BACKWEB TECHNOLOGIES LTD
Form 10-Q
November 15, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2004

or

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition period from to

Commission File Number 000-26241

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)

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

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

The registrant had 40,754,834 Ordinary Shares outstanding as of November 7, 2004.

BACKWEB TECHNOLOGIES LTD.

REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2004

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Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q 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. For example, our statements regarding revenue and expense trend expectations in this Quarterly Report under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements. The words believes, expects, anticipates, intends, forecasts, projects, plans, estimates, ant similar expressions may identify forward-looking statements. Readers are cautioned not to place undue reliance on these 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 Quarterly Report under the caption Risk Factors. 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.

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PART I FINANCIAL INFORMATION

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

BACKWEB TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,380	$ 4,026
Short-term investments	7,729	10,431
Trade accounts receivable, net	1,370	2,403
Other accounts receivable and prepaid expenses	645	782
Total current assets	12,124	17,642
Deposits	24	572
Property and equipment, net	155	301
Total assets	$ 12,303	$ 18,515
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 237	$ 403
Accrued liabilities	2,320	3,813
Deferred revenue	849	1,125
Total current liabilities	3,406	5,341
Long-term liabilities	68	213
Commitments and contingencies (Note 3)		
Shareholders equity:		
Ordinary Shares	151,623	151,496
Accumulated other comprehensive income	(18)	9
Accumulated deficit	(142,776)	(138,544)

Total shareholders equity	8,829	12,961
Total liabilities and shareholders equity	$ 12,303	$ 18,515

Note: The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date

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

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BACKWEB TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
	(Unaudited)		(Unaudited)	
Revenue:				
License	$ 124	$ 911	$ 1,043	$ 2,379
Service	1,057	843	2,923	2,367
Total revenue	1,181	1,754	3,966	4,746
Cost of revenue:				
License	12	29	53	102
Service	348	239	960	724
Total cost of revenue	360	268	1,013	826
Gross profit	821	1,486	2,953	3,920
Operating expenses:				
Research and development	768	1,181	2,527	3,509
Sales and marketing	1,236	1,454	3,273	4,851
General and administrative	505	1,297	1,799	3,323
Restructuring charge / (credit)	(82)		(266)	
Total operating expenses	2,427	3,932	7,334	11,683
Loss from operations	(1,606)	(2,446)	(4,381)	(7,763)
Interest and other income, net	69	(44)	149	27
Write-down of an equity investment				(1,000)
Net loss	$ (1,537)	$ (2,490)	$ (4,232)	$ (8,736)

Basic and diluted net loss per share	$ (0.04)	$ (0.06)	$ (0.10)	$ (0.22)
Weighted average number of shares used in computing basic and diluted net loss per share	40,807	39,985	41,101	39,871

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

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BACKWEB TECHNOLOGIES LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	Unaudited	
Operating Activities		
Net loss	$(4,232)	$ (8,736)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	223	749
Loss/(Gain) on disposal of assets, net	(6)	
Write-down of an equity investment		1,000
Changes in operating assets and liabilities:		
Trade accounts receivable	1,033	(163)
Other receivables, prepaid expenses, and other long-term assets	685	491
Accounts payable and accrued liabilities	(1,766)	(129)
Deferred revenue	(313)	(215)
Net cash used in operating activities	(4,376)	(7,003)
Investing Activities		
Disposals / (purchases) of property and equipment	(71)	(83)
Proceeds from sales of short-term investments	2,702	5,516
Net cash provided by investing activities	3,631	5,433
Financing Activities		
Proceeds from issuance of ordinary shares, net	99	301
Net cash provided by financing activities	99	301
Net increase / (decrease) in cash and cash equivalents	(1,646)	(1,269)
Cash and cash equivalents at beginning of the period	4,026	18,272

Cash and cash equivalents at end of the period	$ 2,380	$ 17,003

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

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BACKWEB TECHNOLOGIES LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization BackWeb Technologies Ltd. was incorporated under the laws of Israel in August 1995 and commenced operations in November 1995. BackWeb Technologies Ltd., together with its subsidiaries (collectively, BackWeb or the Company), is a provider of offline Web infrastructure and application-specific software that enable companies to extend the reach of their Web assets to the mobile community of their customers, partners, and employees. The Company s 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 applications. BackWeb sells its products primarily to end users in a variety of industries, including high technology manufacturing, pharmaceuticals, financial services and insurance, telecommunications, entertainment and media, and government, through its direct sales force, resellers, and OEMs.

Basis of Presentation The unaudited interim condensed consolidated financial statements include the accounts of BackWeb Technologies Ltd. and its wholly owned subsidiaries. They have been prepared in accordance with U.S. generally accepted accounting principles for interim financial reporting and with the instructions of Form 10-Q and Article 10 of Regulation S-X. All significant intercompany balances and transactions have been eliminated on consolidation. In the opinion of management, the interim condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) required to fairly state the Company s financial position, results of operations and cash flows for the periods indicated. The condensed consolidated balance sheet at December 31, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The interim condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003. The results of the Company s operations for the interim periods presented are not necessarily indicative of operating results for the full fiscal year ending December 31, 2004 or any future interim period.

Revenue Recognition To date, the Company has derived its revenue from license fees for its products, maintenance, training, and rendering of consulting services. The Company sells its products primarily through its direct sales force, resellers, and OEMs.

The Company recognizes software license revenue in accordance with Statement of Position 97-2, Software Revenue Recognition, as amended (SOP 97-2), 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 elements.

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. The Company does not generally grant a right of return to its customers. When a right of return exists, the Company defers 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.

