

I2 TECHNOLOGIES INC  
Form 10-Q  
August 09, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-28030

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**i2 Technologies, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

One i2 Place

75-2294945  
(I.R.S. Employer

Identification No.)

75234

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11701 Luna Road

Dallas, Texas

(Address of principal executive offices)

(469) 357-1000

(Zip code)

(Registrant's telephone number, including area code)

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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  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of August 1, 2007, the Registrant had 21,308,220 shares of \$0.00025 par value Common Stock outstanding.

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**i2 TECHNOLOGIES, INC.  
QUARTERLY REPORT ON FORM 10-Q**

**June 30, 2007**

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**Table of Contents****PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****i2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par value)****(unaudited)**

|  | <b>June 30,</b> | <b>December 31,</b> |
|--|-----------------|---------------------|
|  | <b>2007</b>     | <b>2006</b>         |
| <b>ASSETS</b>  |                 |                     |
| Current assets:  |                 |                     |
| Cash and cash equivalents  | \$ 110,989      | \$ 109,419          |
| Restricted cash  | 6,282           | 4,626               |
| Accounts receivable, net   | 26,294          | 25,677              |
| Other current assets   | 8,330           | 9,231               |
| Total current assets   | 151,895         | 148,953             |
| Premises and equipment, net  | 9,519           | 10,691              |
| Goodwill   | 16,685          | 14,760              |
| Non-current deferred tax asset   | 8,719           | 8,060               |
| Other non-current assets   | 8,117           | 7,605               |
| Total assets   | \$ 194,935      | \$ 190,069          |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>  |                 |                     |
| Current liabilities:   |                 |                     |
| Accounts payable   | \$ 6,847        | \$ 11,283           |
| Accrued liabilities  | 16,981          | 22,245              |
| Accrued compensation and related expenses  | 16,731          | 24,010              |
| Deferred revenue   | 72,287          | 74,047              |
| Total current liabilities  | 112,846         | 131,585             |
| Total long-term debt, net  | 84,138          | 83,822              |
| Taxes payable  | 4,044           |                     |
| Total liabilities  | 201,028         | 215,407             |
| Commitments and contingencies  |                 |                     |
| Stockholders' deficit:   |                 |                     |
| Preferred Stock, \$0.001 par value, 5,000 shares authorized, none issued and outstanding   |                 |                     |
| Series A junior participating preferred stock, \$0.001 par value, 2,000 shares authorized, none issued and outstanding   |                 |                     |
| Series B 2.5% convertible preferred stock, \$1,000 par value, 150 shares authorized, 105 issued and outstanding at June 30, 2007 and December 31, 2006               |                 |                     |
|  | 101,903         | 101,686             |
| Common stock, \$0.00025 par value, 2,000,000 shares authorized, 21,298 and 21,005 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively |                 |                     |
|  | 5               | 5                   |

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|   |              |              |
|---|--------------|--------------|
| Additional paid-in capital                  | 10,452,568   | 10,442,261   |
| Accumulated other comprehensive income      | 6,041        | 2,398        |
| Accumulated deficit                         | (10,566,610) | (10,571,688) |
| Net stockholders' deficit                   | (6,093)      | (25,338)     |
| Total liabilities and stockholders' deficit | \$ 194,935   | \$ 190,069   |

**See accompanying notes to condensed consolidated financial statements.**

**Table of Contents****i2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME****(In thousands, except per share data)****(unaudited)**

|   | <b>Three Months Ended<br/>June 30,</b> |                 | <b>Six Months Ended<br/>June 30,</b> |                 |
|---|--|-----------------|--------------------------------------|-----------------|
|   | <b>2007</b>                            | <b>2006</b>     | <b>2007</b>                          | <b>2006</b>     |
| <b>Revenues:</b>  |  |                 |                                      |                 |
| Software solutions  | \$ 11,412                              | \$ 15,388       | \$ 24,845                            | \$ 32,310       |
| Services  | 31,553                                 | 26,143          | 60,248                               | 50,017          |
| Maintenance   | 22,018                                 | 23,120          | 43,027                               | 46,335          |
| Contract  |  | 33              | 2,450                                | 66              |
| <b>Total revenues</b>   | <b>64,983</b>                          | <b>64,684</b>   | <b>130,570</b>                       | <b>128,728</b>  |
| <b>Costs and expenses:</b>  |  |                 |                                      |                 |
| <b>Cost of revenues:</b>  |  |                 |                                      |                 |
| Software solutions  | 2,175                                  | 2,447           | 4,649                                | 5,850           |
| Services and maintenance  | 27,267                                 | 24,376          | 54,047                               | 47,846          |
| Amortization of acquired technology                                   | 6                                      |                 | 12                                   |                 |
| Sales and marketing   | 12,957                                 | 12,573          | 24,654                               | 23,669          |
| Research and development  | 8,750                                  | 8,932           | 17,555                               | 17,879          |
| General and administrative  | 10,549                                 | 11,843          | 20,928                               | 25,381          |
| Amortization of intangibles   | 25                                     |                 | 28                                   |                 |
| Restructuring charges and adjustments                                 | (49)                                   | (95)            | (75)                                 | (145)           |
| <b>Total costs and expenses</b>                                       | <b>61,680</b>                          | <b>60,076</b>   | <b>121,798</b>                       | <b>120,480</b>  |
| <b>Operating income</b>   | <b>3,303</b>                           | <b>4,608</b>    | <b>8,772</b>                         | <b>8,248</b>    |
| <b>Non-operating (expense) income, net:</b>                           |  |                 |                                      |                 |
| Interest income   | 1,302                                  | 1,172           | 2,648                                | 2,218           |
| Interest expense  | (1,236)                                | (1,532)         | (2,476)                              | (3,072)         |
| Realized gains on investments, net                                    |  | 6               |                                      | 591             |
| Foreign currency hedge and transaction losses, net                    | (74)                                   | 177             | (191)                                | (39)            |
| Other expense, net  | (231)                                  | (333)           | (553)                                | (51)            |
| <b>Total non-operating expense, net</b>                               | <b>(239)</b>                           | <b>(510)</b>    | <b>(572)</b>                         | <b>(353)</b>    |
| <b>Income before income taxes</b>                                     | <b>3,064</b>                           | <b>4,098</b>    | <b>8,200</b>                         | <b>7,895</b>    |
| <b>Income tax expense</b>   | <b>740</b>                             | <b>1,297</b>    | <b>1,598</b>                         | <b>3,311</b>    |
| <b>Net income</b>   | <b>\$ 2,324</b>                        | <b>\$ 2,801</b> | <b>\$ 6,602</b>                      | <b>\$ 4,584</b> |
| <b>Preferred stock dividend and accretion of discount</b>             | <b>765</b>                             | <b>770</b>      | <b>1,524</b>                         | <b>1,399</b>    |
| <b>Net income applicable to common stockholders</b>                   | <b>\$ 1,559</b>                        | <b>\$ 2,031</b> | <b>\$ 5,078</b>                      | <b>\$ 3,185</b> |
| <b>Net income per common share applicable to common stockholders:</b> |  |                 |                                      |                 |

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|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.06 | \$ 0.08 | \$ 0.20 | \$ 0.13 |
| Diluted | \$ 0.06 | \$ 0.08 | \$ 0.19 | \$ 0.12 |

Weighted-average common shares outstanding:

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | 25,770 | 25,247 | 25,690 | 25,221 |
| Diluted | 26,806 | 25,699 | 26,870 | 25,738 |

