BACKWEB TECHNOLOGIES LTD
Form 10-K
March 31, 2005

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

Form 10-K

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

For the Fiscal Year Ended December 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 0-26241
BackWeb Technologies Ltd.
(Exact name of registrant as specified in its charter)

Israel	**51-2198508**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
10 Ha amal Street, Park Afek, Rosh Ha ayin, Israel	**48092**
(Address of principal executive offices)	*(Zip Code)*

(972) 3-6118800
(Registrant s Telephone Number, Including Area Code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
None	None

Securities registered pursuant to Section 12(g) of the Act:
Ordinary Shares, NIS 0.03 par value
(Title of Class)

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 þ No o

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

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

As of June 30, 2004, based on the closing sales price of the registrant s Ordinary Shares as quoted by the Nasdaq SmallCap Market, 27.9 million Ordinary Shares, having an aggregate market value of approximately $20.7 million, were held by non-affiliates. For purposes of the above statement only, all directors and executive officers of the registrant and 5% holders of Ordinary Shares are deemed to be affiliates.

As of March 4, 2005:, the registrant had 40,918,058 Ordinary Shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

BACKWEB TECHNOLOGIES LTD.
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BackWeb Technologies Ltd. was incorporated in the State of Israel in 1995. Our principal executive offices are located at 10 Ha amal Street, Park Afek, Rosh Ha ayin, Israel, 48092. In the United States, our principal executive offices are located at 2077 Gateway Place, Suite 500, San Jose, California 95110. Our website may be accessed at www.backweb.com; however, the information in, or that can be accessed through, our website is not part of this Annual Report on Form 10-K.

BackWeb, the BackWeb logo, ProactivePortal, Polite, Polite Agent, Polite Neighborcast, Polite Proxy, and Polite Upstream are our registered trademarks and Offline Access Server, e-Accelerator, Polite Sync Server, and Foundation are trademarks of ours that appear in this Annual Report. All other trademarks or trade names appearing elsewhere in this Annual Report are the property of their respective owners.

The terms BackWeb, Company, we, us, and our as used in this Annual Report refer to BackWeb Technologi Ltd. and its subsidiaries as a combined entity, except where it is made clear that such term means only the parent company.

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Cautionary Statement Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains express or implied forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. The words believes, expects, anticipates, intends, forecasts, projects, plans, estimates, anticipates, o expressions may identify forward-looking statements. Readers are cautioned not to place undue reliance on our forward-looking statements, as they involve many risks and uncertainties. Our actual results may differ materially from such statements. Factors that may cause or contribute to such differences include those discussed in this Annual Report under the caption Risk Factors and elsewhere in this Annual Report, as well as in our other SEC reports and filings. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove inaccurate, and, therefore, we cannot assure you that the results contemplated in such forward-looking statements will be realized. The inclusion of such forward-looking information should not be regarded as a representation by us, or any other person, that the future events, plans or expectations contemplated by us will be achieved. Forward-looking statements reflect our current views with respect to future events and financial performance or operations and speak only as of the date of this report. We undertake no obligation to issue any updates or revisions to any forward-looking statements to reflect any change in our expectations with regard thereto or any change in events, conditions, or circumstances on which any such statements are based.

PART I

Item 1. *Business*

Overview

BackWeb competes in the mobility market and offers a solution allowing users of enterprise Web applications to synchronize those Web applications to their PCs for use while disconnected from the network. Our enabling software is designed to integrate with web applications in a loosely-coupled way that requires no changes in a company s enterprise web applications. This approach has the potential to bring mobility to enterprise web applications quickly and with low total cost of ownership. Our products address the need of mobile users who are disconnected from a network to access and transact with critical enterprise Web content and applications, such as sales tools, forecast management, contact lists, service repair guides, expense report updates, pricing data, time sheets, collaboration sessions, work orders, and other essential documents and information. Our products are designed to improve the productivity of mobile workforces and minimize the impact and costs on enterprise networks to support mobile users.

The BackWeb Offline Access Server (OAS) integrates with Web applications in any technical framework, including portal frameworks, intranets, and websites, to extend the usefulness and function of the web applications to users who are remote with poor connectivity and users who are frequently disconnected from the network. Its two-way synchronization capability enables field personnel to access content from, publish to and conduct transactions on web applications while disconnected, enabling the productive combination of fully-featured enterprise applications used by mobile workers when they would otherwise be unable to interact with those applications.

Using HyperText Markup Language, or HTML,-type tags (called Offline Tagging Markup Language, or OTML), our customers can offline-enable their websites and portals without rewriting code, creating an offline end-user experience that is essentially equal to being online. The BackWeb Polite Sync Server, formerly known as BackWeb Foundation, uses network-sensitive background content delivery that can deliver large amounts of data without impacting the performance of other network applications. This allows organizations to efficiently target and deliver sizeable digital data to users desktops throughout the extended enterprise. At the core of our products is our patented Polite synchronization technology that is designed to distribute large amounts of data over narrow bandwidth connections while minimizing network costs.

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BackWeb Technology and Products

We develop, market, and support offline Web access software that enables companies to extend the reach of their Web applications and content to their mobile community of customers, partners and employees. Our software enables mobile users to access and transact with a company s critical Web content and applications by enabling offline users to work with synchronized, thin-client versions of those enterprise Web applications on their desktop. Mobile users can then use their enterprise Web applications wherever they go and perform transactions when disconnected from the network.

Our products and technology are designed to provide the benefits of:

Improved on-the-road productivity by adapting the online Web to offline usage by mobile users, enabling them to access and transact with Web content and applications while offline;

Acceleration of business processes by allowing offline data entry submission for items, such as service orders, expense reports, sales forecasts, time sheets and collaboration sessions, enabling users to productively use forced down time while traveling;

Increased customer satisfaction by providing our customers field workforce access to important business information when servicing a customer in the field, enabling them to respond to their customers more quickly and effectively;

Decreased costs through the reduction of the costs incurred in manually distributing information, and the costs associated with unnecessary repeat service calls resulting from the inability of users to access service data;

Elimination of costly development projects because BackWeb can enable existing web applications for mobile use and eliminate the need for projects to develop special mobilized version of those applications.

Improved Web and portal effectiveness through tracking and reporting offline interactions, to analyze what content, information, and applications mobile users need most often;

Increased end user productivity by enabling offline synchronization to be done in the background, taking advantage of unused bandwidth, without degrading the end user experience when remotely connected; and

Leveraging current IT investments and lower total cost of ownership by deploying in a matter of weeks, and integrating with a customer s existing portal environment to maintain the existing Web user interface and eliminate the need to rewrite code.

Technology

Our infrastructure software platform is powered by three proprietary core technologies: Polite Synchronization, OTML Offline Web Integration, and Attention Management.

Polite Synchronization

Polite Synchronization enables the transmission of significant volumes of digital data from BackWeb Polite Sync Servers to BackWeb plug-ins on personal computers through existing networks without interfering with normal network applications and traffic. Polite Synchronization enables companies to provide users with rapid communication of bandwidth-intensive data, regardless of whether they utilize high-speed or low-speed data access services. Polite Synchronization is designed to improve the efficiency of transmission by reducing the amount of data to be transmitted through various techniques, including the compression of data, updating only the information which has changed since the user s previous download and by eliminating the need to re-send an interrupted transmission by progressively resuming the transmission at the point where it was interrupted. This bandwidth-sensitive delivery is accomplished through the use of various components, including the following:

Polite Agent monitors the network activity of the plug-in and communicates with BackWeb Polite Sync Servers only when the connection is idle. It is able to interrupt BackWeb communications when other applications request use of the user s network connection.

Polite Proxy allows communication between the BackWeb proxy server and BackWeb Polite Sync Servers only when wide area network, or WAN, bandwidth utilization is below a specified threshold. It achieves this by monitoring the WAN.

Polite Neighborcast enables the automatic transmission of digital data from one BackWeb plug-in to others on the same local area network, or LAN, eliminating the need for transmission of the data from the server to each BackWeb plug-in. The transmission from BackWeb plug-in to BackWeb plug-in on the same LAN enables fast, efficient and cost-effective transmission of data.

Polite Upstream enables the automatic transmission of digital data from BackWeb plug-ins to the BackWeb Polite Sync Server when the network connection is idle.

OTML Offline Web Integration

BackWeb has developed a set of HTML tags, referred to as OTML, that extends HTML to support offline browsing. OTML tags are instructions which tell the BackWeb Content Acquisition Server which parts of the enterprise web application to crawl and package for synchronization to users PCs. These OTML tags can be applied by script files on the BackWeb server or embedded within online HTML pages. They control the transformation of the online HTML pages into pages that a browser, enhanced with the BackWeb plug-in, can display offline. OTML is designed to preserve the personalization of the website or portal, including layout and data preferences. OTML tags also control the transformation of HTML data entry forms, allowing end users to perform transactions while offline. Offline transactions are queued while the user is offline and sent to the server when the user connects to the network. The server applies the transaction to the online Web environment and reports back to the plug-in the results of the submission. A Content Acquisition Server, or CAS, is a high performance OTML processor that retrieves content from the target portal or website and processes content for offline use. The CAS transforms online HTML pages into their offline equivalent based on OTML tags and can process OTML tags that are applied to the HTML in run time (known as scripted OTML) or can process OTML tags that already exist in the HTML (known as embedded OTML). The CAS can be clustered to increase scalability and is responsible for content acquisition scheduling through automated or on-demand synchronization.

Products

BackWeb Offline Access Server

In September 2001, we introduced the BackWeb Offline Access Server (OAS), then known as the BackWeb ProactivePortal Server, which enables mobile users to access Web applications and content, including portal environments, when a user is disconnected or poorly connected to a network. The BackWeb OAS is comprised of two major components: the Web Integration Server and the BackWeb Polite Sync Server.

The Web Integration Server, which is also known as Content Acquistion Server, is a component of the OAS that is designed for highly scalable Web content acquisition from corporate portal, intranet, and Web applications. On an ongoing basis, the OAS logs into the portal, intranet or Web application as if it were an individual user and retrieves HTML pages using standard HTTP or HTTPS protocols (either secure or non-secure). Each page links to additional Web pages or documents that are retrieved once the links are identified. Content transformation and OTML tags parse the HTML pages and create an offline equivalent of the page that is sent to users. The Content Acquisition Server retrieves additional pages when it identifies links to additional portal pages, external documents or Web pages. Since the presentation of content sometimes changes, it is necessary to keep the content transformation

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correct regardless of visual presentation changes. Content transformation is accomplished by embedding OTML tags into the portal, intranet, or Web application page, which tags control the optimized transformation of the pages for offline viewing. OTML is an extension to HTML and applications other than OAS software, such as the browser, will ignore the HTML tags. Although portals, for example, include both personalized and non-personalized content, our OAS acquires content in the context of individual users and creates a single personalized information package for each user. Because a large portion of the content is shared among many users and because that content may be very large, it is necessary to consolidate shared information so that it can be retrieved and stored once for all targeted users. The OAS stores content, including documents and Web pages, in separate information packages that are sent to more than one user. Once content has been acquired, transformed and consolidated, it is packaged for offline delivery into units called InfoPaks. Such packaging includes the creation of database records for targeting, delivery tracking, user interaction reporting and version control of the content, calculating byte-level differences between versions of the content, which is critical when only a small portion of a document is modified, and optimized storage and communication with users plug-ins.

The BackWeb Polite Sync Server, which is also available as a separate product as described below, is a highly scalable content delivery engine for desktops and laptops that enables offline access to Web content via BackWeb plug-ins. The BackWeb Polite Sync Server is designed to manage the delivery of thousands of gigabytes of data every day to end users. The server consults the BackWeb OAS database to find out whether there is new content relevant to the corresponding user. The BackWeb plug-in then begins downloading InfoPaks incrementally via the Polite Sync Server to enable scalable content delivery. The Polite Sync Server includes several key features:

Interruptible content delivery activates only when the network connection is idle;

Byte-level differentiation determines which content has been modified based on the content already stored on the user s computer and ensures the delivery of only the changes rather than the entire content item; and

Polite Neighborcast distributes content over a LAN using the distributed client-based caching system, thereby reducing the amount of WAN traffic.

BackWeb Polite Sync Server

Our infrastructure software platform, the BackWeb Polite Sync Server, formerly known as BackWeb Foundation, is based on a set of flexible components that enable an organization to capture information from most data sources, including websites, file servers, databases, applications and legacy systems, and efficiently and reliably deliver the information throughout its extended enterprise. The Polite Sync Server automatically distributes that data to BackWeb plug-ins. The BackWeb Polite Sync Server is highly scalable and designed to support a large number of plug-ins concurrently. BackWeb Development Tools are used to customize the BackWeb Polite Sync Server solution. Components of BackWeb Development Tools include: the BackWeb Server Extension API, which is an application programming interface that allows companies to integrate the BackWeb Polite Sync Server with any digital data source, enabling automated publishing of content or files from any source to the BackWeb Polite Sync Server; the BackWeb Automation SDK and Automation Editor, which includes application programming interfaces and a library of BackWeb supplied programs that perform tasks between the BackWeb Polite Sync Server and external data source; our BackWeb Authoring Language Interface, or BALI, Editor that is used by companies to create and modify Flash Alerts; and our BackWeb plug-in, our software program operating on personal computers or workstations, which operates in the background and communicates with designated BackWeb Polite Sync Servers during the idle time of a user s network connection, enabling the user to receive data transparently and without disruption while using other applications.

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Customers

We sell our products to customers from a variety of industries. Our customers include industry leaders, such as A.C. Nielsen Co., Boehringer Ingelheim, British Telecommunications plc, Centocor, Inc., Check Point Software Technologies Ltd., Compass Group, Eastman Kodak Company, Fidelity Investments Institutional Services, General Electric Medical Systems, Guidant Corporation, Hewlett-Packard Company, Information Services International Inc. (M&M Mars), International Business Machines Corporation, or IBM, International Monetary Fund, KLA Tencor Corporation, Lam Research Corp., Logitech International S.A., Nalco Chemical Company, Owens-Illinois, Inc., Pfizer Inc., Pioneer Natural Resources Company, and Siemens AG, as well as the United States Social Security Administration.

