VERITAS SOFTWARE CORP /DE/
Form 10-Q
June 14, 2004

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2004

or

o **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: 000-26247

VERITAS Software Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**77-0507675**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

350 Ellis Street
Mountain View, California 94043
(650) 527-8000
(Address, including Zip Code, of Registrant s Principal Executive Offices and 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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No o

The number of shares of the registrant s common stock outstanding as of May 28, 2004 was 431,842,356 shares.

VERITAS SOFTWARE CORPORATION

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PART I: FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

VERITAS SOFTWARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2004	December 31, 2003
(in thousands)	**(Unaudited)**	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 628,394	$ 823,171
Short-term investments	2,055,564	1,679,844
Accounts receivable, net of allowance for doubtful accounts of $7,479 and $7,807, respectively	155,375	250,098
Other current assets	67,583	60,254
Deferred income taxes	18,841	30,302
Total current assets	2,925,757	2,843,669
Property and equipment, net	572,824	572,977
Other intangibles, net	85,691	81,344
Goodwill, net	1,809,309	1,755,591
Other non-current assets	23,883	25,385
Deferred income taxes	83,854	69,500
	$ 5,501,318	$ 5,348,466
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 29,056	$ 38,289
Accrued compensation and benefits	88,223	124,655
Accrued acquisition and restructuring costs	24,953	25,051
Other accrued liabilities	62,767	83,184
Current portion of long-term debt	186,373	
Income taxes payable	181,534	141,623
Deferred revenue	426,943	398,772
Total current liabilities	999,849	811,574
Convertible subordinated notes	520,000	520,000

Long-term debt	194,257	380,630
Accrued acquisition and restructuring costs	63,124	69,019
Other long-term liabilities	25,106	23,649
Total liabilities	1,802,336	1,804,872
Stockholders equity:		
Common stock	460	458
Additional paid-in capital	6,997,443	6,941,798
Accumulated deficit	(1,278,028)	(1,378,076)
Deferred stock-based compensation	(8,849)	(8,455)
Accumulated other comprehensive income	6,259	6,172
Treasury stock, at cost; 28,609 shares at March 31, 2004 and December 31, 2003	(2,018,303)	(2,018,303)
Total stockholders equity	3,698,982	3,543,594
	$ 5,501,318	$ 5,348,466

See accompanying notes to condensed consolidated financial statements.

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VERITAS SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2004	**2003**
(in thousands, except per share amounts)	**(Unaudited)**	
Net revenue:		
User license fees	$302,409	$247,455
Services	183,338	142,681
Total net revenue	485,747	390,136
Cost of revenue:		
User license fees	9,519	11,917
Services (1)	65,843	52,302
Amortization of developed technology	3,824	14,782
Total cost of revenue	79,186	79,001
Gross profit	406,561	311,135
Operating expenses:		
Selling and marketing (1)	143,038	115,298
Research and development (1)	79,924	70,588
General and administrative (1)	47,749	38,179
Amortization of other intangibles	2,394	18,191
In-process research and development	400	4,100
Total operating expenses	273,505	246,356
Income from operations	133,056	64,779
Interest and other income, net	11,326	11,012
Interest expense	(5,702)	(7,738)
Gain (loss) on strategic investments	7,496	(3,518)
Income before income taxes	146,176	64,535
Provision for income taxes	46,128	21,431

Net income	$100,048	$ 43,104
Net income per share basic	$ 0.23	$ 0.10
Number of shares used in computing per share amounts basic	430,714	412,916
Net income per share diluted	$ 0.22	$ 0.10
Number of shares used in computing per share amounts diluted	444,921	419,380

(1) Amortization of stock-based compensation consists of:

Services	$ 237	$
Selling and marketing	2,881	
Research and development	1,222	314
General and administrative	744	
Total amortization of stock-based compensation	$5,084	$314

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2004	**2003**
(in thousands)	**(Unaudited)**	
Cash flows from operating activities:		
Net income	$ 100,048	$ 43,104
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	30,075	31,350
Amortization of developed technology	3,824	14,782
Amortization of other intangibles	2,394	18,191
In-process research and development	400	4,100
Provision for allowance for doubtful accounts	518	708
Stock-based compensation	5,084	314
Tax benefits from stock plans	6,816	1,642
(Gain) loss on strategic investments	(7,496)	3,518
Write-off of property and equipment	1,083	59
Deferred income taxes	(8,320)	(13,079)
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	93,328	96,491
Other assets	(22,600)	6,756
Accounts payable	(9,252)	(1,243)
Accrued compensation and benefits	(36,641)	(31,469)
Accrued acquisition and restructuring costs	(7,479)	(4,204)
Other accrued liabilities	(14,696)	(12,710)
Income and other taxes payable	39,959	31,704
Deferred revenue	25,652	16,835
Net cash provided by operating activities	202,697	206,849
Cash flows from investing activities:		
Purchases of investments	(947,776)	(414,877)
Sales and maturities of investments	598,515	529,812
Purchases of property and equipment	(28,081)	(19,939)
Purchase of businesses and technology, net of cash acquired	(60,449)	(54,524)
Payments made for prior year business and technology acquisitions		(2,106)

Net cash provided by (used for) investing activities	(437,791)	38,366
Cash flows from financing activities:		
Proceeds from issuance of common stock	43,353	19,950
Net cash provided by financing activities	43,353	19,950
Effect of exchange rate changes	(3,036)	2,177
Net increase (decrease) in cash and cash equivalents	(194,777)	267,342
Cash and cash equivalents at beginning of period	823,171	764,062
Cash and cash equivalents at end of period	$ 628,394	$1,031,404
Supplemental disclosures:		
Cash paid for interest	$ 4,822	$ 4,312
Cash paid for income taxes	$ 18,347	$ 1,469

See accompanying notes to condensed consolidated financial statements.

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VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results for the interim periods presented are not necessarily indicative of the results that may be expected for any future period. The following information should be read in conjunction with the consolidated financial statements and accompanying notes included in VERITAS Software Corporation s Annual Report on Form 10-K for the year ended December 31, 2003.

2. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

3. Accounting for Stock-Based Compensation

The Company accounts for employee stock-based compensation in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and the disclosure requirements of SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of FASB Statement No. 123*. Since the exercise price of options granted under the Company s stock option plans is equal to the market value on the date of grant, no compensation cost has been recognized for grants under such plans. In accordance with APB Opinion No. 25, the Company does not recognize compensation cost related to its employee stock purchase plan. The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had accounted for its stock option and stock purchase plans under the fair value method of accounting under SFAS No. 123, *Accounting for Stock-Based Compensation*:

	Three Months Ended March 31,	
(in thousands, except per share amounts)	**2004**	**2003**
Net income (loss):		
As reported	$100,048	$ 43,104
Add:		
Stock-based employee compensation expense included in net income, net of tax	3,457	210
Less:		

Total stock-based employee compensation expense determined under the fair value method for all awards, net of tax	(73,237)	(74,997)
Pro forma	$ 30,268	$ (31,683)
Basic income (loss) per share:		
As reported	$ 0.23	$ 0.10
Pro forma	$ 0.07	$ (0.08)
Diluted income (loss) per share:		
As reported	$ 0.22	$ 0.10
Pro forma	$ 0.07	$ (0.08)

For purposes of the pro forma disclosures, the expected volatility assumptions the Company used prior to the fourth quarter of fiscal 2003 were based solely on the historical volatility of the Company s common stock over the most recent period commensurate with the estimated expected life of the Company s stock options. Beginning with the fourth quarter of fiscal 2003, the Company modified its approach and expected volatility by considering other relevant factors in accordance with SFAS No. 123. The Company considered implied volatility in market-traded options on the Company s common stock as well as historical volatility. The Company will continue to monitor these and other relevant factors used to measure expected volatility for future option grants.

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Also, beginning with the third quarter of fiscal 2003, the Company decreased its estimate of the expected life of new options granted to its employees from 5 years to 4 years. The Company bases its expected life assumption on historical experience as well as the terms and vesting periods of the options granted. The reduction in the estimated expected life was a result of an analysis of the Company s historical experience.

For the pro forma amounts determined under SFAS No. 123, as set forth above, the fair value of each stock option grant under the stock option plans is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants:

	Three Months Ended March 31,	
	2004	2003
Risk-free interest rate	2.58%	2.91%
Dividend yield	0%	0%
Weighted average expected life	4.0 years	5.0 years
Volatility of common stock	55%	90%

The fair value of the employees purchase rights under the employee stock purchase plan is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for these rights:

	Three Months Ended March 31,	
	2004	2003
Risk-free interest rate	1.00%-1.87%	1.20%-1.66%
Dividend yield	0%	0%
Weighted average expected life	6 to 24 months	6 to 24 months
Volatility of common stock	86%	90%

As a result of the delay in filing the Company s Form 10-K for the year ended December 31, 2003, the Company suspended option-holders ability to use the Company s registration statements for its stock option plans (the Plans). As a result, option-holders were unable to exercise options under the Plans until such time as the Company filed its Form 10-K for the year ended December 31, 2003 and lifted the suspension on the use of the registration statements. Pursuant to the terms of the Plans, options held by certain former employees of the Company were scheduled to expire during the suspension period. On March 15, 2004, the Company extended the expiration date of such options for a period of 15 days from the date of filing the Form 10-K, which was considered a modification of such options. For the three months ended March 31, 2004, $4.3 million was expensed in the statement of operations as a result of this modification.

4. Net Income per Share

The following table sets forth the computation of basic and diluted net income per share:

(in thousands, except per share amounts)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Numerator:		
Net income	$100,048	$ 43,104
Denominator:		
Denominator for basic net income per share weighted-average shares outstanding	430,714	412,916
Potential common shares	14,207	6,464
Denominator for diluted net income per share	444,921	419,380
Basic net income per share	$ 0.23	$ 0.10
Diluted net income per share	$ 0.22	$ 0.10

For the three months ended March 31, 2004 and 2003, potential common shares consist of employee stock options using the treasury stock method. The following table sets forth the potential common shares that were excluded from the net income per share computations as their effect would be antidilutive:

(in thousands)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Employee stock options outstanding(1)	27,901	40,953
5.25% convertible subordinated notes(2)		6,695
1.856% convertible subordinated notes(2)		12,981
0.25% convertible subordinated notes(3)	11,274	

(1) For the three months ended March 31, 2004 and 2003, 27,901 and 40,953 employee stock options, respectively, were excluded from the computation of diluted net income per share because the exercise price of these options was greater than the average market price of the Company s common stock during the period, and therefore the effect is antidilutive.

(2) For the three months ended March 31, 2003, 6,695 potential common shares issuable upon the conversion of the Company s 5.25% convertible subordinated notes and 12,981 potential common shares issuable upon the conversion of the Company s 1.856% convertible subordinated notes, respectively, were excluded from the computation of diluted net income per share because the impact of adding back after tax interest expense associated with the convertible subordinated notes, and including the potential common shares, would be antidilutive.

(3) For the three months ended March 31, 2004, 11,274 potential common shares related to the Company s 0.25% convertible subordinated notes were excluded from the computation of diluted net income per share because the specified circumstances under which the 0.25% notes are convertible prior to maturity have not been met (see Note 9).

The weighted average exercise prices of employee stock options with exercise prices exceeding the average fair value of the Company s common stock was $33.00 and $56.04 per share for the three months ended March 31, 2004 and 2003, respectively.

5. Business Combinations

Ejasent, Inc.

In January 2004, the Company acquired all of the outstanding capital stock of Ejasent, Inc. (Ejasent), a privately held provider of application virtualization technology for utility computing. The Company acquired Ejasent to add important application migration technology, which allows IT personnel to move an application from one server to another without disrupting or terminating the application, to the Company s growing utility computing portfolio. The Ejasent acquisition was accounted for using the purchase method of accounting for total purchase consideration of $61.4 million, which included $47.8 million in cash and $13.6 million of acquisition-related costs. The purchase price was allocated to goodwill of $53.7 million, developed technology of $10.2 million, other intangibles of $1.9 million, in-process research and development (IPR&D) of $0.4 million, net deferred tax liabilities of $4.6 million and net tangible liabilities of $0.2 million. The weighted average amortization period for all purchased intangible assets is 4.4 years. Acquisition-related costs consist of $11.5 million of change in control bonuses and direct transaction costs of $2.1 million for legal and other professional fees. Total cash outlays for acquisition-related costs were $12.9 million through March 31, 2004. The results of operations of Ejasent were included in the Company s consolidated financial statements from the date of acquisition. The pro forma impact of the acquisition on the Company s results of operations is not significant.