As noted above, when contracts contain multiple elements wherein VSOE of fair value exists for all undelivered elements, the Company accounts 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.

The Company licenses its products on a perpetual and on a term basis. The Company recognizes license revenue arising from the sale of perpetual licenses and multi-year term licenses upon delivery. For term licenses with a contract period of less than two years, revenue arising from the sale of such licenses is recognized ratably on a monthly basis.

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The Company derives revenue primarily from software license fees paid by corporate customers and resellers, and from royalty fees from OEMs earned upon delivery of products. Revenue derived from resellers is not recognized until the software is sold through to the end user. Royalty revenue is recognized when reported to the Company by the OEM after delivery of the applicable products. In addition, the Company has granted the right to use the Company s products to OEMs and distributors, from which royalty revenue can arise.

Service revenue is primarily comprised of revenue from standard maintenance agreements, consulting and training fees. Customers licensing products generally purchase the standard annual maintenance agreement for the products. The Company recognizes revenue from maintenance over the contractual period of the maintenance agreement, which is generally one year. Maintenance is available at multiple levels of support and is priced as a percentage of the license revenue. For those agreements where the maintenance and license is quoted as one fee, the Company values the maintenance as an undelivered element at standard rates and defers this over the contractual maintenance period for revenue recognition purposes. The customer may choose to buy a maintenance contract at its option. Consulting services are billed at an agreed upon rate, plus out-of-pocket expenses, and training services are billed on a per session basis. The Company recognizes service revenue from consulting and training when provided to the customer.

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

Net Loss Per Share Basic net loss per share is comprised of the weighted average number of Ordinary Shares outstanding during each period. Diluted net loss per share is computed based on the weighted average number of Ordinary Shares outstanding during the period plus potentially dilutive Ordinary Shares considered outstanding during the period in accordance with SFAS No. 128, Earnings per Share. The total number of Ordinary Shares subject to outstanding options excluded from the earnings per share calculation because they would be considered anti-dilutive was 6,584,394 and 6,705,762 at September 30, 2004 and 2003, respectively.

The following table presents the calculation of the basic and diluted net loss per share (in thousands, except per share data):

	Three Months Ended		**Nine Months Ended**	
	September 30, 2004	**September 30, 2003**	**September 30, 2004**	**September 30, 2003**
	Unaudited		**Unaudited**	
Net loss	$ (1,537)	$ (2,490)	$ (4,232)	$ (8,736)
Basic and diluted:				
Weighted-average shares	40,807	39,985	41,101	39,871
Less weighted-average shares subject to forfeiture				
Weighted average number of shares used in computing basic and diluted net loss per share	40,807	39,985	41,101	39,871

Basic and diluted net loss per share	$ (0.04)	$ (0.06)	$ (0.10)	$ (0.22)

Comprehensive Loss The following table presents the components of comprehensive loss (in thousands):

	Three Months Ended		**Nine Months Ended**	
	September 30, 2004	**September 30, 2003**	**September 30, 2004**	**September 30, 2003**
	Unaudited		**Unaudited**	
Net loss	$(1,537)	$ (2,490)	$(4,232)	$ (8,736)
Change in net unrealized gain (loss) on investments	13		(19)	(13)
Change in unrealized gain on forward contracts				31
Total comprehensive loss	$(1,524)	$ (2,490)	$(4,251)	$ 8,718

Stock Compensation BackWeb has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation (FIN 44), in accounting for its employee stock options. Under APB 25, when the exercise price of the Company s stock options is less than the market price of the underlying Ordinary Shares on the date of grant, compensation expense is recognized.

Pro forma information regarding the Company s net loss and net loss per share is required by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS 123.

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The Company calculated the fair market value of each option grant on the date of grant using the Black-Scholes option-pricing model as prescribed by SFAS 123 and the following assumptions:

	Nine Months Ended	
Stock Options	**September 30, 2004**	**September 30, 2003**
Risk-free interest rates	3.3%	2.9%
Expected lives (in years)	5	5
Dividend yield	0%	0%
Expected volatility	79%	132%

	Nine Months Ended	
Stock Purchase Shares	**September 30, 2004**	**September 30, 2003**
Risk-free interest rates	3.3%	2.9%
Expected lives (in years)	.5	.5
Dividend yield	0%	0%
Expected volatility	79%	132%

Pro forma information under SFAS 123 is as follows (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 30, 2004	**September 30, 2003**	**September 30, 2004**	**September 30, 2003**
	Unaudited		Unaudited	
Net loss as reported	$(1,537)	$ (2,490)	$(4,231)	$ (8,736)
Stock based compensation expense reported in net loss				
Stock based compensation expense determined under the fair value method	(304)	(382)	(993)	(1,694)
Pro forma net loss	$(1,841)	$ (2,872)	$(5,224)	$(10,430)
Net loss per share:				
Basic and diluted as reported	$ (0.04)	$ (0.06)	$ (0.10)	$ (0.22)

Basic and diluted pro forma	$ (0.05)	$ (0.07)	$ (0.13)	$ (0.26)

Reclassification Certain prior year amounts have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements. In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 includes new guidance for evaluating and recording impairment losses on debt and equity instruments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting guidance provided in EITF 03-1 is effective for fiscal years beginning after September 15, 2004, while the disclosure requirements for debt and equity securities accounted for under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities are effective for annual periods ending after December 15, 2003. The Company does not expect the adoption of EITF 03-1 will have a material impact on its financial position, results of operations, or cash flows.