For a discussion of customer transactions by geography, please refer to Note 14 of the Notes to Consolidated Financial Statements appearing elsewhere in this Annual Report. For a discussion of our transactions with customers that are our related parties, please refer to Note 8 of the Notes to Consolidated Financial Statements.

Sales and Marketing

Sales

We currently market our software and services primarily through a direct sales organization complemented by indirect sales channels. Our direct sales force is located in the United States and in Germany to serve the European market. Our sales force consists of direct sales representatives and sales engineers. During 2004, most of our revenue was attributable to the efforts of this direct sales force and we expect this mix to continue for the foreseeable future.

In an effort to accelerate the acceptance of our products, we have developed cooperative alliances and entered into reseller and remarketing agreements with leading enterprise software vendors, original equipment manufacturers, or OEMs, and system integrators. We believe these alliances have the potential to provide additional marketing and sales channels for our products, help enable us to raise awareness of BackWeb among enterprise customers and facilitate broad market acceptance for our products. To date, however, these alliances have not proven to be a reliable source of revenue, and we continue to depend upon our direct sales force for the significant part of our revenue. We typically have very little backlog and, accordingly, generate substantially all of our revenue for a given quarter in that quarter.

Marketing

In 2004, our marketing efforts continued to be focused on the portal and Web applications market with the goal of establishing BackWeb as the leading provider of offline Web software. During this time, we have worked to educate industry analysts, portal framework vendors and integrators, and enterprise customers about our technology and its competitive advantages.

Our marketing strategy is designed to identify in enterprises the web applications used by mobile employees for important business processes and to position BackWeb as the fastest and most cost-effective way to mobilize the web application. We believe the trend to web-enable enterprise applications, now more than seven years old, is beginning to result in an increasing number of mature, valuable web applications. Furthermore, we believe enterprises are focused on top-line revenue growth and are investing in cost-effective ways to make their revenue producing employees more productive. Our marketing efforts are directed at creating market awareness and generating leads for our OAS technology. Marketing activities include: inside sales, Web seminars, e-marketing techniques and opportunity generation prospecting activities. In addition, our public relations programs are designed to build market awareness by establishing and maintaining relationships with key trade press, business press, and industry analysts.

Customer Service and Support

We have a comprehensive service and support organization designed to ensure that customers receive high quality service. Our services are primarily comprised of maintenance, consulting, and training. Our technical support group provides post-sales support through renewable annual maintenance contracts. Our support contracts provide for technical and emergency support as well as software upgrades, on an if and when available basis. When our technical support organization is unable to solve a problem, our engineers and product developers work with the support personnel to resolve the problem. We believe that a strong customer support organization is crucial to both the initial marketing of our products and maintaining customer satisfaction, which in turn can enhance our reputation and generate repeat orders. In addition, we believe that the customer interaction and feedback involved in our ongoing support functions provide us with information on market trends and customer requirements that is critical to future product development efforts.

Our professional services organization provides consulting, training, and on-site implementation services, offering our customers the expertise, knowledge, and practices to help implement successfully an enterprise-wide IT strategy. We expect to expand our range of services, both directly and through third-party relationships, in order to meet the growing needs of our customers.

Research and Development

Since our inception in 1995, we have made substantial investments in research and product development. We believe that strong product development capabilities are essential to enhancing our core technology, developing additional applications, and maintaining the competitiveness of our product and service offerings. We have invested significant time and resources in creating a structured process for undertaking all product development projects.

Our research and development group is located in Rosh Ha ayin, Israel. We believe that performing research and development in Israel offers a number of strategic advantages because Israel offers a pool of highly qualified technology engineers, as well as a lower cost structure than the U.S. Operating in Israel has also allowed us to enjoy tax incentives from the government of Israel. Our Israeli engineers typically hold advanced degrees in computer-related disciplines. We have complemented these individuals by hiring senior management with backgrounds in the commercial software development industries. Our research and development expenses were $3.3 million, $4.5 million, and $6.1 million for the years ended December 31, 2004, 2003, and 2002, respectively. To date, all research and development costs have been expensed as incurred.

Competition

We compete in markets that are new, intensely competitive, highly fragmented and rapidly changing. We have experienced, and expect to continue to experience, increased competition from current and potential competitors. Many of our competitors have greater name recognition, longer operating histories, larger customer bases and significantly greater financial, technical, marketing, public relations, sales, distribution and other resources. In addition, some of our potential competitors are among the largest and most well capitalized software companies in the world. We expect to face competition from these and other competitors, including:

- small companies attempting to address the needs of mobile or disconnected Web users such as iOra;
- large enterprise software companies attempting to address the needs of mobile or disconnected Web users that have announced or may have plans to develop mobile technology, such as IBM, Siebel, Microsoft, and SAP;
- mobile middleware vendors such as Sybase iAnywhere and Everypath; and
- synchronization software companies such as Intellisynch.

Additional competition could come from operating system vendors, online service providers, plug-in or server applications and tools vendors, multimedia companies, document management companies and network management vendors. If any of our competitors were to become the industry standard or were to enter into or expand relationships with significantly larger companies through mergers, acquisitions or otherwise, our business and operating results could be seriously harmed. In addition, potential competitors may bundle their products or incorporate functionality into existing products in a manner that discourages users from purchasing our products.

Many of our existing and potential customers evaluate on an ongoing basis whether to develop their own software or purchase it from outside suppliers. In addition, our partners have significant research and development capabilities and are continually evaluating the efficacy of internal software development. As a result, we must, on an ongoing basis, educate existing and potential customers on the advantages of our software over internally developed software, as well as our competitors products. However, IBM and Microsoft have announced plans to develop offline capabilities, and we cannot assure you that our other existing or potential customers or partners will not internally develop products similar to our own.

Our existing and potential customers often have a predetermined budget for which we compete. We currently compete primarily on the basis of the following factors: functionality; product features and effectiveness; ease of installation and use; and total cost of ownership. We believe that we currently compete favorably with respect to each of these factors. However, the market for our products is still rapidly evolving, and we may not be able to compete successfully against present or future competitors, which could harm our operating results.

In addition, emerging wireless technologies, such as wireless fidelity, or WiFi, may pose a competitive challenge as an alternative to BackWeb s capabilities or they may be a source of growth to BackWeb as they raise awareness of the benefits of mobility and potentially highlight increased needs for solutions like BackWeb.

We expect that competition will increase in the near term and that our primary long-term competitors may not have entered the market yet. Increased competition could result in price reductions, fewer customer orders, reduced gross margin and loss of market share, any of which could cause our business to suffer.

Intellectual Property and Proprietary Rights

Our success and ability to compete are dependent on our ability to develop, maintain and protect the proprietary aspects of our technology. We rely on a combination of patent, trademark, trade secret and copyright laws and contractual restrictions to protect the proprietary aspects of our technology.

We have been issued several U.S. patents with respect to certain aspects of our products. In addition, we have filed other U.S. and foreign patent applications on various elements of our products. Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. The status of any patent involves complex legal and factual questions, and the breadth of claims that may be allowed is uncertain. Accordingly, we cannot assure you that any patent application filed by us will result in a patent being issued, or that our patents, and any patents that may be issued in the future, will afford adequate protection against competitors with similar technology, nor can we assure you that patents issued to us will not be infringed or designed around by others.

We have been issued registered trademarks in the U.S. covering certain goods or services for BackWeb, the BackWeb logo design, Polite, Polite Agent, Polite Neighborcast, Polite Proxy, Polite Upstream, and Proactivel In addition, the trademark BackWeb is registered in Australia, the European Community, and Japan.

We seek to protect our source code for our software, documentation and other written materials under trade secret and copyright law. We license our software to our customers under signed license agreements and under electronic (shrink-wrap) agreements that restrict the customer s use of our software to its own business operations and prohibit disclosure to third parties. The enforceability of shrink-wrap licenses is unproven in certain jurisdictions. Finally, we seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality and assignment of invention agreements with us and by restricting access to our source code. However, we have not signed confidentiality agreements in every case.

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Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Policing unauthorized use of our products is difficult, and the steps we have taken might not prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as do the laws of the U.S.

Thus, while we rely on patent, copyright, trade secret and trademark law to protect our technology, we believe that factors such as the technological and creative skills of our personnel, new product developments, frequent product enhancements and reliable product maintenance are more essential to establishing and maintaining a technology leadership position. Others may develop technologies that are similar or superior to our technology.

Our products and services operate in part by making copies of material available on the Internet and other networks and making this material available to end-users from a central location. This creates the potential for claims to be made against us, either directly or through contractual indemnification provisions with customers, including defamation, negligence, copyright or trademark infringement, personal injury, invasion of privacy or other legal theories based on the nature, content or copying of such materials. In the past, these claims have been brought, and sometimes successfully pressed against, companies such as online service providers. It is also possible that if any such information, or information that is copied and stored by customers that have deployed our products, contains errors, third parties could make claims against us for losses incurred in reliance on such information. Although we carry general liability and directors and officers insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed.

Substantial litigation regarding intellectual property rights exists in the software industry. We expect that software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segments grows and the functionality of products in different industry segments overlaps. We believe that many of our competitors have filed or intend to file patent applications covering aspects of their technology that they may claim our technology infringes. Third parties may claim infringement by us with respect to our products and technology. Any such claims, with or without merit, could:

- be time-consuming to defend;
- result in costly litigation;
- divert management s attention and resources;
- cause product shipment delays; or
- require us to enter into royalty or licensing agreements.

Royalty or licensing agreements, if required, may not be available on acceptable terms, if at all. A successful claim of product infringement against us and our failure or inability to license the infringed or similar technology could harm our business.

Employees

As of December 31, 2004, we had a total of 43 employees, of whom 17 were engaged in research and development, 9 in sales, marketing and business development, 9 in professional services and technical support, and 8 in finance, administration, and operations. Our future performance depends in part upon the continued service of our key technical, sales and senior management personnel, none of whom is bound by an employment agreement requiring service for any defined period of time. The loss of the services of one or more of our key employees could have a material adverse effect on our business, financial condition and results of operations. Our future success also depends on our continuing ability to attract, train and retain highly qualified technical, sales and managerial personnel. Competition for such personnel is intense, and we may not be able to retain our key personnel in the future. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our overall relations with our employees to be good.

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We have 23 of our 43 employees located in Israel. Israeli law and certain provisions of the nationwide collective bargaining agreements between the Histadrut, which is the General Federation of Labor in Israel, and the Coordinating Bureau of Economic Organization, which is the Israeli federation of employers organizations, apply to our Israeli employees. These provisions principally concern the maximum length of the work day and the work week, minimum wages, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our employees are subject to cost of living adjustments, based on changes in the Israeli Consumer Price Index. The amounts and frequency of such adjustments are modified from time to time. Israeli law generally requires the payment of severance pay upon the retirement or death of an employee or upon termination of employment by the employer or, in certain circumstances, by the employee. We currently fund our ongoing severance obligations for our Israeli employees by making monthly payments for insurance policies to cover these obligations.

Item 2. ***Properties***

As of December 31, 2004, BackWeb leased approximately 3,234 square feet in a single office building located in Rosh Ha ayin, Israel, and approximately 17,600 square feet in a single office building located in San Jose, California. The office space in Rosh Ha ayin, Israel is leased pursuant to a lease that terminates in June 2006. The office space in San Jose, California is leased pursuant to a lease that expires in January 2007. In addition to these facilities, as of December 31, 2004, BackWeb also leased small field sales and support offices in New York, NY, and Hamburg, Germany. Lease terms on these offices are month-to-month. We believe that our current facilities will be adequate to meet our needs for the foreseeable future.

For a more complete discussion of our lease obligations, please refer to Note 10 of the Notes to Consolidated Financial Statements found elsewhere in this Annual Report.

Item 3. ***Legal Proceedings***

On November 13, 2001, BackWeb, six of our officers and directors, and various underwriters for our initial public offering were named as defendants in a consolidated action captioned In re BackWeb Technologies Ltd. Initial Public Offering Securities Litigation, Case No. 01-CV-10000, a purported securities class action lawsuit filed in the United States District Court, Southern District of New York. Similar cases have been filed alleging violations of the federal securities laws in the initial public offerings of more than 300 other companies, and these cases have been coordinated for pretrial proceedings as In re Initial Public Offering Securities Litigation, 21 MC 92. A consolidated amended complaint filed in the BackWeb case asserts that the prospectus from our June 8, 1999 initial public offering failed to disclose certain alleged improper actions by the underwriters for the offering, including the receipt of excessive brokerage commissions and agreements with customers regarding aftermarket purchases of shares of our stock. The complaint alleges violations of Sections 11 and 15 of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated under the Securities Exchange Act of 1934. On or about July 15, 2002, an omnibus motion to dismiss was filed in the coordinated litigation on behalf of defendants, including BackWeb, on common pleadings issues. In October 2002, the Court dismissed all six individual defendants from the litigation without prejudice, pursuant to a stipulation. On February 19, 2003, the Court denied the motion to dismiss with respect to the claims against BackWeb. No trial date has yet been set.

A proposal has been made for the settlement and for the release of claims against the issuer defendants, including BackWeb, has been submitted to the Court. We have agreed to the proposal. The settlement is subject to a number of conditions, including approval by the proposed settling parties and the court.

If the settlement does not occur, and litigation against us continues, we believe we have meritorious defenses and intend to defend the case vigorously. However, the results of any litigation are inherently uncertain and can require significant management attention, and we could be forced to incur substantial expenditures, even if we ultimately prevail. In the event there were an adverse outcome, our business could be harmed. Thus, we cannot assure you that this lawsuit will not materially and adversely affect our business, results of operations, or the price of our Ordinary Shares.

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From time to time, we are involved in litigation incidental to the conduct of our business. Apart from the litigation described above, we are not party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

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

There were no matters submitted to a vote of the shareholders during the fourth quarter of 2004.