Precise Software Solutions Ltd.

On June 30, 2003, the Company acquired all of the outstanding common stock of Precise Software Solutions Ltd. (Precise), a provider of application performance management products. The Company acquired Precise in order to expand its product and service offerings across storage, databases and application management. The Precise acquisition was accounted for using the purchase method of accounting for total purchase consideration of $715.1 million, which included 7.3 million shares of common stock valued at $210.6 million, $397.8 million of cash, $94.0 million relating to the assumption of Precise s outstanding vested and unvested stock options for 4.4 million shares of the Company s common stock and $12.7 million of acquisition-related costs. The purchase price was allocated to goodwill of $509.7 million, developed technology of $27.6 million, other intangibles of $34.3 million, IPR&D of $15.3 million, net deferred tax liabilities of $21.4 million, deferred stock-based compensation of $7.3 million and net tangible assets of $142.3 million. The weighted average amortization period for all purchased intangible assets is 3.7 years. The acquired IPR&D of $15.3 million was written off and the related charge was expensed in the statement of operations in the second quarter of 2003. Acquisition-related costs of $12.7 million consist of $9.0 million associated with investment banking and other professional fees, $3.3 million for terminating and satisfying existing lease commitments and $0.4 million for severance-related costs. Total cash outlays for acquisition-related costs were approximately $8.7 million for investment banking and other professional fees, $0.4 million for severance-related costs and $0.3 million for leases through March 31, 2004.

The results of operations of Precise are included in the Company s consolidated financial statements from July 1, 2003. The following table presents pro forma results of operations and gives effect to the acquisition of Precise as if the acquisition was consummated at the beginning of fiscal year 2003. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the acquisition been made as of the beginning of the period or of the results that may occur in the future. Net income excludes the write-off of acquired IPR&D of $15.3 million and includes amortization of intangible assets related to the acquisition of $4.7 million per quarter and amortization of deferred compensation of $0.5 million per quarter. The unaudited pro forma information is as follows:

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(in thousands, except per share amounts)		Three Months Ended March 31, 2003
Total net revenue		$ 412,291
Net income		39,191
Net income per share	basic	0.09
Net income per share	diluted	0.09

Jareva Technologies, Inc.

On January 27, 2003, the Company acquired all of the outstanding capital stock of Jareva Technologies, Inc. (Jareva), a privately held provider of automated server provisioning products that enable businesses to automatically deploy additional servers without manual intervention. The Company acquired Jareva to integrate Jareva s technology into the Company s software products to enable the Company s customers to optimize their investments in server hardware by deploying new server resources on demand. The Jareva acquisition was accounted for using the purchase method of accounting for total purchase consideration of $68.7 million, which included $58.7 million of cash, $6.8 million relating to the assumption of options exercisable for 426,766 shares of the Company s common stock and $3.2 million of acquisition-related costs. The purchase price was allocated to goodwill of $51.3 million, developed technology of $9.1 million, other intangibles of $1.9 million, IPR&D of $4.1 million, net deferred tax liabilities of $6.1 million, deferred stock-based compensation of $4.6 million and net tangible assets of $3.8 million. The weighted average amortization period for all purchased intangible assets is 3.3 years. The acquired IPR&D of $4.1 million was written off and the related charge was expensed in the statement of operations in the first quarter of 2003. Acquisition-related costs of $3.2 million consist of $2.7 million associated with terminating and satisfying remaining lease commitments, partially offset by sublease income net of related sublease costs, and direct transaction costs of $0.5 million for legal and other professional fees. Total cash outlays for acquisition-related costs were $1.6 million through March 31, 2004. The results of operations of Jareva are included in the Company s consolidated financial statements from the date of acquisition. The pro forma impact on the Company s results of operations is not significant.

6. Goodwill and Other Intangible Assets

On January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. As a result, the Company no longer amortizes goodwill but will test it for impairment annually or whenever events or changes in circumstances suggest that the carrying amount may not be recoverable.

The following table sets forth the carrying amount of goodwill. Goodwill also includes amounts originally allocated to assembled workforce:

(in thousands)	March 31, 2004	December 31, 2003
Goodwill:		
Gross carrying amount	$ 3,895,936	$ 3,842,218
	(2,086,627)	(2,086,627)

Less accumulated amortization		
Net carrying amount of goodwill	$ 1,809,309	$ 1,755,591

During the first quarter of 2004, the Company acquired Ejasent (see Note 5), which increased goodwill by $53.7 million.

The following tables set forth the carrying amount of other intangible assets that will continue to be amortized:

	March 31, 2004		
(in thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
Developed technology	$299,749	$241,244	$58,505
Distribution channels	234,800	234,800	
Trademarks	26,650	25,213	1,437
Other intangible assets	52,074	35,983	16,091
Intangibles related to acquisitions	613,273	537,240	76,033
Convertible subordinated notes issuance costs	12,401	2,743	9,658
Total other intangibles	$625,674	$539,983	$85,691

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	December 31, 2003		
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$287,949	$237,043	$50,906
Distribution channels	234,800	234,800	
Trademarks	26,650	24,925	1,725
Other intangible assets	51,734	33,714	18,020
Intangibles related to business acquisitions	601,133	530,482	70,651
Convertible subordinated notes issuance costs	12,401	1,708	10,693
Total other intangibles	$613,534	$532,190	$81,344

Total amortization expense of intangible assets related to acquisitions is set forth in the table below:

	Three Months Ended March 31,	
(in thousands)	2004	2003
Developed technology	$ 4,201	$ 15,098
Distribution channels		14,675
Trademarks	288	1,522
Other intangible assets	2,269	2,056
Total amortization expense	$ 6,758	$ 33,351

For the three months ended March 31, 2004 and 2003, total amortization expense for intangible assets includes approximately $0.5 million and $0.4 million, respectively, that is included in cost of user license fees.

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

Future

(in thousands)	Amortization
2004	$18,966
2005	23,167
2006	21,144
2007	10,699
2008	1,912
2009	145
Total	$76,033

7. Strategic Investments

The Company holds investments in capital stock of several privately-held companies. The total carrying amount of these strategic investments was $2.9 million at March 31, 2004 and $5.4 million at December 31, 2003. These strategic investments are included in other non-current assets. During the three months ended March 31, 2004, the Company realized a gain of $7.5 million on the sale of a strategic investment. The Company recorded no impairment losses on strategic investments for the three months ended March 31, 2004 and $3.5 million of impairment losses for the three months ended March 31, 2003. The losses realized represent other-than-temporary declines in the fair value of the investment and were determined based on the value of the investee s stock, its inability to obtain additional private financing, its cash position and current burn rate, the status and competitive position of the investee s products and the uncertainty of its financial condition, among other factors.

8. Accrued Acquisition and Restructuring Costs

In the fourth quarter of 2002, the Company s board of directors approved a facility restructuring plan to exit and consolidate certain of its facilities located in 17 metropolitan areas worldwide. The facility restructuring plan was adopted to address overcapacity in the Company s facilities as a result of lower than planned headcount growth in these metropolitan areas. In connection with this facility restructuring plan, the Company recorded a net restructuring charge to operating expenses of $96.1 million in the fourth quarter of 2002. This restructuring charge is comprised of $86.9 million associated with terminating and satisfying remaining lease commitments, partially offset by sublease income net of related sublease costs, and $9.2 million for net asset write-offs. Total cash outlays under this restructuring plan are expected to be approximately $86.9 million.

Restructuring costs will generally be paid over the remaining lease terms, ending at various dates through 2021, or over a shorter period as the Company may negotiate with its lessors. The Company expects the majority of costs will be paid by the year ending December 31, 2008.

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The Company began vacating facilities during the fourth quarter of 2002 and completed vacating facilities as of January 31, 2004. The Company is in the process of seeking suitable subtenants for these facilities. The Company s estimates of the facility restructure charge may vary significantly, depending in part on factors that are beyond the Company s control, including the commercial real estate market in the applicable metropolitan areas, the Company s ability to obtain subleases related to these facilities and the time period to do so, the sublease rental market rates and the outcome of negotiations with lessors regarding terminations of some of the leases. Adjustments to the accrued restructuring costs will be made if actual lease exit costs or sublease income differ from amounts currently expected. As a portion of the accrued restructuring costs relates to international locations, the accrual will be affected by exchange rate fluctuations. The impact of exchange rate fluctuations is recorded in accumulated other comprehensive income on the balance sheet.

The portion of the accrual expected to be utilized through March 31, 2005 of $18.0 million has been classified in the current portion of accrued acquisition and restructuring costs. The portion of the accrual expected to be utilized in periods subsequent to March 31, 2005 of $58.6 million has been classified in the non-current portion of accrued acquisition and restructuring costs. The components of the accrued restructuring costs and movements within these components through March 31, 2004 were as follows:

(in millions)	**Net Rent Commitments**	**Asset Write-offs**	**Total**
Balance at December 31, 2003	$ 79.8	$ 2.1	$81.9
Cash payments	(3.8)		(3.8)
Asset write-offs		(2.1)	(2.1)
Impact of exchange rates	0.6		0.6
Balance at March 31, 2004	$ 76.6	$	$76.6

In 2002, the Company also recorded incremental restructuring costs of $3.2 million related to restructuring plans initiated in 1999, resulting in total restructuring costs of $99.3 million for the year ended December 31, 2002. Included in total accrued acquisition and restructuring costs of $88.0 million as of March 31, 2004 is the $76.6 million balance related to the facility restructuring plan discussed above, the remaining acquisition costs to be paid in connection with the Company's 2003 acquisition (see Note 5) and the remaining restructuring costs to be paid for other restructuring plans.

9. Convertible Subordinated Notes

In August 2003, the Company issued $520.0 million of 0.25% convertible subordinated notes due August 1, 2013 (the 0.25% Notes), to several initial purchasers in a private offering, for which the Company received net proceeds of approximately $508.2 million. The 0.25% Notes were issued at their face value and provide for semi-annual interest payments of $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of the Company s registration statement having not been declared effective by the Securities and Exchange Commission on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue such additional interest until April 27, 2004, the 90th day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will accrue such additional interest until the registration statement is declared effective or until the Company is no longer required to maintain the effectiveness of the registration statement.

10. Long-Term Debt

In 1999 and 2000, the Company entered into three build-to-suit lease agreements for office buildings in Mountain View, California, Roseville, Minnesota and Milpitas, California. The Company began occupying the Roseville and Mountain View facilities in May and June 2001, respectively, and began occupying the Milpitas facility in April 2003. The Mountain View facility includes 425,000 square feet and serves as the Company s corporate headquarters and for research and development functions. The Milpitas facility includes 466,000 square feet and is primarily used for technical support, sales and general corporate functions. The Roseville facility includes 204,000 square feet and provides space for technical support and research and development functions. A syndicate of financial institutions financed the acquisition and development of these properties. Prior to July 1, 2003, the Company accounted for these properties as operating leases in accordance with SFAS No. 13, *Accounting for Leases*, as amended. On July 1, 2003, the Company adopted Financial Accounting Standards Board (FASB) Interpretation Number (FIN 46) *Consolidation of Variable Interest Entities*. Under FIN 46, the lessors of the facilities are considered variable interest entities, and the Company is considered the primary beneficiary. Accordingly, the Company began consolidating these variable interest entities on July 1, 2003 and has included the property and equipment and long-term debt on its balance sheet at March 31, 2004 and December 31, 2003 and the results of their operations in its consolidated statement of operations for the quarter ended March 31, 2004. As of March 31, 2004, approximately $186.4 million of debt has been classified as current as the lease terms for Mountain View and Roseville facilities expire in March 2005.

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

In January 2002, the Company entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging the cash payments related to the Mountain View and Roseville agreements (see Note 12). Under the terms of these interest rate swaps, the Company makes payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR rate. For the quarters ended March 31, 2004 and 2003, the aggregate payments, including the net payments on the interest rate swaps, were $4.0 million and $4.1 million, respectively. The payments for the quarter ended March 31, 2004 were included in interest expense in the consolidated statement of operations in accordance with FIN 46. The payments made for the quarter ended March 31, 2003 were classified as rent expense and included in cost of revenue and operating expenses, in accordance with SFAS No. 13.