Note 2. Write-Down of Equity Investments

The Company invested $3.5 million during 2000 and 2001 in certain development companies in Internet-centric businesses in which the Company believed it had a significant strategic interest. However, due to an extended economic slowdown and the significant decline in capital available to, and in the valuation of, the privately funded Internet-centric businesses, the Company believed that a portion of these investments became impaired during 2001 and recorded a charge of $2.5 million to reflect impairment of these assets below their recorded cost to represent what the Company considered to be a fair value.

In the three months ended March 31, 2003, the Company concluded that the balance of these investments in the amount of $1.0 million was impaired, and the decline in fair value was other-than-temporary. Accordingly, in the three months ended March 31, 2003, the Company recorded a charge of $1.0 million to reflect the impairment to the carrying value of these assets. As of September 30, 2004, there were no remaining amounts on the balance sheet related to these investments.

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Note 3. Contingencies

Litigation

On November 13, 2001, BackWeb, six of its officers and directors, and various underwriters for BackWeb s 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 September 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 release of claims against the issuer defendants, including BackWeb. The settlement is subject to a number of conditions, including approval of the proposed settling parties and the court. In September 2004, an agreement of settlement was submitted to the court for preliminary approval.

If the settlement does not occur, and litigation against BackWeb continues, BackWeb believes it has meritorious defenses and intends to defend the case vigorously. However, the results of any litigation are inherently uncertain and can require significant management attention, and BackWeb could be forced to incur substantial expenditures, even if it ultimately prevails. In the event there was an adverse outcome, BackWeb s business could be harmed. The Company believes any expenditures related to a settlement would be covered under its directors and officers liability insurance. This insurance carries a deductible of $250,000, of which the Company has satisfied approximately $90,000 through September 30, 2004.

The Company and certain of its officers are currently parties to various other legal proceedings and may become involved, from time to time, in other legal proceedings in the ordinary course of the Company s business activities in the future. In the event there were an adverse outcome with respect to any of these proceedings, the Company s business could be harmed. Thus, the Company cannot provide assurances that these lawsuits will not materially and adversely affect the Company s business, results of operations or share price.

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

Significant Risks

Due to uncertainties in the technology market in particular and the economy in general, the Company has limited visibility to forecast future revenues. While the Company believes there is a market for its products, this lack of revenue visibility exposes the Company to risk should it not be able to adjust its expenditures to mitigate unfavorable trends in its revenue.

Line of Credit

As of September 30, 2004, the Company had a $1.5 million line of credit with a lender. 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 the Company s assets. The line requires that the Company meet certain financial covenants, provides payment penalties for noncompliance and prepayment, limits the amount of other debt the Company can incur, and limits the amount of spending on fixed assets. During the third quarter of 2004, the Company moved the $500,000 deposit related to its lease space in San Jose, California under the line of credit. At September 30, 2004, the Company had unused borrowing capacity of $1.0 million.

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Note 4. Restructuring Liabilities

On September 30, 2002, the Company announced a restructuring plan, which was implemented in the three months ended December 31, 2002. The restructuring plan included a reduction in workforce, vacating certain facilities, canceling of office service leases and impairment of fixed assets as a result of employee terminations and office consolidation. The Company recorded a charge in 2002 of $4.7 million which consisted of $1.6 million of severance and benefit costs, which included forgiveness of a $221,000 shareholder note receivable to one employee, $2.7 million of facility costs representing early termination penalties, office restoration costs and an accrual of certain lease commitments, $200,000 related to the write-down of fixed assets and $200,000 related to other related restructuring costs. In November 2003, the Company accrued an additional charge of approximately $443,000 due to a change in estimate on its facilities costs, of which approximately $289,000 related to the impairment of lease space in its Canadian subsidiary, $120,000 related to an exchange of warrants to the landlord as part of the final settlement of lease space at its headquarters in San Jose, California and approximately $34,000 consisted of other office lease impairment charges.

On July 2, 2001, the Company announced a restructuring plan, which was implemented in the three months ended September 30, 2001. The restructuring plan included a reduction in workforce, vacating certain facilities and canceling office service leases as a result of employee terminations and office consolidation. The Company recorded a charge of $2.8 million, which consisted of $1.3 million of severance and benefit costs, $1.4 million of facility costs representing early termination penalties, office restoration costs and an accrual of certain lease commitments related to the closure and consolidation of offices in Europe, Japan and the United States, and $100,000 related to other related restructuring costs.

During the second quarter of 2004, the Company settled a lease agreement related to its 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, the Company determined that there would be no future cash requirements under the restructuring accrual, and reversed the accrual in full. There was no remaining balance related to restructuring charges remaining at September 30, 2004.

The following table summarizes the costs and activities related to the 2001 and 2002 restructurings (in thousands):

	Involuntary Terminations	Facilities and Other	Total
Total charge 2001 restructuring	$ 1,300	$ 1,500	$ 2,800
Cash payments 2001 restructuring	(700)	(1,300)	(2,000)
Balance at December 31, 2001	600	200	800
Cash payments 2001 restructuring	(600)	(200)	(800)
Total charge 2002 restructuring	1,600	3,100	4,700
Cash payments 2002 restructuring	(1,300)	(2,000)	(3,300)
Balance at December 31, 2002	300	1,100	1,400
Change in estimate 2002 restructuring		400	400

Cash payments 2002 restructuring	(300)	(1,000)	(1,300)
Balance at December 31, 2003		500	500
Cash payments 2002 restructuring			
Balance at March 31, 2004		500	500
Change in estimate 2002 restructuring		(200)	(200)
Cash payments 2002 restructuring		(200)	(200)
Balance at June 30, 2004		100	100
Change in estimate 2002 restructuring		(100)	(100)
Cash payments 2002 restructuring			
Balance at September 30, 2004	$	$	$

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Note 5. Segments and Geographic Information

