, primarily associated with the 2003 Restructuring. The following is a summary of the net restructuring and related expenses recognized during the three and nine months ended September 30, 2003 (in thousands):

	Six Months Ended June 30, 2003	Third Quarter	Nine Months Ended September 30, 2003
Restructuring and related expenses:			
2003 Restructuring-related	$ 10,246	$ 78,545	$ 88,791
Changes in estimates	(9,972)	26,101	16,129
Accretion	--	121	121
Total restructuring and related expenses	$ 274	$ 104,767	$ 105,041

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

Purchased In-Process Product Development

On April 20, 2004, we acquired Eontec, a global provider of multichannel retail banking solutions. We believe that Eontec's technology and certain products and functionality under development, commonly referred to as IPR&D, by Eontec at the time of purchase will enhance our current offerings in the retail banking market. We estimated the fair value of this IPR&D, primarily related to Eontec's Internet banking and teller products, to be approximately $6.0 million. Because the IPR&D had not yet reached technological feasibility and had no alternative future use, we reflected a $6.0 million expense under the heading "purchased in-process product development" in the accompanying statement of operations for the nine months ended September 30, 2004.

At the date of our acquisition of Eontec, we estimated that the IPR&D relating to the Internet banking and teller products were approximately 25% and 75% complete, respectively, and we expected to incur up to an additional $2.5 million to complete this development, with completion expected in late 2004 or early 2005. We estimated the fair value of the IPR&D using the "income" valuation approach and a discount rate of 25%. The discount rate was selected based in part on our weighted average cost of capital and determined after consideration of our rate of return on debt capital and equity, the weighted average return on invested capital and the risk associated with achieving forecasted cash flows.

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

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

Operating Income (Loss) and Operating Margin

The following table sets forth our operating income (loss) and operating margin for the three and nine months ended September 30, 2003 and 2004 (in thousands, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2004	Change	%	2003	2004	Change	%
Operating income (loss)	$ (91,305)	$ 25,725	$ 117,030	128 %	$ (89,501)	$ 67,456	$ 156,957	175 %
Operating margin	(28.4)%	8.1 %			(9.1)%	7.1 %		

Our operating income (loss) and operating margin increased favorably on a year-over-year basis during both the three and nine months ended September 30, 2004 due primarily to (i) net year-over-year reductions of $101.1 million and $95.7 million related to certain significant and unusual charges (i.e., restructuring, asset abandonment and IPR&D charges) and (ii) a $20.3 million and $101.3 million improvement in our operating margins due to the cost savings obtained from the Restructurings and our continued attention to cost controls. Partially offsetting these improvements in our operating margins were year-over-year declines in our total revenues of $4.3 million and $40.1 million during the three and nine months ended September 30, 2004, respectively.

Other Income (Expense), Net

For the three and nine months ended September 30, 2003 and 2004, other income, net was comprised of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Interest income	$ 12,909	$ 12,209	$ 40,620	$ 35,060
Loss on early extinguishment of debt	(10,711)	--	(10,711)	--
Interest expense	(4,827)	(174)	(14,575)	(728)
Net gains on marketable investments	1,055	147	4,760	1,997
Write-down of cost-method investments	(269)	(275)	(675)	(1,821)
Other, net	445	(383)	(143)	(1,432)
	$ (1,398)	$ 11,524	$ 19,276	$ 33,076

Interest income represents earnings on our cash and short-term investments. During the three and nine months ended September 30, 2004, interest income decreased on a year-over-year basis by $0.7 million and $5.6 million, respectively, primarily due to a decline in interest rates.

On September 30, 2003, we redeemed the $300.0 million convertible subordinated debentures ("Debentures") in accordance with their terms for $307.1 million. In connection with this redemption, we incurred a pre-tax charge to operations of $10.7 million, consisting of the $7.1 million premium and the write-off of the remaining unamortized issuance costs of $3.6 million. This pre-tax charge is reflected in the above table under the heading "loss on early extinguishment of debt" for the three and nine months ended September 30, 2003. The decrease in interest expense is primarily due to our redemption of the Debentures. Interest expense for the three and nine months ended September 30, 2004 primarily represents interest associated with our capital lease obligations.

Net gains on marketable investments represent realized gains recognized upon the sale of certain short-term debt instruments. We hold several minority interests, included in other assets, in companies having operations or technology in areas within our strategic focus. Write-down of cost-method investments in the above table represents adjustments to certain of these investments to the estimated fair value as the decline in these investments was deemed to be other-than-temporary. Other, net for all periods presented is primarily comprised of banking fees and foreign currency transaction gains or losses.

Provision for Income Taxes and Income Tax Benefit

During the three and nine months ended September 30, 2003, we recognized an income tax benefit of $33.4 million and $25.3 million, respectively, and during the three and nine months ended September 30, 2004, we recognized a provision for income taxes of $17.9 million and $41.3 million, respectively. Income taxes (benefit) as a percentage of pretax income (loss) (the "Effective Rate") increased from 36% for both the three and nine months ended September 30, 2003 to 48% and 41% for the three and nine months ended September 30, 2004, respectively, primarily due to (i) additional tax expense associated with a tentative settlement of certain IRS examinations, which are discussed further in Note 4 to the accompanying unaudited consolidated financial statements and (ii) certain expenses that are not deductible for income tax purposes. Please refer to Note 5 to the accompanying unaudited consolidated financial statements for a reconciliation of our federal statutory rate to our effective tax rate for the three and nine months ended September 30, 2004.

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

As discussed in Note 4 to the accompanying unaudited consolidated financial statements, our U.S. Federal income tax returns for 1998 through 2003 are currently under examination by the IRS. During 2003 and 2004, we received notices from the IRS of proposed adjustments to certain of these tax returns. In August 2004, the Company reached a tentative settlement with the IRS with respect to the IRS's examination of our income tax returns for the years 1998 to 2000, which we believe resolves all significant matters outstanding with respect to our income tax returns for the tax years 1998 to 2000.

While the final resolution of the IRS's on-going examination is uncertain, we believe that we have made adequate provision in the accompanying unaudited consolidated financial statements for any adjustments that the IRS has or may propose with respect to our U.S. Federal income tax returns. Based on currently available information, we believe that the ultimate outcome of these examinations will not have a material adverse effect on our financial position, cash flows or results of operations. However, the final determination of our tax obligations may exceed the amounts provided by us in the accompanying unaudited consolidated financial statements. We will continually review our estimates related to our income tax obligations, including potential assessments from the IRS of additional taxes, penalties and/or interest, and revise our estimates, if deemed necessary. We will reflect any revision in our estimates of our tax obligations as an adjustment to our income tax provision at the time of the change in our estimates. Such a revision could materially impact our effective tax rate, income tax provision and net income.

Liquidity and Capital Resources

Overview

We derive our liquidity and capital resources primarily from our cash flows from operations and from our working capital. Our working capital increased from $1,708.9 million as of December 31, 2003 to $1,799.7 million as of September 30, 2004, primarily due to our positive earnings during the nine months ended September 30, 2004. With virtually no debt and a strong working capital position, we believe that we have the flexibility to continue investment in further development of our technology and, when necessary or appropriate, make selective acquisitions to continue to strengthen our product portfolio.

The significant components of our working capital are liquid assets such as cash, short-term investments and trade accounts receivable, reduced by accounts payable, accrued expenses, restructuring obligations and deferred revenue. We continue to operate a cash-positive business and, accordingly, we have been able to eliminate substantially all of our long-term debt and maintain our cash and short-term investment balances at over $2.0 billion. Specifically, our cash, cash equivalents and short-term investments increased from $2,023.2 million as of December 31, 2003 to $2,153.7 million as of September 30, 2004, representing approximately 71% and 74% of total assets, respectively. In addition, our days sales outstanding in accounts receivable ("DSO") declined from 64 days as of December 31, 2003 to 59 days as of September 30, 2004.

We believe our current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for at least the next 12 months. Our liquidity could be negatively impacted by a decrease in revenues resulting from a decline in demand for our products, which are subject to rapid technological changes, or a reduction of capital expenditures by our customers as a result of a downturn in the global economy, among other factors.

We did not repurchase any of our common stock during the first nine months of 2004 and do not currently anticipate repurchasing any of our common stock in the remainder of 2004.

Commitments

Our future fixed commitments have not changed significantly since December 31, 2003. Please refer to "Liquidity and Capital Resources" in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2003 for a further discussion of our future fixed commitments, including a five-year schedule of future cash payments under these obligations.

Cash Flows

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

<u>Operations</u>

Net cash provided by operating activities increased from $153.2 million during the nine months ended September 30, 2003 to $195.1 million for the nine months ended September 30, 2004, primarily due to the increase in our earnings from a net loss of $44.9 million during the nine months ended September 30, 2003 to net income of $59.2 million for the nine months ended September 30, 2004. During each of these periods, our cash flows from operations were primarily derived from (i) our earnings from on-going operations prior to non-cash expenses such as depreciation, amortization and bad debt; (ii) the tax benefit related to the exercise of employee stock options, which reduces our cash outlay for income tax expense; and (iii) changes in our working capital, which is primarily composed of net collections of accounts receivable and increases (decreases) in deferred revenue (collectively representing net cash inflows of $69.2 million and $59.2 million in the 2003 and 2004 periods, respectively), partially offset by payments of accounts payable, accrued expenses and restructuring obligations.