**See accompanying notes to condensed consolidated financial statements.**

**Table of Contents****i2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME****(In thousands, except per share data)****(unaudited)**

|  | <b>Three Months Ended June 30,</b> |                 | <b>Six Months Ended June 30,</b> |                 |
|--|------------------------------------|-----------------|----------------------------------|-----------------|
|  | <b>2007</b>                        | <b>2006</b>     | <b>2007</b>                      | <b>2006</b>     |
| <b>Comprehensive income:</b>                 |                                    |                 |                                  |                 |
| Net income applicable to common stockholders | \$ 1,559                           | \$ 2,031        | \$ 5,078                         | \$ 3,185        |
| <b>Other comprehensive income:</b>           |                                    |                 |                                  |                 |
| Foreign currency translation adjustments     | 2,918                              | 1,776           | 3,643                            | 2,192           |
| <b>Total other comprehensive income</b>      | <b>2,918</b>                       | <b>1,776</b>    | <b>3,643</b>                     | <b>2,192</b>    |
| <b>Total comprehensive income</b>            | <b>\$ 4,477</b>                    | <b>\$ 3,807</b> | <b>\$ 8,721</b>                  | <b>\$ 5,377</b> |

**See accompanying notes to condensed consolidated financial statements.**



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|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2007</b>                          | <b>2006</b> |
| <b>Cash flows from operating activities:</b>   |                                      |             |
| Net income   | \$ 6,602                             | \$ 4,584    |
| Adjustments to reconcile net income to net cash provided by operating activities:      |                                      |             |
| Depreciation and amortization  | 3,290                                | 3,695       |
| Stock based compensation   | 7,347                                | 8,930       |
| Gain on extinguishment of debt   |                                      | (3)         |
| Gain on sale of securities   |                                      | (501)       |
| Loss (gain) on disposal of equipment   | 222                                  | (29)        |
| Provision (credit) for bad debts charged to costs and expenses                         | (116)                                | 64          |
| Deferred income taxes  | (92)                                 | 549         |
| Changes in operating assets and liabilities, excluding the effects of acquisitions:    |                                      |             |
| Accounts receivable  | (440)                                | 3,195       |
| Other assets   | 3,791                                | 2,889       |
| Accounts payable   | (863)                                | (1,035)     |
| Accrued liabilities  | (5,442)                              | (10,237)    |
| Accrued compensation and related expenses  | (7,516)                              | (4,463)     |
| Deferred revenue   | (1,688)                              | 4,475       |
| Net cash provided by operating activities  | 5,095                                | 12,113      |
| <b>Cash flows used in investing activities:</b>  |                                      |             |
| Restrictions placed on cash  | (1,656)                              | (262)       |
| Purchases of premises and equipment  | (1,209)                              | (1,267)     |
| Proceeds from sale of premises and equipment   | 12                                   | 141         |
| Proceeds from sale of securities   |                                      | 501         |
| Business acquisition   | (2,125)                              | (569)       |
| Net cash used in investing activities  | (4,978)                              | (1,456)     |
| <b>Cash flows provided by financing activities:</b>                                    |                                      |             |
| Repurchase of debt   |                                      | (3,149)     |
| Proceeds from sale of convertible debt   |                                      | 7,500       |
| Cash dividends paid preferred stock  | (1,307)                              |             |
| Payment of debt issuance costs   |                                      | (483)       |
| Net proceeds from common stock issuance from options and employee stock purchase plans | 2,960                                | 754         |
| Net cash provided by financing activities  | 1,653                                | 4,622       |
| Effect of exchange rates on cash   | (200)                                | 439         |
| Net change in cash and cash equivalents  | 1,570                                | 15,718      |
| Cash and cash equivalents at beginning of period                                       | 109,419                              | 112,882     |

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|  |            |            |
|--|------------|------------|
| Cash and cash equivalents at end of period | \$ 110,989 | \$ 128,600 |
|--|------------|------------|

**Supplemental cash flow information**

|   |          |          |
|---|----------|----------|
| Interest paid                               | \$ 2,156 | \$ 2,688 |
| Income taxes paid (net of refunds received) | \$ 1,772 | \$ 2,587 |

**Schedule of non-cash financing activities**

|  |        |          |
|--|--------|----------|
| Preferred stock dividend and accretion of discount | \$ 217 | \$ 1,399 |
|--|--------|----------|

**See accompanying notes to condensed consolidated financial statements.**

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**i2 TECHNOLOGIES, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Table dollars in thousands, except per share data)**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

*Nature of Operations.* We are a provider of supply chain management solutions, including various software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by managing variability, reducing complexity, improving operational visibility, increasing operating velocity and integrating planning and execution. Our offerings are designed to help customers better achieve the following critical business objectives:

Visibility a clear and unobstructed view up and down the supply chain

Planning supply chain optimization to match supply and demand considering system-wide constraints

Collaboration interoperability with supply chain partners and elimination of functional silos

Control management of data and business processes across the extended supply chain

Our application software is often bundled with other service offerings we provide such as business optimization and technical consulting, training, solution maintenance, software upgrades and development.

*Basis of Presentation.* Our unaudited condensed consolidated financial statements have been prepared by management and reflect all adjustments (all of which are normal and recurring in nature, with the exception of certain accruals, mainly related to 2006, discussed in *Note 7, Commitments and Contingencies*) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2007. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted under the Securities and Exchange Commission's (SEC) rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, presented in our Annual Report on Form 10-K for the year ended December 31, 2006 filed on March 30, 2007 with the SEC (2006 Annual Report on Form 10-K).

*Recent Accounting Pronouncements.* On July 13, 2006, the FASB issued FIN No. 48 *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 applies to all tax positions related to income taxes subject to FAS 109, and is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 on January 1, 2007, as required. See *Note 9, Income Taxes*, for further discussion. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement applies to other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. We plan to adopt SFAS No. 157 beginning in the first quarter of 2008. We are currently evaluating the impact of SFAS No. 157 on our financial statements.

In February 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard permits but does not require entities to measure many financial instruments and certain other items at fair value. Once an entity has elected the fair value

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option for designated financial instruments and other items, changes in fair value must be recognized in the statement of operations. The election is irrevocable once made. The

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statement is effective for the first fiscal year after November 15, 2007. We are currently evaluating the accounting permitted by the standard and have not determined if the fair value option will be elected for eligible financial instruments or other items.

**2. Investment Securities**

Short-term time deposits and other liquid investments in debt securities with original maturities of less than three months when acquired are classified as available-for-sale and reported as cash and cash equivalents on our condensed consolidated balance sheet. Based on their maturities, interest rate movements do not affect the balance sheet valuation of these investments. Investment securities reported as cash and cash equivalents as of June 30, 2007 and December 31, 2006 were as follows:

|                          | June 30,<br>2007 | December 31,<br>2006 |
|--------------------------|------------------|----------------------|
| Short-term time deposits | 3,693            | \$ 4,048             |
| Commercial paper         | 86,855           | 86,376               |
|                          | \$ 90,548        | \$ 90,424            |

In addition to our investment securities, we hold minority equity investments in several privately-held companies, many of which can still be considered in the start-up or development stages or may no longer be viable or operational. At June 30, 2007, the carrying amount of our minority equity investments was zero.

**3. Borrowings and Debt Issuance Costs**

The following table summarizes the outstanding debt and related capitalized debt issuance costs recorded on our condensed consolidated balance sheet at June 30, 2007 and December 31, 2006.

|   | June 30,<br>2007 | December 31,<br>2006 |
|---|------------------|----------------------|
| Senior convertible notes, 5% annual rate payable semi-annually, due November 15, 2015 | 86,250           | 86,250               |
| Unamortized discount on 5% notes  | (2,112)          | (2,428)              |
| <b>Total debt</b>   | <b>\$ 84,138</b> | <b>\$ 83,822</b>     |
| Capitalized debt issuance costs, net  | \$ 3,699         | \$ 4,203             |

We record capitalized debt issuance costs, net of accumulated amortization, in other non-current assets and are amortizing these costs over a five-year period, beginning in November 2005.