BackWeb operates in one industry segment, the development, marketing and sales of network application software. Operations in Israel include research and development and sales. Operations in North America and Europe include sales and marketing and administration. The following is a summary of operations within geographic areas based on the location of the legal entity making that sale (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
	Unaudited		Unaudited	
Revenue:				
North America	$1,006	$ 1,151	$3,130	$ 3,202
Israel	28	408	91	760
Europe	147	195	744	784
	$1,181	$ 1,754	$3,966	$ 4,746

	September 30, 2004	December 31, 2003
	Unaudited	
Total assets:		
North America	$ 1,547	$ 3,097
Israel	10,381	14,859
Other	375	559
	$12,303	$18,515

Revenue generated in the U.S. and Canada (collectively, North America) and Europe is all to customers located in those geographic regions. Revenue generated in Israel consists of export sales to end-customers located in the rest of the world, excluding North America and Europe. OEM sales are made to all geographic regions. One customer accounted for $648,000, or 16%, another accounted for 383,000, or 10%, and another customer accounted for 411,000, or 10% of our total revenue, in the nine months ended September 30, 2004. No customer accounted for more than 10% of our revenue in the three months ended September 30, 2004.

Note 6. Guarantees

Under the terms of the Company s standard contract with its customers, the Company agrees to indemnify the customer against certain liabilities and damages to the extent such liabilities and damages arise from claims that such customer s use of the Company s software or services infringes intellectual property rights of a third party. The Company believes that these terms are common in the high technology industry. The Company does not record a liability for potential litigation claims related to indemnification obligations with its customers as it has not had any claims and does not believe any are likely.

Note 7. Short-Term Investments

The following is a summary of the Company s available-for-sale marketable securities (in thousands):

	Cost	2004 Unrealized Gain/(Loss)	September 30, Estimated Fair Value	Cost	2003 Unrealized Gains	Estimated Fair Value
Money market	$4,430	$	$ 4,430	$	$	$
Commercial paper				13,082		13,094
Certificates of deposit	3,299	(19)	3,145	1,107	(13)	1,095
Totals	$7,729	$ (19)	$ 7,710	$14,189	$ (13)	$14,189

At September 30, 2004, the total amounts of investments due within one year and due after one year were $5.2 million and $2.5 million, respectively.

Note 8. Subsequent Event

The Company has experienced a shortfall in license revenue, and in order to protect the cash reserves of the Company, decided to restructure the Company in October 2004. The focus of the restructuring 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 the Company s current sales level. The product development, technical support and professional services operations experienced only modest reductions. The Company believes that this action will allow it to continue investing in its product line and continue providing active support for our customers. The Company expects that this restructuring, as well as other expense reduction measures, will result in annualized savings of approximately $4 million, which should begin to have an impact in the quarter ending December 31, 2004, with the full impact of these reductions reflected beginning in the first quarter of 2005. The Company expects that there will be approximately $400,000 in employee termination related costs incurred within the fourth quarter of 2004, and no subsequent costs related to this action in 2005.

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Item 2. ***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, our Condensed Consolidated Financial Statements and Notes thereto included elsewhere in this report, as well as the Risk Factors section that is set forth below. 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.

Overview

BackWeb provides offline Web infrastructure and application-specific software that enable companies to extend the reach of their Web assets to the mobile community of their customers, partners, and employees. 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 applications.

The BackWeb® Offline Access Server® is designed to extend the reach of corporate portals to mobile or disconnected users and users who need to be notified of critical new content, which helps increase usage of the portal and critical communications, thereby increasing companies return on investment from their enterprise portals. Our BackWeb e-Accelerator application allows an extended enterprise or geographically dispersed organization to manage and deliver pertinent information and alerts without the use of a portal. This enables sales and service organizations, partners and resellers, and call centers using our products to collect and distribute up-to-date, key data to customers, partners, and employees, enabling users to interact with the data through alerts and notification features. Our core infrastructure software, BackWeb Foundation , is a platform that allows organizations to efficiently target and deliver sizeable digital data of any format to users desktops throughout the extended enterprise.

We derive revenue from licensing our products and from maintenance, consulting and training services. Our products are marketed worldwide through a combination of our direct sales force, reseller channels, and OEMs.

Business Overview

Overall in the first nine months of 2004, we achieved some important strategic objectives around cost control and implementing our new sales effort. However our results for the second and third quarters of 2004 reflected continued challenges in information technology (IT) spending, combined with the impact of the realignment of our sales process we embarked upon in the first quarter of 2004. Our total revenue decreased 33% in the third quarter of 2004 compared with the third quarter of 2003, as well as 3% compared to the second quarter of 2004. The primary driver behind our decrease in revenue during the period was a decrease in our license revenue. License revenue in the third quarter of 2004 declined 86% and 50% compared to last year and the sequential quarter, respectively. We did see a positive trend in our professional services revenue compared to both the sequential and year-ago quarter reflecting an increase in customer deployments of our solution. We believe the decrease in revenue was primarily due to the lack of market demand to date for our BackWeb Offline Access Server product, which has been due in part to changes we implemented to our sales focus and strategy, in addition to a sluggish market recovery, particularly in the technology sector.

Our operating expenses in the third quarter of 2004 declined approximately 38% from the third quarter of 2003. As a result, we were able to reduce our net loss per share in the third quarter of 2004 by $0.02 compared to the same quarter last year.

Anticipating a possible disruption in our sales cycle and related license revenue during this significant transition, we continued to emphasize cost disciplines during the quarter. This enabled us to reduce total operating expenses in the third quarter of 2004 to $2.4 million, compared to $3.9 million in the third quarter of 2003.