As we settle our remaining restructuring obligations ($114.9 million as of September 30, 2004), our future operating cash flows will be reduced from what it otherwise would have been in the period of settlement. We currently estimate that we will settle $36.4 million of these obligations in the next 12 months.

We currently anticipate that we will continue to operate a cash-positive business in the fourth quarter of 2004. Our ability to meet these expectations depends on our ability to achieve positive earnings and maintain or increase the level of our software license revenues, including maintaining or improving the linearity of our revenues compared to our historical levels. In addition, our ability to generate future cash flows from operations could be negatively impacted by a decrease in demand for our products, which are subject to rapid technological change, or a reduction of capital expenditures by our customers as a result of a downturn in the global economy, among other factors.

<u>Investing</u>

Net cash used in investing activities was $10.4 million and $314.0 million for the nine months ended September 30, 2003 and 2004, respectively. During each of these periods, our investment activities primarily related to transactions within our short-term investments. As discussed further below, we repurchased our Debentures for $307.1 million during the nine months ended September 30, 2003, in part funded from the proceeds from sales of short-term investments. Accordingly, we received net proceeds on sales of short-term investments of $0.1 million during the nine months ended September 30, 2003, compared to a net reinvestment of our cash balances into short-term investments of $230.1 million during the comparable period in 2004.

We also utilize our cash position to invest in new property and equipment, with net purchases of property and equipment of $14.0 million and $7.8 million during the nine months ended September 30, 2003 and 2004, respectively. Capital expenditures decreased in the 2004 period primarily due to (i) the reduction/delay of our capital spending where possible; (ii) the consolidation of our data centers, resulting in a decrease in our information technology requirements for servers and other equipment; and (iii) the reduction in the number of offices we are occupying, which allowed us to reduce our purchases of tenant improvements, furniture and fixtures.

We intend to continue to closely monitor our capital expenditures, while making selective investments in additional information technology for (i) our CRM OnDemand product line, (ii) certain product development efforts, (iii) the replacement of certain older computer and information technology infrastructure, and (iv) the needs of an expanded workforce. Accordingly, we expect our total capital expenditures to be between $7.5 million and $10 million for the fourth quarter of 2004.

The remaining cash flows used in investing activities for the nine months ended September 30, 2004 consisted primarily of the acquisitions of Ineto Services, Inc. for net cash consideration of $4.8 million and Eontec for net cash consideration of approximately $71.1 million. Please refer to Note 6 to the accompanying unaudited consolidated financial statements for a further discussion of these acquisitions.

Financing

Net cash provided by (used in) financing activities increased from a net cash outflow of $275.5 million during the nine months ended September 30, 2003 to net cash inflows of $48.0 million for the nine months ended September 30, 2004. The increase from net cash outflows in the 2003 period to net cash inflows in the 2004 period was primarily due to repurchase of the Debentures in 2003 for $307.1 million. Please refer to Note 3 to the accompanying unaudited consolidated financial statements for a further discussion of this repurchase. In addition, our cash provided by financing activities continued to increase on a year-over-year basis due to an increase in the proceeds from the issuance of common stock pursuant to the exercise of stock options and our employee stock purchase plan (the "Purchase Plan"). During the nine months ended September 30, 2004, our cash flows from financing activities were partially offset by our repayment of capital lease obligations, with payments of $9.5 million and $9.4 million during the nine months ended September 30, 2003 and 2004, respectively.

Off-Balance-Sheet Arrangements

We do not use off-balance-sheet arrangements with unconsolidated entities or related parties. Accordingly, our liquidity and capital resources are not subject to off-balance-sheet risks from unconsolidated entities. As of September 30, 2004, we did not have any off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases, expiring between 2004 and 2022, for most U.S. and international sales and support offices and certain equipment in the normal course of business. While these arrangements are often referred to as a form of off-balance sheet financing, these arrangements are not considered off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K. Please refer to Note 4 to the accompanying unaudited consolidated financial statements for detail of our future minimum lease payments under our operating leases as of September 30, 2004.

Application of Critical Accounting Policies and Use of Estimates

Use of Estimates

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

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

Critical Accounting Policies

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

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

Our management has reviewed our critical accounting policies, our critical accounting estimates, and the related disclosures with our Disclosure and Audit Committees. These policies and our procedures related to these policies are described further in our Annual Report on Form 10-K for the year ended December 31, 2003 in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the heading "Application of Critical Accounting Policies and Use of Estimates."

Recent Accounting Pronouncements

In June 2004, the Emerging Issues Task Force ("EITF") issued EITF No. 03-01 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-01"). EITF 03-01 provides guidance with respect to determining the meaning of other-than-temporary impairment and its application to debt and equity securities within the scope of SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), including investments accounted for under the cost method.

We expect to apply the recognition and measurement guidance in EITF 03-01 to other-than-temporary impairment evaluations beginning in the fourth quarter of 2004. We adopted the disclosure provisions of EITF 03-01 for marketable investments as of December 31, 2003 and will adopt the disclosure requirements for cost method investments as of December 31, 2004. We do not expect the adoption of EITF 03-01 to have a material effect on our financial position, results of operations or cash flows.

Employee Stock Options

Section I. Description of Plans

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

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

Substantially all stock-based compensation grants are made after a review by, and with the approval of, the Compensation Committee of the Board of Directors. All members of our Compensation Committee are independent directors, as defined in the applicable rules for issuers traded on The NASDAQ Stock Market. Substantially all of our employees participate in one of the above plans, thereby providing us the ability to meet our goal of long-term retention of our employees. Stock options granted under these plans expire no later than ten years from the grant date and generally vest over five years. Please refer to the "Report of the Compensation Committee of the Board of Directors on Executive Compensation" appearing in "Item 11.

Executive Compensation" of our Annual Report on Form 10-K for the year ended December 31, 2003 for further information concerning our policies and the Compensation Committee's policies regarding the use of stock-based compensation.

Section II. Summary of Stock Option Activity During 2004

As the following table shows, stock options outstanding decreased by 8.2 million, or 6%, during the nine months ended September 30, 2004, primarily due to forfeitures upon terminations. Combined activity under the Plans for the nine months ended September 30, 2004 is summarized as follows:

	Shares Available for Grant	Number of Options	Wtd. Avg. Exercise Price per Share
Balances as of December 31, 2003	192,295,796	143,902,815	$ 13.20
Issuances of restricted stock units, net	(385,000)	--	
Options granted to employees	(6,770,500)	6,770,500	$ 9.90
Options granted to officers and directors	(3,487,000)	3,487,000	$ 10.86
Options exercised	--	(5,685,521)	$ 5.34
Options canceled due to employee termination	12,719,904	(12,790,543)	$ 18.17
Balances as of September 30, 2004	194,373,200	135,684,251	$ 12.83

The following table details the "in-the-money" and "out-of-the-money" status of our stock options outstanding as of September 30, 2004:

	Options Outstanding			Options Exercisable	
Options	Number of Shares	Wtd. Avg. Remaining Life (Years)	Wtd. Avg. Exercise Price	Number of Shares	Wtd. Avg. Exercise Price
In-the-money	46,666,759	2.7	$ 3.40	45,620,629	$ 3.42
Out-of-the-money	89,017,492	5.9	$ 17.77	45,414,625	$ 20.77
	135,684,251	4.8	$ 12.83	91,035,254	$ 12.08

In-the-money stock options in the above table have exercise prices below $7.54, the closing price of our common stock as of September 30, 2004, and out-of-the money stock options have exercise prices equal to or greater than $7.54.

Section III. Dilution

<u>Summary</u>

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

In order to maintain the proper balance between the need to attract and retain employees and minimize the dilution to existing stockholders, effective January 1, 2003 we adjusted our equity guidelines to reduce the size of stock option grants to new and existing employees. In addition, commencing in February 2003, we began granting stock options with a contractual life of six years, as opposed to ten years for stock options granted prior to such time. In 2004, in addition to maintaining these guidelines for new employees, we further reduced the size of our renewal grants to existing employees from 17.8 million stock options granted in 2003 to 3.6 million stock options granted during the first nine months of 2004. Stock options granted in 2004 to existing employees, other than officers and members of our Board of Directors, vest in full on December 31, 2004 and have a contractual life of five years.

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

Summarized below is the net dilution to our stockholders during the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2004, along with our option overhang as of the end of each of these respective periods (in thousands, except percentages):

	Year Ended December 31,		Nine Months Ended September 30,
	2002	2003	2004
Net options granted:			
Stock options granted	5,887	22,787	10,258
Stock options forfeited upon termination	(28,910)	(27,660)	(12,791)
Net granted (forfeited)	(23,023)	(4,873)	(2,533)
Dilution percentage (1)	(4.9)%	(1.0)%	(0.5)%
Option overhang (2)	38 %	29 %	27 %

(1) The potential dilution to stockholders from stock options (the "Dilution Percentage") is calculated as new stock options granted during the period, net of forfeitures by employees terminating employment, divided by the total outstanding shares of common stock at the beginning of the respective period.