In connection with the issuance of our 5% senior convertible notes, we issued certain warrants to purchase our common stock. We assessed the characteristics of the warrants and determined that they should be included in additional paid in capital in the stockholders' deficit portion of our condensed consolidated balance sheet, valued using a Black-Scholes model. The effect of recording the warrants as equity is that the 5% senior convertible notes are recorded at an original discount to their face value. The discount recorded was originally \$3.1 million, and this discount is being accreted as interest expense through earnings over five years. We determined a five-year life to be appropriate due to the conversion features of the 5% senior convertible notes and our assessment of the probability that the debt would be converted prior to the scheduled maturity.

**4. Restructuring Charges and Adjustments**

*Restructuring Plans.* In previous periods, we implemented restructuring plans to reduce operating expenses. See *Note 11, Restructuring Charges and Adjustments*, in our Notes to Consolidated Financial Statements in our 2006 Annual Report on Form 10-K for a description of our

restructuring plans.

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The following table summarizes the changes to previously established restructuring accruals, as well as the components of the remaining restructuring accruals, net of estimated sublease income of \$0.1 million.

|  | Employee Severance and Termination |        | Office Closure and Consolidation |          | Total  |          |
|--|------------------------------------|--------|----------------------------------|----------|--------|----------|
|  | 2007                               | 2006   | 2007                             | 2006     | 2007   | 2006     |
| January 1,                                       | \$ 192                             | \$ 234 | \$ 123                           | \$ 1,343 | \$ 315 | \$ 1,577 |
| Adjustments to 2001 and 2002 restructuring plans | (8)                                |        | (17)                             | (50)     | (25)   | (50)     |
| Cash payments                                    |                                    | (6)    | (32)                             | (358)    | (32)   | (364)    |
| Remaining accrual balance at March 31,           | \$ 184                             | \$ 228 | \$ 74                            | \$ 935   | \$ 258 | \$ 1,163 |
| Adjustments to 2001 and 2002 restructuring plans |                                    | (36)   | (49)                             | (59)     | (49)   | (95)     |
| Cash payments                                    |                                    |        | 10                               | (294)    | 10     | (294)    |
| Remaining accrual balance at June 30,            | \$ 184                             | \$ 192 | \$ 35                            | \$ 582   | \$ 219 | \$ 774   |

In late July and August 2007, we conducted a restructuring program. See *Note 10, Subsequent Events* for more information regarding such program.

**5. Net Income Per Common Share**

*Net Income Per Common Share.* Basic net income per common share was computed by dividing net income applicable to common stockholders by the weighted average number of common shares outstanding for the reporting period following the two-class method. The effect of our participating convertible preferred stock is included in basic earnings per share under the two-class method per EITF 03-6, *Participating Securities and the Two-Class Method* under FASB No. 128 *Earnings per Share*.

Diluted income per common share includes the dilutive effect of stock options, share rights awards, and warrants granted using the treasury stock method, and the effect of contingently issuable shares earned during the period and shares issuable under the conversion feature of our convertible debt. A loss causes all common stock equivalents to be anti-dilutive due to an increase of the weighted average shares from the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. EITF 04-8 requires the inclusion of the effect of contingently convertible instruments in the calculation of diluted income per share, including when the market price of our common stock is below the conversion price of the convertible security and the effect is not anti-dilutive. Accordingly, our convertible debt is considered in the calculation of diluted earnings per share although it is not dilutive for any of the periods presented.

The following is a reconciliation of the number of shares used in the calculation of basic income per share under the two-class method and diluted earnings per share and the number of anti-dilutive shares excluded from such computations for the three months and six months ended June 30, 2007 and June 30, 2006.

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|   | Three Months Ended June 30, |               | Six Months Ended June 30, |               |
|---|-----------------------------|---------------|---------------------------|---------------|
|   | 2007                        | 2006          | 2007                      | 2006          |
| Common and common equivalent shares outstanding using two-class method basic:             |                             |               |                           |               |
| Weighted average common shares outstanding  | 21,222                      | 20,755        | 21,142                    | 20,729        |
| Participating convertible preferred stock   | 4,548                       | 4,492         | 4,548                     | 4,492         |
| <b>Total common and common equivalent shares outstanding using two-class method basic</b> | <b>25,770</b>               | <b>25,247</b> | <b>25,690</b>             | <b>25,221</b> |
| Effect of dilutive securities:  |                             |               |                           |               |
| Outstanding stock option and share right awards   | 916                         | 452           | 1,031                     | 517           |
| Warrants associated with 5% debt  | 120                         |               | 149                       |               |
| <b>Weighted average common and common equivalent shares outstanding diluted</b>           | <b>26,806</b>               | <b>25,699</b> | <b>26,870</b>             | <b>25,738</b> |
| Anti-dilutive shares excluded from calculation:   |                             |               |                           |               |
| Outstanding stock option and share right awards   | 1,686                       | 1,509         | 1,570                     | 1,500         |
| Warrants  |                             | 484           |                           | 484           |
| Convertible debt  | 949                         | 24            | 949                       | 25            |
| <b>Total anti-dilutive shares excluded from calculation</b>                               | <b>2,635</b>                | <b>2,017</b>  | <b>2,519</b>              | <b>2,009</b>  |

**6. Segment Information, International Operations and Customer Concentrations**

We operate our business in one segment as defined by SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. This segment is supply chain management solutions, which is designed to help enterprises optimize business processes both internally and among trading partners.

We market our software and services primarily through our worldwide sales organization augmented by other service providers, including both domestic and international systems consulting and integration firms and other industry-related partners. Our Chief Executive Officer (CEO) evaluates resource allocation decisions and our performance based on financial information, presented on a consolidated basis, accompanied by disaggregated information by geographic regions. Sales to our customers generally include products from some or all of our product suites. We have not consistently allocated revenues from such sales to individual products for internal or general-purpose financial statements.

Revenues are attributable to regions based on the locations of the customers' operations. Total revenues by geographic region, as reported to our CEO, were as follows:

|   | Three Months Ended June 30, |                  | Six Months Ended June 30, |                   |
|---|-----------------------------|------------------|---------------------------|-------------------|
|   | 2007                        | 2006             | 2007                      | 2006              |
| United States                                       | \$ 37,005                   | \$ 35,405        | \$ 75,046                 | \$ 70,240         |
| International revenue:                              |                             |                  |                           |                   |
| Non-US Americas                                     | 1,959                       | 3,090            | 3,307                     | 6,573             |
| Europe, Middle East and Africa                      | 13,205                      | 11,380           | 29,391                    | 23,798            |
| Greater Asia Pacific                                | 12,814                      | 14,809           | 22,826                    | 28,117            |
| <b>Total international revenue</b>                  | <b>27,978</b>               | <b>29,279</b>    | <b>55,524</b>             | <b>58,488</b>     |
| <b>Total Revenue</b>                                | <b>\$ 64,983</b>            | <b>\$ 64,684</b> | <b>\$ 130,570</b>         | <b>\$ 128,728</b> |
| International revenue as a percent of total revenue | 43%                         | 45%              | 43%                       | 45%               |

No individual customer accounted for more than 10% of our total revenues during the periods presented.

Long-lived assets by geographic region excluding deferred taxes, as reported to our CEO, were as follows:



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|                             | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|-----------------------------|--------------------------|------------------------------|
| United States               | \$ 31,543                | \$ 30,224                    |
| Europe, Middle East, Africa | 154                      | 210                          |
| Greater Asia Pacific        | 2,624                    | 2,622                        |
| Total Long Lived Assets     | \$ 34,321                | \$ 33,056                    |

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**7. Commitments and Contingencies**

*Derivative Action*

On March 7, 2007, a purported shareholder derivative lawsuit was filed in the Delaware Chancery Court against certain of our current and former officers and directors, naming the company as a nominal defendant. The complaint, entitled *George Keritsis and Mark Kert v. Michael E. McGrath, Michael J. Berry, Pallab K. Chatterjee, Robert C. Donohoo, Hiten D. Varia, M. Miriam Wardak, Sanjiv S. Sidhu, Stephen P. Bradley, Harvey B. Cash, Richard L. Clemmer, Lloyd G. Waterhouse, Jackson L. Wilson Jr., Robert L. Crandall and i2 Technologies, Inc.*, alleges breach of fiduciary duty and unjust enrichment in connection with stock option grants to certain of the defendant officers and directors on three dates in 2004 and 2005. The complaint states that those stock option grants were manipulated so as to work to the recipients' favor when material non-public information about the company was later disclosed to positive or negative effect. The complaint is derivative in nature and does not seek relief from the company, but does seek damages and other relief from the defendant officers and directors. We have entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors and may be obligated throughout the pendency of this action to advance payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of this matter.