Recent Events

During the first quarter of 2004, we initiated a new sales and marketing focus which placed a heightened emphasis on business value selling. This change in selling technique emphasized how our products can provide greater business value and return on investment to managers who are accountable for the productivity of field sales, services, consulting, and other revenue-related, customer-facing teams. We anticipated that this change in sales strategy could lead to a reduction in license revenue and new customer acquisition, but felt it was an important change for the future of the company.

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As described above, we experienced a significant decrease in license revenue during the second and third quarters of 2004, and in order to protect our cash reserves, we decided to restructure the company in October 2004. The focus of the restructuring was the reduction of management and administrative costs, and to a lesser extent, the reduction of our sales and marketing operation to a level consistent with our current sales level. Our product development, technical support and professional services operations experienced only modest reductions. We believe that this action will allow us to continue investing in our product line and continue providing active support for our customers. We remain committed to our recently launched sales initiatives which focus on the ability to mobilize enterprise Web applications used by the revenue-critical field sales and field service organizations of our customers, and will also continue to remain actively engaged with IT organizations which are critical in evaluating and selecting the right technical solution for the enterprise, as well as ensuring a successful implementation and deployment.

We expect that this restructuring, as well as other expense reduction measures, will result in annualized savings of approximately $4 million, which should begin to have an impact in the quarter ending December 31, 2004, with the full impact of these reductions reflected beginning in the first quarter of 2005. We expect that there will be approximately $400,000 in employee termination related costs incurred within the fourth quarter of 2004, and no subsequent costs related to the restructuring in 2005.

Critical Accounting Policies

Our critical accounting policies are as follows:

Revenue recognition;

Estimating valuation allowances and accrued liabilities, including the allowance 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 original equipment manufacturers (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 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 concentration, 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.

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 II, Item 1 Legal Proceedings of this Form 10-Q.

Review of 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, the Company determined that there would be no future cash requirements under the restructuring accrual, and reversed the accrual in full. There was no remaining balance related to restructuring charges remaining at September 30, 2004.

Results of Operations

The following table sets forth our results of operations for the three and nine months ended September 30, 2004 and 2003 expressed as a percentage of total revenue.

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
	Unaudited		Unaudited	
Revenue:				
License	10%	52%	26%	50%
Service	90	48	74	50
Total revenue	100	100	100	100
Cost of revenue:				
License	1	2	1	2
Service	29	13	24	15
Total cost of revenue	30	15	26	17
Gross profit	70	85	74	83
Operating expenses:				
Research and development	65	83	64	74
Sales and marketing	105	67	83	102
General and administrative	43	74	45	70
Restructuring charge / (credit)	(7)		(7)	
Total operating expenses	206	224	185	246
Loss from operations	(136)	(139)	(110)	(164)
Interest and other income, net	6	(3)	4	1
Write-down of an equity investment				(21)
Net loss	(130%)	(142)%	(107)%	(184)%

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Revenue

Total revenue

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
		(in thousands, except percentages)		
Total revenue	$1,181	($573)	-33%	$ 1,754
As a percentage of total revenue	100%			100%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
		(in thousands, except percentages)		
Total revenue	$3,966	($780)	-16%	$ 4,746
As a percentage of total revenue	100%			100%

We derive revenue from license, maintenance, and consulting services for BackWeb Offline Access Server, BackWeb Polite Sync Server, and BackWeb e-Accelerator Suite. The decrease in total revenue in the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was primarily due to a decrease in license revenue. These decreases were offset, in part, by an increase in maintenance services and consulting fees. We have limited visibility to forecast revenue and therefore we are unable to quantify future overall trends in our total revenue. However, in the sections below we discuss the changes in the individual components of total revenue and expected trends in these individual components.

In the three months ended September 30, 2004, no customer accounted for more than 10% of total revenue. In the nine months ended September 30, 2004, three customers accounted for 36% of total revenue. 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 periods.

License revenue

	Three months ended,		
September 30, 2004	Change $	Change %	September 30, 2003

	(in thousands, except percentages)			
License revenue	$ 124	($787)	-86%	$ 911
As a percentage of total revenue	10%		-42%	52%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
License revenue	$ 1,043	($1,336)	-56%	$ 2,379
As a percentage of total revenue	26%		-24%	50%

The decrease in license revenue in the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was primarily due to a lack of market demand for our BackWeb Offline Access Server product, which was due, in part, to a reorganization within the sales force implemented during the first quarter of 2004. This 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, the first nine months of 2004 saw a transition of several members of our direct sales team. 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 the first nine months of 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

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reflected in our operating results. A license sale to an existing customer accounted for $100,000, or 81%, of license revenue for the three months ended September 30, 2004 and $600,000, or 58%, of license revenue for the nine months ended September 30, 2004.

Service revenue

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Service revenue	$1,057	$214	25%	$ 843
As a percentage of total revenue	90%		42%	48%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Service revenue	$2,923	$556	23%	$ 2,367
As a percentage of total revenue	74%		24%	50%

Service revenue, which includes maintenance and consulting services, increased for the three and nine months ended September 30, 2004 when compared to the same periods in 2003 due to an increase in consulting fees of approximately $260,000 and $600,000, respectively. The increase in the three-month period was partially offset by a decrease in maintenance services fees of approximately $45,000. Maintenance services fees remained relatively flat in the nine-month period. The vast majority of our consulting revenue during the period was associated with our BackWeb Offline Access Server product. Customer deployments of that product increased commensurate with the increase in the product s license revenue that occurred in prior periods.

