BACKWEB TECHNOLOGIES LTD
Form 10-Q
November 14, 2006

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the Quarterly Period Ended September 30, 2006

or

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

For the Transition period from to

Commission File Number 000-26241

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, RoshHa ayin, Israel	**48092**
(Address of Principal Executive Offices)	*(Zip Code)*

(972) 3-6118800

(Registrant s Telephone Number, Including Area Code)

3 Abba Hillel Street, Ramat Gan, Israel

(Former Address, if Changed Since Last Report

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check One):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The registrant had 41,303,994 Ordinary Shares outstanding as of November 1, 2006.

BACKWEB TECHNOLOGIES LTD.
REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2006
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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 the expected impact of the restructuring we implemented in the second quarter of 2006, the expected benefits of our strategic relationship efforts with systems integrators and application service providers, the potential delisting of our Ordinary Shares from the Nasdaq Capital Market and regarding our 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, anticipates, or 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 Item 1A. of Part II of this Quarterly Report under the caption Risk Factors. 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, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,633	$ 1,583
Short-term investments	2,635	6,293
Trade accounts receivable, net	722	1,554
Other accounts receivable and prepaid expenses	424	325
Total current assets	6,414	9,755
Long-term investments and long-term assets	44	35
Property and equipment, net	158	213
Total assets	$ 6,616	$ 10,003
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 206	$ 247
Accrued liabilities	1,599	1,731
Deferred revenue	882	976
Total current liabilities	2,687	2,954
Long-term liabilities		8
Commitments and contingencies (Note 2) Shareholders equity:		
Ordinary Shares	152,151	151,763
Accumulated other comprehensive income		(2)
Accumulated deficit	(148,222)	(144,720)
Total shareholders equity	3,929	7,041
Total liabilities and shareholders equity	$ 6,616	$ 10,003

Note: The balance sheet at December 31, 2005 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, 2006	September 30, 2005	September 30, 2006	September 30, 2005
	(Unaudited)		(Unaudited)	
Revenue:				
License	$ 61	$ 942	$ 1,314	$ 2,569
Service	663	840	2,208	2,589
Total revenue	724	1,782	3,522	5,158
Cost of revenue:				
License	26	14	67	27
Service	149	183	570	533
Total cost of revenue	175	197	637	560
Gross profit	549	1,585	2,885	4,598
Operating expenses:				
Research and development	541	530	1,742	1,670
Sales and marketing	928	787	2,980	2,317
General and administrative	699	531	1,780	1,465
Restructuring credit		(20)		(105)
Total operating expenses	2,168	1,828	6,502	5,347
Loss from operations	(1,619)	(243)	(3,617)	(749)
Interest and other income, net	56	35	116	61
Net loss	$ (1,563)	$ (208)	$ (3,502)	$ (688)
Basic and diluted net loss per share	$ (0.04)	$ (0.01)	$ (0.08)	$ (0.02)
Weighted average number of shares used in computing basic and diluted net loss per share	41,279	41,036	41,232	40,971

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, 2006	September 30, 2005
	Unaudited	
Operating Activities		
Net loss	$ (3,502)	$ (688)
Adjustments to reconcile net loss to net cash used in operating activities:		
Bad debt expense	233	200
Depreciation	117	(41)
FAS 123R equity based compensation expense	314	
Changes in operating assets and liabilities:		
Trade accounts receivable	599	332
Other receivables, prepaid expenses, and other long-term assets	(108)	73
Accounts payable and accrued liabilities	(173)	(105)
Deferred revenue	(102)	(1,591)
Net cash used in operating activities	(2,622)	(1,820)
Investing Activities		
Purchases of property and equipment	(61)	(12)
Purchases of short-term investments	(106)	(1,125)
Proceeds from sale of short-term investments	3,764	
Net cash provided by / (used in) investing activities	3,597	(1,137)
Financing Activities		
Proceeds from issuance of Ordinary Shares, net	75	129
Net cash provided by financing activities	75	129
Net increase (decrease) in cash and cash equivalents	1,050	(2,828)
Cash and cash equivalents at beginning of the period	1,583	5,213
Cash and cash equivalents at end of the period	$ 2,633	$ 2,385

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 enables 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, 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 Company s products are designed to reduce network costs and improve the productivity of increasingly mobile workforces. BackWeb sells its products primarily to end users in a variety of industries, including the telecommunications, financial and computer industries, through its direct sales force, resellers, OEMs and sales/marketing partners.

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 upon 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, 2005 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, 2005. 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, 2006 or any future interim period.