*Indemnification Agreements*

We have indemnification agreements with certain of our officers, directors and employees that may require us, among other things, to indemnify such officers, directors and employees against certain liabilities that may arise by reason of their status or service as directors, officers or employees and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified. We have also entered into agreements regarding the advancement of costs with certain other officers and employees.

Pursuant to these indemnification and cost-advancement agreements, we have advanced fees and expenses incurred by certain current and former directors, officers and employees in connection with the governmental investigations and actions related to the 2003 restatement of our consolidated financial statements and other matters. We incurred no such expenses during the three months ended June 30, 2007 and incurred approximately \$3.2 million of such expenses during the three months ended June 30, 2006; we incurred approximately \$0.1 million and \$5.2 million of such expenses during the six months ended June 30, 2007 and June 30, 2006, respectively.

We may continue to advance fees and expenses incurred by certain current and former directors, officers and employees in the future. The maximum potential amount of future payments we could be required to make under these indemnification and cost-advancement agreements is unlimited. Additionally, our corporate by-laws allow us to choose to indemnify any employee for certain events or occurrences while the employee is, or was, serving at our request in such capacity.

Under the terms of our software license agreements with our customers, we agree that in the event the licensed software infringes upon any patent, copyright, trademark, or any other proprietary right of a third-party, we will indemnify our customer licensees against any loss, expense, or liability from any damages that may be awarded against our customer. We include this infringement indemnification in substantially all of our software license agreements and selected managed service arrangements. In the event the customer cannot use the software or service due to infringement and we can not obtain the right to use, replace or modify the software or service in a commercially feasible

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manner so that it no longer infringes, then we may terminate the license and provide the customer a pro-rata refund of the fees paid by the customer for the infringing software or service. We have not recorded any liability associated with this indemnification, as we are not aware of any pending or threatened infringement actions that are probable losses. We believe the estimated fair value of these intellectual property indemnification clauses is minimal.

If we believe a liability associated with any of the aforementioned indemnification obligations becomes probable and the amount of the liability is reasonably estimable then an appropriate liability will be recorded in our financial statements.

*India Tax Assessments*

We are under tax examinations in India primarily related to our intercompany pricing for services rendered by our Indian subsidiary to other i2 companies and our qualification for a tax holiday. We have been assessed approximately \$3.3 million, \$1.1 million, and \$2.0 million for the Indian statutory fiscal years ended March 31, 2002, 2003 and 2004, respectively. We have paid approximately \$3.1 million of the assessments related to the Indian statutory fiscal year ended March 31, 2002.

We believe the Indian tax authorities' positions regarding our intercompany transactions and tax holiday qualification are without merit, that all intercompany transactions were conducted at appropriate pricing levels and that our operations qualify for the tax holiday claimed. Accordingly, we have appealed all of the assessments discussed above and expect the ultimate resolution will not exceed the tax contingency reserves we have established for these matters.

We have also sought assistance from the United States competent authority under the mutual agreement procedure of the income tax treaty between the United States and India. This assistance does not guarantee favorable resolution of these assessments but provides us with an opportunity to resolve these matters in an environment which includes governmental representatives of both countries. By invoking the mutual agreement procedure and pursuant to our requests for a Stay of Demand for Payment, we are required to issue a bank guarantee in favor of the Indian government in an amount equal to the assessed tax and interest. We have issued such bank guarantee regarding the assessment related to the Indian statutory fiscal year ended March 31, 2003. Based on recent discussions with the Indian tax authorities, we may be required to issue a cash payment in an amount up to 25% of the bank guarantee, or approximately \$0.3 million during the third quarter of 2007. A similar bank guarantee for the Indian statutory fiscal year ended March 31, 2004 will be issued in the future, likely with a similar required cash payment of 25% of the bank guarantee, or approximately \$0.6 million during the third or fourth quarter of 2007.

*Certain Accruals*

We have accrued for estimated losses in the accompanying condensed consolidated financial statements for matters where we believe the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

We are subject to various claims and legal proceedings that arise in the ordinary course of our business from time to time, including claims and legal proceedings that have been asserted against us by former employees and certain customers, and have been in negotiations to settle certain of those contingencies. The adverse resolution of any one or more of those matters or the matters described above, over and above the amount, if any, that has been estimated and accrued in our condensed consolidated financial statements could have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

**8. Stock-Based Compensation Plans.**

For a description of our stock-based compensation plans, see *Note 10, Stock-Based Compensation*, in our Notes to Consolidated Financial Statements filed in our 2006 Annual Report on Form 10-K.

Stock-based compensation expense for the three-month and six-month periods ended June 30, 2007 and June 30, 2006 is as follows:

|                                 | Three Months Ended June 30, |        | Six Months Ended June 30, |          |
|---------------------------------|-----------------------------|--------|---------------------------|----------|
|                                 | 2007                        | 2006   | 2007                      | 2006     |
| Cost of service and maintenance | \$ 654                      | \$ 945 | \$ 1,317                  | \$ 1,713 |
| Sales and marketing             | 676                         | 1,130  | 1,774                     | 2,235    |
| Research and development        | 713                         | 1,220  | 1,604                     | 2,344    |

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|                            |          |          |          |          |
|----------------------------|----------|----------|----------|----------|
| General and administrative | 1,125    | 1,235    | 2,652    | 2,638    |
| Total                      | \$ 3,168 | \$ 4,530 | \$ 7,347 | \$ 8,930 |

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Included in stock-based compensation expense was restricted stock expense of \$0.2 million and \$0.1 million for the three-month periods ended June 30, 2007 and June 30, 2006, respectively, and \$1.2 million and \$0.2 million for the six-month periods ended June 30, 2007 and June 30, 2006, respectively.

In February 2007, we made a grant of Restricted Stock Units ( RSUs ) to certain key employees that vest based on specified performance over a two-year performance period. We are required to assess whether the performance criteria is probable of being achieved, and only recognize compensation expense if the vesting is considered probable. As of June 30, 2007, we assessed that vesting is not probable and reversed approximately \$0.3 million of the previously recorded compensation expense associated with the RSUs in the second quarter of 2007.

Fair values of stock options and employee stock purchase plan (ESPP) shares are estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

|                         | Stock Options                  |       | ESPP                           |       | Stock Options                |       | ESPP                         |       |
|-------------------------|--------------------------------|-------|--------------------------------|-------|------------------------------|-------|------------------------------|-------|
|                         | Three Months Ended<br>June 30, |       | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|                         | 2007                           | 2006  | 2007                           | 2006  | 2007                         | 2006  | 2007                         | 2006  |
| Expected term (years)   | 4.00                           | 4     | 0.5                            | 0.5   | 4                            | 4     | 0.5                          | 0.5   |
| Volatility factor       | 0.78                           | 0.91  | 0.36                           | 0.51  | 0.81                         | 0.96  | 0.34                         | 0.72  |
| Risk-free interest rate | 4.77%                          | 4.99% | 4.64%                          | 4.77% | 4.70%                        | 4.77% | 4.66%                        | 4.54% |
| Dividend yield          | 0%                             | 0%    | 0%                             | 0%    | 0%                           | 0%    | 0%                           | 0%    |

**9. Income Taxes**

Income taxes have been provided using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ). In accordance with Accounting Principles Board Opinion No. 28, *Interim Financial Reporting* ( APB 28 ), and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods – an interpretation of APB Opinion No. 28* ( FIN 18 ), the provision for income taxes reflects the Company's estimate of the effective rate expected to be applicable for the full fiscal year, adjusted by any discrete events which are reported in the period in which they occur. This estimate is re-evaluated each quarter based on our estimated tax expense for the year.