During the balance of 2004 we expect service revenue to remain relatively flat, or to decrease slightly from the first nine months of 2004. We expect that maintenance revenue associated with our older products will continue to decrease, offset by an increase in maintenance revenue associated with BackWeb Offline Access Server. Any increase in maintenance revenue from BackWeb Offline Access Server, however, is dependent upon an absolute dollar level increase in license revenue from that product, which might not occur, especially due to the changes we have implemented in our sales force and strategy. Further, while we expect consulting revenue to remain relatively flat over the balance of 2004, this too is dependent on increased licenses of our BackWeb Offline Access Server.

Cost of Revenue

	Three months ended,

	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Cost of revenue	$360	$92	34%	$ 268
As a percentage of total revenue	30%		15%	15%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Cost of revenue	$1,013	$187	23%	$ 826
As a percentage of total revenue	26%		9%	17%

Cost of revenue increased as a percentage of revenue during the three months ended September 30, 2004 as compared to the same period in 2003, primarily due to a decrease in license revenues. Cost of revenue increased in the nine-month period primarily due to higher professional services costs including the use of more senior consultants on our professional services engagements in the first quarter of 2004, which has a higher cost of revenue than license revenue, combined with a decrease in license revenues.

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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.

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Cost of license revenue	$12	($17)	(59)%	$ 29
As a percentage of license revenue	10%		7%	3%
As a percentage of total revenue	1%		1%	2%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Cost of license revenue	$53	($49)	(48)%	$ 102
As a percentage of license revenue	5%		(1)%	4%
As a percentage of total revenue	1%		(1)%	2%

Cost of license revenue increased as a percentage of revenue during the three months ended September 30, 2004 as compared to the same period in 2003 primarily due to a decrease in license revenue. Cost of license revenue in absolute dollars decreased during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 due to a shift in our license revenue mix away from products with higher associated royalties.

We expect our cost of license revenue as a percentage of license revenue to remain relatively consistent for the balance of 2004.

Cost of Service Revenue

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

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003

	(in thousands, except percentages)			
Cost of service revenue	$348	$109	46%	$ 239
As a percentage of service revenue	33%		5%	28%
As a percentage of total revenue	29%		16%	13%

	Nine months ended,			
	September 30, 2004	Change		September 30, 2003
		$	%	
	(in thousands, except percentages)			
Cost of service revenue	$960	$236	33%	$ 724
As a percentage of service revenue	33%		2%	31%
As a percentage of total revenue	26%		9%	17%

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Cost of service revenue increased as a percentage of total revenue as well as in absolute dollars during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 primarily due to 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, and the increase in services revenue.

We expect cost of service revenue to increase marginally and remain relatively constant as a percentage of service revenue during the balance of 2004.

Operating Expenses

Research and Development

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

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Research and development	$768	($413)	(35)%	$ 1,181
As a percentage of total revenue	65%		(18)%	83%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Research and development	$2,527	($982)	(28)%	$ 3,509
As a percentage of total revenue	64%		(10)%	74%

The decrease in research and development expenses during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was primarily due to lower personnel and third party contractor costs and a reduction in associated travel and other related expenses. In the latter portion 2003, we significantly reduced our use of outside contractors and reduced headcount in our research and development department through attrition and personnel management. Additionally, during the first quarter of 2004, we further reduced headcount in our research and development department 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 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 decrease in terms of absolute dollars during the fourth quarter of 2004 and into 2005.

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Sales and Marketing

Sales and marketing expenses consist of personnel and related costs for our direct sales force, 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.

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Sales and marketing	$1,236	($218)	(15%)	$ 1,454
As a percentage of total revenue	105%		38%	67%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Sales and marketing	$3,273	($1,578)	(33%)	$ 4,851
As a percentage of total revenue	83%		(19%)	102%

The decrease in sales and marketing expenses during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 resulted primarily from a reduction in personnel related costs. Realizing the full effect of the reorganization in October 2002, plus additional personnel expense management during 2003, resulted in a benefit that we continue to realize in 2004. We continue to seek ways to reduce our fixed costs, such as the closing of non-strategic field sales offices.

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 direct sales organization when and where appropriate, particularly in connection with our realigned sales strategy and personnel towards our new focus on selling to line of business executives as opposed to our traditional focus on IT organizations. In light of the changes in personnel implemented in October 2004, we expect reduced expenses in 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 the fourth quarter of 2004 and into 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, legal, and the provision for bad and doubtful debts.

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
General and administrative	$505	($792)	(61%)	$ 1,297
As a percentage of total revenue	43%		(31%)	74%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
General and administrative	$1,799	($1,524)	(46%)	$ 3,323
As a percentage of total revenue	45%		(25%)	70%

The decrease in general and administrative expenses during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was primarily due to a reduction in facilities costs and outside services expenses associated with our

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reorganization in October 2002. Additionally we have reduced the fees associated with third party consultants and substituted higher cost vendors with more cost effective alternatives where possible.

We expect general and administrative expenses will decrease on an absolute basis during the fourth quarter of 2004 and into 2005 in light of the changes in personnel implemented in October 2004 and due to a continued focus on cost reduction programs.

Restructuring Charge

	Three months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Restructuring charge	($82)	$(82)	n/a	$ 0
As a percentage of total revenue	-7%			0.0%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Restructuring charge	$(266)	($266)	n/a	$ 0
As a percentage of total revenue	7%			0.0%

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 plan. During the second quarter of 2004, we settled a lease agreement related to our Canadian subsidiary for approximately $187,000 against the restructuring accrual. 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, the Company determined that there would be no future cash requirements under the restructuring accrual, and reversed the accrual in full. There was no remaining balance related to restructuring charges remaining at September 30, 2004.

Interest and Other Income (Expense), Net

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.