PART II

Item 5. ***Market for Our Common Stock and Related Stockholder Matters***

Our Ordinary Shares are traded on the Nasdaq SmallCap Market under the symbol BWEB. The following table presents the high and low intra-day sales prices per share of our Ordinary Shares as reported on the Nasdaq SmallCap Market during the quarters indicated below:

	High	Low
2003		
First Quarter	$ 0.51	$ 0.16
Second Quarter	$ 0.82	$ 0.23
Third Quarter	$ 1.24	$ 0.42
Fourth Quarter	$ 2.04	$ 0.84

	High	Low
2004		
First Quarter	$ 1.77	$ 0.84
Second Quarter	$ 1.24	$ 0.62
Third Quarter	$ 0.84	$ 0.30
Fourth Quarter	$ 0.88	$ 0.32

Our transfer agent is American Stock Transfer & Trust Company, 59 Maiden Lane, New York, NY 10038. AST s telephone number for shareholder services is 1-800-937-5449.

According to the records of our transfer agent, we had approximately 173 shareholders of record as of March 4, 2005. Because many of our Ordinary Shares are held by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of shareholders represented by these record holders.

Our policy is to reinvest earnings to fund future operations. Accordingly, we have never declared a dividend and do not anticipate declaring or paying any dividends in the foreseeable future.

If we were to distribute cash dividends out of income that had been exempt from tax because of our investment program s Approved Enterprise status (for description of such status please refer to the section entitled Effective Corporate Tax Rate in the Management s Discussion and Analysis of Financial Condition and Results of Operations or MD&A section below) such income would become subject to Israeli corporate tax.

If we were to declare dividends in the future, we would declare those dividends in NIS but pay those dividends to our non-Israeli shareholders in U.S. dollars. Because exchange rates between NIS and the dollar fluctuate continuously, a U.S. shareholder would be subject to currency fluctuation between the date when the dividends were declared and the date the dividends were paid.

In 1998, the Israeli currency control regulations were liberalized significantly, and, since January 1, 2003, all exchange control restrictions have been removed, although there are still reporting requirements for foreign currency transactions. There are no longer Israeli currency control restrictions on remittances of dividends on the Ordinary Shares (after deduction of withholding tax) or the proceeds from the sale of the Ordinary

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Shares, and shareholders may freely convert these amounts into non-Israeli currencies and remit these amounts abroad. However, legislation remains in effect, pursuant to which currency controls can be imposed by administrative action at any time.

Item 6. *Selected Consolidated Financial Data*

The selected consolidated financial data set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, our Consolidated Financial Statements and Notes thereto, and other financial information included elsewhere in this Report. Historical results are not necessarily indicative of the results to be expected in the future.

	Years Ended December 31,				
	2004	**2003**	**2002**	**2001**	**2000**
	(In thousands, except per share data)				
Consolidated Statements of Operations					
Revenue:					
License	$ 1,593	$ 3,232	$ 2,119	$ 13,807	$ 29,294
Service	3,906	3,270	4,228	6,831	9,052
Total revenue	5,499	6,502	6,347	20,638	38,346
Cost of revenue:					
License	72	128	213	443	249
Service	1,170	1,057	3,050	5,238	6,051
Total cost of revenue	1,242	1,185	3,263	5,681	6,300
Gross profit	4,257	5,317	3,084	14,957	32,046
Operating expenses:					
Research and development	3,298	4,487	6,059	9,230	8,672
Sales and marketing	4,071	6,272	10,298	22,882	28,479
General and administrative	1,958	3,939	4,557	10,494	7,480
Restructuring charges	469	443	4,678	2,825	
Write-off and amortization of intellectual property, other intangibles and deferred stock compensation			3,546	3,806	11,377
Total operating expenses	9,796	15,141	29,138	49,237	56,008
Loss from operations	(5,539)	(9,824)	(26,054)	(34,280)	(23,962)
Interest and other income, net	396	98	1,172	2,037	4,749
Write down of equity investments		(1,000)		(2,500)	
Net loss	$ (5,143)	$ (10,726)	$ (24,882)	$ (34,743)	$ (19,213)
Basic and diluted net loss per share	$ (0.13)	$ (0.27)	$ (0.63)	$ (0.91)	$ (0.52)

Weighted average number of shares used in computing basic and diluted net loss per share(1)	40,711	40,000	39,284	38,225	37,205

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	As of December 31,				
	2004	2003	2002	2001	2000
	(In thousands)				
Consolidated Balance Sheets Data:					
Cash, cash equivalents and short-term investments	$ 10,320	$ 14,457	$ 23,757	$ 41,824	$ 64,734
Working capital	7,903	12,301	20,334	37,905	63,916
Total assets	12,555	18,515	29,409	56,512	90,374
Total shareholders equity	$ 7,938	$ 12,961	$ 22,521	$ 46,581	$ 78,430

(1) For the calculation of the weighted average number of shares used to calculated basic and diluted net loss per share, please see Note 2 of the Notes to Consolidated Financial Statements, Net Loss Per Share.

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion and analysis should be read in conjunction with, and is qualified by, the Selected Consolidated Financial Data and our consolidated financial statements and notes thereto included elsewhere in this report, as well as the section on Risk Factors that is set forth below in this Item 7. In addition, this discussion contains forward-looking statements and is, therefore, subject to the overall qualification on forward-looking statements that appears at the beginning of this report.

We are in the mobility market and have a solution allowing users of enterprise Web applications to synchronize those Web applications down to PCs for use by individuals who are frequently disconnected from the network. Our enabling software is designed to integrate with web applications in a loosely-coupled way that requires no changes in a company s enterprise web applications. This approach has the potential to bring mobility to enterprise web applications quickly and with low total cost of ownership. Our products address the need of mobile users who are disconnected from a network to access and transact with critical enterprise Web content and applications, such as sales tools, forecast management, contact lists, service repair guides, expense report updates, pricing data, time sheets, collaboration sessions, work orders, and other essential documents and information. Our products are designed to improve the productivity of mobile workforces and minimize the impact and costs on enterprise networks to support mobile users.

The BackWeb Offline Access Server (OAS) integrates with Web applications in any technical framework, including portal frameworks, intranets, and websites, to extend the usefulness and function of the web applications to users who are remote with poor connectivity and users who are frequently disconnected from the network. Its two-way synchronization capability enables field personnel to access content from, publish to and conduct transactions on web applications while disconnected, enabling the productive combination of fully-featured enterprise applications used by mobile workers when they would otherwise be unable to interact with those applications.

Our customers can offline-enable their websites and portals without rewriting code, creating an offline end-user experience that is essentially equal to being online. The BackWeb Polite Sync Server, formerly known as BackWeb Foundation, uses network-sensitive background content delivery that can deliver large amounts of data without impacting the performance of other network applications. This allows organizations to efficiently target and deliver sizeable digital data to users desktops throughout the extended enterprise. At the core of our products is our patented Polite synchronization technology that is designed to distribute large amounts of data over narrow bandwidth connections while minimizing network costs.

We derive revenue from licensing our products and from maintenance, consulting and training services. Our products are marketed worldwide primarily through our direct sales force. We also have generated revenue through business partners via our reseller and OEM channels. Since 2002, our direct sales force has accounted for a significant majority of our revenue. While we expect our indirect channels to grow, we expect our direct sales efforts will continue to generate most of our revenue for the foreseeable future.

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Business Overview

During 2004, we achieved some important strategic objectives around cost control and implementing new programs, including a revised sales process that we embarked upon in the first quarter of 2004. However, our results for the first three quarters of 2004 reflected continued challenges in information technology, or IT, spending and the impact of the realignment of our sales process. Despite an increase in revenues during the fourth quarter compared with the first three quarters of 2004, our total revenue decreased 15% in 2004 compared with 2003. The primary driver behind the decrease was a 51% decrease in our license revenue. We believe the decrease in license revenue was primarily due to the lower than anticipated market demand to date for our BackWeb Offline Access Server product, which has been due in part to the changes we implemented to our sales focus and strategy, in addition to a sluggish market recovery, particularly in the technology sector. This decrease in revenues was partially offset by a 19% increase in our services revenue compared to 2003, primarily due to consulting revenue generated from our increased license sales during 2003.

Our operating expenses in 2004 declined approximately 35% from 2003 due to the cost reductions discussed above. As a result, we were able to reduce our net loss per share in 2004 by $0.14 compared to 2003.

Recent Events

During the fourth quarter of 2004, we implemented a change in our management structure to further reduce expenses and work towards the goal of profitability. The focus of the management change was the reduction of management and administrative costs, and to a lesser extent, the reduction of the sales and marketing operation to a level consistent with our current sales. As a result, we reduced our headcount by 19 employees in various departments, including our Chief Executive Officer and the Chief Financial Officer. BackWeb s product development, technical support and professional services operations experienced only modest reductions. The goal of the changes was to improve our short- and long-term finances while continuing to invest in our product lines and to continue providing active support for our customers. Our total operating expenses in 2004 of $10.7 million included accrual reversals of approximately $1 million. We expect that the restructurings, as well as other expense reduction measures, will result in annualized savings of approximately $4 million, and expect the full impact of these reductions to be reflected beginning in the first quarter of 2005. BackWeb remains committed to its recently launched sales initiatives which focus on the ability to mobilize enterprise Web applications used by business-critical managers, field sales and field service personnel.

We expect that these actions, as well as other expense reduction measures, will result in annualized savings of approximately $4 million, with the full impact of these reductions reflected beginning in the first quarter of 2005.

Near Term Outlook

In 2005, we believe that the recent demand for our off-line solution coupled with the cost reduction measures implemented throughout 2004 could help us achieve our goal of becoming cash flow positive during 2005.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. We consider the accounting polices described below to be our critical accounting polices. These critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements and actual results could differ materially from the amounts reported based on these policies.

Our critical accounting policies are as follows:

revenue recognition;

estimating valuation allowances and accrued liabilities, specifically the trade receivable allowances for doubtful accounts; and

accrued restructuring charges.

Revenue Recognition

We derive revenue primarily from software license fees, maintenance service fees, and consulting services paid to us directly by corporate customers and resellers and, to a lesser extent, from royalty fees from OEMs. Revenue derived from resellers is not recognized until the software is sold through to the end user. Royalty revenue is recognized when reported to us by the OEM after delivery of the applicable products. In addition, royalty revenue can arise from the right of OEMs and other distributors to use our products. As described below, management estimates must be made and used in connection with the revenue we recognize in any accounting period.

We recognize software license revenue in accordance with Statement of Position 97-2 Software Revenue Recognition (SOP 97-2), as amended, and SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions (SOP 98-9). SOP 98-9 requires that revenue be recognized under the Residual Method when vendor specific objective evidence (VSOE) of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the Residual Method, any discounts in the arrangement are allocated to the delivered element.

When contracts contain multiple elements wherein VSOE of fair value exists for all undelivered elements, we account for the delivered elements in accordance with the Residual Method prescribed by SOP 98-9. Maintenance revenue included in these arrangements is deferred and recognized on a straight-line basis over the term of the maintenance agreement. The VSOE of fair value of the undelivered elements (maintenance, training, and consulting services) is determined based on the price charged for the undelivered element when sold separately.

Revenue from software license agreements is recognized when all of the following criteria are met as set forth in SOP 97-2: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the fee is fixed or determinable; and (4) collectibility is probable. We do not generally grant a right of return to our customers. When a right of return exists, we defer revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria have been met. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer provided that all other revenue recognition criteria have been met.

We license our products on a perpetual and on a term basis. We recognize license revenue arising from perpetual licenses and multi-year term licenses in the accounting period that all revenue recognition criteria have been met, which is generally upon delivery of the software to the end user. For term licenses with a contract period of less than two years, revenue is recognized on a monthly basis.

At the time of each transaction, we assess whether the fee associated with our license sale is fixed or determinable. If the fee is not fixed or determinable, we recognize revenue as payments become due from the customer provided that all other revenue recognition criteria have been met. In determining whether the fee is fixed or determinable, we compare the payment terms of the transaction to our normal payment terms. We assess the likelihood of collection based on a number of factors, including past transaction history, the credit worthiness of the customer and, in some instances, a review of the customer s financial statements. We do not request collateral from our customers. If credit worthiness cannot be established, we defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon the receipt of cash.

Service revenue is primarily comprised of revenue from standard maintenance agreements and consulting services. Customers licensing products generally purchase the standard annual maintenance agreement for the

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products. We recognize revenue from maintenance over the contractual period of the maintenance agreement, which is generally one year. Maintenance is priced as a percentage of the license revenue. For those agreements where the maintenance and license is quoted as one fee, we value the maintenance as an undelivered element at standard rates and recognize this revenue over the contractual maintenance period. Consulting services are billed at an agreed-upon rate, plus out-of-pocket expenses. We generally charge for our consulting services on a time and materials basis and recognize revenue from such services as they are provided to the customer. We account for fixed fee service arrangements in a similar manner to an agreement containing an acceptance clause. Our arrangements do not generally include acceptance clauses. However if an acceptance provision exists, then we defer revenue recognition until we receive written acceptance of the product from the customer.

Deferred revenue includes amounts billed to customers and cash received from customers for which revenue has not been recognized.

Estimating Valuation Allowances and Accrued Liabilities, Including the Allowance for Doubtful Accounts

Management continually reviews the collectibility of trade accounts receivable and the adequacy of the allowance for doubtful accounts against the trade accounts receivable. Management specifically analyzes customer accounts, account receivable aging reports, history of bad debts, the business or industry sector to which the customer belongs, customer concentrations, customer credit-worthiness, current economic trends, and any other pertinent factors. Generally, we make a provision for doubtful accounts when a trade receivable becomes 90 days past due. In exceptional cases, we will waive a provision after a trade receivable is 90 days or more past due when, in the judgment of management, after conducting due diligence with the management of the customer, the receivable is still collectible and the customer has demonstrated that payment is imminent. During 2004, management s review of the allowance for doubtful accounts resulted in a write offs during the year of $1.5 million related to past due accounts, primarily from amounts recorded in prior years.

Management believes that it is able to make reasonably objective judgments on the adequacy of other provisions relating to trade accruals. We have not made any provision for contingent liabilities which has involved significant management judgment that either we will prevail in the case of material litigation or that we have sufficient insurance to cover any adverse outcome. A discussion of our outstanding material litigation is contained in Part I, Item 3 Legal Proceedings of this Form 10-K.