We recognized income tax expense of approximately \$0.7 million for the three months ended June 30, 2007 and \$1.3 million for the three months ended June 30, 2006, representing effective income tax rates of 24.1% and 31.6%, respectively. Factors that affect income tax expense include, among others, the effect of foreign operations, state income taxes (net of federal income tax benefits), non-deductible meals and entertainment, research and development tax credits, and the effect of foreign withholding taxes. Income tax expense included the effect of foreign withholding taxes of \$1.0 million for the three months ended June 30, 2007 and \$0.8 million for the three months ended June 30, 2006. Foreign withholding taxes are recorded when incurred, normally upon receipt of payments from certain non-US customers, and affect our income tax expense due to our domestic valuation allowance. Accordingly, our effective income tax rates during the three months ended June 30, 2007 and June 30, 2006, as well as the six months ended June 30, 2007 and June 30, 2006, differ from the U.S. statutory rate primarily due to changes in our valuation allowance. In addition, on June 14, 2007 we were notified by the United Kingdom tax authorities that the tax examination related to the 2003 tax year had been concluded and that the issue for which we had previously accrued a \$0.8 million tax liability had been resolved in our favor. As a result, we reversed the \$0.8 million tax liability during the three-month period ended June 30, 2007 and this reversal is reflected as a credit to our income tax expense for the period.

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We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ) on January 1, 2007. As a result of the implementation of FIN 48, there was no adjustment to the January 1, 2007 balance of our accumulated deficit.

Estimated potential interest and penalties related to our unrecognized tax benefits within our global organization is recorded in income tax expense and totaled approximately \$0.2 million for the three months ended June 30, 2007. Accrued interest and penalties were approximately \$1.1 million and \$1.6 million as of January 1, 2007 and June 30, 2007, respectively. Management believes recording interest and penalties related to income tax uncertainties as income tax expense better reflects income tax expense and provides better information reporting.

We or one of our subsidiaries file income tax returns in the United States (U.S.) federal jurisdiction and various state and foreign jurisdictions. We have open tax years for the U.S. federal return back to 1992 with respect to our net operating loss ( NOL ) carryforwards, where the IRS may not raise tax for these years, but can reduce NOLs. Otherwise, with few exceptions, we are no longer subject to federal, state, local or foreign income tax examinations for years prior to 2003.

We are subject to potential change by various tax jurisdictions in the inter-company pricing at which we have conducted business within our global related group of companies. Additional tax examinations may be opened or existing examinations may be resolved within the next 12 months. We closely monitor developments in this area and make changes as necessary in the accruals we have made for what we believe will be the ultimate outcome of any tax adjustments. It is reasonably possible that, within the next 12 months, the accrual we have recorded for this issue may increase by approximately \$0.5 million to \$1.2 million.

We plan to file amended state income tax returns related to adjustments made to our 1999-2001 federal taxable income as a result of our previous IRS examination, which was concluded in 2003 and had no material federal income tax effect. We believe we have fully accrued all state income tax liability related to these filings. Upon filing the returns, the recorded tax liability will be eliminated. Any difference between the ultimate income tax liability on the filed returns and our existing accrual will be recorded in the quarter in which the returns are filed. It is not expected that such difference, if any, will be material.

As part of the process of preparing unaudited condensed consolidated financial statements, we are required to estimate our full-year income and the related income tax expense in each jurisdiction in which we operate. Changes in the geographical mix or estimated level of annual pre-tax income can impact our effective tax rate. This process involves estimating our current tax liabilities in each jurisdiction in which we operate, including the impact, if any, of additional taxes resulting from tax examinations, as well as making judgments regarding the recoverability of deferred tax assets. To the extent recovery of deferred tax assets is not likely based on, among other things, our estimation of future taxable income in each jurisdiction, a valuation allowance is established. Tax liabilities can involve complex issues and may require an extended period to resolve.

## **10. Subsequent Events**

Effective July 30, 2007, Michael McGrath resigned his positions as i2 CEO and president, and Pallab K. Chatterjee, executive vice president and chief delivery officer, was appointed interim CEO. As a result, Mr. Chatterjee is now our principal executive officer. Mr. McGrath will remain employed as CEO Emeritus and has agreed to resign this position on October 31, 2007. Mr. McGrath is no longer an officer of the Company and his only duties and responsibilities as CEO Emeritus will be to assist the Board of Directors, as requested or directed by the Board, in identifying, selecting, recruiting and interviewing candidates to fill the position of CEO on a permanent basis and in respect of such other strategic matters as may be determined from time to time by the Board in its sole discretion. Notwithstanding the foregoing, the Board may terminate Mr. McGrath's employment as CEO Emeritus prior to October 31, 2007 for cause or if Mr. McGrath breaches or violates any of the terms of the Resignation Agreement or the General Release.

In late July 2007, we initiated a reorganization eliminating approximately 45 positions. The third quarter 2007 charge is expected to be approximately \$3.0 million, primarily related to severance costs.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**Forward-Looking Statements**

This report contains 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. All statements other than statements of historical or current facts, including, without limitation, statements about our business strategy, plans, objectives and future prospects, are forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from these expectations, which could have a material adverse effect on our business, results of operations, cash flow and financial condition. Such risks and uncertainties include, without limitation, the following:

We have recently implement restructuring and reorganization initiatives. Failure to achieve the desired results of our restructuring and reorganization initiatives could harm our business, results of operations, cash flow and financial condition.

Effective July 30, 2007, our Chief Executive Officer resigned. Failure to appoint a permanent CEO with the appropriate level of experience could harm our business, results of operations, cash flow and financial condition.

Our financial results have varied and may continue to vary significantly from quarter-to-quarter. We may fail to meet analysts' and investors' expectations.

We have historically experienced negative cash flows. A failure to maintain profitability and achieve consistent positive cash flows would have a significant adverse effect on our business, impair our ability to support our operations and adversely affect our liquidity.

Holders of our 5% senior convertible notes may convert the senior convertible notes upon the occurrence of certain events prior to May 15, 2010, and at any time on or after May 15, 2010, and have the right to require us to repurchase all or any portion of the senior convertible notes on November 15, 2010. There is no assurance that at the time of conversion or required repurchase, we will have the ability to satisfy the cash portion of any such conversion obligation or to make any such required repurchase.

We may require additional private or public debt or equity financing. Such financing may only be available on disadvantageous terms, or may not be available at all. Any new financing could have a substantial dilutive effect on our existing shareholders.

The indenture governing our 5% senior convertible notes contains a debt incurrence covenant that places restrictions on the amount and type of additional indebtedness that we can incur. The debt incurrence restrictions imposed by the indenture could restrict or impede our ability to incur additional debt, which in turn could impair our ability to support our operations, adversely affect our liquidity and threaten our ability to repay our debts when they become due.

If we are unable to develop and generate additional demand for our products, serious harm could result to our business.

We may not be competitive, and increased competition could seriously harm our business. Our strategy to sell new-generation solutions may not be successful.

We face risks related to product quality and performance claims and other litigation that could have a material adverse effect on our relationships with customers and our business, results of operations, cash flow and financial condition. We may face other claims and litigation in the future that could harm our business and impair our liquidity.

Loss of key personnel or our failure to attract, train and retain additional personnel could negatively affect our operating results and revenues and seriously harm our company.