Three months ended,

	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Interest and other income (expense), net	$69	$113	257%	$ (44)
As a percentage of total revenue	6%		9%	(3)%

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Interest and other income (expense), net	$149	$122	452%	$ 27
As a percentage of total revenue	4%		3%	1%

The increase in interest and other income (expense), net during the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was primarily due to a modest increase in the interest rate of our investments during the quarter combined with a reduction in bank fees. This gain was partially offset by a decrease in interest income resulting from utilization of our cash, cash equivalents and short-term investments due to our operating losses. We expect interest and other income (expense), net to decrease gradually during the fourth quarter of 2004 as we expect we will continue to use cash during 2004 and, as a result, earn less investment and interest income.

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Write-Down of an Equity Investment

	Nine months ended,			
	September 30, 2004	Change $	Change %	September 30, 2003
	(in thousands, except percentages)			
Write-down of an equity investment	$ 0	($1,000)	(100.0)%	$ 1,000
As a percentage of total revenue	0.0%		(33.4)%	33.4%

In 2000, we invested in certain development-stage companies operating Internet-centric businesses in which we believed we had a significant strategic interest. However, 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 such investments had become impaired. In 2001, we recorded a charge of $2.5 million to reflect impairment of these assets below their recorded cost to represent what management considered to be fair value. During March 2003, we determined the remaining investment was fully impaired primarily due to continuing difficulties in the economy, and recorded a charge for the full remaining investment balance of $1.0 million.

Income Taxes

There was no provision for income taxes because we have incurred operating losses. As of September 30, 2004, we had approximately $72.0 million of Israeli net operating loss carry forwards and $5.0 million of U.S. federal net operating loss carry forwards available to offset future taxable income. The U.S. net operating loss carry forwards expires in varying amounts between the years 2011 and 2022. The Israeli net operating loss carry forwards have no expiration date.

Off-Balance Sheet Financings And Liabilities

Other than operating lease commitments, we do not have any off-balance sheet financing arrangements or liabilities, retained or contingent interests in transferred assets or any obligation arising out of a material variable interest in an unconsolidated entity. We do provide standard indemnification agreements to our customers related to our product. We do not have any majority-owned subsidiaries that are not included in the consolidated financial statements.

Liquidity and Capital Resources

As of September 30, 2004, we had approximately $10.1 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 approximately $4.4 million and $7.0 million for the nine months ended September 30, 2004 and 2003, respectively, and was primarily used to fund our ongoing operational needs. The decrease in cash used in operating activities was primarily due to the ongoing effect of the restructuring that was implemented in the latter half of 2002, which resulted in significant headcount and other operational cost reductions combined with further reductions in subsequent periods. Cash provided by investing activities was approximately $2.6 million and $5.4 million for the nine months ended September 30, 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 approximately $100,000 and $300,000 for the nine months ended September 30, 2004 and 2003, respectively, and consisted primarily of proceeds from the issuance of Ordinary Shares under our 1999 Employee Stock Purchase Plan and as a result of the exercise of stock options issued under our 1998 Employee Stock Option Plan.

In May, 2004, we entered into a $1.5 million line of credit with a lender. 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 September 30, 2004, we had unused borrowing capacity of $1 million.

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As of September 30, 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 equivalent and short-term investment balances will be sufficient to fund our operations for at least the next 12 months. We may elect to raise additional funds prior to the expiration of this period if we believe such funds will help achieve strategic goals. If we decide to raise additional funds, it could be difficult to obtain additional financing on favorable terms, if at all. We may try to obtain additional financing by issuing Ordinary Shares or convertible debt securities, which could 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.

Contractual Obligations

The following summarizes our contractual obligations at September 30, 2004 (in thousands):

Payments Due by Period

	Total	Less than 1 year	1-3 years	3-5 years
Operating Lease Obligations	$2,047	$ 683	$1,364	$ —
Total Contractual Commitments	$2,047	$ 683	$1,364	$ —

As part of the restructuring plan that began in the three months ended September 30, 2002, we entered into negotiations with our various landlords to renegotiate our lease obligations. We have finalized agreements with respect to our San Jose, California, Toronto, Canada, and Rosh Ha ayin, Israel leases whereby we were able to mitigate our lease obligations by, among other things, buying out certain of our obligations, subletting space or reducing rent, entering into a new lease agreement, or a combination of these.

Effective Corporate Tax Rates

Our tax rate reflects a mix of the U.S. statutory tax rate on our U.S. income, versus 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, 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 is derived from our capital investment program with Approved Enterprise status under the Law for the Encouragement of Capital Investments, and is eligible 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. 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 September 30, 2004, we have not yet used the tax benefits for which we are eligible.

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, primarily because we hedge through the use of forward contracts for our R&D expenses in Israel.

RISK FACTORS

We operate in a rapidly changing environment that involves numerous risks and uncertainties, some of which are beyond our control. The following discussion highlights some of these risks and uncertainties. You should consider the following factors, as well as other information set forth in this Quarterly Report on Form 10-Q, 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.

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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 net losses of approximately $4.2 million for the nine months ended September 30, 2004, $10.7 million in the year ended December 31, 2003, $24.9 million for the year ended December 31, 2002, and $34.7 million for the year ended December 31, 2001. As of September 30, 2004, we had an accumulated deficit of approximately $143.0 million. We expect to continue to incur significant sales and marketing, research and development, and general and administrative expenses through the remainder of 2004 and into 2005. As a result, we will need to significantly increase our 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 will reduce cash operating expenses, our ability to adequately reduce cash used in operations, and ultimately generate profitable results from operations, is dependent 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. Recently, 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.