Accrued Restructuring Costs

We have made decisions to provide for certain costs associated with corporate restructurings we believed were required in order to align our cost structure with changing market conditions. Before a charge is executed, our executive management and Board of Directors approve the plan. Our restructuring plans executed in each of our last three fiscal years resulted in a reduction in headcount and the consolidation of facilities through the closing of excess field offices. We reassess this liability each period based on market conditions. Revisions to our estimates of this liability could materially impact our operating results and financial position in future periods if anticipated events and key assumptions either change or do not materialize. During 2001, our Board of Directors approved a restructuring plan, and we recorded a charge of $2.8 million. In 2002, we recorded a charge of $4.7 million. In the fourth quarter of 2003, management reviews determined that an additional reserve of $443,000 was needed related to excess leased facilities that were part of the 2002 restructuring plan. During the second quarter of 2004, we settled a lease agreement related to our Canadian subsidiary for approximately $187,000. This settlement was more favorable than had been originally accrued for, resulting in a decrease in restructuring expense of approximately $184,000. During the third quarter of 2004, we determined that there would be no future cash requirements under the restructuring accrual, and reversed the accrual in full. During the fourth quarter of 2004, we recorded a charge of approximately $500,000 related to the termination of 19 employees throughout the company, including our Chief Executive Officer and Chief Financial Officer. All amounts related to this action were expensed in 2004, and at December 31, 2004, there was an accrual of $119,000 related to severance and other payments yet to be distributed.

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Results of Operations

The following table sets forth the results of operations, for the periods indicated, expressed as a percentage of total revenue.

	Year Ended December 31,		
	2004	2003	2002
Revenue:			
License	29%	50%	33%
Service	71	50	67
Total revenue	100	100	100
Cost of revenue:			
License	1	2	3
Service	21	16	48
Total cost of revenue	23	18	51
Gross profit	77	82	49
Operating expenses:			
Research and development	60	69	95
Sales and marketing	74	96	162
General and administrative	36	61	72
Restructuring charges	8	7	74
Write-off and amortization of intellectual property, other intangibles, and deferred stock compensation			56
Total operating expenses	178	233	459
Loss from operations	(101)	(151)	(410)
Interest and other income, net	7	2	18
Write down of equity investments		(15)	
Net loss	(94)%	(165)%	(392)%

Revenue

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Total revenue	$ 5,499	$ (1,003)	(15.4)%	$ 6,502	$ 155	2.4%	$ 6,347

We derive revenue from licensing and providing maintenance and consulting services for our BackWeb Offline Access Server (OAS), BackWeb Polite Sync Server, and BackWeb e-Accelerator products. The decrease in total revenue in 2004 was due to a $1.6 million decrease in license revenue, partially offset by an increase in consulting service revenue of $634,000. The increase in total revenue in 2003 was due to a $1.1 million increase in license fees and an increase in consulting fees of $400,000 compared to 2002. These increases were partially offset by a decrease in maintenance revenue of $1.3 million. The re-positioning of our company during 2002 to focus on licensing our new OAS product offering resulted in increased license and consulting revenue associated with this emerging product line, offset by decreases in maintenance revenue associated with our other product lines which were not strongly emphasized and marketed. Further discussion of the changes in the components of total revenue is included in the sections below. We have limited visibility to forecast revenue for 2005 and therefore we are unable to quantify future overall trends in our total revenue. However, in the sections below we discuss expected trends in the individual components of our total revenue and in our product revenue mix.

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Customers outside of the United States accounted for 15.8%, 24.0% and 46.3% of our total revenue in the years ended December 31, 2004, 2003 and 2002, respectively. The variations in the mix of revenue generated in the United States as compared to the revenue generated outside of the United States is partially due to the reduced number of deals closed in these periods, as each individual deal had a greater impact on the composition of our revenue and the significant variability in the value of these deals. The overall decline in revenue generated outside of the United States was also attributable to more significant reductions in sales personnel and activities in Europe relative to the United States.

CABC accounted for 16% of our revenue in 2004. Hewlett-Packard Company accounted for approximately 15% of our revenue in 2003. SAP AG accounted for 20% and Hewlett-Packard Company for 11% of our revenue in 2002. We expect that a small number of customers will continue to account for a substantial portion of our total revenue for the foreseeable future and revenue from one or more of these customers may represent more than 10% of our total revenue in future years.

License Revenue

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
License revenue	$ 1,593	$ (1,639)	(50.7)%	$ 3,232	$ 1,113	52.5%	$ 2,119
As a percentage of total revenue	29.0%			49.7%			33.4%

License revenue decreased significantly in 2004 as compared to 2003 primarily due to a $1.6 million decrease in license revenue generated from our OAS product offering. We released the OAS product at the end of 2002, and the demand that had been generated prior to its release led to increased license revenues in the first half of 2003. These revenues gradually decreased towards the end of 2003, a trend that continued into 2004 as we realigned our sales team and management team. This realignment included the hiring of a new vice president of sales who assumed responsibility for the sales organization in late March 2004 from Erez Lorber, our then CEO, who had been acting vice president of sales since his appointment as CEO in January 2004. Additionally, we transitioned out several members of our direct sales team during 2004. These personnel changes were a result of our realignment of the skills within the sales team towards our new sales focus targeting line of business owners and reduced focus on targeting IT department personnel. We believe this transition of both personnel and sales strategy during 2004 contributed to the decrease in license revenue as new personnel were hired, trained, and assumed new customer and prospect lists from former personnel. We believe this change within our sales execution model to be now complete, but will take some time before the full benefits of this change, if any, will be reflected in our operating results. License revenue associated with our e-Accelerator and BackWeb Polite Synch Server products also decreased approximately $900,000, or 82%, largely due to the realignment of our sales and management teams as discussed above. These decreases were partially offset by an $800,000 license of our source code to an existing customer in the first quarter of 2004 recognized ratably over the year.

License revenue increased significantly in 2003 primarily due to our re-positioning during 2002 to focus on licensing our OAS product offering and the subsequent demand upon the product s release. In 2003, license revenue associated with our OAS product offering increased by approximately 660.0% to approximately 60.1% of license revenue. License revenue associated with our e-Accelerator product decreased by approximately 75.0% to approximately 4.6% of license revenue, while license revenue from our BackWeb Polite Synch Server product decreased by approximately 7.3% to approximately 35.3% of license revenue.

During 2005 we expect license revenue from our OAS product offering to increase both in absolute dollars and as a percentage of overall license revenue. We expect to continue to generate license revenue from our older products, in particular the BackWeb Polite Synch Server product, but we expect this to continue to decrease as a percentage of overall license revenue.

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Service Revenue

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Service revenue	$ 3,906	$ 634	19.4%	$ 3,270	$ (958)	(22.7)%	$ 4,228
As a percentage of total revenue	71.0%			50.3%			66.6%

Service revenue consists of maintenance, consulting and training services. The increase in service revenue in 2004 was primarily attributable to the consulting revenue generated from the increased license sales during 2003. Generally we generate consulting revenues subsequent to selling licenses of our products. In 2004, this trend resulted in an increase of approximately $600,000 in service revenues. As in 2003, the vast majority of consulting revenue was related to the deployments of our OAS product. Maintenance revenue in 2004 was relatively flat as compared to 2003, as maintenance contracts related to new product sales replaced cancelled maintenance contracts related to our older product lines.

The decrease in service revenue in 2003 was attributable to a decrease in maintenance revenue associated with our BackWeb Polite Synch Server and BackWeb e-Accelerator products. Overall, maintenance revenue decreased by $1.3 million, or 38.0%, as customers began terminating their maintenance agreements for these older products. This development reflected our re-positioning during 2002 to focus on licensing our new BackWeb Offline Access Server and de-emphasizing our older products, the relative age of a number of our customers installments utilizing our older products, and an overall trend in the IT industry toward reducing maintenance obligations. This decrease in maintenance revenue was partially offset by an increase of $377,000, or 52.7%, in consulting revenue. The vast majority of our consulting revenue was associated with increased customer deployments of our BackWeb OAS product.

During 2005 we expect service revenue to remain relatively flat as compared to 2004. We expect that maintenance revenue associated with our older products will continue to decrease, offset by an increase in maintenance revenue associated with our OAS product offering. Any increase in maintenance revenue from our OAS product offering, however, is dependent upon an absolute dollar level increase in license revenue from that product, which cannot be assured. Further, while we expect consulting revenue to remain relatively consistent with the prior year, this too is dependent on increased licenses of our OAS product offering.

Cost of Revenue

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Cost of revenue	$ 1,242	$ 57	4.8%	$ 1,185	$ (2,078)	(63.7)%	$ 3,263
As a percentage of total revenue	22.6%		4.4%	18.2%		(33.2)%	51.4%

Cost of revenue remained relatively flat in 2004 as compared to 2003 both in absolute dollars and as a percentage of total revenue, reflecting the cost reductions we implemented in prior years. The decrease in cost of revenue in absolute dollars in 2003 was primarily due to the reduction in personnel, facilities, and associated general overhead within our support department as a result of organizational restructurings in 2001 and 2002 that significantly reduced personnel across our company. In 2003, the decrease in cost of revenue as a percentage of total revenue was due to a shift in the revenue mix from having a majority of our revenue from lower gross margin service revenue to having a larger portion of our revenue from higher gross margin license revenue.

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Cost of License Revenue

Cost of license revenue consists primarily of expenses related to media duplication, packaging of products, and royalty payables to OEM vendors.

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
Cost of license revenue	$ 72	$ (56)	(43.8)%	$ 128	$ (85)	(39.9)%	$ 213
As a percentage of license revenue	6.5%		2.5%	4.0%		(6.1)%	10.1%
As a percentage of total revenue	1.3%		(0.7)%	2.0%		(1.4)%	3.4%

Cost of license revenue decreased in absolute dollars in 2004 as compared to 2003 due to a decrease in the amount of media duplication required to distribute our products as well as a decrease in license revenue. Cost of license revenue decreased in absolute dollars in 2003 as compared to 2002 due to a shift in the license revenue mix away from products with higher royalties associated with them. In 2003, cost of license revenue was lower as a percentage of license revenue when compared to 2002 due to a decrease in revenue from third parties, including a decrease in revenue from products with higher royalties associated with them, resulting in a decrease in royalties payable.

During 2005 we expect our cost of license revenue as a percentage of license revenue to remain at approximately the same levels as 2004.

Cost of Service Revenue

Cost of service revenue consists primarily of personnel and overhead related expenses of our customer support and professional service organizations, including related expenses of BackWeb consultants, third party consultants, and contractors.

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
Cost of service revenue	$ 1,170	$ 113	10.7%	$ 1,057	$ (1,993)	(65.3)%	$ 3,050
As a percentage of service revenue	30%		(2.3)%	32.3%		(39.8)%	72.1%
As a percentage of total revenue	21.3%		5%	16.3%		(31.8)%	48.1%

The increase in absolute dollars of cost of service revenue in 2004 as compared to 2003 was primarily due to the increase in consulting services revenue, and the use of more senior consultants on our professional services engagements in the first quarter of 2004, which increased the related cost of delivering the service revenue. These increases were partially offset by a reduced level of payroll and related expenses together with a reduction in the associated overhead expenses that resulted from the reorganizations that occurred in October 2004, October 2002 and July 2001, and continuing cost containment and reduction programs applied throughout 2003 and 2004. The decrease in cost of service revenue as a percentage of service revenue in all periods presented was primarily a result of a reduction in infrastructure and overhead expenses associated with both our support and professional services departments, primarily stemming from the reorganization in October 2002.

The decrease in absolute dollars of cost of service revenue in 2003 and 2002 was primarily due to the reduced level of payroll and related expenses together with a reduction in the associated overhead expenses that resulted from the reorganizations that occurred in October 2002 and July 2001, and continuing cost containment and reduction programs applied throughout 2003.

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We expect cost of service revenue to increase marginally and remain relatively constant as a percentage of service revenue during 2005.

Operating Expenses

Research and Development

Research and development expenses consist of personnel, equipment and supply costs for our development efforts. We charge these expenses to operations as they are incurred. We have our research and development facilities in Israel.

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Research and development	$ 3,298	$ (1,189)	(26.5)%	$ 4,487	$ (1,572)	(25.9)%	$ 6,059
As a percentage of total revenue	59.9%		(9.1)%	69.0%		(26.5)%	95.5%

The decrease in research and development expenses during 2004 was primarily due to lower personnel and third party contractor costs and a reduction in associated travel and other related expenses. During 2004, we continued to reduce our headcount across all departments, including a reduction of full-time employees in the research and development department from 30 in 2003 to 17 in 2004.

The decrease in research and development expenses during 2003 was primarily due to lower personnel and third party contractor costs. During 2003, we realized a full year of savings resulting from the reorganization we implemented in October 2002. Additionally, we significantly reduced our use of outside contractors and reduced headcount in our research and development department from 37 to 30 full-time employees through attrition and personnel management.

We believe that continued investment in research and development is important in order to attain our strategic objectives. However, we intend to continually monitor expenses across the organization and continually strive for cost reductions, particularly in light of the changes in personnel we implemented in October 2004, in areas such as facilities, travel and entertainment, and telecommunications expenses. As a result, we expect that research and development expenses will moderately decrease in terms of absolute dollars during 2005.

Sales and Marketing

Sales and marketing expenses consist of personnel and related costs for our direct sales force and our product management, marketing, business development, and operations management employees, together with the costs of marketing programs, including trade shows and other related direct expenses and general overhead.

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Sales and marketing	$ 4,071	$ (2,201)	(35.1)%	$ 6,272	$ (4,026)	(39.1)%	$ 10,298
	74.0%		(22.5)%	96.5%		(65.8)%	162.3%

As a percentage of total revenue

The decrease in sales and marketing expenses during 2004 resulted primarily from further reductions in personnel related costs and facilities expenses. Personnel related costs decreased $1.0 million, or 22% as compared to 2003. Reductions in travel and entertainment expenses resulted in a savings in 2004 of approximately $300,000, or 59%.