We face other risks indicated in Item 1A, Risk Factors, in our 2006 Annual Report on Form 10-K. Many of these risks and uncertainties are beyond our control and, in many cases, we cannot accurately predict the risks and uncertainties that could cause our actual results to differ materially from those indicated by the forward-looking statements. When used in this document, the words believes, plans, expects, anticipates, intends, continue, may, will, should or the negative of such terms and similar expressions relate to us, our customers or our management are intended to identify forward-looking statements.



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References in this report to the terms "optimal" and "optimization" and words to that effect are not intended to connote the mathematically optimal solution, but may connote near-optimal solutions, which reflect practical considerations such as customer requirements as to response time, precision of the results and other commercial factors.

### **Overview**

#### Nature of Operations

We are a provider of supply chain management solutions, including various software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by managing variability, reducing complexity, improving operational visibility, increasing operating velocity and integrating planning and execution. Our offerings are designed to help customers better achieve the following critical business objectives:

Visibility – a clear and unobstructed view up and down the supply chain

Planning – supply chain optimization to match supply and demand considering system-wide constraints

Collaboration – interoperability with supply chain partners and elimination of functional silos

Control – management of data and business processes across the extended supply chain

Our application software is often bundled with other service offerings we provide such as business optimization and technical consulting, training, solution maintenance, software upgrades and development.

#### Key Performance Indicators and Operating Metrics

In managing our business, management focuses on four principal financial areas: bookings, backlog and deferred revenue, revenues (excluding contract revenue, as discussed below), and cash flow/liquidity. Each of these areas is discussed in more detail below.

In our internal analysis of revenue, we review operating revenue, which we define as total revenue less contract revenue. We do not consider contract revenue indicative of the performance of our business since it related to sales prior to September 30, 2002 for which revenue was deferred as a result of a restatement in 2003 of our consolidated financial statements for the years ended December 31, 2000 and 2001 and the first three quarters of 2002. Inclusion of contract revenue in our evaluation of our performance would have overstated our periodic results since recognition was based on our fulfillment of contractual obligations, many of which required minimal cash outlays and generally did not relate to any significant activity in the period of recognition. Additionally, the cash associated with contract revenue had been collected in prior periods. All remaining contract revenue was recognized by March 31, 2007, so it is not relevant to our on-going operations and we exclude it from comparisons to prior period results.

Our operating revenue has remained relatively consistent in the past three years (approximately \$275 million, \$294 million and \$289 million in 2006, 2005 and 2004, respectively).

*Bookings.* We monitor bookings as an indicator of future revenue and cash flows. We define bookings as the non-contingent fees stated in a duly executed contract. We exclude from bookings any amounts subject to contingencies outside of our control, such as optional renewal periods, amounts subject to a customer's internal approvals, and amounts that are refundable for reasons outside of our standard warranty provisions. Because our revenues are recognized under several different accounting standards and thus are subject to variability quarter to quarter, we closely monitor our bookings as a leading indicator of the future revenues and overall performance of our business. Bookings result in future revenue as products are delivered or services are performed. The unrecognized portion of bookings represents our backlog of future revenues. We report the prepaid portion of backlog on our balance sheet as deferred revenue.



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Total bookings for the second quarter of 2007 and 2006 were \$75.0 million and \$75.4 million, respectively. Included in total bookings for the second quarter of 2007 are \$13.1 million related to the renewal of two supply chain leader agreements from 2004. Included in the second quarter of 2006 were \$10.5 million of platform technology bookings. Total bookings for the first quarter of 2007 and 2006 were \$61.5 million and \$61.6 million, respectively. . Seasonally our fiscal third quarter has been our lowest quarter for total bookings, as reflected in the \$56.4 million from the third quarter of 2006. Although total bookings have been relatively consistent since the beginning of 2006, the software solutions category of our bookings has varied widely from quarter to quarter since it is highly dependent on the timing of a small number of large multi-million dollar bookings.

*Backlog and Deferred revenue.* We review our backlog (contracted future revenue) and deferred revenue (prepaid portion of backlog, as reflected on our condensed consolidated balance sheet) to assess future revenue that may be recognized from bookings in previous fiscal periods. We monitor whether we are recognizing more or less revenue in each period compared to the amount we book in that period as an indicator of whether we are adding to or subtracting from our backlog and deferred revenue. We have generally been recognizing more revenue in each quarter than the corresponding amount of bookings, leading to a decline in our backlog and deferred revenue. As a result, in order to increase future revenues, our future bookings need to increase and consistently exceed our recognized revenue.

*Revenues.* Since the first quarter of 2006, our revenue (excluding contract revenue) has remained relatively constant. One key trend related to our software solutions revenue is our recognition from backlog versus new software solutions bookings. In 2005 and 2006 our total software solutions revenue consistently exceeded our new software solutions bookings, thereby reducing our backlog, as indicated in the table below. Our lower software solutions backlog entering 2007 resulted in lower software solutions revenue in the first six months of 2007 versus the comparable period in 2006. The trend in backlog is important to monitor as it illustrates that we are recognizing software solutions revenue at a rate greater than we are generating new software solutions bookings.

|   | Year Ended        |                   | Six Months Ended |               |
|---|-------------------|-------------------|------------------|---------------|
|   | December 31, 2005 | December 31, 2006 | June 30, 2006    | June 30, 2007 |
| <b>Additions to Backlog:</b>                |                   |                   |                  |               |
| Software Solutions Bookings                 | \$ 36,433         | \$ 49,540         | \$ 24,248        | \$ 26,243     |
| Platform Technology/Source Code Bookings    | 10,000            | 10,480            | 10,480           |               |
| Net Additions to Backlog                    | 46,433            | 60,020            | 34,728           | 26,243        |
| Less: Software Solutions Revenue Recognized | 89,937            | 76,243            | 32,310           | 24,845        |
| Increase/(Decrease) in Backlog              | \$ (43,504)       | \$ (16,223)       | \$ 2,418         | \$ 1,398      |

Our product and service offerings have changed in recent years in response to market demands as well as the introduction of new technology and products. We are transitioning to being a solutions-oriented provider, and accordingly have experienced a shift to a greater mix of services revenue versus software solutions revenue. These changes impact the mix of revenues we generate as well as the proportion of revenue recognized at the time of booking versus over time. We now expect that over time a higher proportion of our software solutions revenue will be recognized under a percentage of completion basis or subscription basis, rather than being recognized in the period the booking is signed.

Bookings that do not include essential services and are not recurring in nature are generally recognized as revenue in the same period the bookings are signed, unless there are concerns about collectibility which leads us to defer such recognition until receipt of payment. However, we have transitioned our offerings toward licensing New Generation Solutions, which generally require essential services and are recognized on a percentage of completion basis as the essential services are performed. Our Recurring items category of software solutions revenue includes: subscription arrangements which provide access to our current and future products over a contractually stated term, hosted offerings such as FreightMatrix, managed services arrangements such as Vendor Managed Inventory and short duration term licenses. Over time, the increasing proportion of revenues recognized under percentage of completion and our recurring items may reduce quarterly variability in software solutions revenues, since these revenues are recognized over time and

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are less dependent on the timing of signing of license transactions. There are still variations that occur under percentage of completion accounting and with recurring items based on the amount of deferred revenue that carries over from quarter to quarter, together with contractually stated milestones in our agreements that could result in our working on a particular project and incurring related costs, but not recognizing revenue in a fiscal period due to not meeting milestones. There are also certain situations that require us to account for projects on the completed contract method, including when a third party is the primary implementer of the solution.

In the first quarter of 2006, we began hiring more services personnel based on our view of the demand for our services and our existing backlog. In addition to deriving increased services revenue from the increased headcount, we have also increased the billability of our services personnel, and have been successful at strategically placing certain of our research and development staff on billable services projects when their skill sets are appropriate. These factors and their impact on current and prior period results are described in more detail below in the section entitled, Analysis of Current Period Financial Results.