The agreements for the facilities described above require that the Company maintain specified financial covenants, all of which the Company was in compliance with as of March 31, 2004. The specified financial covenants as of March 31, 2004 require the Company to maintain a minimum rolling four quarters earnings before interest, taxes, depreciation and amortization (EBITDA) of $400.0 million, a minimum ratio of cash and cash equivalents and accounts receivable to current liabilities plus the debt consolidated under the build-to-suit lease agreements of 1.2 to 1, and a leverage ratio of total funded indebtedness to rolling four quarter EBITDA of not more than 2 to 1. For purposes of these financial covenants, EBITDA represents the Company s net income for the applicable period, plus interest expense, taxes, depreciation and amortization and all non-cash restructuring charges, less software development expenses classified as capital expenditures. In order to secure the obligation under each agreement, each of the facilities is subject to a deed of trust in favor of the financial institutions that financed the development and acquisition of the respective facility. Bank of America, N.A. was the agent for the syndicate of banks that funded the development of the Mountain View and Roseville facilities, and ABN AMRO Bank, N.V. was the agent for the syndicate of banks that funded the development of the Milpitas facility. The Company has received waivers from the respective syndicate of banks for each facility in relation to any non-compliance that would have resulted from the delay in filing its 2003 Form 10-K or this Form 10-Q.

11. Comprehensive Income

The following are the components of comprehensive income:

	Three Months Ended March 31,	
(in thousands)	**2004**	**2003**
Net income	$ 100,048	$ 43,104
Other comprehensive income, net of tax:		

Foreign currency translation adjustments	(2,128)	3,910
Derivative financial instrument adjustments	920	(571)
Unrealized gain (loss) on marketable securities	1,295	(197)
Comprehensive income	$ 100,135	$ 46,246

The components of accumulated other comprehensive income are:

(in thousands)	March 31, 2004	December 31, 2003
Foreign currency translation adjustments	$11,328	$ 13,456
Derivative financial instrument adjustments	(6,862)	(7,782)
Unrealized gain on marketable securities	1,793	498
Accumulated other comprehensive income	$ 6,259	$ 6,172

12. Derivative Financial Instruments

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

In January 2002, the Company entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging cash flows on variable interest rate debt related to Mountain View, California and Roseville, Minnesota build-to-suit lease agreements. Under the terms of these interest rate swaps, the Company makes payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR. The Company s payments on its build-to-suit lease agreements are based upon a 3-month LIBOR plus a credit spread. If critical terms of the interest rate swap or the hedged item do not change, the interest rate swap will be considered to be highly effective with all changes in the fair value included in other comprehensive income. If critical terms of the interest rate swap or the hedged item change, the hedge may become partially or fully ineffective, which could result in all or a portion of the changes in fair value of the derivative recorded in the statement of operations. The interest rate swaps settle the first day of January, April, July and October until expiration. As of March 31, 2004, the fair value of the interest rate swaps was $(6.9) million and was recorded in other long-term liabilities. As a result of entering into the interest rate swaps, the Company has mitigated its exposure to variable cash flows associated with interest rate fluctuations. Because the rental payments on the leases are based on the 3-month LIBOR and the Company receives 3-month LIBOR from the interest rate swap counter-party, the Company has eliminated any impact to raising interest rates related to its rent payments under the build-to-suit lease agreements. On July 1, 2003, the Company began accounting for its variable interest rate debt in accordance with FIN 46 (see Note 10). In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company had designated the interest rate swap as a cash flow hedge of the variability embedded in the rent expense as it was based on a 3-moth LIBOR. However, with the adoption of FIN 46, the Company redesignated the interest rate swap as a cash flow hedge of variability in interest expense and it remains highly effective with all changes in the fair value included in other comprehensive income.

As of March 31, 2004, the total gross notional amount of the Company s forward contracts was approximately $348.5 million, all hedging intercompany accounts of certain of its international subsidiaries. The forward contracts had terms of 35 days or less and settled on April 30, 2004. All foreign currency transactions and all outstanding forward contracts are marked-to-market at the end of the period with unrealized gains and losses included in other income. The unrealized gain (loss) on the outstanding forward contracts at March 31, 2004 was not material to the Company s consolidated financial statements.

13. Segment Information

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

Geographic Information

	Three Months Ended March 31,	
(in thousands)	**2004**	**2003**

User license fees (1):		
United States	$172,510	$157,891
Europe (2)	89,699	58,264
Other (3)	40,200	31,300
Total user license fees	302,409	247,455
Services (1):		
United States	125,738	100,953
Europe (2)	41,000	29,928
Other (3)	16,600	11,800
Total services	183,338	142,681
Total net revenue	$485,747	$390,136

(in thousands)	**March 31, 2004**	**December 31, 2003**
Long-lived assets (4):		
United States	$1,959,407	$1,902,181
Europe (2)	485,695	483,315
Other (3)	13,064	13,723
Total	$2,458,166	$2,399,219

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

(2) Europe includes the Middle East and Africa.

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

(4) Long-lived assets include all long-term assets except those specifically excluded under SFAS No. 131, such as deferred income taxes. Reconciliation to total assets reported is as follows:

(in thousands)	March 31, 2004	December 31, 2003
Total long-lived assets	$2,458,166	$2,399,219
Other assets, including current	3,043,152	2,949,247
Total consolidated assets	$5,501,318	$5,348,466

For the three months ended March 31, 2004, no end-user customer accounted for 10% or more of the Company s net revenue. For the three months ended March 31, 2003, a distributor that sells the Company s products and services through resellers, accounted for 10% of the Company s net revenue.

User License Fees Information

The Company markets and distributes its software products both as stand-alone software products and as integrated product suites, also referenced as application solutions. The Company derives its user license fees from the licensing of its technology, segregated into three product areas: Data Protection, which includes its NetBackup and Backup Exec product families; Storage Management, which includes its File Systems, Volume Manager, replication, Database Editions and storage resource management product families; and Utility Computing Infrastructure, which includes its clustering, high-availability offerings, application performance management, OpForce and CommandCentral Service product families. User license fees from data protection were $161.8 million and $139.3 million for the three months ended March 31, 2004 and 2003, respectively. User license fees from storage management were $83.9 million and $61.2 million for the three months ended March 31, 2004 and 2003, respectively. User license fees from utility computing infrastructure were $56.7 million and $47.0 million for the three months ended March 31, 2004 and 2003, respectively.

14. Credit Facility

During 2002, the Company s Japanese subsidiary entered into a short-term credit facility with a multinational Japanese bank in the amount of 1.0 billion Japanese yen ($9.5 million USD). At March 31, 2004, no amount was outstanding. The short-term credit facility was renewed in March 2004 and is due to expire in March 2005. Borrowings under the short-term credit facility bear interest at Tokyo Inter Bank Offered Rate plus 0.5%. There are no covenants on the short-term credit facility and the loan has been guaranteed by VERITAS Software Global LLC, a wholly-owned subsidiary of the Company.

15. Commitments and Contingencies

Acquired Technology

On October 1, 2002, the Company acquired volume replicator software technology for $6.0 million and contingent payments of up to another $6.0 million based on future revenues generated by the acquired technology. The contingent payments will be paid quarterly over 40 quarters, in amounts between $150,000 and $300,000. The Company issued a promissory note payable in the principal amount of $5.0 million, representing the present value of the Company s minimum payment obligations under the purchase agreement for the acquired technology, which are payable quarterly commencing in the first quarter of 2003 and ending in the fourth quarter of 2012. The contingent payments in excess of the quarterly minimum obligations will be paid as they may become due. The outstanding balance of the note payable was $4.5 million as of March 31, 2004 and $4.6 million as of December 31, 2003 and is included in other long-term liabilities.

SEC Related Matters

SEC Investigation. As previously disclosed, since the third quarter of 2002, the Company has received subpoenas issued by the Securities Exchange Commission in the investigation entitled *In the Matter of AOL/Time Warner.* The SEC has requested information concerning the facts and circumstances surrounding the Company s transactions with AOL Time Warner, or AOL, and related accounting and disclosure matters. The Company s transactions with AOL, entered into in September 2000, involved a software and services purchase by AOL at a stated value of $50.0 million and the purchase by the Company of advertising services from AOL at a stated value of $20.0 million. In March 2003, the Company restated its financial statements for 2001 and 2000 to reflect a reduction in revenues and expenses of $20.0 million. The restatement included an additional reduction in revenues and expenses of $1.0 million related to two other contemporaneous transactions with other parties entered into in 2000 that involved software licenses and the purchase of on-line advertising services.

In June 2004, the Company restated its financial statements for 2002 and 2001 and revised its previously announced financial results for 2003. Prior to the restatement, the Company voluntarily disclosed to the staff of the SEC past accounting practices applicable to its 2002 and 2001 financial statements that the Company determined were not in compliance with GAAP. For more information regarding the restatement of the Company s financial statements for 2002 and 2001, including the corresponding interim periods for 2002 and 2001, and the interim periods ended March, June and September 2003, see Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Financial Statements and Supplementary Data Selected Quarterly Results of Operations and Note 2 of the Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

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

Securities Class Actions. After the Company announced in January 2003 that it would restate its financial results as a result of transactions entered into with AOL in September 2000, numerous separate complaints purporting to be class actions were filed in the United States District Court for the Northern District of California alleging that the Company and some of its officers and directors violated provisions of the Securities Exchange Act of 1934. The complaints contain varying allegations, including that the Company made materially false and misleading statements with respect to our 2000, 2001 and 2002 financial results included in its filings with the SEC, press releases and other public disclosures. On May 2, 2003, a lead plaintiff and lead counsel were appointed. A consolidated complaint was filed by the lead plaintiff on July 18, 2003. On December 10, 2003, the District Court granted the defendants motion to dismiss the consolidated complaint, with leave to amend. On May 19, 2004, the District Court granted the defendants motion to dismiss the plaintiffs first amended complaint, with leave to amend. In addition, in 2003 several complaints purporting to be derivative actions were filed in California state court against some of the Company s directors and officers. These complaints are based on the same facts and circumstances as the class actions and generally allege that the named directors and officers breached their fiduciary duties by failing to oversee adequately the Company s financial reporting. The state court complaints have been consolidated into the action *In Re VERITAS Software Corporation Derivative Litigation*, which was filed on May 8, 2003 in the Superior Court of Santa Clara County and is currently pending. All of the complaints generally seek an unspecified amount of damages. The cases are still in the preliminary stages, and it is not possible for the Company to quantify the extent of its potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on the Company s business, financial condition, results of operations and cash flow. In addition, defending any litigation may be costly and divert management s attention from the day-to-day operations of the Company s business.

Other Litigation

On January 10, 2003, Raytheon Company sued VERITAS along with Brocade Communications Systems, Oracle Corporation, Overland Storage Inc., Qualstar Corporation, QLogic Corporation, Ricoh Corporation and Spectra Logic

Corporation in the United States District Court for the Eastern District of Texas. Raytheon alleged infringement of a patent entitled Mass Data Storage Library and sought damages and an injunction against all defendants. On February 26, 2004, a confidential settlement was agreed to by Raytheon and VERITAS, and on March 17, 2004, the case was dismissed with prejudice pursuant to the settlement agreement. The settlement agreement did not have a material impact on the Company s financial position or overall results of operations.

On October 23, 2001, Storage Computer Corporation sued VERITAS in the United States District Court for the Northern District of Texas alleging infringement of one of Storage Computer Corporation s patents. Currently, Storage Computer Corporation is alleging the Company infringed two of their U.S. patents. The Company has denied all material allegations in the complaints, filed counterclaims for declaratory judgment of invalidity and non-infringement of the patents-in-suit and alleged their infringement of one of the Company s patents. Storage Computer Corporation is seeking damages of approximately $50.0 million, treble damages, costs of suit and attorneys fees and a permanent injunction from further alleged infringement. On March 12, 2004, the Court granted

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VERITAS motions for summary judgment of non-infringement of the two patents at issue, and denied Storage Computer s motion for partial summary judgment. The Court did not address additional matters raised in VERITAS motion. Storage Computer Corporation recently filed a notice of appeal.

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

For each of the matters noted, the Company does not believe that it is probable that a liability has been incurred nor does it believe that the amount of any loss can be reasonably estimated. Accordingly, no liability has been accrued for these matters.

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

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

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

Overview

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

Our Business

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

We generate revenues, income and cash flows by licensing software products and selling related services to our customers, which include many leading global corporations and small and medium-sized enterprises around the world operating in a wide variety of industries. We market our products and related services both directly and through a variety of indirect sales channels, which include value added resellers, or VARs, distributors, system integrators, or SIs, and original equipment manufacturers, or OEMs. Specifically, the channel mix for the quarter ended March 31, 2004 was 60% from sales to end-users and through VARs, and 40% from other indirect sales channels, which includes 10% from our OEM partners.