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The decrease in sales and marketing expenses during 2003 resulted primarily from a reduction in personnel related costs, marketing programs, and facilities expenses. Sales and marketing expense decreased significantly as we realized the full effect of the reorganization we implemented in October 2002 and realized savings from additional personnel expense management. We significantly reduced our marketing program expenses beginning in the latter half of 2002 and continuing throughout 2003, resulting in savings of approximately $600,000. The closing of several sales and marketing offices in conjunction with the October 2002 reorganization resulted in a savings in 2003 of approximately $500,000.

We consider maintaining a marketing presence and an effective sales organization to be vital to the achievement of our strategic objectives. Though we intend to continually monitor expenses across the organization and continually strive for cost reductions, we expect to selectively increase our sales organization when and where appropriate, particularly in connection with our realigned sales strategy . In light of the changes in personnel implemented in October 2004, we expect reduced expenses in the areas of facilities, travel and entertainment, and telecommunications expenses as well as personnel expenses and, thus, we expect sales and marketing expenses will decrease during 2005.

General and Administrative

General and administrative expenses consist primarily of personnel and related costs and outside services for general corporate functions, including finance, accounting, general management, human resources, information services, and legal, as well as the provision for bad debts.

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
General and administrative	$ 1,958	$ (1,981)	(50.3)%	$ 3,939	$ (618)	(13.6)%	$ 4,557
As a percentage of total revenue	35.6%		(25.0)%	60.6%		(11.2)%	71.8%

During 2004, the decrease in general and administrative expenses was primarily due to a reduction in accounting and legal services, insurance costs and facilities expenses due in large part to the reorganization we implemented in October 2002. The reduction in accounting, legal and other outside service expenses was approximately $2.3 million in 2004 as compared to 2003 primarily due to a change in our external accounting firm, a concerted effort to reduce legal expenses, and the discontinuation of the use of certain external consultants. In addition, the restructuring and renegotiation of our insurance programs, particularly the rates related to our directors and officers insurance, resulted in savings in 2004 of approximately $400,000 as compared to 2003. These reductions were offset in part by an increase in expenses related to facilities and bad debt expense.

During 2003, the decrease in general and administrative expenses was primarily due to a reduction in personnel and facilities expenses associated with the reorganization we implemented in October 2002. Realizing the full effect of the reorganization in October 2002 resulted in a reduction of approximately $400,000 in payroll and related expenses. In addition, the closing and consolidation of several offices in conjunction with the October 2002 reorganization resulted in a savings in 2003 of approximately $250,000. These reductions were partially offset by an increase in legal and other professional fees associated with our real estate holdings, securities litigation related to our initial public offering, expenses related to the liquidation of certain European entities, expenses related to being a public company, and various employee litigation matters.

We expect general and administrative expenses will decrease on an absolute basis over the next year due to realizing the full effects of reductions in personnel we implemented in October 2004 and a continued focus on cost reduction programs.

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Restructuring Charges

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Restructuring and other charges	$ 469	$ 26	5.9%	$ 443	$ (4,235)	(90.5)%	$ 4,678
As a percentage of total revenue	8.5%		1.7%	6.8%		(66.9)%	73.7%

During 2002, we implemented a restructuring plan which included reducing our workforce by 61 employees, vacating some facilities, canceling office service leases, and writing-down fixed assets as a result of such employee terminations and office consolidation. During the three-month period ended September 30, 2002, we recorded a restructuring charge of $4.7 million, which included $1.6 million of severance and benefit costs, $2.7 million of facility costs, $200,000 related to the write-down of fixed assets, and $200,000 related to other restructuring costs. Additionally, in November 2003, we accrued a charge of approximately $443,000, of which approximately $289,000 related to the impairment of leased facilities in Canada, $120,000 related to a charge for settlement of leased space in San Jose, California, and approximately $34,000 related to other office lease impairment charges. During the fourth quarter of 2004, we recorded a charge of approximately $469,000 related to the termination of 19 employees throughout the company, including our Chief Executive Officer and the Chief Financial Officer. All amounts related to this action were expensed in 2004, and at December 31, 2004, there was an accrual of $119,000 related to severance and other payments yet to be distributed. For further information related to this restructuring, see Note 9 of the Notes to the Consolidated Financial Statements.

Write-off of Intellectual Property and Other Intangible Assets

	December 31,						
		Change			Change		
	2004	$	%	2003	$	%	2002
	(In thousands, except percentages)						
Write-off of intellectual property and other intangible assets	$	$	0%	$	$ (1,764)	(100.0)%	$ 1,764
As a percentage of total revenue	0.0%		0%	0.0%		(27.8)%	27.8%

In conjunction with the restructuring we implemented during 2002, we changed our internal allocation of resources. As of June 30, 2002, we believed that it was unlikely that any future value would be realized from the wireless technology we acquired from Mobix Communications Ltd. This wireless technology had a carrying value of $1.8 million as of June 30, 2002, which was in excess of its fair value of zero. Therefore, we wrote-off the $1.8 million remaining carrying value of these intangibles during 2003.

Amortization of Intellectual Property, Other Intangibles and Deferred Stock Compensation

December 31,

	2004	Change $	Change %	2003	Change $	Change %	2002
	(In thousands, except percentages)						
Amortization of intellectual property, other intangibles and deferred stock compensation	$	$	0%	$	$ (1,782)	(100.0)%	$ 1,782
As a percentage of total revenue	0.0%		0%	0.0%		(28.1)%	28.1%

Amortization of intellectual property, other intangible assets and deferred stock compensation consists of amortization of deferred stock compensation related to grants of stock options prior to our initial public offering of $0 in 2004 and 2003, and $216,000 in 2002, and amortization of intellectual property and other intangibles associated with the acquisition of certain assets from Mobix for approximately $0 in 2004 and

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2003, and $3.1 million in 2002. Deferred stock compensation represents the aggregate differences between the respective exercise price of options at their dates of grant and the deemed fair market value of our Ordinary Shares for accounting purposes. Intellectual property and other intangibles are being amortized on a straight-line basis over their estimated useful lives, generally two to three years. Deferred stock compensation is presented as a reduction of shareholders equity and is amortized over the vesting period of the underlying options based on an accelerated vesting method.

Interest and Other Income, Net

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
Interest and other income, net	$ 396	$ 298	304%	$ 98	$ (1,061)	(90.5)%	$ 1,172
As a percentage of total revenue	7.2%		5.5%	1.7%		(16.8)%	18.5%

Interest and other income, net includes interest income earned on our cash, cash equivalents and short-term investments, offset by interest expense and the effects of exchange gains and losses arising from the re-measurement of transactions in foreign currencies. The increase in interest and other income, net during 2004 as compared to 2003 was primarily due to an accrual reversal of $270,000 related to a provision for foreign taxes not expected to be remitted as of December 31, 2004. The decrease in interest and other income, net during 2003 was due to the decrease in our cash, cash equivalents and short-term investments due to our operating losses and reduced interest rates. We expect interest and other income, net to continue to decrease slightly during 2005 as we anticipate we will continue to use cash during 2005 and, as a result, we expect to earn less investment and interest income.

Write-Down of Equity Investments

	December 31,						
		Change			Change		
	2004	**$**	**%**	**2003**	**$**	**%**	**2002**
	(In thousands, except percentages)						
Write-down of equity investments	$	$ (1,000)	(100)%	$ 1,000	$ 1,000	100%	$
As a percentage of total revenue	%		(15.4)%	15.4%		15.4%	0.0%

In 2000, we invested in certain development-stage companies operating Internet-centric businesses which we believed had a significant strategic interest. Due to the economic slowdown and the significant decline in capital available to, and in the valuations of, the privately funded Internet-centric businesses, management determined that one of our investments had become impaired. Accordingly, in 2001, we recorded a charge of $2.5 million to reflect impairment of this asset below its recorded cost to represent what management considered to be fair value. No impairment charge was recorded during the year ended December 31, 2002. During September 2003, we determined our one remaining investment was fully impaired primarily due to continuing difficulties in the economy, and recorded a charge for the full remaining carrying value of that investment, or $1.0 million.

Income Taxes

There is no provision for income taxes because we have incurred operating losses since our inception. As of December 31, 2004, we had approximately $100.0 million of Israeli net operating loss carry forwards and $7.3 million and $3.2 million of U.S. federal and state net operating losses carry forwards, respectively, available to offset future taxable income. The U.S. federal and state net operating loss carry forwards expire in varying amounts between the years 2006 and 2024. The Israeli net operating loss carry forwards have no expiration date.

Off-Balance Sheet Financings and Liabilities

Off-Balance Sheet Arrangement We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products. Management evaluates estimated losses for such indemnifications under SFAS No. 5, Accounting for Contingencies, as interpreted by FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees. Management considers such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of the loss. As of December 31, 2004, we have not encountered material costs as a result of such obligations and have not accrued any liabilities related to such indemnifications in our consolidated financial statements.

Liquidity and Capital Resources

As of December 31, 2004, we had $10.3 million of cash, cash equivalents and short-term investments as compared to $14.5 million as of December 31, 2003.

Net cash used in operating activities was $4.4 million and $10.4 million for the twelve months ended December 31, 2004 and 2003, respectively, and was primarily used to fund our ongoing operational needs. The decrease in cash used in operating activities reflects the restructuring that we implemented in 2002, which resulted in significant headcount and other operational cost reductions throughout 2003 and 2004. Cash provided by investing activities was $5.5 million and $8.5 million for the twelve months ended December 31, 2004 and 2003, respectively, and primarily represents the net proceeds from the purchases and sales of short-term investments to fund operational needs. Cash provided by financing activities was $121,000 and $1.1 million for the twelve months ended December 31, 2004 and 2003, respectively, and consisted primarily of proceeds from the issuance of Ordinary Shares under our employee stock purchase plan, issuances related to the exercise of stock options and proceeds from shareholders notes receivable in 2003.

In May 2004, we entered into a $1.5 million line of credit with Silicon Valley Bank. The amount of borrowings available under the line of credit is based on a formula using accounts receivable. The line of credit has a stated maturity date of May 21, 2005 and provides that the lender may demand payment in full of the entire outstanding balance of the loan at any time. The line of credit is secured by substantially all of our assets. The line requires that we meet certain financial covenants, provides payment penalties for noncompliance and prepayment, limits the amount of other debt we can incur, and limits the amount of spending on fixed assets. During the third quarter of 2004, we moved the $500,000 deposit related to our lease space in San Jose, California under the line of credit. At December 31, 2004, we had an unused borrowing capacity of $1.0 million. We expect to renew this line of credit but do not intend to draw further upon it in the near term.

As of December 31, 2004, we had no material commitments for capital expenditures. Our capital requirements depend on numerous factors, including market acceptance of our products, the resources we devote to developing, marketing, selling and supporting our products and the timing and extent of establishing additional operations. As a result of the restructuring we implemented in October 2004, we believe that our current cash, cash equivalents, and short term investment balances will be sufficient to fund our operations for at least the next 12 months. However, we might need to raise additional funds prior to the expiration of this period to fund expansion, product development, acquisitions or working capital. This need may arise sooner than we anticipate if our revenue does not grow in line with our expectations, particularly revenue from licensing our OAS product, if our costs are higher than we expect or if we change our strategic plans.. If we were required to raise additional funds, it could be difficult to obtain additional financing on favorable terms, or at all, due to our financial condition. We may try to obtain additional financing by issuing Ordinary Shares or convertible debt securities, which would dilute our existing shareholders. If we cannot raise needed funds on acceptable terms, or at all, we may not be able to develop or enhance our products, respond to competitive pressures or grow our business, or we may be required to further reduce our expenditures, any of which could harm our business.

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Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2004, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands). We did not have long-term debt obligations, capital lease obligations, or purchase obligations as of such date.

	Payments Due by Period				
	Total	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**After 5 Years**
Operating lease obligations	$ 1,819	$ 911	$ 908	$	$

Effective Corporate Tax Rates

Our tax rate reflects a mix of the U.S. statutory tax rate on our U.S. income, European country tax rates on our individual European country income and the Israeli tax rate discussed below. We expect that most of our future taxable income will be generated in Israel. Israeli companies are generally subject to corporate tax on their taxable income at a rate of 35% in the 2004 tax year, 34% in the 2005 tax year, 32% in the 2006 tax year, and 30% in and after the 2007 tax year. However, as discussed below, the rate is effectively reduced for income derived from an Approved Enterprise. The majority of our income, however, is derived from our capital investment program with Approved Enterprise status under the Law for the Encouragement of Capital Investments, and is eligible therefore for tax benefits. As a result of these benefits, we expect to have a tax exemption on income derived during the first two years in which this investment program produces taxable income, provided that we do not distribute such income as a dividend, and a reduced tax rate of 10% to 25% for the following 5 to 8 years, depending upon the proportion of foreign ownership of BackWeb.

All of these tax benefits are subject to various conditions and restrictions. See Note 13 Income Taxes Israeli Income Taxes Tax Benefits under the Law for the Encouragement of Capital Investments, 1959, of Notes to the Consolidated Financial Statements elsewhere in this report. We cannot assure you that we will obtain approval for additional Approved Enterprise Programs, or that the provisions of the law will not change.

Since we have incurred tax losses through December 31, 2004, we have not yet used the tax benefits for which we are eligible. See Risk Factors Any future profitability may be diminished if tax benefits from the State of Israel are reduced or withheld.

Impact of Inflation and Currency Fluctuations

Most of our sales are denominated in U.S. dollars. However, we incur a large portion of our costs from our operations in Israel. A substantial portion of our operating expenses, primarily our research and development costs, are denominated in NIS. Costs not denominated in U.S. dollars are translated to U.S. dollars when recorded, at prevailing rates of exchange. This is done for the purposes of our financial statements and reporting. Costs not denominated in U.S. dollars will increase if the rate of inflation exceeds the devaluation of the foreign currency as compared to the U.S. dollar or if the timing of such devaluations lags considerably behind inflation. Consequently, we are, and will be, affected by changes in the prevailing exchange rate. We might also be affected by the U.S. dollar exchange rate to the major European currencies due to the fact that we do business in Europe. To date these fluctuations have not been material.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment, a revision of SFAS No. 123, Accounting for Stock-Based Compensation and superseding APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires us to expense grants made under our stock option program. That cost will be recognized over the vesting period of the plans. SFAS No. 123R is effective for interim periods beginning after June 15, 2005. Upon adoption of SFAS No. 123R, amounts previously disclosed under SFAS No. 123 will be recorded in our statements of operations. We are evaluating the alternatives allowed under the standard, which we are required to adopt effective for our third quarter of fiscal 2005.