(2) Stock option overhang is calculated by dividing total stock options outstanding by the total outstanding shares of common stock at the end of each period.

Distribution of Grants

As the table below indicates, we have continued to allocate the majority of our stock options to employees who are not officers and directors. "Named Executive Officers" in the below table for 2002 and 2003 represent our CEO and the four most highly compensated executive officers for the respective year. For all 2004 periods presented in this Quarterly Report on Form 10-Q, Named Executive Officers represent our then-CEO (Thomas M. Siebel) and the four most highly compensated executive officers, as disclosed in Item 11 "Executive Compensation" of our Annual Report on Form 10-K for the year ended December 31, 2003, along with our recently appointed CEO, J. Michael Lawrie.

Summarized below is the distribution of our stock options for the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2004:

	Year Ended December 31,		Nine Months Ended September 30,
	2002	2003	2004
Grants during the period as a percentage of total granted:			
Named Executive Officers	3.4 %	4.6 %	23.4 %
All other officers and directors as a group	0.3	3.3	10.6
Total for all officers and directors	3.7	7.9	34.0
All other employees as a group	96.3	92.1	66.0
Total all grants	100.0 %	100.0 %	100.0 %

During the nine months ended September 30, 2004, stock options granted to both our Named Executive Officers and "all other officers and directors as a group" increased significantly compared to our historical percentages for these same grant categories primarily due to stock options granted to newly hired officers upon commencement of employment. Specifically, grants to Named Executive Officers include an aggregate of 2.0 million stock options granted to our new CEO, J. Michael Lawrie, upon his commencement of employment and grants to "all other officers and directors as a group" include 0.5 million stock options granted to our new President, EMEA Sales upon his commencement of employment. These two grants represented 24% of all stock options granted during the nine months ended September 30, 2004.

Section IV. Accounting for Stock-Based Compensation

We account for our employee stock-based compensation plans using the intrinsic value method, as prescribed by APB No. 25 "Accounting for Stock Issued to Employees" and interpretations thereof (collectively "APB 25"). Accordingly, we record deferred compensation costs related to our employee stock options when the market price of the underlying stock on the date of grant exceeds the exercise price of the stock option on the date of grant. We record and measure deferred compensation for stock options granted to non-employees at their fair value. Deferred compensation is expensed on a straight-line basis over the vesting period of the related stock option, which is generally five years.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
Net income (loss):				
As reported	$ (59,330)	$ 19,370	$ (44,944)	$ 59,238
Compensation expense related to:				
Stock options dilutive to stockholders:				
Stock-based compensation accounted for under APB 25	346	386	1,326	2,494
In-the-money stock options and restricted stock units	(7,109)	(584)	(20,853)	(3,140)
Stock purchase rights under the Purchase Plan	(1,904)	(2,554)	(3,973)	(8,071)
Subtotal	(8,667)	(2,752)	(23,500)	(8,717)
Stock options not dilutive to stockholders:				
Out-of-the-money stock options	(35,738)	(35,109)	(108,320)	(120,002)
Stock options cancelled for no consideration	--	--	(251,821)	--
Stock options forfeited in connection with terminations	(6,390)	--	(29,337)	(1,940)
Subtotal	(42,128)	(35,109)	(389,478)	(121,942)
Total pro forma expense giving effect to SFAS 123	(50,795)	(37,861)	(412,978)	(130,659)
Pro forma net loss giving effect to SFAS 123	$ (110,125)	$ (18,491)	$ (457,922)	$ (71,421)

In-the-money stock options in the above table have exercise prices below the closing price of our common stock as of the end of each of the respective periods, and out-of-the-money stock options have exercise prices equal to or greater than the closing price of our common stock as of the end of each of the respective periods. The closing prices as of September 30, 2003 and 2004 were $9.76 and $7.54, respectively.

As the table above illustrates, total pro forma expense for stock options includes $42.1 million and $389.5 million of expense during the three and nine months ended September 30, 2003, respectively, and $35.1 million and $121.9 million of expense during the three and nine months ended September 30, 2004, respectively, related to (i) stock options that were cancelled by our Chairman for no consideration, (ii) stock options forfeited by employees upon termination for no consideration, and (iii) stock options that are significantly out of the money (e.g., the weighted-average exercise price of the out-of-the-money stock options was $17.77 per share compared to a closing price of $7.54 per share as of September 30, 2004). These items represented 83% and 94% of the pro forma expense for the three and nine months ended September 30, 2003, respectively, and 93% of the pro forma expense for both the three and nine months ended September 30, 2004.

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

Section V. Executive and Director Stock-Based Compensation

Executive Stock-Based Compensation

The following table sets forth certain information regarding stock options granted to the Named Executive Officers during the nine months ended September 30, 2004:

Officer Name	Number of Securities Underlying Options Granted (1)	Percent of Total Options Granted to Employees in 2004 (2)	Exercise or Base Price ($/Share) (3)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for the Option Term (4) 5%	10%	Aggregate Black-Scholes Value on Date of Grant (5)
Thomas M. Siebel	--	-- %	$ --	--	$ --	$ --	$ --
J. Michael Lawrie (6)	2,000,000	19.5 %	$ 10.38	05/04/2010	$ 7,060,385	$ 16,017,606	$ 7,503,600
R. David Schmaier	100,000	1.0 %	$ 10.38	05/04/2010	$ 353,019	$ 800,880	$ 361,500
Kenneth A. Goldman	100,000	1.0 %	$ 10.38	05/04/2010	$ 353,019	$ 800,880	$ 361,500
Edward Y. Abbo	100,000	1.0 %	$ 10.38	05/04/2010	$ 353,019	$ 800,880	$ 361,500
Steven M. Mankoff	100,000	1.0 %	$ 10.38	05/04/2010	$ 353,019	$ 800,880	$ 361,500

(1) Stock options vest 20% on May 5, 2005, and at a rate of 5% for each quarter of service thereafter, and have a term of six years. The stock option granted to Mr. Lawrie incorporates accelerated vesting and extended exercise provisions upon a termination without cause or a change of control. Please refer to Mr. Lawrie's offer letter, a copy of which is filed as Exhibit 10.3 to the Form 10-Q for the quarter ended June 30, 2004, for further information.

(2) Based on an aggregate of 10.3 million shares subject to stock options granted to employees pursuant to our 1996 and 1998 Plans during the nine months ended September 30, 2004, including grants to the Named Executive Officers.

(3) Under all stock option plans, the stock option exercise price is equal to the fair market value on the date of grant.

(4) The potential realizable value is calculated based on the term of the option at the time of grant. Stock price appreciation of 5% and 10% is assumed pursuant to rules promulgated by the SEC and does not represent our prediction of our stock price performance or the actual value of the stock options.

(5) Represents the aggregate fair value of the stock options on the date of grant (ranging from $3.62 to $3.75 per share), as calculated using the Black-Scholes option valuation model. The fair value does not represent our prediction of our stock price performance, and historically has had little to no relationship to the value that is actually realized. Please refer to Section IV above for a discussion of the limitations of SFAS 123.

(6) Mr. Lawrie commenced employment on May 3, 2004 and was appointed our CEO effective May 4, 2004.

In addition to the above grants of stock options, on May 5, 2004 we granted Mr. Lawrie an RSU for 350,000 shares of our common stock in connection with his commencement of employment. The terms of the RSU provide that 150,000 of the underlying shares of common stock vested during the second quarter of 2004 and the remaining 200,000 shares vest two years from his commencement of employment. In the event that Mr. Lawrie is terminated without cause or in the event of a change of control (each as defined in Mr. Lawrie's offer letter, which is filed as Exhibit 10.3 to the Form 10-Q for the quarter ended June 30, 2004) within the first two years of Mr. Lawrie's employment, all unvested units will immediately vest in full.

The following summarizes the distribution and dilutive impact of the stock options held by our Named Executive Officers as of December 31, 2002 and 2003, and September 30, 2004:

	December 31, 2002	December 31, 2003	September 30, 2004
Stock options held by Named Executive Officers as a percentage of:			
Total options outstanding	29.3 %	18.7 %	21.3 %
Outstanding shares of common stock	11.2 %	5.4 %	5.7 %

The following table sets forth for each of the Named Executive Officers the shares acquired and the value realized on each exercise of stock options during the nine months ended September 30, 2004 and the number and value of securities underlying unexercised stock options held by the Named Executive Officers as of September 30, 2004:

Officer Name	Shares Acquired on Exercise	Value Realized (1)	Number of Securities Underlying Unexercised Options at September 30, 2004 (2)		Value of Unexercised In-the-Money Options at September 30, 2004 (3)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Thomas M. Siebel	--	$ --	18,686,134	--	$ 86,937,062	$ --
J. Michael Lawrie (4)	--	$ --	--	2,000,000	$ --	$ --
R. David Schmaier	292,856	$ 2,585,732	1,743,932	986,072	$ 1,315,903	$ 208,254
Kenneth A. Goldman	--	$ --	1,980,000	990,000	$ --	$ --
Edward Y. Abbo	96,200	$ 1,172,732	560,000	400,000	$ 820,400	$ --
Steven M. Mankoff	30,000	$ 279,113	949,300	537,500	$ 1,329,021	$ --

(1) Based on the fair market value of our common stock on the exercise date, minus the exercise price, multiplied by the number of shares exercised.