We invest significantly in research and development activities and for the quarter ended March 31, 2004, we spent $79.9 million on research and development. Our research and development efforts have been directed toward developing new products for UNIX, Linux and Windows, developing new features and functionality for existing products, integrating products across our existing product lines, porting new and existing products to different operating systems and expanding our product portfolio into new markets such as application performance management, server provisioning and centralized service level management.

In the fourth quarter of 2003, we revised our revenue reporting categories to more closely align them with the way we manage our business. Historically, we categorized our revenue between Core and Emerging technologies. We believe these new revenue categories will provide investors with better insight into our results of operations. These new categories are Data Protection, Storage Management and Utility Computing Infrastructure. Our revenue performance in these categories is described in the User License Fees section of MD&A.

Our Strategy

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

We expect to continue to grow the company organically and through acquisitions. In 2003, we completed two key acquisitions that provided us with essential components of our utility computing infrastructure product strategy, including application performance management software and server provisioning technology. In January 2004, we completed the acquisition of Ejasent, Inc., which added application migration technology to our utility computing infrastructure portfolio. We will continue to evaluate new strategic acquisitions in the future.

For the quarter ended March 31, 2004, revenue from international sales, consisting of sales of license and services to customers located outside the United States, was $187.5 million, up 43% from the quarter ended March 31, 2003, and represented 39% of our total revenue. This growth is primarily the result of our increased sales investment in our international geographies, market strength in the emerging market areas in Europe and Asia and a favorable impact of changes in foreign currency exchange rates related to the weaker U.S. dollar. We expect to continue to grow international revenue faster than total revenue by increasing the size and breadth of our international operations.

Our Financial Position

In the fiscal year ended December 31, 2003 and continuing through the quarter ended March 31, 2004, our operating results were impacted by several factors, including IT spending trends, the growing need of enterprises to effectively manage storage and computing infrastructure, the strength of our product offerings and the contribution of our recent acquisitions. In the first quarter of 2004, we continued to experience stronger IT spending in our customer base, resulting in stronger demand for our products and growth in our user license fees. The acquisition of Precise and the integration of the acquired products into our product offerings contributed to our growth, as did our increased sales penetration in international markets and the favorable impact of changes in foreign currency exchange rates. Additionally, our services revenue grew significantly due to new service contracts associated with user license fees as well as our success in increasing support contract renewals within our customer base.

Net revenue and net income per share are key measurements of our financial condition. For the quarter ended March 31, 2004, net revenue was $485.7 million, an increase of 25% from the quarter ended March 31, 2003. Revenue from user license fees was $302.4 million, an increase of 22% from 2003 and representing 62% of total revenue. Services revenue in the quarter ended March 31, 2004 was $183.3 million, an increase of 28% from 2003, and representing 38% of total net revenue. Diluted net income per share for the quarter ended March 31, 2004 was $0.22, up significantly from $0.10 in 2003, primarily as a result of earnings leverage from revenue growth.

We continue to retain a significant balance of cash and short-term investments and to generate cash from operations. As of March 31, 2004, we had approximately $2,684.0 million in cash, cash equivalents and short-term investments, which represented approximately 74% of our tangible assets. We generated approximately $202.7 million of cash from operating activities for the quarter ended March 31, 2004. We utilize cash in ways that management believes provides an optimal return on investment. Principal uses of our cash include purchases of property and equipment, acquisition of businesses and technologies and repurchase of common stock.

Recent Acquisitions

In January 2004, we acquired Ejasent, Inc., or Ejasent, a privately held provider of application virtualization technology for utility computing. We acquired Ejasent to add important application migration technology, which allows IT personnel to move an application from one server to another without disrupting or terminating the application. We accounted for the Ejasent acquisition using the purchase method of accounting for total purchase consideration of $61.4 million. We have included the results of operations of Ejasent in our consolidated financial statements beginning January 20, 2004. In connection with the acquisition of Ejasent, we allocated approximately $0.4 million of the purchase price to in-process research and development, or IPR&D, that had not yet reached technological feasibility and had no alternative future use. We have expensed this amount as a non-tax deductible charge in our consolidated statement of operations for the quarter ended March 31, 2004.

In June 2003, we acquired Precise, a provider of application performance management products. We acquired Precise to expand our product and service offerings into application performance management. We accounted for the Precise acquisition using the purchase method of accounting for total purchase consideration of $715.1 million. We have included the results of operations of Precise in our consolidated financial statements beginning July 1, 2003. In connection with the acquisition of Precise, we allocated approximately $15.3 million of the purchase price to IPR&D that had not yet reached technological feasibility and had no alternative future use. We have expensed this amount as a non-tax deductible charge in our consolidated statement of operations for the year ended December 31, 2003.

In January 2003, we acquired Jareva Technologies, Inc., or Jareva, a privately held provider of automated server provisioning products that enable businesses to automatically deploy additional servers without manual intervention. We acquired Jareva to integrate its technology into our software products. This technology enables our customers to optimize their investments in server hardware by deploying new server resources on demand. We accounted for the Jareva acquisition using the purchase method of

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accounting for total purchase consideration of $68.7 million. We have expensed the acquired IPR&D of $4.1 million in our consolidated statement of operations in the quarter ended March 31, 2003.

Critical Accounting Policies and Estimates

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

- revenue recognition;
- restructuring expenses and related accruals;
- impairment of long-lived assets; and
- accounting for income taxes.

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

Revenue Recognition

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

Multiple Element Arrangements

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

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

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

The Fee is Fixed or Determinable

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

Collection is Probable

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

Indirect Channel Sales

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

Transactions with our Suppliers

Some of our customers are also our suppliers. Occasionally, in the normal course of business, we purchase goods or services for our operations from these suppliers at or about the same time we license our software to them. We also have multi-year agreements under which we receive sub-licensing royalty payments from OEMs from whom we may also purchase goods or services. We identify and review significant transactions to confirm that they are separately negotiated at terms we consider to be arm s length. In cases where the transactions are not separately negotiated, we apply the provisions of Accounting Principles Board, or APB, Opinion No. 29, *Accounting for Nonmonetary Transactions*, and Emerging Issues Task Force Issue, or EITF, No. 01-02, *Interpretations of APB Opinion 29*. If the fair values are reasonably determinable, revenue is recorded at the fair values of the products delivered or products or services received, whichever is more readily determinable. If we cannot determine fair value of either of the goods or services involved within reasonable limits, we record the transaction on a net basis. License revenue associated with software licenses entered into with our suppliers at or about the same time that we purchase goods or services from them is not material to our consolidated financial statements.

Product Returns

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

Delivery of Software Products

Delivery of our software products is a prerequisite to the recognition of software license revenue. We consider delivery complete when the software products have been shipped and the customer has access to license keys. If arrangements include an acceptance provision, we defer the revenue and recognize it upon the earlier of receipt of written customer acceptance or expiration of the acceptance period. In some cases, we have discretion over the timing of product shipments, which affects the timing of revenue recognition for software license orders. In those cases, we consider a number of factors, including: the impact of the related license revenue on our business plan; the delivery dates requested by customers and resellers; the amount of software license orders received in the quarter; the amount of software license orders shipped in the quarter; the degree to which software license orders received are concentrated at the end of a quarter; and our operational capacity to fulfill software license orders at the end of a quarter.

Restructuring Expenses and Related Accruals

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

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

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

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

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

Impairment of Long-Lived Assets

We review our goodwill for impairment annually or whenever events or changes in circumstances suggest that the carrying amount may not be recoverable or at least once a year. We are required to test our goodwill for impairment at the reporting unit level. We have determined that we have only one reporting unit. The test for goodwill impairment is a two-step process:

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

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

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

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

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

significant underperformance of our company relative to expected operating results;

our net book value compared to our market capitalization;

significant adverse economic and industry trends;

significant decrease in the market value of the asset;

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

significant changes to the asset since we acquired it.

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

Accounting for Income Taxes

We are required to estimate our income taxes in each federal, state and international jurisdiction in which we operate. This process requires that we estimate the current tax exposure as well as assess temporary differences between the accounting and tax treatment of assets and liabilities, including items such as accruals and allowances not currently deductible for tax purposes. The income tax effects of the differences we identify are classified as current or long-term deferred tax assets and liabilities in our consolidated balance sheets. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax laws or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our balance sheet and results of operations. We must also assess the likelihood that deferred tax assets will be realized from future taxable income and, based on this assessment, establish a valuation allowance, if required. As of March 31, 2004, we determined the valuation allowance to be $138.4 million based upon uncertainties related to our ability to recover certain deferred tax assets. These deferred tax assets are in specific geographical or jurisdictional locations or are related to losses on strategic investments that will only be realized with the generation of future capital gains within a limited time period. Our determination of our valuation allowance is based upon a number of assumptions, judgments and estimates, including forecasted earnings, future taxable income and the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. Future results may vary from these estimates, and at this time it is not practicable to determine if we will need to establish an additional valuation allowance and if it would have a material impact on our financial statements.

Restatement of Consolidated Financial Statements

As a result of the findings of an investigation into past accounting practices, we restated our financial statements for the years ended December 31, 2002 and 2001, including the corresponding interim periods for 2002 and 2001, and the interim periods ended March, June and September 2003. We also revised our previously announced financial results as of and for the quarter ended March 31, 2004 and for the quarter and year ended December 31, 2003. For the quarter ended March 31, 2004, these adjustments impacted our previously announced financial results as follows: total net revenue decreased from $487 million to $486 million and net income decreased from $103 million to $100 million. Diluted earnings per share for the quarter ended March 31, 2004 decreased from $0.23 to $0.22. For the quarter ended March 31, 2003, these adjustments impacted our previously issued financial results as follows: total net revenue decreased from $394 million to $390 million and net income remained at approximately $43 million. Diluted earnings per share for the quarter ended March 31, 2003 remained unchanged at $0.10. Please refer to our annual report on Form 10-K for the year ended December 31, 2003 for additional information regarding the impact of the restatement on our quarterly results during the years ended December 31, 2003, 2002 and 2001.

Results of Operations

Net Revenues

	Three Months

	Ended March 31,		
(in millions, except percentages)	2004	2003	% Change
Total net revenue	$485.7	$390.1	25%

For the quarter ended March 31, 2004, our total net revenue increased by $95.6 million or 25% due primarily to the growth in user license fees, increased sales penetration of international markets, revenues as a result of our acquisition of Precise and the continued growth of our services businesses. During 2003 and 2004, as part of our strategy to increase our net revenues, we continued expanding our product portfolio and offerings, increased the computer platforms supported by our software and continued to invest in sales and service capacity internationally. While we believe that the increase in total net revenue achieved in recent periods is not necessarily indicative of future results, we expect total net revenue to continue to increase in 2004 assuming increased penetration of international markets, the benefit of new product offerings and continued growth of services revenue, as well as improved general

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economic conditions.

International Sales and Operations

Our international sales consist of sales of licenses and services to customer locations outside the United States and are generated primarily through our international sales subsidiaries. International revenue, a majority of which is collectible in foreign currencies, accounted for approximately 39% and 34% of our total net revenue for the quarters ended March 31, 2004 and 2003, respectively. Our international revenue increased 43% to $187.5 million year-over-year. During 2003 and through the first quarter of 2004, our international revenue increased across all geographic areas and we saw greater strength in the emerging markets in Europe, Asia-Pacific and Japan. Additionally, during 2004 our international sales benefited from favorable foreign currency exchange rate movements relative to the weaker U.S. dollar. Excluding the benefit from foreign currency movement, the increase in international sales would have been 32% over the first quarter of 2003. We expect that our international revenue will continue to increase in absolute dollars and as a percent of total revenue for the remainder of 2004 because of the continued expansion of international markets and the focus and increased investment by our company in these markets.

We believe that a key component of our growth strategy is the continued expansion of our international operations. We currently have sales and services offices and resellers located in Europe, Asia-Pacific and Japan, Latin America, Canada, Africa and the Middle East, and research and development centers in India, the United Kingdom and Israel. International expansion will require us to establish additional foreign offices, hire additional personnel and recruit new international resellers, resulting in the diversion of management attention and the expenditure of financial resources. To the extent that we are unable to meet these additional requirements, growth in international sales will be limited, which would have an adverse effect on our business, operating results and financial condition.

User License Fees

We market and distribute our software products both as standalone software products and as integrated product suites, which we also refer to as application solutions. We derive our user license fees from the licensing of our technology, segregated into three product areas: Data Protection, which includes our NetBackup and Backup Exec product families; Storage Management, which includes our File Systems, Volume Manager, replication, Database Editions and storage resource management product families; and Utility Computing Infrastructure, which includes our clustering, high-availability offerings, application performance management, or APM, OpForce and CommandCentral Service product families.