In December 2004, the FASB issued Staff Position SFAS No. 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes* (FSP No. 109-1) to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 which was signed into law by the President of the United States on October 22, 2004. Companies that qualify for the recent tax law s deduction for domestic production activities must account for it as a special deduction under SFAS No. 109 and reduce their tax expense in the period or periods the amounts are deductible, according to FSP No. 109-1, effective for the Company in its fiscal year 2006. The FASB s guidance is not expected to have a material impact to the Company s financial results.

In December 2004, the FASB also issued Staff Position SFAS No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision* (FSP No. 109-2) within the American Jobs Creation Act of 2004. The Act provides for a one-time deduction of 85 percent of certain foreign earnings that are repatriated in either an enterprise s last tax year that began before the date of enactment, or the first tax year that begins during the one-year period beginning on the date of enactment. FSP No. 109-2 allows companies additional time to evaluate whether foreign earnings will be repatriated under the repatriation provisions of the new tax law and requires specified disclosures for companies needing the additional time to complete the evaluation. The Company is currently evaluating the repatriation provisions of the Act and shall complete its evaluation once guidance has been issued by the Treasury Department on the repatriation provision, which is expected sometime in 2005.

RISK FACTORS

You should consider the following factors, as well as other information set forth in this Annual Report, in connection with any investment in our Ordinary Shares. If any of the risks described below occurs, our business, results of operations and financial condition could be adversely affected. In such cases, the price of our Ordinary Shares could decline, and you could lose part or all of your investment.

Risks Relating to Our Business

We have a history of losses and we expect future losses.

Since our inception, we have not achieved profitability and we expect to continue to incur net losses for the foreseeable future. We incurred a net loss of approximately $5.1 million in the year ended December 31, 2004. As of December 31, 2004, we had an accumulated deficit of $143.7 million. We expect to continue to incur significant sales and marketing, research and development, and general and administrative expenses through the remainder of 2005 and into 2006. As a result, we will need to generate significant revenue to achieve and maintain profitability, and we may not be able to do so. Failure to achieve profitability or achieve and sustain the level of profitability expected by investors and securities analysts may adversely affect the market price of our common stock.

Our business strategy requires that we derive a significant amount of license revenue from our OAS product. If demand for OAS does not increase, our total revenue will not increase and our business will suffer.

Our business strategy requires that we derive a significant amount of license revenue from licensing our OAS product and derive additional related revenue through providing related consulting and maintenance services. Accordingly, our future operating results will depend on the demand for OAS by future customers. To date, we have not succeeded in generating significant revenue from licensing our OAS product, which has negatively impacted our operating results. If our competitors release products that are superior to OAS in performance or price, OAS is not widely accepted by the market, or we fail to enhance OAS and introduce new versions in a timely manner, we may never generate significant license revenue from this product. If demand for our OAS product does not significantly increase, as a result of competition, technological change or other factors, it would significantly and adversely affect our business, financial condition, and operating results.

We have recently restructured our company, which could make it more difficult for us to achieve our business objectives or could result in further restructurings if we don t meet the goals of the restructuring.

In October 2004, we restructured our company in order to reduce management and administrative costs and bring our sales and marketing operations in line with our current sales level. While the restructuring has reduced cash operating expenses, our ability to adequately reduce cash used in operations, and ultimately generate profitable results from operations, depends upon successful execution of our business plan and obtaining new customers. As a result of the reduction in personnel, however, we may not have sufficient resources to execute our refocused sales strategy, particularly with respect to our OAS product, which could adversely affect our revenues and operating results. In addition, we reorganized our management team in connection with the restructuring, including changing our chief executive officer and chief financial officer. Our new management team must work together effectively and in a timely manner in order for us to successfully execute our business strategy. If we do not meet our restructuring objectives, we may have to implement additional restructuring plans, which could impact the long-term viability of our company. Further, these plans may not achieve our desired goals due to such factors as significant costs or restrictions that may be imposed in some international locales on workforce reductions and a potential adverse affect on employee morale that could harm our efficiency and our ability to act quickly and effectively in the rapidly changing technology markets in which we sell our products.

The economic outlook has adversely affected, and may continue to adversely affect, the demand for our current products and our results of operations.

Despite recent signs of improvement, general economic indicators suggest continued uncertain economic conditions for the near future. Weak or uncertain economic conditions may continue to cause a reduction in or irregular information technology spending generally. In addition, some of our customers continue to operate Internet-centric businesses, and these companies have been more acutely affected by uncertain economic conditions and have encountered significant difficulties in raising additional capital. If our customers experience financial difficulties, it could have an adverse impact on the demand for our products, which would adversely affect our results of operations. In addition, predictions regarding economic conditions have a low degree of certainty, and further predicting the effects of the changing economy is even more difficult. We may not accurately gauge the effect of the general economy on our business. As a result, we may not react to changing conditions in a timely manner, which could adversely impact our business and results of operations and cause the price of our Ordinary Shares to decline.

Our business is difficult to evaluate because our operating history is limited, and we have changed our strategic focus and repositioned our product line.

We have a limited operating history generally and an even more limited history operating our business in our current markets. We cannot be certain that our business strategy will be successful. We were incorporated on August 31, 1995, and did not begin generating revenue until December 1996. In early 1998, we changed our strategic focus from a consumer-oriented to an enterprise-oriented Internet communications company. In 2001, we again re-positioned our products to focus on the portal market. During 2003, we expanded our market focus to include corporate intranets and other Web-based applications. During 2004, we realigned our sales strategy to focus on selling to the line of business owner as opposed to the IT department. These changes required us to adjust our business processes and make a number of significant personnel changes. To date, we have only generated limited revenue from our new strategic focus, and we do not know if we will ever generate significant revenue from our new products. To the extent we do not succeed in generating significant revenue from licensing our new products, particularly our OAS product, our business, operating results and financial conditions will suffer.

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We are increasingly relying on our direct sales force, rather than strategic relationships, for revenue generation and this trend could negatively affect our revenues.

Until recently, we had expected revenue to be generated increasingly through or by our various strategic relationships and our business plans and budgets reflected such expectations. However, in the year ended December 31, 2004, we did not generate significant revenue from our strategic reseller relationships. We do not know if these existing or any future strategic partnerships will prove to be successful, or if we will derive material revenue from them. Moreover, these companies are constantly evaluating their product offerings and evaluating build or buy scenarios with respect to market offerings. For example, we are aware that certain of our partners, such as IBM and SAP, and potential resellers are actively evaluating and may be developing their own offline solutions that could be competitive with or replace our OAS technology solution. In addition, one or more of these companies may use the information they gain from their relationship with us to develop or market competing products. Such events would have an adverse impact on our revenue. As a result, we are increasingly relying on our direct sales force, rather than strategic relationships, for sales of licenses to our new products. If our direct sales force is not successful in these efforts, we may not achieve our business plans or attain our revenue goals.

If we require additional financing for our future capital needs but are not able to obtain it, we may be unable to develop or enhance our products, expand operations or respond to competitive pressures.

Our cash, cash equivalents and short-term investments balances have declined from $14.5 million as of December 31, 2003 to $10.3 million as of December 31, 2004, and we expect to continue to use cash in our operations for the foreseeable future. As a result, we might need to raise additional capital to fund expansion, product development, acquisitions or working capital. This need may arise sooner than we anticipate if our revenue does not grow in line with our expectations, particularly revenue from licensing our OAS product, if our costs are higher than we expect or if we change our strategic plans. If we were required to raise additional funds, it could be difficult to obtain additional financing on favorable terms, or at all, due to our financial condition. In the event that we obtain additional financing by issuing Ordinary Shares or securities that are convertible into Ordinary Shares, the interests of existing shareholders would be diluted. If we cannot raise needed funds on acceptable terms, or at all, we may not be able to develop or enhance our products, respond to competitive pressures or grow our business or we may be required to further reduce our expenditures, any of which could harm our business.

Our long and unpredictable sales cycle depends on factors outside our control and may cause our license revenue to vary significantly.

To date, our average engagement with our customers have typically taken between 3 and 12 months for them to evaluate our products before making their purchasing decisions. The long, and often unpredictable, sales and implementation cycles for our products have caused, and may continue to cause, our license revenue and operating results to vary significantly from period to period. Sales of licenses and implementation schedules are subject to a number of risks over which we have little or no control, including customer budgetary constraints, customer internal acceptance reviews, the success and continued internal support of customers own development efforts, the sales and implementation efforts of businesses with which we have relationships, the nature, size and specific needs of a customer and the possibility of cancellation of projects by customers. Along with our distributors, we spend significant time educating and providing information to our prospective customers regarding the use and benefits of our products with no guarantee that such investment will result in a sale. In addition, our customers often begin by purchasing our products on a pilot basis before they decide whether or not to purchase additional licenses for full deployment. For example, even after purchase, our customers tend to deploy our OAS solution slowly, depending upon the skill set of the customer, the size of the deployment, the stage of the customer s deployment of a portal, the complexity of the customer s network environment and the quantity of hardware and the degree of hardware configuration necessary to deploy the products.

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Our quarterly operating results are subject to fluctuations.

Our operating results are difficult to predict. Our revenue and operating results have fluctuated in the past and may, in the future, vary significantly from quarter to quarter due to a number of factors, including:

- demand for our products and services;
- internal budget constraints and the approval processes of our current and prospective customers;
- the timing and mix of revenue generated by product licenses and professional services;
- the length and unpredictability of our sales cycle;
- loss of customers;
- new product introductions or internal development efforts by competitors or partners;
- costs related to acquisitions of technology or businesses; and
- economic conditions generally, as well as those specific to the Internet and related industries.

Due to the foregoing factors, we believe that quarter-to-quarter comparisons of our operating results are not necessarily a good indication of our future performance. We incur expenses based predominantly on operating plans and estimates of future revenue. Our expenses are to a large extent fixed and we may not be able to adjust them quickly to meet a shortfall in revenue during any particular quarter. Any significant shortfall in revenue in relation to our expenses would decrease our net income or increase our operating losses and would also harm our financial condition. In some recent quarters our operating results have been below the expectations of public market analysts and investors. It is likely that in some future quarters, our operating results may also be below such expectations, which would likely cause our stock price to decline.

Our quarterly license revenue typically depends on a small number of large orders, and any failure to complete one or more substantial license sales in a quarter could materially and adversely affect our operating results.

We typically derive a significant portion of our license revenue in each quarter from a small number of relatively large orders. For example, for the year ended December 31, 2004, we derived approximately 16% of our license revenue from a license to an existing customer. Our operating results for a particular fiscal quarter could be materially and adversely affected if we are unable to complete one or more substantial license sales forecasted for that quarter. Additionally, we also offer volume-based pricing, which may adversely affect our operating margins. We typically have very little backlog and, accordingly, generate substantially all of our revenue for a given quarter in that quarter.

If we lose a major customer, our revenue could suffer because of our customer concentration.

We have historically generated a substantial portion of our revenue from a limited number of customers, and we expect this to continue for the foreseeable future. As a result, if we lose a major customer, or if there is a decline in the use of our products within our existing customers organizations, our revenue would be adversely affected. In 2004, our three largest customers represented approximately 34% of our total revenue. In 2003, our three largest customers represented approximately 28% of our total revenue. In 2002, our three largest customers represented approximately 40% of our total revenue, with one OEM customer, whose contract with us terminated in early 2002, accounting for 20% of our total revenue. We signed a new reseller agreement with this customer, but the agreement does not require the customer to purchase any product from us. In 2003, we did not generate significant revenue from this reseller agreement, and we cannot assure you that we will derive revenue from this reseller agreement in the future.

We depend on increased business from new customers, as well as additional business from existing customers, and if we fail to grow our customer base or generate repeat business, our operating results could be harmed.

Our business model generally depends on the sale of our products to new customers as well as expanded use of our products within our existing customers organizations. If we fail to grow our customer base or to generate repeat and expanded business from our current and future customers, our business and operating results will be seriously harmed. In some cases, our customers initially make a limited purchase of our products and services for trials, pilot or proof of concept programs. These customers might not choose to acquire additional licenses to expand their use of our products.

In addition, as we have introduced new versions of our products or new products, such as our OAS, we have experienced a decline in licensing revenue generated from our older products, such as Polite Sync Server and e-Accelerator, and we anticipate future declines in licensing revenue from these products. However, it is also possible that our current customers might not require the functionality of our new products and might not ultimately license these products. Because the total amount of maintenance and support fees we receive in any period depends, in large part, on the size and number of licenses that we have previously sold, any downturn in our software license revenue would negatively affect our future maintenance and support revenue. In addition, if customers elect not to renew their maintenance agreements, our services revenue will decline significantly. Further, some of our customers are telecommunications or information technology companies, which have been forced to significantly reduce their operations in light of limited access to sources of financing and the national and global economic uncertainty. If customers are unable to pay for their current products or are unwilling to purchase additional products, our revenue will decline, which would likely materially and adversely affect our revenue, operating results and stock price.

Rapid technological changes could cause our products to become obsolete.

The Internet communications market is characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. If we are unable to develop and introduce products or enhancements in a timely manner to meet these technological changes, we may not be able to successfully compete. In addition, our products may become obsolete, in which event we may not remain a viable business.