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 nine months ended September 30, 2004 and in the year ended December 31, 2003, we did not generate significant revenue from our strategic reseller relationships. We do not know if these existing or any future strategic relationships 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. Indeed, we are aware that certain of our strategic relationships, 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 $10.1 million as of September 30, 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.

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

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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.

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, in the nine months ended September 30, 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 the nine months ended September 30, 2004, three customers accounted for 36% 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 and, for the nine months ended September 30, 2004, we did not generate any 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.

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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 first three quarters of 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.

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.

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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 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 $175,000, or 15% of our total revenue, for the three months ended September 30, 2004, approximately $850,000, or 21% of our total revenue, for the nine months ended September 30, 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 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. Our products could be used 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.

If we are required to treat employee stock option and employee stock purchase plans as a compensation expense, it could significantly increase our net loss and net loss per share.

There has been ongoing public debate whether employee stock option and employee stock purchase plan shares should be treated as a compensation expense and, if so, how to properly value such charges. In March 2004, and as subsequently amended, the Financial Accounting Standards Board issued an exposure draft of a proposed standard that, if adopted, will significantly change the accounting for employee stock options and other equity-based compensation. If we elected or were required to record an expense for our stock-based compensation plans using the fair value method, we could have significant accounting charges. For example, in 2003 and the first three quarters of 2004, had we accounted for stock-based compensation plans as a compensation expense, annual diluted net loss per share would have been reduced by $0.05 and $0.03 per share, respectively. Although we are not currently required to record any compensation expense using the fair value method in connection with option grants that have an exercise price at or above fair market value and for shares issued under our employee stock purchase plan, it is possible that future laws or regulations will require us to treat all stock-based compensation as a compensation expense using the fair value method.

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 and was in the process of being extended at October 31, 2004. The expiration date may be extended by ministerial decision until December 31, 2004, 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 October 31, 2004 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 have 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 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 II, Item 1 Legal Proceedings of this Quarterly 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.

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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, or NMS, 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 September 30, 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.

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 27% of our outstanding Ordinary Shares as of September 30, 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 3. *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, we do 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. Therefore, no quantitative tabular disclosures are required.

Foreign Currency Exchange Rate Risk

We hedge certain forecasted committed expenses that are payable in NIS to minimize our exposure to fluctuations in the exchange rate between the NIS and the U.S. dollar. We compare budgeted NIS exchange rates to the forward contract rates for the NIS for various periods of time into the future where we are reasonably confident that we can forecast a stable stream of expenses payable in NIS. Taking all industry specific and macroeconomic indicators into account, in order to protect ourselves from fluctuating exchange rates, we enter into forward contracts. The contracts are generally monthly and timed in the month to mature when we incur most of our expense in NIS, which are payroll and related expenses. We take out a number of forward contracts at a time for future months, depending on how confident we feel about both our forecasted NIS expenses and our visibility into future exchange rate movement. We do not anticipate any material adverse effect on our consolidated financial position utilizing our current hedging strategy. At September 30, 2004, we had no forward contracts in place.

Item 4. *Controls and Procedures*

Evaluation of disclosure controls and procedures. We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

On November 13, 2001, BackWeb, six of its officers and directors, and various underwriters for BackWeb s 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 September 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 release of claims against the issuer defendants, including BackWeb. The settlement is subject to a number of conditions, including approval of the proposed settling parties and the court. In September 2004, an agreement of settlement was submitted to the court for preliminary approval.

If the settlement does not occur, and litigation against BackWeb continues, BackWeb believes it has meritorious defenses and intends 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.

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 2. ***Changes in Securities, Use of Proceeds and Issuer Repurchases of Equity Securities***

None.

Item 3. ***Defaults Upon Changes of Senior Securities***

None.

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

At our Annual General Meeting of Shareholders held on August 10, 2004, our shareholders voted on and approved the following proposals:

1. To elect three directors, each to serve for the term stated below or until their successors are duly elected and qualified

	For	Withhold Authority
Uday Bellary Class I director (term through the 2006 Annual General Meeting of Shareholders)	33,210,659	79,698
Charles Federman Class II director (term through the 2007 Annual General Meeting of Shareholders)	33,217,479	72,878
Erez Lorber Class II director (term through the 2007 Annual General Meeting of Shareholders)	33,216,479	73,878

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2. To elect the following director for a three-year term as an Outside Director under the Israeli Companies Law:

	For	**Withhold Authority**
Amir Makleff	33,188,984	84,248

3. To approve the compensation of the our Chief Executive Officer for the fiscal year 2003, as required by the Israeli Companies Law:

For	13,794,066
Against	139,367
Abstain	9,155
Not Voted	19,347,769

4. To ratify the appointment of Grant Thornton L.L.P. as our independent auditors for the fiscal year ending December 31, 2004:

For	33,229,450
Against	56,432
Abstain	4,475

The following directors terms of office continued after the Annual General Meeting of Shareholders: Eli Barkat and Isabel Maxwell.

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

On July 15, 2004, we filed a report under Item 4 of Form 8-K reporting that Grant Thorton LLP had been retained as the Company s auditors for 2004.

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Exhibit No.	Description
31.1	Certification of BackWeb s Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of BackWeb s Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of BackWeb s Chief Executive Officer and Chief Financial Officer, dated August 13, 2004*

* These certifications are furnished with this Quarterly Report on Form 10-Q and are not deemed filed with the SEC and are not to be incorporated by reference in any filing of BackWeb under the Securities Act of 1933 or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

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SIGNATURE

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

BACKWEB TECHNOLOGIES LTD.

By: /s/ KEN HOLMES

Ken Holmes

Vice President, Finance

Date: November 15, 2004

(Mr. Holmes is the Principal Financial Officer and has been duly authorized to sign on behalf of Registrant.)

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