	Three Months Ended March 31,		
(in millions, except percentages)	**2004**	**2003**	**% Change**
User license fees:			
Data protection	$161.8	$139.3	16%
Storage management	83.9	61.2	37
Utility computing infrastructure	56.7	47.0	21
Total user license fees	$302.4	$247.5	22%

As a percentage of user license fees:		
Data protection	53%	56%
Storage management	28	25
Utility computing infrastructure	19	19
Total user license fees	100%	100%
As a percentage of total net revenue	62%	63%

For the quarter ended March 31, 2004 compared to March 31, 2003, user license fees increased by $54.9 million or 22% due to increases across each product category. Data protection increased by $22.5 million due primarily to increases in our core backup family of products, including NetBackup 5.0 which was introduced during the fourth quarter of 2003. Storage management increased $22.7 million due primarily to increases in our replication and storage resource management products, including the introduction of Storage Foundation Suite 4.0 which was introduced during the first quarter of 2004. Utility computing infrastructure increased by $9.7 million due primarily to increases in clustering, Database Editions/Advanced Cluster and the addition of APM products as a result of our acquisition of Precise.

User license fees from OEMs accounted for 12% of user license fees for the quarters ended March 31, 2004 and 2003.

Unfilled license orders and deferred license revenue were approximately $78 million and $53 million at March 31, 2004 and 2003, respectively. Unfilled license orders represent cancelable and non-cancelable license orders that have been received from our customers for the license of our software products but have not been shipped as of the end of the applicable fiscal period. Deferred license revenue represents license orders for our software products that have been billed to and paid by the customer and for which revenue has not yet been earned, but is generally earned within the next year.

For the quarter ended March 31, 2004, we completed 25 transactions valued at over $1.0 million, including services, and 246 transactions valued at over $100,000. For the quarter ended March 31, 2003, we completed 12 transactions valued at over $1.0 million, including services, and 202 transactions valued at over $100,000.

Services Revenue

(in millions, except percentages)	Three Months Ended March 31, 2004	2003	% Change
Services revenue	$183.3	$142.7	28%
As a percentage of net revenue	38%	37%	

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

Deferred services revenue, which in the case of maintenance and technical support is generally recognized over the maintenance and support period of twelve months, or in the case of professional services, training or consulting services is generally recognized over the period the specifics service are rendered, was approximately $400 million and $269 million at March 31, 2004 and 2003, respectively. The increase in deferred services revenue is the result of significant growth in our installed base of customers under software maintenance and technical support contracts and our continued focus on maintenance and technical support contract renewals.

Cost of Revenue

(in millions, except percentages)	Three Months Ended March 31, 2004	2003	% Change
Cost of revenue	$79.2	$79.0	
As a percentage of net revenue	16%	20%	

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

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

	Three Months Ended March 31,		
(in millions, except percentages)	**2004**	**2003**	**% Change**
Cost of user license fees:			
User license fees	$ 9.5	$11.9	(20)%
Amortization of developed technology	3.8	14.8	(74)%
Total cost of user license fees	$13.3	$26.7	(50)%
Gross profit:			
User license fees including amortization of developed technology	96%	89%	

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Cost of user license fees consists primarily of amortization of developed technology, royalties, media, manuals and distribution costs. The amortization of developed technology is related primarily to acquisitions completed during 1999 and the first and second quarters of 2003. If we had excluded the amortization of developed technology from the cost of user license fees, the gross profit on user license fees would have been 97% and 95% for the quarters ended March 31, 2004 and 2003, respectively. The gross profit on user license fees may vary from period to period based on the license revenue mix because some of our products carry higher royalty rates than others. Excluding the amortization of developed technology, we expect gross profits on user license fees to remain relatively constant.

The decrease in amortization of developed technology for the first quarter of 2004 over 2003 was primarily the result of the developed technology related to the 1999 acquisitions reaching full amortization in 2003. This decrease was partially offset by the amortization of developed technology related to the Precise, Jareva and Ejasent acquisitions. We expect amortization of developed technology to be approximately $4 million per quarter for the remainder of 2004 for our current intangible assets.

Cost of Services

(in millions, except percentages)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	% Change
Cost of service revenue	$65.8	$52.3	26%
Gross profit	64%	63%	

Cost of services consists primarily of personnel-related costs in providing maintenance and technical support, consulting and education to customers. The gross profit improvement for the first quarter of 2004 over 2003 was primarily the result of the increase in maintenance and support revenues of 30%, while related expenses increased only 27% as we continued to take advantage of the economies of scale of the larger installed customer base. We expect gross profit on services revenue to remain stable or increase slightly as a result of higher maintenance and support revenue and reductions in labor costs associated with technical support services by increasing our use of lower cost operations in India.

Operating Expenses

(in millions, except percentages)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	% Change
Operating expenses	$273.5	$246.4	11%
As a percentage of net revenue	56%	63%	

Operating expenses for the quarter ended March 31, 2004 increased by $27.1 million compared to 2003 due primarily to an increase in selling and marketing, research and development and general and administrative expenses. The increase in operating expenses was the result of an overall increase in operations offset by a decrease from the first quarter of 2003 of $15.8 million for amortization of other intangibles from our 1999 acquisitions reaching full amortization in 2003 and a decrease of $3.7 million of IPR&D year over year. We believe that the percentage changes in total operating expenses in these periods are not necessarily indicative of future results. Our operating expenses include selling and marketing expenses, research and development expenses, general and administrative expenses, amortization of other intangibles and IPR&D.

Selling and Marketing

	Three Months Ended March 31,		
(in millions, except percentages)	**2004**	**2003**	**% Change**
Selling and marketing	$143.0	$115.3	24%
As a percentage of net revenue	29%	30%	

Selling and marketing expenses consist primarily of salaries, related benefits, commissions, consultant fees and other costs associated with our sales and marketing efforts. The increase for the first quarter of 2004 over 2003 of $27.7 million was primarily the result of an increase in sales commissions, compensation and benefit costs due to an increase in personnel partially resulting from the Precise acquisition and higher sales commissions resulting from the increase in license revenues. Although our selling and marketing expenses decreased as a percentage of total revenues, they remained relatively constant when compared to user license fees at approximately 47% for each of the first quarters of 2004 and 2003. We expect selling and marketing expenses to continue to grow in absolute dollars for 2004 and to remain relatively constant as a percentage of user license fees for fiscal year 2004.

Research and Development

(in millions, except percentages)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	% Change
Research and development	$79.9	$70.6	13%
As a percentage of net revenue	16%	18%	

Research and development expenses consist primarily of salaries, related benefits, third-party consultant fees and other engineering related costs. The increase of $9.3 million for the first quarter of 2004 over 2003 was primarily the result of increases in compensation costs from an increase in staffing levels partially due to the Precise acquisition and an increase in outside services used to supplement engineering personnel. We believe that a significant level of research and development investment is required to remain competitive and we expect to continue to invest in research and development in 2004 at current levels as a percentage of revenue, including increasing our use of lower cost operations in India.

General and Administrative

(in millions, except percentages)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	% Change
General and administrative	$47.7	$38.2	25%
As a percentage of net revenue	10%	10%	

General and administrative expenses consist primarily of salaries, related benefits and fees for professional services, such as legal and accounting services. The increase of $9.5 million for the first quarter of 2004 over 2003 was primarily the result of an increase in compensation and benefit costs, depreciation expense as a result of consolidating certain leased buildings costs associated with our recent restatement and compliance with our corporate governance initiatives, including those requirements under the Sarbanes-Oxley Act of 2002. We expect to incur costs related to our restatement in the second quarter of 2004 and expect general and administrative expenses to remain relatively constant as a percentage of revenue in 2004.

Amortization of Other Intangibles

	Three Months Ended March 31,		
(in millions, except percentages)	2004	2003	% Change
Amortization of other intangibles	$2.4	$18.2	(87)%
As a percentage of net revenue	%	5%	

Amortization of other intangibles principally represents amortization of distribution channels, trademarks and other intangibles related to acquisitions. The decrease in amortization of other intangibles for the first quarter of 2004 over 2003 was primarily due to other intangibles related to the 1999 acquisitions reaching full amortization during the second quarter of 2003. The amortization of other intangibles also includes intangibles from the acquisition of Precise, Jareva and Ejasent which are being amortized over the estimated useful lives of two to four years. We expect amortization of other intangibles to be approximately $2 million per quarter for the remainder of 2004 for our current intangible assets.

In-Process Research and Development

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

Interest and Other Income, Net

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(in millions, except percentages)	Three Months Ended March 31, 2004	2003	% Change
Interest and other income, net	$11.3	$11.0	3%
As a percentage of net revenue	2%	3%	

Interest and other income, net, includes interest income on our cash and investments held and, to a lesser extent, foreign currency exchange gains or losses.

Interest Expense

(in millions, except percentages)	Three Months Ended March 31, 2004	2003	% Change
Interest expense	$5.7	$7.7	(26)%
As a percentage of net revenue	1%	2%	

Interest expense for the quarter ended March 31, 2004 consisted of interest recorded under the 0.25% convertible subordinated notes issued in August 2003 and interest of approximately $4 million per quarter, beginning in July 2003, as a result of our adoption of Financial Accounting Standards Board, or FASB, Interpretation Number, or FIN, 46, *Consolidation of Variable Interest Entities*, which required us to consolidate the properties from our build-to-suit lease agreements and related debt in our financial statements. Previously, interest on the build-to-suit lease agreements was recorded as rent expense in cost of revenue and operating expenses. Interest expense for the quarter ended March 31, 2003 consisted of interest recorded under the 1.856% convertible subordinated notes issued in August 1999 and partially redeemed for cash and partially converted to common stock in August 2003 and interest recorded under the 5.25% convertible subordinated notes issued in October 1997 and converted to common stock in August 2003. We expect interest expense for the second quarter of 2004 to be approximately $5 million representing the interest on the 0.25% convertible subordinated notes, including the additional interest as a result of our registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance date of the 0.25% convertible subordinated notes, and the interest on the build-to-suit lease agreements.

Gain (Loss) on Strategic Investments

(in millions, except percentages)	Three Months Ended March 31, 2004	2003	% Change

Gain (loss) on strategic investments	$7.5	$(3.5)	(314)%
As a percentage of net revenue	2%	(1)%	

For the quarter ended March 31, 2004, we recognized a gain on strategic investments of $7.5 million related to the sale of one of our investments. During the first quarter of 2003, we recognized impairment losses of $3.5 million on our strategic investments when we determined that there had been a decline in the fair value of these investments that was other than temporary. These losses represented write-downs of the carrying amount of our investments.

Provision for Income Taxes

	Three Months Ended March 31,		
(in millions, except percentages)	**2004**	**2003**	**% Change**
Income taxes	$46.1	$21.4	115%
As a percentage of net revenue	9%	5%	

Our effective tax rate for the first quarter of 2004 differed from the combined federal and state statutory rates due primarily to the tax effect of international operations and amortization of intangible assets. Our effective tax rate for the quarter ended March 31, 2004 was approximately 32% compared to 33% for the quarter ended March 31, 2003. The reduction in our effective tax rate for the first quarter of 2004 over the first quarter of 2003 is primarily the result of the increased share of international revenue as a percentage of total worldwide revenue combined with a lower effective tax rate associated with our international operations.

Accrued Acquisition and Restructuring Costs

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

Restructuring costs will generally be paid over the remaining lease terms, ending at various dates through 2021, or over a shorter period as we may negotiate with our lessors. We expect the majority of costs will be paid by the year ending December 31, 2008.

During the fourth quarter of 2002, we began vacating excess facilities, and by January 31, 2004 we had vacated all excess facilities associated with this restructuring. We began realizing cost savings from the exiting of these facilities during the third quarter of 2003. We are in the process of seeking suitable subtenants for these facilities. Our estimates of the facility restructure charge may vary significantly depending, in part, on factors that are beyond our control, including the commercial real estate market in the applicable metropolitan areas, our ability to obtain subleases related to these facilities and the time period to do so, the sublease rental market rates and the outcome of negotiations with lessors regarding terminations of some of the leases. Adjustments to the accrued restructuring costs will be made if actual lease exit costs or sublease income differ from amounts currently expected. Because a portion of the accrued restructuring costs relate to international locations, the accrual will be affected by exchange rate fluctuations.

For the quarter ended March 31, 2004, we incurred acquisition related costs of $13.6 million related to the acquisition of Ejasent. As of December 31, 2003, accrued acquisition and restructuring costs consisted of the facility restructuring plan discussed above and other accrued acquisition and restructuring charges incurred from 1999 through 2003, net of cash payments made.