Our market is susceptible to rapid changes due to technology innovation, evolving industry standards, and frequent new service and product introductions. New services and products based on new technologies or new industry standards expose us to risks of technical or product obsolescence. For example, emerging technologies, such as wireless, that take a different approach to the challenge of offline Web access by, for example, re-engineering platforms and applications, pose a competitive challenge. In addition, other companies, including some of our partners, also approach the issue of offline Web architecture differently than we do in some cases, and such approaches may achieve a greater degree of market acceptance. If we do not use leading technologies effectively, meet the challenges posed by emerging technologies or other architectures, continue to develop our technical expertise and enhance our existing products on a timely basis, we may be unable to compete successfully in this industry, which would adversely affect our business and results of operations.

Our inability to integrate our products with other third-party software could adversely affect market acceptance of our products.

Our ability to compete successfully depends on the continued compatibility and interoperability of our products with products and systems sold by various third parties, such as portal framework vendors. Currently, these vendors have open applications program interfaces, which facilitate our ability to integrate with their systems. These vendors have also been willing to license to us rights to build integrations to their products and use their development tools. If any one of them were to close their programs interfaces or fail to grant us necessary licenses, our ability to provide a close integration of our products could become more difficult and could delay or prevent our products integration with future systems.

Failure to successfully develop versions and updates of our products that run on the operating systems used by our current and prospective customers could reduce our sales.

Many of our products run on the Microsoft Windows NT, Microsoft Windows 2000 or certain versions of the Sun Solaris Unix operating systems, and some require the use of third party software. Any change to our customers operating systems could require us to modify our products and could cause us to delay product releases. In addition, any decline in the market acceptance of these operating systems we support may require us to ensure that all of our products and services are compatible with other operating systems to meet the demands of our customers. If potential customers do not want to use the Microsoft or Sun Solaris operating systems we support, we will need to develop more products that run on other operating systems adopted by our customers. If we cannot successfully develop these products in response to customer demands, our business could be adversely impacted. The development of new products in response to these risks would require us to commit a substantial investment of resources, and we might not be able to develop or introduce new products on a timely or cost-effective basis, or at all, which could lead potential customers to choose alternative products.

In addition, our products may face competition from operating system software providers, which may elect to incorporate similar technology into their own products.

Competition in the Internet communications market may reduce the demand for, or price of, our products.

The Internet communications market is intensely competitive and rapidly changing. We expect that competition will intensify in the near-term because there are very limited barriers to entry. Our primary long-term competitors may not have entered the market yet because the Internet communications market is relatively new. Competition could impact us through price reductions, fewer customer orders, reduced gross margin and loss of market share, any of which could cause our business to suffer. Many of our current and potential competitors have greater name recognition, longer operating histories, larger customer bases and significantly greater financial, technical, marketing, public relations, sales, distribution and other resources than we do. Some of our potential competitors are among the largest and most well capitalized software companies in the world. For example, both Microsoft and IBM have announced product plans addressing the offline Web application market segment served by our OAS product. If such companies enter this market segment, we may not be able to compete successfully, and competitive pressures may harm our business.

The loss of our right to use software licensed to us by third parties could harm our business.

We license technology that is incorporated into our products from third parties, including security and encryption software. Any interruption in the supply or support of any licensed software could disrupt our operations and delay our sales, unless and until we can replace the functionality provided by this licensed software. Because our products incorporate software developed and maintained by third parties, we depend on these third parties to deliver and support reliable products, enhance their current products, develop new products on a timely and cost-effective basis and respond effectively to emerging industry standards and other technological changes.

Our growth may suffer because of the complexities involved in implementing our products.

The use of our products by our customers often requires implementation services, and our growth will be limited in the event we are unable to expand our implementation services personnel or subcontract these services to qualified third parties. In addition, customers could delay product implementations. In the second half of 2003 and in 2004, there were a greater number of deployments of our OAS solution by customers, and that solution is being subjected to actual commercial use and implementation. Initial implementation typically involves working with sophisticated software, computers and communications systems. If we experience difficulties with implementation or do not meet project milestones in a timely manner, we could be obligated to devote more customer support, engineering and other resources to a particular project at the expense of other projects.

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Our business will suffer if the Internet infrastructure cannot support the demands placed on it.

Our future revenue and profits, if any, depend upon the widespread acceptance and use of the Internet as an effective medium of business and communication by our customers. Rapid growth in the use of, and interest in, the Internet has placed increased demands on its infrastructure. Our success will depend, in large part, on the acceptance of the Internet in the commercial marketplace and on the ability of third parties to provide a reliable Internet infrastructure network with the speed, data capacity, security and hardware necessary for reliable Internet access and services. To the extent that the Internet continues to experience increased numbers of users, increased frequency of use or increased bandwidth requirements, the Internet infrastructure may not be able to support the demands placed on it and the performance or reliability of the Internet could suffer.

Factors outside our control may cause the timing of our license revenue to vary from quarter-to-quarter, possibly adversely affecting our operating results.

We recognize license revenue when persuasive evidence of an agreement exists, the product has been delivered, the license fee is fixed or determinable, and collection of the fee is probable. If an arrangement requires acceptance testing or specialized professional services, recognition of the associated license and service revenue would be delayed. The timing of the commencement and completion of these services is subject to factors that may be beyond our control, such as access to the customer s facilities and coordination with the customer s personnel after delivery of the software. If new or existing customers have difficulty deploying our products or require significant amounts of our professional services support for specialized features, our revenue recognition could be further delayed and our costs could increase, causing increased variability in our operating results.

If the economic slowdown continues, or if our revenue does not increase in the near future, we may have to implement additional plans in order to reduce our operating costs.

As a result of the economic slowdown, in the third quarter of 2002 and fourth quarter of 2004 we announced restructuring plans to reduce our operating costs to match the current business environment. We also previously implemented a restructuring plan in July 2001. If the economic slowdown continues, or if our revenue does not increase from its current level, we may have to implement additional plans to reduce our operating costs, which could cause us to incur additional restructuring charges. Further, these plans may not achieve our desired goals due to such factors as significant costs or restrictions that may be imposed in some international locales on workforce reductions and a potential adverse affect on employee morale that could harm our efficiency and our ability to act quickly and effectively in the rapidly changing technology markets in which we sell our products.

We may experience tax liabilities in connection with the liquidation of wholly owned subsidiaries that have ceased trading.

As a result of the restructuring plans we announced on July 1, 2001 and September 30, 2002, we ceased commercial operations of the following subsidiaries: BackWeb Technologies B.V., BackWeb Technologies (U.K.) Ltd., BackWeb Technologies S.a.r.l., BackWeb Technologies A.B., BackWeb Canada Inc., and BackWeb K.K. Ltd. We decided to liquidate these companies in order to further streamline our operations and to simplify our legal entity structure. We cannot assure you that we will not have any termination liability issues with the appropriate tax authorities in each jurisdiction. If such termination liability issues were to arise and we did not prevail, we might be required to pay significant taxes and penalties, which could adversely affect our cash balances and results of operations.

We may experience difficulties managing our expected growth and geographic dispersion.

Our ability to successfully offer products and services and to implement our business plan in the rapidly evolving Internet communications market requires an effective planning and management process. These factors, together with our anticipated future operations and geographic dispersion, will continue to place a

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significant strain on our management systems and resources. We expect that we will need to continue to improve our financial and managerial controls and reporting systems and procedures, and expand, train and manage our work force worldwide.

Our international operations are subject to additional risks.

Revenue from customers outside the United States represented approximately $962,000, or 18% of our total revenue, for the year ended December 31, 2004, and $1.6 million, or 24% of our total revenue, for the year ended December 31, 2003. Our international operations will continue to be subject to a number of risks, including, but not limited to:

- laws and business practices favoring local competition;
- compliance with multiple, conflicting and changing laws and regulations;
- longer sales cycles;
- greater difficulty or delay in accounts receivable collection;
- import and export restrictions and tariffs;
- difficulties in staffing and managing foreign operations;
- difficulties in investing in foreign operations at appropriate levels to compete effectively; and
- political and economic instability.

Our international operations also face foreign-currency-related risks. To date, substantially all of our revenue has been denominated in U.S. dollars, but we believe that, in the future, an increasing portion of our revenue may be denominated in foreign currencies, including the Euro and the British Pound. Fluctuations in the value of foreign currencies may cause further volatility in our operating results, reduce the accuracy of our financial forecasts and could have a material adverse effect on our business, operating results and financial condition.

Our efforts to protect our proprietary rights may be inadequate.

To protect our proprietary rights, we rely primarily on a combination of patent, copyright, trade secret and trademark laws, confidentiality agreements with employees and third parties, and protective contractual provisions such as those contained in license agreements with customers, consultants and vendors. However, these parties could breach such confidentiality agreements and other protective contracts. In addition, we have not signed confidentiality agreements in every case. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our products and obtain and use information that we regard as proprietary. We may not become aware of, or have adequate remedies in the event of, such breaches.

We pursue the registration of some of our trademarks and service marks in the United States and in certain other countries, but we have not secured registration of all our marks. We license certain trademark rights to third parties. Such licensees may not abide by compliance and quality control guidelines with respect to such trademark rights and may take actions that would adversely affect our trademarks.

We do not conduct comprehensive patent searches to determine whether the technology used in our products infringes patents held by third parties. Product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, which are confidential when filed, with regard to potentially similar technologies. We expect that software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Although we believe that our products do not infringe the proprietary rights of any third parties, third parties could assert infringement claims against us in the future. The defense of any such claims would require us to incur substantial costs and would divert management s attention and resources, which could materially and adversely affect our financial condition and operations. If a party succeeded in making such a claim, we could

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be liable for substantial damages, as well as injunctive or equitable relief that could effectively block our ability to sell our products and services. Royalty or licensing agreements, if required, may not be available on acceptable terms, if at all. Any such outcome could have a material adverse effect on our business, financial condition, operating results and stock price.

Our products may be used in an unintended and negative manner.

Our products are used to transmit information through the Internet. A BackWeb customer could potentially use our products to transmit harmful applications, negative messages, unauthorized reproduction of copyrighted material, inaccurate data, or computer viruses to end users in the course of delivery. Any such transmission could damage our reputation or could give rise to legal claims against us. We have received emails from certain of our customers end users claiming that our technology is a form of spyware, and we are actively engaged in challenging such accusations. In the event such allegations result in litigation, we could spend a significant amount of time and money pursuing or defending legal claims, which could have a material adverse effect on our business.

We may not have sufficient insurance to cover all potential product liability and warranty claims.

Our products are integrated into our customers networks. The sale and support of our products may entail the risk of product liability or warranty claims based on damage to these networks. In addition, the failure of our products to perform to customer expectations could give rise to warranty claims. Although we carry general commercial liability insurance, our insurance may not cover potential claims of this type or may not be adequate to protect us from all liability that may be imposed.

Our financial performance and workforce reductions may adversely affect the morale and performance of our personnel and our ability to hire new personnel.

In connection with the evolution of our business model and in order to reduce our cash expenses, we have adopted a number of changes in personnel, including significant workforce reductions. The changes in personnel may adversely affect morale and our ability to attract and retain key personnel. In addition, recent trading levels of our common stock have decreased the value of the stock options granted to employees pursuant to our stock option plan. As a result of these factors, our remaining personnel may seek employment with larger, more established companies or companies they perceive to have better prospects. If this were to occur, our revenue could decline and our operations in general could be impacted. None of our officers or key employees is bound by an employment agreement for any specific term. Our relationships with these officers and key employees are at will. Moreover, we do not have key person life insurance policies covering any of our employees.

Legislation and regulatory changes may cause us to incur increased costs, limit our ability to obtain director and officer liability insurance, and make it more difficult for us to attract and retain qualified officers and directors.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules adopted by the SEC and Nasdaq, have required changes in some of our corporate governance and accounting practices. We expect these laws, rules, and regulations to increase our legal and financial compliance costs and to make some activities more difficult, time consuming and costly. The new rules could also make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, particularly on our audit committee, or as executive officers.

Risks Relating to Our Location in Israel

Any major developments in the political or economic conditions in Israel could cause our business to suffer because we are incorporated in Israel and have important facilities and resources located in Israel.

We are incorporated under the laws of the State of Israel. Our research and development facilities, as well as one of our executive offices, are located in Israel. Although substantial portions of our sales are currently made to customers outside of Israel, any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could significantly harm our business. Since September 2000, a continuous armed conflict with the Palestinian Authority has been taking place. We cannot predict the effect on BackWeb of an increase in the degree of violence in Israel or of any possible military action elsewhere in the Middle East. We incur a large portion of our costs from operations in Israel in NIS. If Israel s economy is impaired by a high inflation rate or if the timing of the devaluation of the NIS against the U.S. dollar were to lag considerably behind inflation, our operations and financial condition may be negatively impacted to the extent that the inflation rate exceeds the rate of devaluation of the NIS against the U.S. dollar.

Any future profitability may be diminished if tax benefits from the State of Israel are reduced or withheld.

Pursuant to the Law for the Encouragement of Capital Investments, the Israeli Government has granted Approved Enterprise status to our existing capital investment programs. Consequently, we are eligible for tax benefits for the first several years in which we generate taxable income. Our future profitability may be diminished if all or portions of these tax benefits are reduced or eliminated. These tax benefits may be cancelled if we fail to comply with requisite conditions and criteria. Currently the most significant conditions that we must continue to meet include making specified investments in fixed assets, financing at least 30% of these investments through the issuance of capital stock, and maintaining the development and production nature of our facilities. In addition, the law and regulations prescribing the benefits provide for an expiration date for the grant of new benefits. The expiration date has been extended several times in the past. The expiration date currently is June 30, 2005, and no new benefits will be granted after that date unless the expiration date is extended. We cannot assure you that new benefits will be available after June 30, 2005 or that the benefits will be continued in the future at their current levels or at any level.

Israeli regulations may limit our ability to engage in research and development and export our products.

Under Israeli law, we are required to obtain an Israeli government license to engage in research and development and the export of the encryption technology incorporated in our products. Our current government license to engage in these activities expires in April 2005. Our research and development activities in Israel, together with our ability to export our products out of Israel, would be limited if the Israeli government revokes our current license, our current license is not renewed, our license fails to cover the scope of the technology in our products, or Israeli law regarding research and development or export of encryption technologies were to change.