(2) Represents the total number of shares of our common stock subject to stock options held by the Named Executive Officers as of September 30, 2004.

(3) Based on the fair market value of our common stock as of September 30, 2004 ($7.54 per share), minus the exercise price, multiplied by the number of shares underlying the stock options.

(4) Mr. Lawrie commenced employment on May 3, 2004 and was appointed our CEO effective May 4, 2004.

Director Stock-Based Compensation

Our directors do not currently receive any cash compensation for service on the Board of Directors or any committee thereof, but are eligible for reimbursement for certain expenses incurred in attending Board of Directors' and committee meetings. Historically, our non-employee directors have received discretionary periodic stock option grants under the 1996 Plan for service on our Board of Directors. In May 2003, after considering the criteria relating to awarding stock options and general market conditions, our Board of Directors approved the following formal guidelines relating to the grant of stock options to our non-employee directors:

- Initial Grants—Each new non-employee director will be granted an option to purchase 80,000 shares of our common stock as soon as practicable following such director's appointment to the Board of Directors.

- Annual Grants—Each non-employee director who has served on the Board of Directors for more than six months will be granted an option to purchase 20,000 shares of our common stock in January of each year.

We do not intend for stock options granted to non-employee directors to qualify as incentive stock options under the Internal Revenue Code. We believe that these option grant guidelines will motivate and reward our non-employee directors for their service in a manner that is consistent with good corporate practice and the independence requirements of the NASDAQ National Market applicable to members of boards of directors and compensation committees. Notwithstanding the foregoing guidelines, from time to time, including prior to any stock option grant made to any non-employee director, the Compensation Committee of the Board of Directors will review the appropriateness and adequacy of these compensation guidelines, taking into consideration actual performance by us and the non-employee director and such other factors and circumstances as deemed necessary and appropriate, and exercising such other power and authority as may be permitted or required under the 1996 Plan.

During the nine months ended September 30, 2004, we granted 20,000 stock options with an exercise price of $15.39 to each of our non-employee directors, including James C. Gaither, Marc F. Racicot, Eric E. Schmidt, Charles R. Schwab and George T. Shaheen. The fair value of each of these stock options on the date of grant was approximately $106,000, or $5.31 per share, as determined using the Black-Scholes option valuation model. In addition, we granted 80,000 stock options with an exercise price of $12.15 per share to John W. White upon his appointment to the Board of Directors. The fair value of these stock options on the date of grant was approximately $351,000, or $4.39 per share, as determined using the Black-Scholes option valuation model.

The exercise price per share of each of the stock options granted to our Board of Director members during the nine months ended September 30, 2004 was equal to the fair market value of common stock on the date of grant. Each of these stock options vest 20% on the one-year anniversary of the date of grant, and at a rate of 5% for each quarter of service thereafter, and have a term of six years.

Section VI. Equity Compensation Plan Information

Information as of September 30, 2004 related to each of our stock option plans is summarized as follows:

Plan Category	Number of Shares to Be Issued Upon Exercise of Outstanding Options		Weighted Average Exercise Price of Outstanding Options	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Options Outstanding)
Equity compensation plans:				
Approved by stockholders (1)	51,882,873	$	7.42	79,159,368
Not approved by stockholders (2)	82,890,649	$	16.25	126,538,825
Acquired companies' plans (3)	910,729	$	8.78	--
	135,684,251	$	12.83	205,698,193

(1) Represents shares available under the 1996 Plan, which is used for grants to our officers and directors. The shares remaining available for future issuance amount also includes 11.3 million shares available under our 2003 Employee Stock Purchase Plan.

(2) Represents shares available under the 1998 Plan, which is used for grants to our employees other than officers and directors.

(3) We have assumed certain stock options granted to former employees of acquired companies (the "Acquired Options"). All of the Acquired Options have been adjusted to give effect to the conversion under the terms of the agreements between us and the companies acquired. The Acquired Options generally become exercisable over a four-year period and expire ten years from the date of grant. Additional stock options will not be granted under any of the acquired companies' plans, and these plans have not been approved by our stockholders.

Risk Factors

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

Our total revenue and operating results may fluctuate.

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

- Corporate and consumer confidence in the economy, evidenced, in part, by stock market levels;
- Changes in the domestic and international economic, business and political conditions;
- Economic conditions within the information technology industry;
- Level of product and price competition;
- Length of our sales cycle and customer licensing patterns;
- Size and timing of individual license transactions;
- Delay or deferral of customer implementations of our products;
- Success in expanding our Global Services Organization, direct sales force and indirect distribution channels;
- Timing of new product introductions and product enhancements;
- Appropriate mix of products licensed and services sold;
- Levels of international transactions;
- Activities of and acquisitions by competitors;
- Timing of new hires and the allocation of our resources;
- Increases in the cost of software and professional services;
- Changes in foreign currency exchange rates;
- Changes in accounting principles generally accepted in the United States;
- Success of integrating and achieving the anticipated benefits of our acquired companies; and
- Our ability to develop and market new products and control costs.

One or more of the foregoing factors, as well as other factors, may cause our operating expenses to be disproportionately high during any given period or may cause our net revenue and operating results to fluctuate significantly. Based upon the preceding and other factors, we may experience a shortfall in revenue or earnings or otherwise fail to meet public market expectations, which could materially and adversely affect our business, financial condition, results of operations and the market price of our common stock.

Our quarterly operating results may fluctuate.

Our total revenue and operating results may vary significantly from quarter-to-quarter. Some of the main factors that may affect these fluctuations are:

- Domestic and international economic, business and political conditions;
- Economic conditions within the information technology industry;
- The discretionary nature of our customers' purchase and budget cycles;
- The size and complexity of our license transactions;
- The potential delays in recognizing revenue from license transactions;
- The timing of new product releases;
- Hiring additional personnel, including sales staff, programmers and other staff;
- Seasonal variations in operating results; and
- Variations in the fiscal or quarterly cycles of our customers.

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

As a result of these and other factors, revenues for any quarter are subject to significant variation, and we believe that period-to-period comparisons of our results of operations are not necessarily meaningful. You should not rely on these comparisons as indications of future performance. Our future quarterly operating results may not meet the expectations of market analysts or investors, which would likely have an adverse effect on the price of our common stock.

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

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

Economic conditions could adversely affect our revenue growth and ability to forecast revenue.

The revenue growth and profitability of our business depends on the overall demand for business applications software and services, particularly within the industries in which we offer specific versions of our products. Because we sell our products primarily to major corporate customers in the high technology, telecommunications, financial services (including insurance), pharmaceutical, utilities and consumer packaged goods industries, our business depends on the overall economy and the economic and business conditions within these industries. For example, weak global economic conditions in 2001, 2002 and 2003 significantly impacted capital spending, particularly information technology spending within the industries listed above, resulting in a decrease in our software license revenues in 2001, 2002 and 2003. Future decreases in demand for computer software caused, in part, by weakness of the global economy may result in a decrease in revenues, operating income and/or our growth rates.

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

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

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

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

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

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

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

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

In particular, our efforts to comply with Section 404 of SOX and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. Although we believe that the on-going review of our internal controls will enable us to provide an assessment of our internal controls and our external auditors to provide their audit opinion in our Annual Report on Form 10-K for the year ended December 31, 2004 as required by Section 404 of SOX, we can give no assurance that these efforts will be completed on a timely and successful basis.

Moreover, because these laws, regulations and standards are subject to varying interpretations, their application in practice may evolve over time as new guidance becomes available. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by on-going revisions to our disclosure and governance practices.

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

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

Our U.S. Federal income tax returns for 1998 through 2003 are currently under examination by the IRS. During 2003 and 2004, we received notices from the IRS of proposed adjustments to these income tax returns. In addition, certain of our U.S. payroll tax returns (primarily related to taxes associated with stock option exercises), U.S. sales and use tax returns, and international sales and value added tax returns are currently under examination and/or review by the applicable taxing authorities. While we believe that we have made adequate provisions related to the audits of these tax returns, the final determination of our obligations may exceed the amounts provided for by us in the accompanying consolidated financial statements.

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

Because of our limited history with our Siebel CRM OnDemand subscription model, we cannot predict with any degree of certainty the rate of the conversion of our sales pipeline, customer subscription renewals and the impact these renewals will have on our revenue or operating results.