The components of the accrued acquisition and restructuring costs and movements within these components through March 31, 2004 were as follows:

(in millions)	Direct Transaction Costs	Involuntary Termination Benefits	Facility Related Costs	Asset Write-offs	Total
Balance at December 31, 2003	$ 0.6	$	$ 91.4	$ 2.1	$ 94.1
Additions	2.1	11.4	0.1		13.6
Cash payments	(1.8)	(11.3)	(5.2)		(18.3)
Non-cash charges				(2.1)	(2.1)
Impact of exchange rates			0.7		0.7
Balance at March 31, 2004	$ 0.9	$ 0.1	$ 87.0	$	$ 88.0

Recent Accounting Pronouncements

There are no applicable recent accounting pronouncements requiring disclosure.

Liquidity and Capital Resources

Cash Flows

Our cash, cash equivalents and short-term investments totaled $2,684.0 million at March 31, 2004 and represented 74% of our tangible assets. Our cash, cash equivalents and short-term investments totaled $2,503.0 million at December 31, 2003 and represented 71% of our tangible assets. Cash and cash equivalents are highly liquid with original maturities of 90 days or less. Short-term investments consist mainly of commercial paper, medium-term notes, corporate notes, government securities (taxable and non-taxable), asset-backed securities and auction market securities.

Operating activities provided cash of $202.7 million for the three months ended March 31, 2004, primarily due to net income of $100.0 million, adjusted for depreciation and amortization of $30.1 million, a decrease in accounts receivable of $93.3 million and increases in income and other taxes payable of $40.0 million and deferred revenue of $25.7 million which were partially offset by an increase in other assets of $22.6 million and decrease in accounts payable of $9.3 million, accrued compensation of $36.6 million and other accrued liabilities of $14.7 million. Operating activities provided cash of $206.8 million for the three months ended March 31, 2003, primarily due to net income of $43.1 million, adjusted for depreciation and amortization of $31.4 million, amortization of other intangibles and developed technology of $33.0 million, a decrease in accounts receivable of $96.5 million and an increase in income and other taxes payable of $31.7 million and deferred revenue of $16.8 million, partially offset by a decrease in deferred income taxes of $13.1 million, in accrued compensation of $31.5 million and other accrued liabilities of $12.7 million. We expect cash flows from operating activities to decrease in the second quarter of 2004.

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Investing activities used cash of $437.8 million for the three months ended March 31, 2004, primarily due to net purchases of short-term investments of $349.3 million, purchases of property and equipment of $28.1 million and purchases of businesses and technology net of cash acquired of $60.4 million. Investing activities provided cash of $38.4 million for the three months ended March 31, 2003, primarily due to the net sales of short-term investments of $114.9 million partially offset by purchases of property and equipment of $19.9 million and purchases of businesses and technology, net of cash acquired of $56.6 million.

Financing activities provided cash of $43.4 million and $20.0 million for the three months ended March 31, 2004 and 2003, respectively, as a result of the issuance of common stock under our employee stock plans.

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

Convertible Subordinated Notes

In August 2003, we issued $520.0 million of 0.25% convertible subordinated notes due August 1, 2013, or 0.25% Notes, for which we received net proceeds of approximately $508.2 million, to several initial purchasers in a private offering. The 0.25% Notes were issued at their face value and provide for semi-annual interest payments of $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of our registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue additional interest at that rate until April 27, 2004, the 90^{th} day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will accrue such additional interest until the registration statement is declared effective or until we are no longer required to maintain the effectiveness of the registration statement.

At March 31, 2004, we had a ratio of long-term debt to total capitalization of approximately 16%. The degree to which we are leveraged could materially and adversely affect our ability to obtain financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. We will require substantial amounts of cash to fund scheduled payments of principal and interest on our indebtedness, future capital expenditures and any increased working capital requirements.

Long-Term Debt

In 1999 and 2000, we entered into three build-to-suit lease agreements for office buildings in Mountain View, California, Roseville, Minnesota and Milpitas, California. We began occupying the Roseville and Mountain View facilities in May and June 2001, respectively, and began occupying the Milpitas facility in April 2003. A syndicate of financial institutions financed the acquisition and development of these properties. Prior to July 1, 2003, we accounted for these properties as operating leases in accordance with SFAS No. 13, *Accounting for Leases*, as amended. On July 1, 2003, we adopted FIN 46. Under FIN 46, the lessors of the facilities are considered variable interest entities, and we are considered the primary beneficiary. Accordingly, we began consolidating the variable interest entities on July 1, 2003 and have included the property and equipment and long-term debt on our balance sheet at March 31, 2004 and December 31, 2003 and the results of their operations in our consolidated statement of operations for the quarter ended March 31, 2004. As of March 31, 2004, approximately $186.4 million of debt has been classified as current as the lease terms for the Mountain View and Roseville facilities expire in March 2005.

Interest only payments under our debt agreements relating to the facilities are generally paid quarterly and are equal to the termination value of the outstanding debt obligations multiplied by our cost of funds, which is based on

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

In January 2002, we entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging the cash payments related to the Mountain View and Roseville agreements. Under the terms of these interest rate swaps, we make payments based on the fixed rate and will receive interest payments based on the 3-month LIBOR rate. For the quarter ended March 31, 2004, our aggregate payments on the debt agreements, including the net payments on the interest rate swaps, were $4.0 million and were included in interest expense in the consolidated statement of operations in accordance with FIN 46. The payments for the quarter ended March 31, 2003 of $4.1 million were classified as rent expense and included in cost of revenue and operating expenses, in accordance with SFAS No. 13. We expect future interest expense from the build-to-suit agreements to be approximately $4 million per quarter.

The agreements for each of the facilities described above require that we maintain specified financial covenants, all of which we were in compliance with as of March 31, 2004. The specified financial covenants as of March 31, 2004 require us to maintain a minimum rolling four quarter earnings before interest, taxes, depreciation and amortization of EBITDA of $400.0 million, a minimum ratio of cash and cash equivalents and accounts receivable to current liabilities plus the debt consolidated under the build-to-suit lease agreements of 1.2 to 1, and a leverage ratio of total funded indebtedness to rolling four quarter EBITDA of not more than 2 to 1. For purposes of these financial covenants, EBITDA represents our net income for the applicable period, plus interest expense, taxes, depreciation and amortization and all non-cash restructuring charges, less software development expenses classified as capital expenditures. In order to secure the obligation under each agreement, each of the facilities is subject to a deed of trust in favor of the financial institutions that financed the acquisition and development of the respective facility. Bank of America, N.A. was the agent for the syndicate of banks that funded the development of the Mountain View and Roseville facilities, and ABN AMRO Bank, N.V. was the agent for the syndicate of banks that funded the development of the Milpitas facility. We have received waivers from the respective syndicate of banks for each facility in relation to any non-compliance that would have resulted from the delay in filing this Form 10-Q or our 2003 Form 10-K.

Credit Facility

During 2002, our Japanese subsidiary entered into a short-term credit facility with a multinational Japanese bank in the amount of 1.0 billion Japanese yen ($9.5 million USD). At March 31, 2004, no amount was outstanding. The short-term credit facility was renewed in March 2004 and is due to expire in March 2005. Borrowings under the short-term credit facility bear interest at Tokyo Inter Bank Offered Rate, plus 0.5%. There are no covenants on the short-term credit facility and the loan has been guaranteed by VERITAS Software Global LLC, one of our wholly-owned subsidiaries.

Acquired Technology Commitments

On October 1, 2002, we acquired volume replicator software technology for $6.0 million and contingent payments of up to another $6.0 million based on future revenues generated by the acquired technology. The contingent payments will be paid quarterly over 40 quarters, in amounts between $150,000 and $300,000, which includes interest. We issued a promissory note payable in the principal amount of $5.0 million, representing the present value of our minimum payment obligations under the purchase agreement for the acquired technology, which are payable quarterly commencing in the first quarter of 2003 and ending in the fourth quarter of 2012. The contingent payments in excess of the quarterly minimum obligations will be paid as they may become due. The outstanding balance of the note payable was $4.5 million as of March 31, 2004 and $4.6 million as of December 31, 2003 and is included in other long-term liabilities.

Contractual Commitments

The following table is a summary of the contractual commitments, including principal and interest payments, associated with our obligations as of March 31, 2004:

(in thousands)	2004	2005	2006	2007	2008	Thereafter	Total
Operating lease commitments	$44,446	$ 50,107	$42,406	$37,043	$33,128	$167,457	$ 374,587
Convertible subordinated notes	975	1,300	1,300	1,300	1,300	525,958	532,133
Long-term debt	12,691	385,688					398,379
Other long-term liabilities	450	600	600	600	600	2,400	5,250
Total contractual commitments	$58,562	$437,695	$44,306	$38,943	$35,028	$695,815	$1,310,349

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

Factors That May Affect Future Results

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

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

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

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

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

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

We derive a majority of our revenue from a small number of software products, including our NetBackup and Backup Exec data protection products. In addition, our software products are concentrated within the market for data storage. For example, in 2003, we derived approximately 56% of our user license fees from the NetBackup and Backup Exec products, and a similar percentage of our services revenue from associated maintenance and technical support. As a result, we are particularly vulnerable to fluctuations in demand for these products, whether as a result of competition, product obsolescence, technological change, budget constraints of our potential customers or other factors. If our revenue derived from these software products were to decline significantly, our business and operating results would be adversely affected. In addition, because our software products are concentrated within the market for data storage, a decline in the demand for storage devices, storage software applications or storage capacity could result in a significant reduction in our revenue and adversely affect our business and operating results.

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

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

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

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

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

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

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

- our lack of control over the shipping dates or volume of systems shipped;
- our OEM partners are not subject to minimum sales requirements or any obligation to market our products to their customers;
- our OEM partners may terminate or renegotiate their arrangements with us and new terms may be less favorable in recognition of our increasingly competitive relationship with certain partners;
- the development work that we must generally undertake under our agreements with our OEM partners may require us to invest significant resources and incur significant costs with little or no associated revenue;

- the time and expense required for the sales and marketing organizations of our OEM partners to become familiar with our products make it more difficult to introduce those products to the market; and

- our OEM partners may develop, market and distribute their own products and market and distribute products of our competitors, which could reduce our sales.

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

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

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

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

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

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

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

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

We derive a substantial portion of our revenue from customers located outside of the U.S. and have significant operations outside of the U.S., including engineering, sales, customer support and production operations. We plan to expand our international operations and our planned growth is contingent upon the successful expansion of our international revenue. Our international operations are subject to risks in addition to those faced by our domestic operations, including:

potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights;

imposition of foreign laws and other governmental controls, including trade and employment restrictions;

fluctuations in currency exchange rates and economic instability such as higher interest rates and inflation, which could reduce our customers ability to obtain financing for software products or which could make our products more expensive in those countries;

limitations on future growth or inability to maintain current levels of revenue from international sales if we do not invest sufficiently in our international operations;

difficulties in hedging foreign currency transaction exposures;

longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;

- difficulties in staffing, managing and operating our international operations, including difficulties related to administering our stock plans in some foreign countries;
- difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations;
- seasonal reductions in business activity in the summer months in Europe and in other periods in other countries;
- costs and delays associated with developing software in multiple languages; and
- political unrest, war or terrorism, particularly in areas in which we have facilities.

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

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

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

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

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

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

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

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

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

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

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

In addition, for some operating systems, we must obtain from the owner of the operating system a source code license to portions of the operating system software to port some of our products to or develop products for the operating system. Operating system owners have no obligation to assist in these porting or development efforts. If they do not grant us a license or if they do not renew our license, we may not be able to expand our product line into other areas.

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

We derive a large amount of revenue from a distributor that sells our products and services through resellers. For the quarter ended March 31, 2004, this distributor accounted for less than 10% of our net revenue. If this distributor were to reduce purchases of our products or services, our revenues would decline unless we were able to increase sales through other distributors or direct sales to customers. Our contract does not require this distributor to purchase any specified amount of our product or services. Accordingly, we cannot be sure that this distributor will continue to market and sell our products and services at current levels.

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

Since the third quarter of 2002, we have received subpoenas and other requests for information issued by the SEC in the investigation entitled *In the Matter of AOL/Time Warner.* We continue to furnish information requested by the SEC and otherwise cooperate with regard to this investigation and related accounting and disclosure matters. In addition, in the first quarter of 2004, we voluntarily disclosed to the SEC past accounting practices that we determined were not in compliance with GAAP. We are cooperating with the SEC s requests for information regarding these matters. The SEC s investigation and inquiries may continue to require significant management attention and accounting and legal resources, or require us to amend our periodic reports for 2003 or prior periods, which could adversely affect our business, results of operations and cash flows.