Israeli courts might not enforce judgments rendered outside of Israel that may make it difficult to collect on judgments rendered against us.

Some of our directors and executive officers are not residents of the United States and some of their assets and our assets are located outside the United States. Service of process upon these directors and executive officers, and enforcement of judgments obtained in the United States against us, and these directors and executive officers, may be difficult to obtain within the United States. BackWeb Technologies, Inc., our U.S. subsidiary, is the U.S. agent authorized to receive service of process in any action against us in any federal or state court arising out of our initial public offering or any related purchase or sale of securities. We have not given consent for this agent to accept service of process in connection with any other claim.

We have been informed by our legal counsel in Israel, Naschitz, Brandes & Co., that there is doubt as to the enforceability of civil liabilities under U.S. securities laws in original actions instituted in Israel. However, subject to certain time limitations, an Israeli court may declare a foreign civil judgment enforceable if it finds that:

- the judgment was rendered by a court that was, according to the laws of the state of the court, competent to render the judgment;
- the judgment is no longer able to be appealed;
- the obligation imposed by the judgment is enforceable according to the rules relating to the enforceability of judgments in Israel and the substance of the judgment is not contrary to public policy; and
- the judgment is executory in the state in which it was given.

Even if the above conditions are satisfied, an Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel. An Israeli court also will not declare a foreign judgment enforceable if:

- the judgment was obtained by fraud;
- there was no due process;
- the judgment was rendered by a court not competent to render it according to the laws of private international law in Israel;
- the judgment is at variance with another judgment that was given in the same matter between the same parties and which is still valid; or
- at the time the action was brought in the foreign court a suit in the same matter and between the same parties was pending before a court or tribunal in Israel.

If a foreign judgment is enforced by an Israeli court, it generally will be payable in NIS, which can then be converted into non-Israeli currency and transferred out of Israel. The usual practice in an action to recover an amount in non-Israeli currency is for the Israeli court to render judgment for the equivalent amount in NIS at the rate of exchange on the date of payment, but the judgment debtor also may make payment in non-Israeli currency. Pending collection, the amount of the judgment of an Israeli court stated in NIS ordinarily will be linked to the Israel consumer price index plus interest at the annual rate (set by Israeli law) prevailing at that time. Judgment creditors bear the risk of unfavorable exchange rates.

We have adopted anti-takeover provisions that could delay or prevent an acquisition of BackWeb, even if an acquisition would be beneficial to our shareholders.

Provisions of Israel corporate and tax law and of our articles of association, such as our staggered Board, may have the effect of delaying, preventing or making more difficult a merger or other acquisition of BackWeb, even if an acquisition would be beneficial to our shareholders.

Israeli corporate law regulates acquisitions of shares through tender offers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. In addition, our articles of association provide for a staggered board of directors.

The new tax reform in Israel may reduce our tax benefit, which might adversely affect our profitability.

On January 1, 2003, a comprehensive tax reform took effect in Israel. We performed an analysis of the likely implications of the new tax reform legislation on our results of operations. Our evaluation concluded that the impact of the tax reform on both our corporate and income tax framework would not have a material effect on our results and operations. This evaluation was based, in part, on the assumptions that we would not expand beyond the countries in which we already operate and that we would remain in a net operating loss for tax

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purposes for at least the next three years. We cannot assure you that these assumptions will be met, and the tax reform will not materially and adversely affect our results of operations.

Our results of operations may be negatively affected by the obligation of key personnel to perform military service.

Certain of our officers and employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called for active military duty at any time. Although we have operated effectively under these requirements since our inception, we cannot predict the effect these obligations will have on us in the future. Our operations could be disrupted by the absence, for a significant period, of one or more of our officers or key employees due to military service. Such military requirement could be increased in the event of war or military action involving Israel.

Risks Relating to Our Ordinary Shares

Our stock price has been volatile and could fluctuate in the future.

The market price of our Ordinary Shares has been volatile. We expect our stock price to continue to fluctuate:

- in response to quarterly variations in operating results;
- in response to announcements of technological innovations or new products by us or our competitors or partners;
- because of market conditions in the enterprise software or portal industry;
- in reaction to changes in financial estimates by securities analysts, and our failure to meet or exceed the expectations of analysts or investors;
- in response to our announcements of strategic relationships or joint ventures; and
- in response to sales of our Ordinary Shares.

In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We are currently subject to a securities class action described in Part I, Item 3 Legal Proceedings of this Annual Report, and the volatility of our stock price could make us a target for additional suits. Securities class action litigation could result in substantial costs and a diversion of our management s attention and resources, which could seriously harm our business and results of operations.

Our stock is listed on the Nasdaq SmallCap Market and our continued listing on the Nasdaq SmallCap Market listing is not assured.

Effective on September 23, 2002, we transferred the listing of our Ordinary Shares from the Nasdaq National Market System and began trading on the Nasdaq SmallCap Market. We will remain eligible to be quoted on the Nasdaq SmallCap Market, subject to our compliance with the applicable continued listing requirements which require, among other things, that (i) we have shareholders equity of $2.5 million, (ii) we have $500,000 in net income, or (iii) the market value of our publicly held shares be $35 million or more. At December 31, 2004, we met these listing requirements. However, we cannot assure you that we will be able to maintain the continued listing requirements, and, as a result, may be delisted from trading on the Nasdaq SmallCap Market. If our Ordinary Shares are delisted from trading on the Nasdaq SmallCap Market, then the trading market for our Ordinary Shares, and the ability of our shareholders to trade our shares and obtain liquidity for their shares, may be significantly impaired and the market price of our Ordinary Shares may decline significantly.

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Holders of our Ordinary Shares who are United States residents face income tax risks.

We believe that we will be classified as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Our treatment as a PFIC could result in a reduction in the after-tax return to the holders of our Ordinary Shares and may cause a reduction in the value of such shares. For U.S. federal income tax purposes, we will be classified as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, cash is considered to be an asset, which produces passive income. Passive income also includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets, which produce passive income. As a result of our cash position and the decline in the value of our stock, we might be considered a PFIC under a literal application of the asset test that looks solely to market value. If we are a PFIC for U.S. federal income tax purposes, holders of our Ordinary Shares who are residents of the United States (U.S. Holders) would be required, in certain circumstances, to pay an interest charge together with tax calculated at maximum rates on certain excess distributions, including any gain on the sale of Ordinary Shares.

The consequences described above can be mitigated if the U.S. Holder makes an election to treat us as a qualified electing fund, or QEF. A shareholder making the QEF election is required for each taxable year to include in income a pro rata share of the net capital gain of the QEF as long-term capital gain, subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. We have agreed to supply U.S. Holders with the information needed to report income and gain pursuant to a QEF election. The QEF election is made on a shareholder-by-shareholder basis and can be revoked only with the consent of the Internal Revenue Service, or IRS.

As an alternative to making the QEF election, the U.S. Holder of PFIC stock which is publicly traded could mitigate the consequences of the PFIC rules by electing to mark the stock to market annually, recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the PFIC stock and the U.S. Holder s adjusted tax basis in the PFIC stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years.

All U.S. Holders are advised to consult their own tax advisers about the PFIC rules generally and about the advisability, procedures and timing of their making any of the available tax elections, including the QEF or mark-to-market elections.

Our officers, directors and affiliated entities own a large percentage of BackWeb and could significantly influence the outcome of actions.

Our executive officers, directors and entities affiliated with them, in the aggregate, beneficially owned approximately 28% of our outstanding Ordinary Shares as of December 31, 2004. These shareholders, if acting together, would be able to significantly influence all matters requiring approval by our shareholders, including the election of directors and the approval of mergers or other business combination transactions.

Item 7A. *Quantitative and Qualitative Disclosures about Market Risk*

We develop products in Israel and sell them in the U.S., Canada, Europe and Israel. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As most of our sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term instruments. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. As a result, the Company does not anticipate material losses in these areas. Due to the nature of our short-term investments, we have concluded that there is no material market risk exposure.

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Item 8. ***Financial Statements and Supplementary Data***

The following are summaries of consolidated quarterly financial data for the years ended December 31, 2004 and 2003:

	First Qtr	Second Qtr	Third Qtr	Fourth Qtr
	Unaudited (In thousands, except per share data)			
2004				
Total revenue	$ 1,638	$ 1,147	$ 1,181	$ 1,533
Gross profit	1,221	910	822	1,304
Net loss	(1,371)	(1,323)	(1,537)	(912)
Basic and diluted net loss per share	(0.03)	(0.03)	(0.04)	(0.02)
2003				
Total revenue	$ 1,527	$ 1,465	$ 1,754	$ 1,756
Gross profit	1,251	1,183	1,486	1,397
Net loss	(3,638)	(2,608)	(2,490)	(1,990)
Basic and diluted net loss per share	(0.09)	(0.07)	(0.06)	(0.05)

(b) Financial Statements

The following consolidated financial statements and the related notes thereto of BackWeb Technologies Ltd. and the Report of Independent Auditors are filed as a part of this Annual Report on Form 10-K.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of BackWeb Technologies Ltd.

We have audited the accompanying balance sheet of BackWeb Technologies Ltd. (the Company) and its subsidiaries as of December 31, 2004, and the related consolidated statements of operations, shareholders equity and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BackWeb Technologies Ltd. and its subsidiaries as of December 31, 2004 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II for the year ended December 31, 2004. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

/s/ GRANT THORNTON LLP

San Jose, CA
February 4, 2005

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders of
BackWeb Technologies Ltd.

We have audited the accompanying consolidated balance sheet of BackWeb Technologies Ltd. (the Company) and its subsidiaries as of December 31, 2003, and the related consolidated statement of operations, shareholders equity and cash flows for the year then ended. Our audit also included the financial statement schedule listed at Item 15(a) 2. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of BackWeb Technologies Ltd. and its subsidiaries as of December 31, 2003 and the consolidated results of their operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Palo Alto, CA
January 27, 2004

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders of
BackWeb Technologies Ltd.

We have audited the accompanying consolidated balance sheets of BackWeb Technologies Ltd. (the Company) and its subsidiaries as of December 31, 2002, and the related consolidated statements of operations, shareholders equity and cash flows for each of the two years in the period ended December 31, 2002. Our audits also included the financial statement schedules listed at Item 15(a)2. These financial statements and schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of BackWeb Technologies Ltd. and its subsidiaries as of December 31, 2002 and the consolidated results of their operations and cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
February 4, 2003

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BACKWEB TECHNOLOGIES LTD.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2004	2003
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,213	$ 4,026
Short-term investments	5,107	10,431
Trade accounts receivable, net of allowance for doubtful accounts of $643,000 and $2.1 million at December 31, 2004 and 2003, respectively	1,677	2,403
Other accounts receivables and prepaid expenses	378	782
Total current assets	12,375	17,642
Long-term investments and other long term assets	26	572
Property and equipment, net	154	301
Total assets	$ 12,555	$ 18,515
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 175	$ 403
Accrued liabilities	1,625	3,813
Deferred revenue	2,672	1,125
Total current liabilities	4,472	5,341
Accrued severance pay, net	85	108
Long-term deferred revenue	60	105
Commitments and contingencies		
Shareholders equity:		
Preferred Shares, nominal value NIS 0.01 per share; 50,000,000 shares authorized and zero outstanding at December 31, 2004 and December 31, 2003, Series E Preferred Shares, nominal value NIS 0.01 per share; zero and one share authorized and issued and outstanding at December 31, 2004 and December 31, 2003, respectively		
Ordinary Shares, nominal value NIS 0.03 per share; 150,067,829 shares authorized at December 31, 2004 and 2003; 40,560,182 and 39,772,254 shares issued and outstanding at December 31, 2004 and 2003, respectively	151,644	151,496
Accumulated other comprehensive income (loss)	(19)	9
Accumulated deficit	(143,687)	(138,544)

Total shareholders equity		7,938		12,961
Total liabilities and shareholders equity	$	12,555	$	18,515

The accompanying notes are an integral part of the consolidated financial statements.

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BACKWEB TECHNOLOGIES LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2004	2003	2002
	(In thousands, except per share data)		
Revenue:			
License	$ 1,593	$ 3,232	$ 2,119
Service	3,906	3,270	4,228
Total revenue	5,499	6,502	6,347
Cost of revenue:			
License	72	128	213
Service	1,170	1,057	3,050
Total cost of revenue	1,242	1,185	3,263
Gross profit	4,257	5,317	3,084
Operating expenses:			
Research and development	3,298	4,487	6,059
Sales and marketing	4,071	6,272	10,298
General and administrative	1,958	3,939	4,557
Restructuring and other charges	469	443	4,678
Write-off of intellectual property and other purchased intangible assets			1,764
Amortization of intellectual property and other intangible assets			1,566
Amortization of deferred stock compensation			216
Total operating expenses	9,796	15,141	29,138
Loss from operations	(5,539)	(9,824)	(26,054)
Interest and other income, net	396	98	1,172
Write down of equity investments		(1,000)	
Net loss	$ (5,143)	$ (10,726)	$ (24,882)
Basic and diluted net loss per share	$ (0.13)	$ (0.27)	$ (0.63)
Weighted average number of shares used in computing basic and diluted net loss per share	40,711	40,000	39,284

The accompanying notes are an integral part of the consolidated financial statements.

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BACKWEB TECHNOLOGIES LTD.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

Shareholders Equity

	Series E Preferred Shares		Ordinary Shares		Notes Receivable from Shareholders	Deferred Stock Compensation	Accumulated Other Comprehensive Income/(Loss)	Accumulated Deficit	Comprehensive Income/(Loss)	Total Shareholders Equity
	Shares	Amount	Shares	Amount						
	(In thousands, except share data)									
Balance at December 31, 2001	1	3,454	38,613,328	147,114	(1,235)	(216)	400	(102,936)		46,581
Issuance of Ordinary Shares pursuant to options exercised and ESPP purchases			736,714	299						299
Exchange of Series E preferred shares	(1)	(3,454)	422,212	3,454						
Forgiveness of shareholder loan					221					221
Repayment of notes receivable from shareholders					508					508
Amortization of deferred stock compensation						216				216
Comprehensive loss:										