The market for on-demand or “hosted” application services is relatively new and unproven, and it is uncertain whether these services will achieve and sustain high levels of demand and market acceptance. Our success will depend in part on the willingness of enterprises to increase their use of on-demand application services in general and for CRM in particular. If enterprises do not perceive the benefits of on-demand application services, then the market for these services may not develop at all, or it may develop more slowly than we expect, either of which could significantly adversely affect our operating results. In addition, if the demand for our Siebel CRM OnDemand service does not materialize as expected, our ability to recover our investment in UpShot Corporation and Ineto Services, Inc. may be impaired. As of September 30, 2004, the carrying value of the goodwill and amortizable intangibles related to these entities was approximately $63.2 million and $6.7 million, respectively.

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

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

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

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

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

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

We have in the past and may in the future acquire additional companies, products or technologies. Most recently, we acquired Eontec Limited in April 2004, Ineto in January 2004 and UpShot in November 2003. We may not realize the anticipated benefits of these or any other acquisition and each acquisition has numerous risks. These risks include:

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

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

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

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

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

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

If we fail to manage the size of our operations effectively, our business, financial condition or results of operations could be materially and adversely affected. Since we began operations in 1994 and continuing throughout early 2001, our business grew rapidly. Beginning in early 2001 and continuing through much of 2004, our revenues declined as a result of a deterioration of the overall economy and information technology industry. These rapid changes in our business have placed a significant strain on our management systems and resources. In response to the deterioration in the information technology industry, management completed a series of Restructurings, as described more fully in Note 2 to the accompanying unaudited consolidated financial statements. The Restructurings have particular risks, many of which are discussed above under "We may incur future restructuring charges, which may adversely impact our operations." In addition, if our operations return to positive growth we may need to implement new systems or upgrade current systems. The failure to successfully implement such new or improved systems could materially and adversely affect our business, financial condition or results of operations.

Rapid change will require us to manage the size of our employee base.

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

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

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

We currently account for stock options under APB 25 and, accordingly, we only record compensation expense related to stock options if the current market price of the underlying stock exceeds the exercise price of the stock option on the date of grant. On March 31, 2004, the FASB issued a draft accounting pronouncement which, if implemented, will require us to expense stock options in our statement of operations no later than July 1, 2005. The draft accounting pronouncement applies to all outstanding stock options that are not vested at the effective date and grants of new stock options made subsequent to the effective date. The final statement is expected to be issued in the fourth quarter of 2004.

If we are required to change our accounting policy in accordance with this draft accounting pronouncement, we estimate that our earnings in 2005 could be reduced by up to approximately $40.0 million per quarter. This estimate is based solely on the expense associated with stock options outstanding as of September 30, 2004 (including stock-based compensation under the Purchase Plan) and therefore does not take into consideration new stock option grants, which would increase this estimate, or forfeitures of stock options, which would reduce this estimate.

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

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

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

In particular, we have established non-exclusive strategic relationships with Accenture, Capgemini, Deloitte Consulting, IBM and BearingPoint, among others. A significant portion of our revenues has historically been derived from customers that have engaged systems integrators with which we have a relationship. Any deterioration of our relationships with these significant systems integrators could have a material adverse effect on our business, financial condition or results of operations. We also have relationships with technology vendors such as Hewlett-Packard, Microsoft and Sun Microsystems, among others. Failure to maintain existing relationships on acceptable terms, or to establish new relationships in the future, could have a material adverse effect on our business, financial condition or results of operations.

Our current and potential customers may also rely on third-party systems integrators to develop, deploy or manage Siebel *e*Business Applications. If we do not adequately train a sufficient number of systems integrators, or if these integrators do not have, or do not devote, the resources necessary to implement our products, our business, financial condition or results of operations could be materially and adversely affected.

Our customers may not successfully implement our products.

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

A limited number of products provide a substantial part of our license revenues.

A majority of our software license revenues are attributable to sales of our sales, marketing and service automation products, particularly Siebel Sales, Siebel Service, Siebel Call Center, Siebel Interactive Selling and related products. We have also expanded our product offerings to include Siebel Analytics, Siebel Employee Relationship Management, Universal Application Network and Siebel CRM OnDemand. We expect that these applications, along with the related consulting, maintenance and training services, will continue to account for a majority of our future revenues. Factors adversely affecting the cost and pricing of, or demand for, these products, such as competition or technological change, could have a material adverse effect on our business, financial condition or results of operations.

Our software license revenue is dependent on our ability to enter into significant software license transactions with new and existing customers.

Our success depends on gaining new customers and maintaining relationships with our existing customers. In particular, if the number of software license transactions and/or the average size of these transactions decrease, our software license revenue may be negatively impacted, which may in turn negatively impact our services and total revenues. For example, during the nine months ended September 30, 2004, the number of transactions generating software license revenues greater than $1 million declined from 80 transactions in the nine months ended September 30, 2003 to 76 transactions in the nine months ended September 30, 2004, accounting for a significant portion of the decline in our software license revenues. The failure to enter into these larger software license transactions and/or maintain or increase the number of software license transactions could have a material adverse effect on our business, financial condition or results of operations.

Our distribution channels may create additional risks.

We have a number of relationships with resellers that assist us in obtaining broad market coverage. We have generally avoided exclusive relationships with resellers of our products. Discount policies and reseller licensing programs are intended to support each distribution channel with a minimum level of channel conflicts. Failure to minimize channel conflicts could materially and adversely affect our business, operating results and financial condition.

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

The software market in which we compete is characterized by (i) rapid technological change, (ii) frequent introductions of new products, (iii) changing customer needs, and (iv) evolving industry standards. To keep pace with technological developments, evolving industry standards and changing customer needs, we must support existing products and develop new products. We may not be successful in developing, marketing and releasing new products or enhancements to Siebel *e*Business Applications or CRM OnDemand that respond to technological developments, evolving industry standards or changing customer requirements. We may also experience difficulties that could delay or prevent the successful development, introduction and sale of these new products or enhancements. In addition, these new products or enhancements may not adequately meet the requirements of the marketplace and may not achieve any significant degree of market acceptance. If release dates of any future products or enhancements to Siebel *e*Business Applications or CRM OnDemand are delayed, or if these products or enhancements fail to achieve market acceptance when released, our business, operating results or financial condition could be materially and adversely affected. In addition, new products or enhancements by our competitors may cause customers to defer or forego purchases of our products, which could have a material adverse effect on our business, financial condition or results of operations.

We may not be able to compete effectively in the Internet-related products and services market.

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

We operate in a competitive and rapidly changing market.

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

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

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

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

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

<u>Internal Development</u>

Many of our customers and potential customers have in the past attempted to develop sales, marketing, customer service and employee relationship information systems in-house, either alone or with the help of systems integrators. Internal information technology departments have staffed projects to build their own systems utilizing a variety of tools. In some cases, such internal development projects have been successful in satisfying the needs of an organization. To compete successfully, our products must conform to the customer's information technology standards, scale to meet the needs of growing enterprises, operate globally and cost less than the result of an internal development effort. We may not be able to compete effectively against these internal development efforts.

System Integrators

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

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

Other Competitors

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

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

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

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

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

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

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

Software errors or defects in our products could reduce revenues.

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

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

Our performance depends on the continued service of our key technical, sales and senior management personnel. Our key employees have not entered into employment agreements with us. The loss of one or more of our senior management personnel could have a material adverse effect on our business, operating results and financial condition. In recent years, we have had members of our senior management announce their retirement or departure from our company. We replace these individuals with internal candidates and, if deemed appropriate, individuals from outside our organization. While our internal candidates understand our business model, they must learn a new position and take on additional or new responsibilities, which could take time and result in the disruption to our on-going operations. To integrate into our company, new senior personnel must spend a significant amount of time learning our business model and management systems, in addition to performing their regular duties. Accordingly, until new senior personnel become familiar with our business model and systems, their integration may result in some disruption to our on-going operations. Additionally, we may need to hire additional personnel in general or to replace internal candidates who have been promoted and as a result, we may experience increased compensation costs that are not offset by either improved productivity or higher prices.

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

We continue to rely heavily on our direct sales force. In recent years, we have restructured or made other adjustments to our sales force in response to factors such as management changes, product changes and other internal considerations. Changes in the structure of the sales force and sales force management have generally resulted in a temporary lack of focus and reduced productivity that may have affected revenues in one or more quarters. We cannot assure you that we will not continue to restructure our sales force or that the transition issues associated with restructuring the sales force will not recur. Such restructuring or associated transition issues can be disruptive and adversely impact our business and operating results.

We may not be able to protect our proprietary information.

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

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

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

Our international operations involve unique risks.

Our revenues are primarily derived from large multinational companies. To service the needs of these companies, we must provide worldwide product support services. We have expanded and in the future may expand our international operations and enter additional international markets. This will require significant management attention and financial resources that could adversely affect our operating margins and earnings. We may not be able to maintain or increase international market demand for Siebel *e*Business Applications and CRM OnDemand. If we do not, our international sales will be limited and our business, financial condition or results of operations could be materially and adversely affected.

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

Our stock price may continue to be volatile.