Net Loss Per Share Basic net loss per share is computed based on 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 Statement of Financial Accounting Standard (SFAS) No. 128, Earnings per Share. The total number of Ordinary Shares subject to outstanding options excluded from the diluted net loss per share calculation because they would be considered anti-dilutive was 5,974,974 and 5,979,615 at September 30, 2006 and 2005, respectively.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
	Unaudited		Unaudited	
Net loss	$ (1,563)	$ (208)	$ (3,502)	$ (688)
Basic and diluted:				
Weighted-average shares	41,279	41,036	41,232	40,971
Less weighted-average shares subject to forfeiture				

Weighted-average number of shares used in computing basic and diluted net loss per share	41,279	41,036	41,232	40,971
Basic and diluted net loss per share	$ (0.04)	$ (0.01)	$ (0.08)	$ (0.02)

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

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
	Unaudited		Unaudited	
Net loss	$ (1,563)	$ (208)	$ (3,502)	$ (688)
Change in net unrealized loss on investments	(1)	5	2	16
Total comprehensive loss	$ (1,564)	$ (203)	$ (3,500)	$ (672)

The Company believes that its current cash, cash equivalents and short-term investment balances will be sufficient to fund its operations for at least the next 12 months. However, since its inception the Company has not achieved profitability and expects to continue to incur net losses for the foreseeable future. In addition, the Company s net loss significantly increased during the first nine months of 2006 as compared to its net loss for the first nine months of 2005 and in the future, its business may not go as planned, and the Company may need to raise additional funds prior to the expiration of this period. If the Company decides to raise additional funds, it could be difficult to obtain additional financing on favorable terms, if at all. The Company may try to obtain additional financing by issuing Ordinary Shares or convertible debt securities, which could dilute our existing shareholders. If the Company cannot raise needed funds on acceptable terms, or at all, it may not be able to develop or enhance our products, respond to competitive pressures or grow its business, and the Company may be required to undertake further expense reduction measures.

Stock-Based Compensation In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard 123R, which revised FAS 123 *Accounting for stock based compensation* (SFAS 123R). SFAS 123R requires all share-based payments to employees, or to non-employee directors as compensation for service on the Board of Directors, to be recognized as compensation expense in the consolidated financial statements based on the fair values of such payments. The Company maintains shareholder approved stock-based compensation plans, pursuant to which it grants stock-based compensation to its employees, and to non-employee directors for Board service. These grants are primarily in the form of options that allow a grantee to purchase a fixed number of shares of the Company s Ordinary Shares at a fixed exercise price equal to the market price of the shares at the date of the grant. The options may vest on a single date or in tranches over a period of time, but normally they do not vest unless the grantee is still employed by, or is a director of, the Company on the vesting date. The compensation expense for these grants will be recognized over the requisite service period, which is typically the period over which the stock-based compensation awards vest.

The Company made no modifications to outstanding options with respect to vesting periods or exercise prices prior to adopting SFAS 123R. In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107), which provides guidance on the implementation of SFAS 123R. The Company applied the principles of SAB 107 in conjunction with its adoption of SFAS 123R.

The Company adopted SFAS 123R effective January 1, 2006, using the modified-prospective transition method. Under this transition method, compensation expense will be recognized based on the grant date fair value estimated in accordance with the provisions of SFAS 123R for all new grants effective January 1, 2006, and for options granted prior to but not vested as of December 31, 2005. Prior periods were not restated to reflect the impact of adopting the new standard and therefore do not include compensation expense related to stock option grants for those periods. In accordance with SFAS 123R, the Company recognized stock option related compensation expense of approximately $100,000 for the three-month period ended September 30, 2006 and a total of approximately $300,000 for the nine-month period ended September 30, 2006. All options granted in the periods were stock options and the related compensation expense will be recognized on a straight-line basis over the vesting period of each grant, net of estimated forfeitures. The Company s estimated forfeiture rates are based on its historical experience. The estimated fair value of the options granted through the first nine months of 2006 and prior years was calculated using a Black

Scholes Merton option pricing model (Black Scholes model). The following summarizes the assumptions used in the Black Scholes model as applied in the three- and nine-month periods ended September 30, 2006:

Stock Options	Three Months Ended September 30, 2006
Risk-free interest rates (1)	5.1%
Expected lives (in years) (2)	6.25
Dividend yield (3)	0%
Expected volatility (4)	278%

Stock Options	Nine Months Ended September 30, 2006
Risk-free interest rates (1)	4.7% - 6.0%
Expected lives (in years) (2)	6.25
Dividend yield (3)	0%
Expected volatility (4)	83% - 180%

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Stock Purchase Plan Shares	Three Months Ended September 30, 2006
Risk-free interest rates (1)	5.0%
Expected lives (in years) (2)	.5
Dividend yield (3)	0%
Expected volatility (4)	278%

Stock Purchase Plan Shares	Nine Months Ended September 30, 2006
Risk-free interest rates (1)	4.8 6.0%
Expected lives (in years) (2)	.5
Dividend yield (3)	0%
Expected volatility (4)	82% - 180%

(1) The risk-free interest rate is based on U.S. Treasury debt securities with maturities close to the expected term of the option.

(2) The expected term represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior

(3) No cash dividends have

been declared on the Company s Ordinary Shares since the Company s inception, and the Company currently does not anticipate paying cash dividends over the expected term of the option.

(4) Expected volatility is based on relevant historical volatility of the Company s stock factoring in daily share price observations.

At September 30, 2006, approximately $200,000 of unrecognized compensation expense related to stock options is expected to be recognized over a weighted average period of approximately 4.7 years. The resulting effect on net loss and net loss per share attributable to common shareholders is not likely to be representative of the effects in future periods, due to additional grants and subsequent periods of vesting.

Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*. In accordance with APB 25, the Company recognized no compensation expense for qualified stock option grants. For options issued with an exercise price less than the fair market value of the shares at the date of grant, the Company recognized the difference between the exercise price and fair market value as compensation expense in accordance with APB 25. Prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 123 *Accounting for Stock-Based Compensation,* (SFAS 123) as amended by SFAS No. 148 *Accounting for Stock-Based Compensation - Transition and Disclosure* (SFAS 148). As compensation expense was disclosed but not recognized in periods prior to January 1, 2006, no cumulative adjustment for forfeitures was recorded in any subsequent period. The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation in the prior three- and nine-month periods ended September 30, 2005:

		Three Months ended September 30, 2005
Net loss as reported	$	(208)
Stock based compensation expense determined under the fair value method		(207)

Pro forma net loss	$	(415)
Net loss per share:		
Basic and diluted as reported	$	(0.01)
Basic and diluted pro forma	$	(0.01)

		Nine Months ended September 30, 2005
Net loss as reported	$	(688)
Stock based compensation expense determined under the fair value method		(491)
Pro forma net loss	$	(1,179)
Net loss per share:		
Basic and diluted as reported	$	(0.02)
Basic and diluted pro forma	$	(0.03)

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The Company accounts for stock options granted to non-employees in accordance with SFAS 123 and Emerging Issues Task Force (EITF) 96-18 *Accounting For Equity Instruments That Are Issued To Other Than Employees For Acquiring, Or In Conjunction With Selling, Goods Or Services*, and, accordingly, recognizes as expense the estimated fair value of such options as calculated using the Black Scholes model. The fair value is remeasured during the service period and is amortized over the vesting period of each option or the recipient s contractual arrangement, if shorter. No stock options were issued to non-employees other than options granted to non-employee members of the Board of Directors for service as Board members.

A summary of activity under the Company s equity based plans is as follows:

	Shares Available For Grant	Options Outstanding	Exercise Price per Share	Weighted-Average Exercise Price	Weighted-Average Fair Value of Option Granted
Balance at December 31, 2005	11,277,654	6,323,840	$ 2.85-$17.25	$ 0.58	$ 0.46
Options granted	(70,000)	70,000	$ 0.47-$0.85	$ 0.64	
Options exercised		(36,525)	$ 0.39-$0.77	$ 0.53	
Options canceled	382,341	(382,341)	$ 0.37-$7.32	$ 4.25	
Options Expired	(834)				
Balance at September 30, 2006	11,589,161	5,974,974	$ 0.37-$17.25	$ 0.53	$ 0.64

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of $0.35 as of September 29, 2006, which would have been received by the option holders had all option holders exercised their options as of that date.

The options outstanding and currently exercisable at September 30, 2006 were in the following exercise price ranges:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Prices	**Number Outstanding as Of 12/31/05**	**Weighted Average Remaining Contractual Years**	**Weighted Average Exercise Price**	**Number Exercisable as of 12/31/05**	**Weighted Average Exercise Price**
$0.26 - $0.37	30,468	3.92	$ 0.30	30,468	$ 0.30
$0.39 - $0.39	2,147,562	5.10	$ 0.39	1,709,768	$ 0.39
$0.40 - $0.60	1,073,562	6.23	$ 0.54	448,059	$ 0.57
$0.61 - $1.07	746,575	3.07	$ 0.83	702,825	$ 0.84
$1.13 - $1.20	208,407	3.74	$ 1.16	154,344	$ 1.16
$1.32 - $1.32	725,000	5.25	$ 1.32	362,500	$ 1.32
$1.50 - $3.75	110,600	2.42	$ 1.98	108,162	$ 1.99
$7.32 - $7.32	179,800	1.09	$ 7.32	179,800	$ 7.32
$15.63 - $15.63	3,000	0.65	$ 15.63	3,000	$ 15.63
$17.25 - $17.25	750,000	0.90	$ 17.25	750,000	$ 17.25
$0.26 - $17.25	5,974,974	4.31	$ 2.97	4,448,926	$ 3.75

As of September 30, 2006, the unrecorded deferred stock-based compensation balance related to stock options was approximately $200,000 and will be recognized over an estimated weighted average amortization period of 0.6 years. The amortization period is based on the expected term of the options, which is defined as the period from grant date to exercise date.

Recent Accounting Pronouncements.

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

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

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). Under FIN 48, companies are required to apply the more likely than not threshold to the recognition and derecognition of tax positions. FIN 48 also provides guidance on the measurement of tax positions, balance sheet classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will be effective beginning January 1, 2007. The Company is currently evaluating the provisions in FIN 48; however, at the present time the Company does not anticipate the adoption of FIN 48 will have a material impact on its consolidated financial position, results of operations and cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the Company s fiscal year ending December 31, 2006.. The Company does not expect the adoption of SAB 108 to have an effect on our consolidated financial position, results of operations and cash flows.

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Note 2. Contingencies

Litigation

On November 13, 2001, BackWeb, six of our officers and directors, and