Although maintenance revenues have been declining in recent quarters, in the second quarter of 2007 our maintenance revenue increased sequentially from the first quarter of 2007. Maintenance revenues on new software licenses have not been sufficient to offset the normal periodic decline in maintenance resulting from customers who renew at a lower dollar amount, or who decide not to renew. We are actively attempting to put programs in place that demonstrate the value of maintenance to our customers in efforts to prevent further declines in this revenue type.

*Cash flow and liquidity.* Our working capital was approximately \$39.0 million at June 30, 2007. This has improved substantially from the \$17.4 million balance at December 31, 2006 and the (\$19.9) million deficit at March 31, 2006. The chart below shows the components of our working capital and the percentage changes from period to period for the quarterly periods beginning March 31, 2006. The positive trend in our working capital reflects the our positive cash flow from operations, retirement of the remaining 5.25% convertible subordinated notes in December 2006 and the continued decline in our deferred revenue. We provide more discussion in Liquidity and Capital Resources, below.

|                                | March 31, 2006 | June 30, 2006 | September 30, 2006 | December 31, 2006 | March 31, 2007 | June 30, 2007 |
|--------------------------------|----------------|---------------|--------------------|-------------------|----------------|---------------|
| Total cash                     | \$ 115,130     | \$ 133,635    | \$ 130,053         | \$ 114,045        | \$ 108,493     | \$ 117,271    |
| Accounts receivable            | 22,732         | 22,845        | 26,461             | 25,677            | 25,491         | 26,294        |
| Other current assets           | 18,684         | 16,483        | 15,339             | 9,231             | 10,749         | 8,330         |
| Total current assets           | 156,546        | 172,963       | 171,853            | 148,953           | 144,733        | 151,895       |
| Current liabilities            | 58,928         | 56,337        | 59,865             | 57,538            | 41,980         | 40,559        |
| Deferred revenue               | 93,678         | 103,487       | 89,105             | 74,047            | 70,468         | 72,287        |
| Current portion long-term debt | 23,860         | 21,848        | 21,848             |                   |                |               |
|                                | 176,466        | 181,672       | 170,818            | 131,585           | 112,448        | 112,846       |
| Working capital                | \$ (19,920)    | \$ (8,709)    | \$ 1,035           | \$ 17,368         | \$ 32,285      | \$ 39,049     |

Dollar change from perious period \$ 11,211 \$ 9,744 \$ 16,333 \$ 14,917 \$ 6,764

We closely monitor our projected bookings and expenses and the associated cash flows and attempt to adjust our expenses to remain cash flow positive from operations on an annual basis. We also monitor our cash levels as compared to the principal amount of our debt to maintain sufficient liquidity above the debt amount. Although our outstanding indebtedness is comprised of convertible notes, the notes require net share settlement, under which the principal amount is required to be settled in cash upon conversion, with any conversion premium settled in shares of common stock. Absent a change in control or a fundamental change, as defined in the debt agreement, the earliest the debt holders can effect a conversion is May 2008 and is dependent upon our stock price being above certain levels. We also maintain a letter of credit line, and have evaluated other alternatives such as lines of credit to provide liquidity. However, based on our current cash levels, we presently believe the cost of those alternatives are excessive relative to our current liquidity needs.

**Application of Critical Accounting Policies and Accounting Estimates**

There have been no changes during the second quarter of 2007 to our critical accounting policies as we described in our 2006 Annual Report on Form 10-K.



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In addition to the critical accounting policies described in our Form 10-K, we believe it is important to further describe the accounting areas that involve the use of significant judgments and estimates.

**Revenue Recognition**

*Software solutions revenue SOP 97-2* The recognition of revenue under SOP 97-2 requires us to make judgments concerning whether the services associated with the license, if any, are considered essential to the licensed functionality. If they are deemed essential, revenue cannot be recognized under SOP 97-2, but rather is required to be recognized under SOP 81-1. During 2003, we implemented formal processes for evaluation of each of our licensed products to determine whether they can be implemented without essential services, and are therefore considered eligible for recognition under 97-2. We also implemented processes, including internal representations from sales, services and research and development personnel, to evaluate each transaction that is comprised solely of products that are eligible under SOP 97-2 to determine whether there are specific requirements or commitments associated with the licensed functionality that would require recognition under SOP 81-1. We are also required to assess the existence of vendor specific objective evidence ( VSOE ) of fair value for undelivered elements in agreements recognized under SOP 97-2, which for our arrangements commonly include implementation services and maintenance. If we lose our ability to demonstrate VSOE for undelivered elements, the timing of recognition of transactions under SOP 97-2 will change.

*Software solutions revenue SOP 81-1 and Services revenue* A significant portion of these revenues pertain to projects recognized under the percentage of completion method of SOP 81-1, which requires that we make estimates about the number of hours required and the amount of fees to be received to periodically assess the progress to completion of a particular project. We are also required as a prerequisite for using percentage of completion to assess whether we have the ability to reliably estimate the hours and fees for each project.

*Collectibility.* All of our revenues are subject to our assessment of the probability of collection of the underlying fees. The revenue type that is most susceptible to collection risk is software solutions revenue recognized under SOP 97-2, since the revenue is generally recognized up-front upon delivery of the software, and payment is usually due approximately 30 to 60 days after recognition. To address our collection risk, we have reviewed our collection history and determined that for certain countries, particularly in the Greater Asia Pacific region and in certain of the developing countries within Europe, that we will only recognize our license revenues under SOP 97-2 on a cash received basis. For our other revenue types, which are recurring in nature in that they occur over several months, we have a policy in place whereby we review customers that have invoices that are overdue by more than 30 days and we begin deferring recognition of revenue for customers that become delinquent in their payment. This policy prevents us from continuing to recognize revenue related to an implementation or maintenance arrangement when payments are late, and it therefore appears that collection is not reasonably assured. Our policies and procedures in this area have resulted in minimizing our bad debt expense since we are diligent in our evaluation of collectibility risk prior to recognizing revenue.

**Stock compensation expense**

As disclosed in our footnotes, the valuation of stock compensation expense is based on several variables that are inputs to the Black Scholes model. Although these involve a level of judgment, the most critical judgment involved in this area involves the estimation of the impact of forfeitures. Under FAS 123(R), we are required to estimate the impact of forfeitures of stock options, and reduce our expenses based on those estimates. We calculate our monthly forfeiture rates, annualize the amount and apply the resulting amount as a reduction of current period expense. We are then required to regularly evaluate our actual forfeiture experience and make periodic adjustments to expense as needed.

In February 2007, we made a grant of Restricted Stock Units ( RSUs ) to certain key employees that vest based on specified performance over a two-year performance period. In addition to estimating the potential impact of forfeitures on this grant, we are also required to assess whether the performance criteria is probable of being achieved, and only recognize compensation expense if the vesting is considered probable.

**Taxes**

We operate directly and indirectly in numerous countries and are subject to the tax laws, rules and regulations of those jurisdictions. Positions we take in our tax filings are subject to scrutiny by the local country tax authorities and, to

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the extent, it affects our domestic tax position, the Internal Revenue Service. Determining the appropriate tax treatment of complicated issues involves the use of significant judgment and estimates and such judgment and estimates may not be agreed to by the relevant taxing authority and may require extensive discussions and negotiations to resolve these matters. We accrue tax expense in an amount at which we believe an issue may be ultimately resolved in a manner differently from the position taken in our tax filings. The amount of our accrued tax expense for a particular matter may be significantly different from that determined upon the ultimate resolution of the issue. It is also possible that a tax issue may arise of which we were unaware and no accrual was made. In both cases, adjustments to income tax expense in the relevant reporting period may be material.

We expect tax expense variability to increase as a result of the implementation of FIN 48, which was effective January 1, 2007.

### **Accrued Expenses**

We are required to use judgment in estimating amounts recorded as accrued expenses. Such estimates include our assessment of estimated losses resulting from claims and legal proceedings. We record a liability if our assessments indicate that the likelihood of an unfavorable outcome is probable and the related cost can be reasonably estimated.