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

The following table summarizes as of September 30, 2004 our foreign currency forward contracts, by currency. All of our foreign currency forward contracts mature within one year. Contract amounts are representative of the expected payments to be made under these instruments (in thousands):

	Contract Amount (Local Currency)	Contract Amount	Fair Value (US$)	
Australian dollars ("AUD") (contracts to pay AUD/receive US$)................................	(AUD) 13,347	US$9,472	$	(5)
Brazilian real ("BRL") (contracts to pay BRL/receive US$)......................................	(BRL) 27,623	US$9,122	$	(273)
British pounds ("GBP") (contracts to pay GBP/receive EUR).....................................	(GBP) 10,284	EUR 15,176	$	246
Canadian dollars ("CAD") (contracts to pay CAD/receive US$)................................	(CAD) 2,407	US$1,943	$	52
Japanese yen ("JPY") (contracts to pay JPY/receive US$).......................................	(JPY) 1,151,383	US$10,474	$	81
Korean won ("KRW") (contracts to pay KRW/receive US$)...	(KRW) 98,000	US$83	$	3
Mexican pesos ("MXN") (contracts to pay MXN/receive US$)...............................	(MXN) 26,232	US$2,267	$	11
Singapore dollars ("SGD") (contracts to pay SGD/receive US$).................................	(SGD) 57	US$62	$	24
Czech Republic koruna ("CZK") (contracts to receive CZK/pay EUR)................................	(CZK) 37,250	EUR 1,183	$	(9)
Euros ("EUR") (contracts to receive EUR/pay US$)...	(EUR) 182,073	US$222,336	$	1,761
Swedish krona ("SEK") (contracts to receive SEK/pay EUR).....................................	(SEK) 10,705	EUR 1,176	$	3
Swiss francs ("CHF") (contracts to receive CHF/pay EUR).....................................	(CHF) 2,419	EUR 1,576	$	(15)

The following table summarizes our short-term investments and the weighted average yields as of September 30, 2004 (in thousands, except percentages):

	Expected Maturity Date						
	2004	2005	2006	2007	2008	Thereafter	Total
US Treasury and Agency securities...	$ 71,181	$ 147,416	$ 224,842	$ 49,751	$ 8,913	$ 9,136	$ 511,239
Weighted average yield......................	2.04%	2.19%	2.66%	3.03%	3.37%	3.56%	
Corporate bonds...................................	$ 29,805	$ 159,755	$ 292,542	$ 165,009	$ 58,610	$ 19,474	$ 725,195
Weighted average yield......................	2.01%	2.38%	2.60%	3.13%	3.55%	3.93%	
Asset-backed securities........................	$ 19,762	$ 120,951	$ 196,494	$ 54,334	$ 7,301	$ 11,886	$ 410,728
Weighted average yield......................	1.92%	2.68%	3.01%	3.52%	4.30%	2.97%	
Total short-term investments...............	$ 120,748	$ 428,122	$ 713,878	$ 269,094	$ 74,824	$ 40,496	$ 1,647,162

The securities in the above table, like all fixed income instruments, are subject to interest rate risk and, accordingly, if market interest rates increase, these investments will decline in value. If market interest rates were to increase immediately and uniformly by 100 basis points from levels as of September 30, 2004, the fair value of the above investments would decline by approximately $23.7 million.

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

Item 4. Controls and Procedures

We have historically made our internal controls over financial reporting a high priority and we continue to do so. Our Internal Controls Committee, comprised primarily of senior financial and legal personnel, assists us in ensuring that our internal controls over financial reporting are complete, accurate and appropriately documented. In addition, our internal audit department reviews and tests our internal controls in order to ensure that the internal controls are designed appropriately and are operating as designed. The Sarbanes-Oxley Act of 2002 ("SOX") and resulting rules adopted by the Securities and Exchange Commission ("SEC") served as a catalyst for us to formalize many of our processes, controls and procedures that we have implemented to ensure proper financial reporting. The following is a summary of the procedures that we have undertaken with respect to Section 302 of SOX ("Section 302") and Section 404 of SOX ("Section 404").

Section 302

Attached as Exhibits 31 and 32 to this quarterly report are two separate forms of certifications of our CEO and CFO. The certifications attached as Exhibits 31.1 and 31.2 are required in accordance with Section 302 of SOX (the "Section 302 Certifications"). The information contained below relates to the "Controls Evaluation" referred to in the Section 302 Certifications, and should be read with the Section 302 Certifications for a more complete understanding of the topics presented.

As of September 30, 2004 (the "Evaluation Date"), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (the "Disclosure Controls"), as such terms are defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934 (the "Exchange Act"), and our internal controls and procedures for financial reporting (the "Internal Controls"). This evaluation (the "Controls Evaluation") was done under the supervision and with the participation of management, including our CEO and CFO. Rules adopted by the SEC require that we present the conclusions of our CEO and the CFO about the effectiveness of our Disclosure Controls and Internal Controls based on and as of the date of the Controls Evaluation.

Based upon the Controls Evaluation, our CEO and CFO have concluded that, subject to the limitations noted below under Section 404, our Disclosure Controls are effective in alerting them on a timely basis to material information related to us (including our consolidated subsidiaries) that is required to be included in our reports filed or submitted under the Exchange Act.

Our CEO and CFO note that during the three and nine months ended September 30, 2004, there have been no changes in our Internal Controls or in other factors that materially affected or are reasonably likely to materially affect such controls, including any corrective actions with regard to material weaknesses. We have historically considered our Internal Controls over financial reporting a high priority and strive to continually improve our Internal Controls. Accordingly, we have taken and will continue to take corrective action as we discover deficiencies in our Internal Controls.

Section 404

Under Section 404, we are required to document all of our Internal Controls over business and financial processes and procedures that may affect our reported financial results. In addition, we will issue a report on the effectiveness of our Internal Controls over financial reporting, including a statement as to whether or not such controls are effective. In addition, our independent auditors will perform an audit of our Internal Controls over financial reporting and provide an assessment of those controls as of December 31, 2004.

Responsibility for Disclosure and Internal Controls

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

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

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

Limitations on the Effectiveness of Controls

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

Scope of Our Controls Evaluation Under Section 404

As of December 31, 2003, we had substantially completed the documentation and testing of our significant business and financial process and procedures, representing approximately 50 individual processes, which may materially impact our reported financial and operating results. In accordance with SOX, we will test our Internal Controls each year and, accordingly, we have begun our testing for 2004 and expect to complete this testing prior to the filing of our Annual Report on Form 10-K. As of September 30, 2004, our management and internal audit department have completed their review and testing of the majority of our individual processes and we believe we are on schedule to complete this testing prior to the filing of our Annual Report on Form 10-K. In addition, our auditors have begun their test work, which we also believe will be completed in accordance with the requirements of SOX. To date, we have found no material weaknesses, as defined in the professional accounting literature and described below, with our Internal Control structure.

Our Controls Evaluation included formal documentation and review of the controls’ objectives and designs, along with our controls’ implementation and the effect of the controls on the information generated for use in this quarterly report. In the course of the Controls Evaluation, we sought to identify data errors, controls problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken. We also sought to deal with other controls matters in the Controls Evaluation, and in each case if a problem was identified, we considered what revision, improvement or correction to make in accordance with our on-going procedures.

Among other matters, we sought in our evaluation to determine whether there were any control deficiencies (particularly "significant deficiencies" or "material weaknesses") in our Internal Controls, and whether we have identified any acts of fraud involving personnel who have a significant role in our Internal Controls. This information was important both for our Controls Evaluation and because Item 5 in the Section 302 Certifications require that the CEO and CFO disclose such information to our Audit Committee of the Board of Directors and to our independent auditors and to report on related matters in this section of the quarterly report. In professional auditing literature, a control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A "significant deficiency" in the control structure exists when there is a control deficiency, or combination of control deficiencies, that adversely affects a company's ability to initiate, record, process or report external financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the annual or interim financial statements that is more than inconsequential in amount will not be prevented or detected. A "material weakness" is defined in auditing literature as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

We will perform this type of evaluation on a quarterly basis and report the conclusions concerning controls effectiveness in our quarterly reports and annual report. Our Internal Controls are also evaluated on an on-going basis by our internal audit department and by other personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our Disclosure Controls and our Internal Controls and to make modifications as necessary. Our objective is to maintain Disclosure Controls and Internal Controls as dynamic systems that change (including improvements and corrections) as conditions warrant.

Evaluation of Our Disclosure Controls and Internal Controls Under Section 404

Based upon our management's review and our internal audit department's testing of our Internal Controls, we believe that our Internal Controls provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. We believe we are well positioned to be in compliance with Section 404 when all provisions of Section 404 are effective, including our ability to issue a report on our Internal Controls and obtain an audit report on our Internal Controls from our auditors.

Part II. Other Information

Item 1. Legal Proceedings

On May 6, 2003, the Enforcement Division staff ("Staff") of the SEC contacted us and indicated that a May 1, 2003 article on CBS MarketWatch had raised questions regarding our compliance with Regulation FD. In August 2003, the Staff notified us and two of our officers of the Staff's preliminary decision to recommend that the SEC take enforcement action against us and these officers in regard to statements allegedly made prior to and during an April 30, 2003 dinner. We, along with our officers, have filed submissions with the SEC in response to the SEC notices that we believe contained numerous meritorious defenses to these allegations. Despite these submissions, on June 29, 2004, the SEC filed a lawsuit in the United States District Court of the Southern District of New York against us and two of our officers alleging, among other things, that we, along with our officers, violated Regulation FD in connection with the statements described above. In September 2004, we filed a motion to dismiss the complaint. A hearing on the motion has been scheduled for December 2004. We believe the allegations in this action are without merit and we intend to defend ourselves vigorously.