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

our business, financial condition, results of operations and cash flows.

After we announced in January 2003 that we would restate our financial results as a result of transactions entered into with AOL Time Warner in September 2000, numerous separate complaints purporting to be class actions were filed in federal court alleging that we and some of our officers and directors violated provisions of the Securities Exchange Act of 1934. Several similar complaints purporting to be derivative actions have been filed in state court against some of our directors and officers. In addition, as a result of the current restatement, we are subject to an increased risk that we will be the subject of additional class action securities litigation. The expense of defending any such litigation may be costly and divert management s attention from the day-to-day operations of our business, which could adversely affect our business, results of operations and cash flows. In addition, an unfavorable outcome in any such litigation could have a material adverse effect on our business, results of operations and cash flows.

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

On March 17, 2004, we received a letter from The Nasdaq Stock Market, or Nasdaq, stating that due to our delinquency in filing our annual report on Form 10-K, our securities are subject to delisting from Nasdaq. We received a similar letter from Nasdaq on

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May 19, 2004, relating to our delinquency in filing this quarterly report on Form 10-Q. After a hearing before The Nasdaq Listing Qualifications Panel we received a written determination providing for the continued listing of our common stock provided that, among other things, we file with the SEC and deliver to Nasdaq our annual report on Form 10-K and this quarterly report on Form 10-Q on or before June 22, 2004. The Panel determination further stated that we must timely file with the SEC and deliver to Nasdaq periodic reports for all reporting periods ending on or before June 30, 2005. Should we fail to comply with these requirements, our securities could be delisted, which would materially and adversely affect the liquidity and trading price of our common stock.

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

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

- diversion of management s attention from our business;
- integration of acquired business operations and employees into our existing business, including coordination of geographically dispersed operations, which in the past has taken longer and has been more complex than initially expected;
- incorporation of acquired products and business technology into our existing product lines, including consolidating technology with duplicative functionality or designed on different technological architecture, and our ability to sell the acquired products through our existing or acquired sales channels;
- loss or termination of employees, including costly litigation resulting from the termination of those employees;
- dilution of our then-current stockholders percentage ownership;
- dilution of earnings if synergies with the acquired business are not achieved;
- assumption of liabilities of the acquired business, including costly litigation related to alleged liabilities of the acquired business;
- presentation of a unified corporate image to our customers and our employees; and
- risk of impairment charges related to potential write-down of acquired assets in future acquisitions.

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

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

Our effective tax rate could be adversely affected by several factors, many of which are outside of our control. Our effective tax rate is directly affected by the relative proportions of revenue and income before taxes in the various domestic and international jurisdictions in which we operate. We are also subject to changing tax laws, regulations and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings. In particular, we are subject to a number of tax rulings from the country of Israel related to the activities of Precise. Failure to comply with the terms and conditions of such rulings could significantly impact our effective tax rate. The use of tax benefits available under such rulings is dependent upon the scope of future activities in Israel related to the historic Precise business. We do not have a substantial history of audit activity from various taxing authorities and while we believe we are in compliance with all federal, state and international tax laws, there are various interpretations of their application that could result in additional tax assessments. Our effective tax rate is also influenced by the tax effects of purchase accounting for acquisitions and non-recurring charges, which may cause fluctuations between reporting periods, and may also be influenced by tax assessments against acquired entities with respect to tax periods prior to the acquisition, which may significantly affect our effective tax rate for the period in which the settlements take place.

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

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

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software revenue recognition;

accounting for stock-based compensation;

accounting for variable interest entities; and

accounting for goodwill and other intangible assets.

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

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

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

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

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

be time consuming to defend;

result in costly litigation;

divert management s attention from our core business;

require us to stop selling, to delay shipping or to redesign our product; and require us to pay monetary amounts as damages, for royalty or licensing arrangements, or to satisfy indemnification obligations that we have with some of our customers.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- announcements of our quarterly operating results and revenue and earnings forecasts or those of our competitors or our customers;
- rumors, announcements or press articles regarding changes in our management, organization, operations or prior financial statements;
- inquiries by the SEC, Nasdaq, law enforcement or other regulatory bodies;
- changes in revenues and earnings estimates by securities analysts;
- announcements of planned acquisitions by us or by our competitors;
- gain or loss of a significant customer;
- announcements of new products by us, our competitors or our OEM customers; and
- acts of terrorism, the threat of war and economic slowdowns in general.

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

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

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

Foreign Currency Risk

We transact business in various foreign currencies and have established a foreign currency hedging program, utilizing foreign currency forward exchange contracts, or forward contracts, to hedge certain foreign currency transaction exposures. Under this program, increases or decreases in our foreign currency transactions are offset by gains and losses on the forward contracts, so as to mitigate the possibility of foreign currency transaction gains and losses. We do not use forward contracts for speculative or trading purposes. All foreign currency transactions and all outstanding forward contracts are marked-to-market at the end of the period with unrealized gains and losses included in other income (expense). The unrealized gain (loss) on the outstanding forward contracts at March 31, 2004 was immaterial to our consolidated financial statements.

Our outstanding forward contracts as of March 31, 2004 are presented in the table below. All forward contract amounts are representative of the expected payments to be made under these instruments. As of March 31, 2004, all forward contracts mature in 35 days or less:

(in thousands)	Local Currency Contract Amount		Contract Amount		Fair Market Value at March 31, 2004 (US$)
Contracts to Buy US $					
Australian dollar	1,100.0	AUD	822.1	USD	20.1
British pound	1,900.0	GBP	3,445.8	USD	56.9
Euro	38,844.0	EUR	47,176.8	USD	636.2
Indian rupee	177,000.0	INR	4,013.6	USD	46.0
Israel shekel	13,500.0	ILS	2,980.3	USD	1.8
Japanese yen	53,000.0	JPY	503.0	USD	5.6
Mexican peso	11,200.0	MXN	999.3	USD	7.1
Singapore dollars	25,600.0	SGD	15,158.6	EUR	126.8
Contracts to Sell US $					
Brazilian real	7,400.0	BRL	2,479.1	USD	402.9
Canadian dollar	12,400.0	CAD	9,467.4	USD	0.3

Euro	58,819.5	EUR	71,456.6	USD	(631.6)
Contracts to Buy Euro					
Danish krona	5,400.0	DKK	725.3	EUR	
Indian rupee	45,200.0	INR	843.3	EUR	(1.3)
South African rand	5,100.0	ZAR	653.5	EUR	8.2
Swiss franc	1,050.0	CHF	673.2	EUR	0.6
Swedish krona	12,400.0	SEK	1,338.8	EUR	(4.1)
United States dollar	35,000.0	USD	28,806.6	EUR	(372.1)
Contracts to Sell Euro					
British pound	43,100.0	GBP	64,411.0	EUR	(157.7)
Indian rupee	195,500.0	INR	3,645.1	EUR	2.9
Japanese yen	2,453,000.0	JPY	19,178.3	EUR	67.5
Singapore dollars	8,400.0	SGD	4,104.2	EUR	37.0
UAE dirham	17,200.0	AED	3,849.9	EUR	57.1
United States dollar	22,000.0	USD	18,262.1	EUR	226.5
Contracts to Buy SGD $					
Australian dollar	11,300.0	AUD	14,225.0	SGD	(96.7)
Indian rupee	24,700.0	INR	944.2	SGD	2.7
South Korean won	331,000.0	KRW	483.4	SGD	(0.1)
Contracts to Sell SGD $					
Hong Kong dollar	21,500.0	HKD	4,656.5	SGD	20.8

In January 2002, we entered into two three-year pay fixed, receive floating, interest rate swaps for the purpose of hedging cash flows on variable interest rate debt of two of our build-to-suit agreements. Under the terms of these interest rate swaps, we make payments based on the fixed rate and will receive interest payments based on the 3-month London Inter Bank Offered Rate, or LIBOR. The payments on our build-to-suit lease agreements are based upon a 3-month LIBOR plus a credit spread. If critical terms of the interest rate swap or the hedged item do not change, the interest rate swap will be considered to be highly effective with all

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changes in the fair value included in other comprehensive income. If critical terms of the interest rate swap or the hedged item change, the hedge may become partially or fully ineffective, which could result in all or a portion of the changes in fair value of the derivative recorded in the statement of operations. The interest rate swaps settle the first day of January, April, July and October until expiration. As of March 31, 2004, the fair value of the interest rate swaps was $(6.9) million. As a result of entering into the interest rate swaps, we have mitigated our exposure to variable cash flows associated with interest rate fluctuations. Because the rental payments on the leases are based on the 3-month LIBOR and we receive 3-month LIBOR from the interest rate swap counter-party, we have eliminated any impact to raising interest rates related to our rent payments under the build-to-suit lease agreements. We have deemed this hedge to be highly effective as of March 31, 2004. On July 1, 2003, we began accounting for our variable interest rate debt in accordance with FIN 46. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, we had designated the interest rate swap as a cash flow hedge of the variability embedded in the rent expense as it is based on the 3-month LIBOR. However, with the adoption of FIN 46, we redesignated the interest rate swap as a cash flow hedge of variability in interest expense and it remains highly effective with all changes in the fair value included in other comprehensive income.

Interest Rate Risk

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

Debt obligations consist of $520.0 million of our 0.25% convertible subordinated notes due August 1, 2013 and $380.6 million of our debt related to our build-to-suit lease agreements. The nominal interest rate on the 0.25% Notes is fixed and the notes provide for semi-annual interest payments of approximately $0.7 million each February 1 and August 1, beginning February 1, 2004. Effective as of January 28, 2004, the 0.25% Notes began accruing additional interest at a rate of 0.25% as a result of our registration statement having not been declared effective by the SEC on or before the 180th day following the original issuance of the 0.25% Notes and the 0.25% Notes continued to accrue such additional interest until April 27, 2004, the 90th day following such registration default. As of April 27, 2004, the 0.25% Notes began to accrue additional interest at a rate of 0.50% and will accrue such additional interest until the registration statement is declared effective or we are no longer required to maintain the effectiveness of the registration statement. The 0.25% Notes are convertible, under specified conditions, into shares of our common stock unless previously redeemed or repurchased and are subject to adjustment under the terms of the notes. Long-term debt consists of the three build-to-suit agreements. The interest rates on the build-to-suit agreements are variable based on a 3-month LIBOR plus a credit spread and provide for quarterly interest payments in January, April, July and October (see Management s Discussion and Analysis of Financial Condition and Results of Operations Long-Term Debt for more information regarding debt payout).

The following table presents the amounts of our cash equivalents, short-term investments and long-term obligations, according to maturity date, that may be subject to interest rate risk and the average interest rates as of March 31, 2004 by year of maturity:

	Amortized Cost			
(in thousands, except percentages)	Due in 2005 and Thereafter	Total	2004 Fair Value	2003 Amortized Cost

	Due in 2004				
Cash equivalents and short-term investments:					
Fixed rate	$358,811	$ 941,445	$1,300,256	$1,302,255	$1,235,767
Average fixed rate	1.68%	2.42%	2.22%	2.22%	2.11%
Variable rate	$471,937	$ 372,277	$ 844,214	$ 844,725	$ 509,727
Average variable rate	1.13%	1.46%	1.28%	1.28%	1.40%
Total cash equivalents and short-term investments	$830,748	$1,313,722	$2,144,470	$2,146,980	$1,745,494
Average rate	1.37%	2.15%	1.85%	1.85%	1.90%
Long-term obligations:					
Fixed rate	$ 330	$ 524,142	$ 524,472	$ 524,472	$ 524,578
Average fixed rate (1)	3.68%	0.28%	0.28%	0.28%	0.28%
Variable rate (2)	$186,373	$ 194,257	$ 380,630	$ 380,630	$ 380,630
Average variable rate	2.45%	2.45%	2.45%	2.45%	2.45%

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

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(2) $186.4 million of the variable rate long-term debt is, in effect, a fixed rate as the result of the interest rate swaps (see Note 12, Derivative Financial Instruments in the Notes to Consolidated Financial Statements) entered into by VERITAS. Including the effect of these interest rate swaps, the average fixed rate would be 6.14%.