On March 10, 2004, William Wollrab, on behalf of himself and purportedly on behalf of a class of our stockholders, filed an action in the United States District Court for the Northern District of California against us and certain of our officers. This complaint was consolidated and amended on August 27, 2004, with the Policemen's Annuity and Benefit Fund of Chicago being appointed to serve as lead plaintiff. In October 2004, we filed a motion for dismissal of the consolidated complaint in this case. On April 12, 2004, Pamela Plotkin, on behalf of herself and purportedly on behalf of a class of our stockholders, filed an action in the Superior Court of California (the "Superior Court") against us and certain members of our Board of Directors. These actions allege claims in connection with various public statements made by us and seek damages together with interest and reimbursement of costs and expenses of litigation. The Superior Court dismissed the complaint by Ms. Plotkin on September 23, 2004, but gave Ms. Plotkin leave to file a new, amended complaint. We believe the allegations in these actions are without merit and we intend to defend vigorously against these claims.

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

Item 5. Other Information

(a) Charles R. Schwab resigned from our Board of Directors effective November 5, 2004, to focus on his duties as Chief Executive Officer of The Charles Schwab Corporation, a position to which he was re-appointed in July 2004. We extend a great debt of gratitude to Mr. Schwab for his enormous contributions to Siebel Systems since joining our Board in October 1994.

Item 6. Exhibits

Exhibit Number	Description of Document
3.1	Amended and Restated Certificate of Incorporation of the Registrant, as amended to date. (1)
3.2	Amended and Restated Bylaws of the Registrant. (2)
4.1	Reference is made to Exhibit 3.1 and Exhibit 3.2.
4.2	Specimen Stock Certificate. (3)
4.3	Certificate of Designation of Series A1 Preferred Stock of the Registrant. (4)
4.4	Indenture between the Registrant, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated September 15, 1999. (5)
4.5	Certificate of Designation of Series A2 Junior Participating Preferred Stock. (6)
4.6	Rights Agreement dated as of January 29, 2003, between the Registrant and Mellon Investors Services LLC, as Rights Agent. (6)
4.7	Form of Rights Certificate. (6)
10.1	Siebel Systems, Inc. Nonqualified Deferred Compensation Plan. (7)
10.2	Offer Letter, dated April 28, 2004, to J. Michael Lawrie. (8)
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (8)
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (8)
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (8)

(1) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.
(2) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002.
(3) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (No. 333-03751), as amended.
(4) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 27, 2000.
(5) Incorporated by reference to the Registrant's Registration Statement on Form S-3 (No. 333-91777) filed on November 30, 1999.
(6) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 29, 2003.
(7) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on September 7, 2004.
(8) Filed herewith.

Availability of this Report

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

SIGNATURE

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

SIEBEL SYSTEMS, INC.

Date: November 5, 2004

By: /s/ Kenneth A. Goldman
Kenneth A. Goldman
Senior Vice President, Finance and Administration
and Chief Financial Officer

Exhibit 10.2

April 28, 2004

Michael J. Lawrie
8 Country Club Road
Ridgefield, CT 06877

Dear Mike:

Siebel Systems, Inc. (the "Company") is pleased to offer you the position of Chief Executive Officer. As Chief Executive Officer, you will report directly to the Board of Directors. You agree to perform the duties set forth in the next sentence, as well as any other reasonable duties determined by the Board of Directors. The parties' initial expectations regarding the primary duties of this position are as follows: (i) all duties, authorities and responsibilities customary for a chief executive officer of a public company, including executive responsibility for developing strategic direction and all operational and execution activities of the Company, (ii) ultimate management responsibility for all employees of the Company, other than those employees reporting to the Chairman of the Board of Directors, and (iii) preparation and submission of a revised operating budget to the Board of Directors on a quarterly basis, which shall serve to provide the scope of operational authority. While you remain an employee of the Company, the Company will recommend that you be elected as a member of the Company's Board of Directors at no additional compensation. You will resign from the Board upon termination of employment, unless requested to continue.

Salary and Bonus

Your starting salary will be $1,000,000 per year, paid on a semi-monthly basis. You will be eligible to receive a target bonus of up to 125% of your base salary per year in the event the Board determines that you have achieved the performance objectives to be determined by the Board. This bonus may be increased up to 200% of your base salary per year in the event the Board determines that you have substantially exceeded certain additional performance objectives established by the Board, in a manner consistent with market practices. Such bonuses are earned and paid at the discretion of the Board. The Company will endeavor to pay any bonus amounts determined by the Board in accordance with the foregoing within ninety (90) days after the end of the fiscal year. During the fiscal year ending December 31, 2004, you will be guaranteed to receive a bonus equal to the amount payable at the 125% level.

Stock Options

In addition, you will be granted stock options totaling 2,000,000 shares of Company common stock (the "Option"), subject to approval by the Board of Directors. The Option will be granted at the first meeting of the Board of Directors or its Compensation Committee following your first day of employment, with a strike price equal to the fair market value on that date. The Option will have a 5-year vesting schedule, such that the option will vest 20% upon your first anniversary of employment with the Company and 5% each quarter thereafter. This option will vest in its entirety upon death during your employment with the Company. The agreement embodying this stock option shall be consistent with the Company's standard form agreement, modified as necessary to incorporate the terms of this letter agreement.

Restricted Stock

Upon commencement of your employment on or before May 3, 2004, you will also be given a restricted stock award of 350,000 shares of common stock. You will be required to hold 200,000 of these shares for at least two years following your start date. In the event you voluntarily resign your employment with the Company during such two year period, you will be required to forfeit such shares. In the event you are terminated without cause (as defined below) or in the event of a change of control (as defined below) during such two year period, such holding restriction will immediately expire. The agreement embodying this restricted stock award shall be consistent with the Company's standard form agreement, modified as necessary to incorporate the terms of this letter agreement.

Indemnification

The parties acknowledge that they have no reason to believe that you are contractually prohibited by your current employer, International Business Machines Corporation ("IBM"), from accepting employment with the Company as outlined herein. The parties also believe that the Company is not a competitor of IBM for purposes of impacting your ability to retain the proceeds of your IBM option exercises. However, in the unlikely event that IBM incorrectly asserts that the Company is a competitor for purposes of such option exercises and is able to get a court of competent and final jurisdiction to enforce that assertion in a manner that causes you to irretrievably lose the right to retain the proceeds of such option exercises, the Company will reimburse you for such lost amount, up to a maximum of $6 million. The parties agree that this promise is made solely to help you bear the risk of an erroneous assertion and enforcement, and not as an inducement for you to breach any obligations you may have to IBM. You agree to cooperate fully in any legal actions to avoid this loss. You also agree to cooperate with the Company in the acquisition of an insurance policy to cover this risk, if the Company chooses in its sole discretion to acquire such a policy; however, the foregoing shall not be construed as requiring any responsibility on your part to pay premiums or other monetary costs related to such policy. In the event you voluntarily resign your employment with the Company during the two (2) year period following the commencement of your employment, the foregoing indemnity shall then terminate and you will be required to return immediately to the Company the entirety of any indemnity payments made to you on or before the effective date of such resignation.

Additionally, the Company will defend and indemnify you against any claims arising from any decision made by you in good faith while performing services for the Company.

<u>Severance Benefits</u>

You will be entitled to the following severance benefits, subject to your execution of a release of claims and two-year non-competition agreement in forms satisfactory to the Company or its successor(s)[1]:

A. Termination Without Cause

In the event you are terminated without cause (as defined below), you shall be entitled to receive the following severance payments:

1. Two (2) years' base salary and target bonus;

2. If you elect to continue your medical coverage under COBRA, the Company will reimburse your COBRA costs for one (1) year following the date of termination;

3. If you are terminated without cause any time during your first two (2) years of employment, you will receive immediate vesting of the first forty percent (40%) of your initial two (2) million share option grant (which shall include any shares already vested pursuant to the normal vesting schedule);

4. You will have a one-year period following termination of employment under this section A to exercise vested options, to the extent such options do not expire prior to or during such one-year period; and

5. Any holding restrictions remaining on your initial restricted stock grant (as described above) shall be terminated.

For purposes of the foregoing, termination "without cause" means termination by the Company for any reason other than (i) conviction of a felony or a crime involving moral turpitude, fraud, or an act of dishonesty against the Company; (ii) gross negligence in the performance of your responsibilities; (iii) material violation or breach of any Company policy or statutory, fiduciary, or contractual duty to the Company; or (iv) other willful misconduct. Termination without cause shall also be deemed to include the resignation by you for "good reason" (as defined below, absent the threshold requirement of a change of control).

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[1] Such non-competition agreement will include a specific list of the Company's then-current primary competitors, and shall be restricted to such list. For reference purposes only, the Company currently considers the following companies to be its primary competitors: Microsoft Corporation; Oracle Corporation; PeopleSoft, Inc.; Salesforce.com, Inc.; and SAP AG. All other terms of such release and non-competition agreements will be negotiated in good faith between the parties at the time of severance, with the intent of structuring an agreement that is (i) consistent with then-applicable industry standards and (ii) effective and enforceable under applicable law. In the event the parties are unable to agree on a particular term, they agree to seek the advice of a neutral third party benefits expert to help determine the applicable industry standards regarding such term. You agree not to challenge the effectiveness or enforceability of such release and non-competition agreements, either directly or indirectly, in your individual capacity or through any subsequent employer or other third party. Similarly, the Company agrees not to challenge the effectiveness or enforceability of such release and non-competition agreements as a means of avoiding payment of any severance benefits.

B. Change of Control

In the event there is a change of control (as defined below) during your employment and within one (1) year thereafter, you either quit for good reason (as defined below) or are terminated without cause, you shall be entitled to receive the following severance payments:

1. Two (2) years' continuation of your base salary and target bonus;

2. If you elect to continue your medical coverage under COBRA, the Company will reimburse the cost of COBRA coverage for one (1) year following the date of termination;

3. If your employment terminates under this section B at any time during your first two (2) years of employment, you will receive immediate vesting of 100% of your initial two (2) million share option grant;

4. You will have a one-year period following termination of employment under this section B to exercise vested options, to the extent such options do not expire prior to or during such one-year period; and

5. Any holding restrictions remaining on your initial restricted stock grant (as described above) shall be terminated.

For purposes of the foregoing, a "change in control" will be deemed to include the following events:

- a merger, consolidation or reorganization approved by the Company's stockholders, unless securities representing more than fifty percent (50%) of the total combined voting power of the outstanding voting securities of the successor corporation are immediately thereafter beneficially owned, directly or indirectly and in substantially the same proportion, by the persons who beneficially owned the Company's outstanding voting securities immediately prior to such transaction;

- the sale, transfer or other disposition of all or substantially all of the Company's assets as an entirety or substantially as an entirety to any person, entity or group of persons acting in consort other than a sale, transfer or disposition to an entity, at least fifty percent (50%) of the combined voting power of the voting securities of which is owned by the Company or by stockholders of the Company in substantially the same proportion as their ownership of the Company immediately prior to such sale; or

- any transaction or series of related transactions pursuant to which any person or any group of persons comprising a "group" within the meaning of Rule 13d-5(b)(1) under the Securities Exchange Act of 1934, as amended (other than the Company or a person that, prior to such transaction or series of related transactions, directly or indirectly controls, is controlled by or is under common control with, the Company) becomes directly or indirectly the beneficial owner (within the meaning of Rule l3d-3 of the Securities Exchange Act of 1934, as amended) of securities possessing (or convertible into or exercisable for securities possessing) more than thirty-five percent (35%) of the total combined voting power of the Company's securities outstanding immediately after the consummation of such transaction or series of related transactions, whether such transaction involves a direct issuance from the Company or the acquisition of outstanding securities held by one or more of the Company's stockholders; provided, however, that any such transaction or series of transactions by Thomas M. Siebel, acting either alone or in conjunction with any affiliate, shall be exempt from the foregoing.

For purposes of the foregoing, "good reason" means the occurrence of any of the following after a change in control (without your agreement and with such occurrence failing to be cured within a reasonable time following prior written notice):

- Any reduction in the aggregate level of your base salary and annual target bonus by more than 25%;

- Any material reduction in your duties or responsibilities;

- A requirement that you relocate to a location more than fifty (50) miles from your then current office location (other than to the San Francisco Bay Area or Fairfield County, Connecticut); or

- A change in reporting structure such that you no longer report to the Board of Directors.

Compensation received by you in connection with any post-termination employment with another company shall not be deemed to reduce the amount of any severance payment provided for under this letter agreement.

The Company agrees to cooperate with your efforts to extend the medical portion of your COBRA benefits for up to thirty (30) months following your last day of employment pursuant to this Severance Benefits section, to the extent permitted by applicable law. Any such coverage beyond the first year shall be at your sole expense.

Relocation and Other Expenses

You will work at our facility located in San Mateo, California. You will be provided up to $5,000 per month for housing in the San Francisco Bay Area for up to 48 months following the commencement of your employment. The Company agrees to pay all reasonable costs associated with your relocation to the Bay Area on or prior to the expiration of such period, up to a maximum of $50,000. Such relocation costs will be refunded to the Company in the event you voluntarily terminate your employment within twenty four (24) months following the commencement of your employment with the Company.

During the course of your employment, the Company will reimburse you for all reasonable expenses incurred by you in the performance of your duties.

The Company shall reimburse you for your reasonable attorneys' fees incurred in connection with the contemplation, preparation, negotiation and execution of this letter agreement, up to $20,000.

General

The validity, interpretation, construction and performance of this letter agreement and the rights of the parties under this letter agreement shall be interpreted and enforced under California law without reference to principles of conflicts of laws.

In the event of litigation between the parties to this letter agreement, each party will be responsible for its own attorneys' fees.

As a condition of employment with the Company and in order to accept this offer, please sign and return the enclosed Terms and Conditions of Employment and Proprietary Information and Inventions Agreement.

If you accept our offer, your first day of employment will be no later than May 3, 2004.

If you have any questions, please feel free to call me at 650-295-5000. I look forward to your favorable reply and to a productive and exciting working relationship.

Sincerely,

/s/ Thomas M. Siebel
Thomas M. Siebel
Chairman and CEO

/s/ J. Michael Lawrie
J. Michael Lawrie

Terms and Conditions of Employment

This document sets forth important benefit information and terms and conditions related to your employment (the "Terms and Conditions of Employment") with Siebel Systems, Inc. (the "Company"). Please review the information carefully, sign and date the acknowledgement below, and return the signed Terms and Conditions of Employment in the enclosed envelope.

As a Company employee, you will be expected to abide by all Company rules, policies and procedures. You will be expected to sign and comply with the enclosed Proprietary Information and Inventions Agreement (the "PIIA"), the terms of which are incorporated herein by reference, which requires, among other provisions, the assignment of intellectual property rights to any invention made during your employment at the Company and non-disclosure of proprietary information. You agree that the non-solicitation provisions included in such PIIA are hereby extended to two (2) years following your last day of employment. You will also be expected to sign the Company's Employee Handbook acknowledging that you have received and read the current version of the handbook.

Your offer of employment is subject to your submission of an I-9 form and satisfactory documentation respecting your identification and right to work in the United States no later than three (3) days after your employment begins. Your offer of employment is also contingent on successful completion of a background investigation. Failure to consent to, complete, or pass the background screening will cause the Company to withdraw its offer of employment.

The Company offers a complete benefit program which includes medical, dental, vision, basic life/AD&D, supplemental life/AD&D, long/short term disability, flexible spending accounts, employee assistance program, 401(k) and an employee stock purchase plan. The benefit costs, coverage levels and enrollment processes are outlined in detail in the enclosed benefit summary.

Your starting compensation, position, stock information and other terms are set forth in the attached offer letter. By signing the Terms and Conditions of Employment, you are also agreeing to the terms set forth in the offer letter. Oral or written representations contradicting or supplementing the terms of the offer letter are not valid.

Your employment relationship with the Company will be an "at-will" relationship, which means that the Company will have the right to terminate your employment at any time, with or without advance notice and with or without cause. In the event you voluntarily terminate your employment, you agree to give the Company at least 30 days' written notice. The terms and conditions of your employment, including the "at will" employment relationship, supersede all prior written and oral communication with you regarding your employment with the Company and can only be modified by written agreement signed by you and an authorized officer of the Company.

By signing below, you acknowledge and agree that you have read and understood the terms and conditions of your employment.

ACKNOWLEDGED AND AGREED:

/s/ J. Michael Lawrie	4/30/04
J. Michael Lawrie	Date

Exhibit 31.1

CERTIFICATION

I, J. Michael Lawrie, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Siebel Systems, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2004

By: /s/ J. Michael Lawrie

J. Michael Lawrie

Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Kenneth A. Goldman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Siebel Systems, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2004

By: /s/ Kenneth A. Goldman

Kenneth A. Goldman

Senior Vice President, Finance and
Administration and Chief
Financial Officer

Exhibit 32.1

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

I, J. Michael Lawrie, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Siebel Systems, Inc. on Form 10-Q for the period ended September 30, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Siebel Systems, Inc.

In Witness Whereof, the undersigned has set his hand hereto as of the 5th day of November 2004.

/s/ J. Michael Lawrie
Chief Executive Officer
(Principal Executive Officer)

I, Kenneth A. Goldman, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Siebel Systems, Inc. on Form 10-Q for the period ended September 30, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Siebel Systems, Inc.

In Witness Whereof, the undersigned has set his hand hereto as of the 5th day of November 2004.

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

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

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