Equity Price Risk

We have made investments in development-stage companies that we believe provide strategic opportunities for us. We intend that these investments will provide access to new technologies and emerging markets, and create opportunities for additional sales of our products and services. We recognize impairment losses on our strategic investments when we determine that there has been a decline in the fair value of the investment that is other than temporary. For the three months ended March 31, 2004, we realized a gain of $7.5 million on the sale of a strategic investment. For the three months ended March 31, 2003, we recognized impairment losses of $3.5 million on our strategic investments when we determined that there had been a decline in the fair value of the investments that was other than temporary. The losses represented other-than-temporary declines in the fair value of our investments and were determined based on the value of the investee s stock, its inability to obtain additional private financing, its cash position and current burn rate, the status and competitive position of the investee s products and the uncertainty of its financial condition among other factors. As of March 31, 2004, our strategic investments had a carrying value of $2.9 million, and we determined that there was no further impairment in these investments at that date. We cannot assure you that our investments will have the above mentioned results, or even that we will not lose all or any part of these investments.

Item 4. Controls and Procedures

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as of March 31, 2004, which included an evaluation of disclosure controls and procedures applicable to the period covered by and existing through the filing of this periodic report. This evaluation has allowed us to make conclusions, as set forth below, regarding the state of our disclosure controls and procedures. As noted below, we have identified a material weakness in our internal controls that existed during 2003 and prior periods.

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

Our chief executive officer and chief financial officer, with the assistance of our disclosure committee, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of March 31, 2004. Our evaluation process included the identification, review and evaluation of the effectiveness of our disclosure controls and procedures applicable to the period covered under and existing through the filing of this periodic report. In addition, we sought to identify any changes to our internal controls during the quarter ended March 31, 2004 that would have a material effect on our internal controls, any significant deficiencies or material weaknesses in our internal controls and any acts of fraud involving personnel who had a significant role in our internal controls. We perform this type of evaluation on a quarterly basis so that the conclusions concerning the effectiveness of our disclosure controls can be reported in our quarterly reports on Form 10-Q and annual report on Form 10-K.

As more fully described in our annual report on Form 10-K for the year ended December 31, 2003, we determined in March 2004 to restate our financial statements for 2002 and 2001 and to revise our previously announced financial results for 2003. Our decision to restate resulted from the findings of an independent investigation under the direction of our audit committee into past accounting practices that occurred in 2002 and prior periods. Following the investigation and our determination to restate our financial statements, we performed additional procedures to ensure the accuracy of our financial information. These additional procedures included a further review of internal documents, tests of certain system controls, cut-off procedures and a review of revenue transactions and other cost and expense accounts. As a result, we determined to correct additional errors made in 2003 and prior periods, including errors that were previously not recorded because in each such case and in aggregate we believed the amount of any such error was not material to our consolidated financial statements. We also made certain revenue, expense and balance sheet reclassifications.

In connection with our restatement, we and KPMG LLP, our independent registered public accounting firm, identified and reported to our audit committee significant internal control deficiencies that collectively constituted a material weakness (as such term is defined under standards established by the American Institute of Certified Public Accountants) in our internal controls that existed during 2003 and prior periods. These internal control deficiencies related to the conduct of certain former financial management and accounting personnel in over-riding internal controls; insufficient documentation and training around standard financial policies and procedures; insufficient review procedures; and insufficient supporting documentation for general ledger account reconciliations and manual journal entries.

Since the latter part of 2002, we have adopted and implemented numerous measures in connection with our ongoing efforts to improve our control processes and corporate governance, some of which have been enhanced further or implemented in connection with the restatement process. These measures included the following:

We have formalized a Standards of Business Conduct and a Financial Code of Ethics. Our Financial Code of Ethics is designed to promote ethical conduct and full, fair and accurate disclosure in our periodic reports. We have re-emphasized to our finance and accounting personnel the importance of these requirements.

We have recruited new personnel to our finance organization who have expertise in financial controls and reporting, including a new chief financial officer, a senior vice president of finance and a corporate controller, and made other changes in finance personnel to improve the overall quality and level of experience of our finance organization globally.

We have reorganized our finance and general and administrative organizations to create a single global organization to improve financial oversight.

We have made changes in our organizational structure to provide a clearer segregation of responsibilities in connection with account reconciliations, manual journal entries, and the preparation and review of documentation to support our quarterly and annual financial statements.

We have implemented an enhanced quarterly financial review process, including a formal closing meeting each quarter chaired by the chief financial officer and attended by a broader cross-section of senior financial management.

We have adopted and implemented standard financial policies and procedures on a global basis. Since January 2003 we have documented over 45 financial policies, all of which are readily available to our employees via our intranet site. These policies provide global finance and accounting guidance and include process documentation designed to ensure consistent application of our global policies and procedures.

We have implemented a global account reconciliation policy which requires the monthly reconciliation of all balance sheet accounts and the use of standard methodology and templates for account reconciliations.

We have implemented and communicated formal reporting systems to enable employees to identify potential financial or ethical issues on an anonymous basis.

We continue to implement remedial measures in response to specific accounting and reporting issues related to the restatement. These remedial measures include personnel and organizational changes to improve supervision and increased training for finance and accounting personnel. We will continue to develop new policies and procedures and educate and train our employees on our existing policies and procedures in our effort to constantly improve our internal controls and control environment.

Our disclosure controls and procedures are not capable of preventing all instances of error or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be attained. Our disclosure controls and procedures can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected on a timely basis.

Based on an evaluation of the effectiveness of our disclosure controls and procedures as of March 31, 2004, which included an evaluation of the effectiveness of our disclosure controls and procedures applicable to the period covered by and existing through the filing of this periodic report, and subject to the information set forth in this Item 4, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that material information required to be included in our Exchange Act reports, including this report on Form 10-Q, is made known to them on a timely basis. Except for the improvements described above, there have been no other changes in our internal control over financial reporting during the quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

PART II: OTHER INFORMATION

Item 1. *Legal Proceedings*

SEC Related Matters

SEC Investigation. As previously disclosed, since the third quarter of 2002, we have received subpoenas issued by the Securities Exchange Commission in the investigation entitled *In the Matter of AOL/Time Warner.* The SEC has requested information concerning the facts and circumstances surrounding our transactions with AOL Time Warner, or AOL, and related accounting and disclosure matters. Our transactions with AOL, entered into in September 2000, involved a software and services purchase by AOL at a stated value of $50.0 million and the purchase by us of advertising services from AOL at a stated value of $20.0 million. In March 2003, we restated our financial statements for 2001 and 2000 to reflect a reduction in revenues and expenses of $20.0 million. The restatement included an additional reduction in revenues and expenses of $1.0 million related to two other contemporaneous transactions with other parties entered into in 2000 that involved software licenses and the purchase of on-line advertising services.

In June 2004, we restated our financial statements for 2002 and 2001 and revised our previously announced financial results for 2003. Prior to the restatement, we voluntarily disclosed to the staff of the SEC past accounting practices applicable to our 2002 and 2001 financial statements that we determined were not in compliance with GAAP. For more information regarding the restatement of our financial statements for 2002 and 2001, including the corresponding interim periods for 2002 and 2001, and the interim periods ended March, June and September 2003, and the revision of our financial results for 2003, see Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Financial Statements and Supplementary Data Selected Quarterly Results of Operations and Note 2 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10K for the year ended December 31, 2003.

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

Securities Class Actions. After we announced in January 2003 that we would restate our financial results as a result of transactions entered into with AOL in September 2000, numerous separate complaints purporting to be class actions were filed in the United States District Court for the Northern District of California alleging that we and some of our officers and directors violated provisions of the Securities Exchange Act of 1934. The complaints contain varying allegations, including that we made materially false and misleading statements with respect to our 2000, 2001 and 2002 financial results included in our filings with the SEC, press releases and other public disclosures. On May 2, 2003, a lead plaintiff and lead counsel were appointed. A consolidated complaint was filed by the lead plaintiff on July 18, 2003. On December 10, 2003, the District Court granted the defendants motion to dismiss the consolidated complaint, with leave to amend. On May 19, 2004, the District Court granted the defendants motion to dismiss the plaintiffs first amended complaint, with leave to amend. In addition, in 2003 several complaints purporting to be derivative actions were filed in California state court against some of our directors and officers. These complaints are based on the same facts and circumstances as the class actions and generally allege that the named directors and officers breached their fiduciary duties by failing to oversee adequately our financial reporting. The state court complaints have been consolidated into the action *In Re VERITAS Software Corporation Derivative Litigation*, which was filed on May 8, 2003 in the Superior Court of Santa Clara County and is currently pending. All of the complaints generally seek an unspecified amount of damages. The cases are still in the preliminary stages, and it is not possible for us to quantify the extent of our potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on our business, financial condition, results of operations and cash flow. In addition, defending any litigation may be costly and divert management s attention from the day-to-day operations of our business.

Other Litigation

On January 10, 2003, Raytheon Company sued VERITAS along with Brocade Communications Systems, Oracle Corporation, Overland Storage Inc., Qualstar Corp., QLogic Corporation, Ricoh Corporation and Spectra Logic Corporation in the United States District Court for the Eastern District of Texas. Raytheon alleged infringement of a patent entitled Mass Data Storage Library and sought damages and an injunction against all defendants. On February 26, 2004, a confidential settlement was agreed to by Raytheon and VERITAS, and on March 17, 2004, the case was dismissed with prejudice pursuant to the settlement agreement. The settlement agreement did not have a material impact on our financial position or overall results of operations.

On October 23, 2001, Storage Computer Corporation sued VERITAS in the United States District Court for the Northern District of Texas alleging infringement of one of Storage Computer Corporation s patents. Currently, Storage Computer Corporation is

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alleging we infringed two of their U.S. patents. We have denied all material allegations in the complaints, filed counterclaims for declaratory judgment of invalidity and non-infringement of the patents-in-suit and alleged their infringement of one of our patents. Storage Computer Corporation is seeking damages of approximately $50.0 million, treble damages, costs of suit and attorneys fees and a permanent injunction from further alleged infringement. On March 12, 2004, the Court granted our motions for summary judgment of non-infringement of the two patents at issue, and denied Storage Computer s motion for partial summary judgment. The Court did not address additional matters raised in our motion. Storage Computer Corporation recently filed a notice of appeal.

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

Item 5. Other Information

2004 Annual Meeting of Stockholders. Our 2004 annual meeting of stockholders will be held at our principal executive offices located at 350 Ellis Street, Mountain View, California 94043 on Wednesday, August 25, 2004, beginning at 8:30 a.m. Pacific Time.

Stockholder Proposals for 2004 Annual Meeting. If you want us to consider including a proposal in our proxy statement for our 2004 annual meeting of stockholders, you must deliver a copy of your proposal to our Secretary at our principal executive offices at 350 Ellis Street, Mountain View, California 94043 no later than June 26, 2004. If you intend to present a proposal or nominate directors at our 2004 annual meeting of stockholders, but you do not intend to have it included in our proxy statement, you must deliver a written copy of your proposal or notice of director nomination to our Secretary at our principal executive offices by June 26, 2004. If we do not receive your proposal within the specified time frame, you will not be permitted to raise your proposal at the annual meeting.

Item 6. *Exhibits and Reports on Form 8-K*

(a) *Exhibits*

		Incorporated by Reference			
Exhibit Number	**Exhibit Description**	**Form**	**Date**	**Number**	**Filed Herewith**
3.01	Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation	8-A	06/02/99	3.01	
3.02	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation (changing name of corporation to VERITAS Software Corporation)	8-A	06/02/99	3.02	

3.03	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS	S-8	06/02/00	4.03	
3.04	Amended and Restated Bylaws of VERITAS	S-4/A	09/28/00	3.04	
31.01	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X

(b) *Reports on Form 8-K*

Date of Report	**Item(s)**	**Description**
1/28/04	12	VERITAS announces financial results for the year and quarter ended

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Date of Report	Item(s)	Description
		December 31, 2003.
3/15/04	12	VERITAS announces delay in filing its annual report on Form 10-K for the year ended December 31, 2003, restatement of financial statements for 2001 and 2002 and revisions to reported results for 2003.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on June 11, 2004.

VERITAS SOFTWARE CORPORATION

By: /s/ Edwin J. Gillis

Edwin J. Gillis
Executive Vice President, Finance
and Chief Financial Officer
(Principal Financial and Accounting Officer)

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Exhibit Index

(a) *Exhibits*

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
3.01	Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation	8-A	06/02/99	3.01	
3.02	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS Holding Corporation (changing name of corporation to VERITAS Software Corporation)	8-A	06/02/99	3.02	
3.03	Certificate of Amendment of Amended and Restated Certificate of Incorporation of VERITAS	S-8	06/02/00	4.03	
3.04	Amended and Restated Bylaws of VERITAS	S-4/A	09/28/00	3.04	
31.01	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X