## **Analysis of Current Period Financial Results**

### **Summary of Second Quarter 2007 Results**

Total revenue increased \$0.3 million from the same period in 2006

Total costs and expenses increased \$1.6 million from the same period in 2006

Net income applicable to common stockholders was \$1.6 million compared to \$2.0 million in the same period in 2006

Diluted earnings per share was \$0.06 versus \$0.08 from the same period in 2006

Cash provided by operations was approximately \$11.6 million for the quarter ended June 30, 2007

Total bookings were approximately \$75.0 million

### **Revenues**

We derive revenues from licenses of our software and related services, which include assistance in implementation, integration, customization, training, consulting and maintenance.

We recognize revenue for software and related services in accordance with *Statement of Position (SOP) 81-1, Accounting for Certain Construction Type and Certain Production Type Contracts*, *SOP 97-2, Software Revenue Recognition*, as modified by *SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*, *SEC Staff Accounting Bulletin (SAB) 104, Revenue Recognition*, and *SAB 103, Update of Codification of Staff Accounting Bulletins*, and *SEC Staff Accounting Bulletin Topic 13, Revenue Recognition*.

*Software solutions.* Software solutions revenue includes core license revenue, recurring license revenue, and fees received to develop the licensed functionality. We recognize these revenues under SOP 97-2 or SOP 81-1 based on our evaluation of whether the associated services are essential to the licensed software as described within SOP 97-2. If the services are considered essential, revenue is generally recognized on a percentage of completion basis under SOP 81-1. Services are considered essential to the software when they involve significant modifications or additions to the software features and functionality. In addition, we have several subscription and other recurring revenue transactions, which are recognized ratably over the life of each contract.

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*Services.* Services revenue is primarily derived from fees for services that are not essential to the software, including implementation, integration, consulting and training, and is generally recognized when services are performed. In addition, services revenue may include fees received from arrangements to customize or enhance previously purchased licensed software, when such services are not essential to the previously licensed software. Services revenue also includes reimbursable expense revenue, with the related costs of reimbursable expenses included in cost of services.



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*Maintenance.* Maintenance revenue consists of fees generated by providing support services to customers, such as telephone support, and unspecified upgrades/enhancements on a when-and-if available basis. A customer typically prepays maintenance and support fees for an initial period, and the related revenue is deferred and generally recognized over the term of such initial period. Maintenance is renewable by the customer on an annual basis thereafter. Rates for maintenance, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the contract.

*Contract Revenue.* As explained above, we do not consider contract revenue an indication of the current performance of our business. We collected the cash in prior periods and recorded the revenue as we fulfilled the contract obligations. Deferred contract revenue was zero at June 30, 2007.

The following table sets forth revenues and the percentages of total revenues of selected items reflected in our condensed consolidated statements of operations and comprehensive income for the three months ended June 30, 2007 and June 30, 2006. The period-to-period comparisons of financial results are not necessarily indicative of future results.

|                          | Three Months              |                       | Three Months              |                       |
|--------------------------|---------------------------|-----------------------|---------------------------|-----------------------|
|                          | Ended<br>June 30,<br>2007 | Percent of<br>Revenue | Ended<br>June 30,<br>2006 | Percent of<br>Revenue |
| SOP 97-2 recognition     | \$ 3,180                  | 5%                    | \$ 5,630                  | 9%                    |
| SOP 81-1 recognition     | 2,552                     | 4%                    | 4,646                     | 7%                    |
| Recurring items          | 5,680                     | 9%                    | 5,112                     | 8%                    |
| Total software solutions | 11,412                    | 18%                   | 15,388                    | 24%                   |
| Services                 | 31,553                    | 48%                   | 26,143                    | 40%                   |
| Maintenance              | 22,018                    | 34%                   | 23,120                    | 36%                   |
| Contract                 |                           |                       | 33                        |                       |
| <b>Total revenues</b>    | <b>\$ 64,983</b>          | <b>100%</b>           | <b>\$ 64,684</b>          | <b>100%</b>           |

The following table sets forth the change in our different revenue categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                          | Change 2007 versus 2006<br>3 months ended June 30, |          |
|--------------------------|--|----------|
|                          | Change<br>\$                                       | % Change |
| SOP 97-2 recognition     | \$ (2,450)   | -44%     |
| SOP 81-1 recognition     | (2,094)  | -45%     |
| Recurring items          | 568  | 11%      |
| Total software solutions | (3,976)  | -26%     |
| Services                 | 5,410  | 21%      |
| Maintenance              | (1,102)  | -5%      |
| Contract                 | (33)   | -100%    |
| <b>Total revenues</b>    | <b>\$ 299</b>                                      |          |

Total software solutions revenue decreased \$4.0 million for the three months ended June 30, 2007 compared to the same period in 2006. Overall we experienced lower software solutions revenue in the three months ended June 30, 2007 due to less current period bookings being recognized as revenue and a lower number and smaller size of projects being recognized under percentage of completion accounting, when compared to the

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same period in 2006. The components of the changes in software solutions is explained below. See the discussion above entitled *Backlog and Deferred revenue* for information related to how backlog impacts current period revenue.

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The primary cause of the decline in revenue recognized under SOP 97-2 for the three months ended June 30, 2007 is due to the recognition in the three months ended June 30, 2006 of \$2.1 million related to an agreement signed in 2001 that was pending resolution of a customer claim, that was not repeated in the comparable period of 2007. During the three months ended June 30, 2007 we recognized revenue related to 20 contracts at an average of \$0.2 million per contract compared to 21 contracts an average of \$0.3 million per contract in the comparable period of 2006.

The primary cause of the decline in revenue recognized under SOP 81-1 for the three months ended June 30, 2007 is due to a decline in the number and size of projects generating revenue as compared to the same period in 2006, due primarily to the continued decline in our backlog. Revenue recognized under SOP 81-1 is dependent upon the amount of work performed and milestones met during the applicable period on projects booked in both current and prior periods. During the three months ended June 30, 2007 we recognized revenue under 13 projects at an average of \$0.2 million per project compared to 15 projects at an average of \$0.3 million in the comparable period of 2006. See the discussion above entitled *Backlog and Deferred revenue* for information related to how backlog impacts current period revenue.

The increase in revenue from recurring items for the three months ended June 30, 2007 was primarily driven by the signing of a significant subscription transaction in the third quarter of 2006. This increase is partially offset by the renewal of two Supply Chain Leader transactions, one at a lower renewal rate and one that was determined to be, in substance, a maintenance renewal and is now being classified as such.

The 21% increase in services revenue for the three months ended June 30, 2007 was primarily driven by an increase in billable hours of 16%. The increase in billable hours is related to our increased hiring of services personnel that began in the first quarter of 2006. Services revenue is dependent upon a number of factors, including:

the number and value of services transactions booked during the current and preceding periods,

the number and availability of service resources actively engaged on billable projects,

the timing of milestone acceptance for engagements contractually requiring customer sign-off, and

the timing of cash payments when collectibility is uncertain

The decrease in maintenance revenue for the three months ended June 30, 2007 resulted from customers not renewing their maintenance agreements or customers renewing on less favorable terms, with such decreases not being offset by initial maintenance agreements. Maintenance revenue varies from period to period based on several factors, including:

initial maintenance from new Software Solutions bookings,

the timing of negotiating and signing maintenance renewals,

completing a renewal several months into the annual maintenance period resulting in a one-time catch up for the period that maintenance services were performed prior to signature of the contract. A similar catch-up of revenue occurs due to the timing of cash receipts for cash basis customers when cash is not received until several months into the maintenance period,

renewals that occur on less favorable terms than in the prior period, and

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customers that do not renew their maintenance agreements.

The following table set forth revenues and the percentages of total revenues of selected items reflected in our condensed consolidated statements of operations and comprehensive income for the six months ended June 30, 2007 and June 30, 2006. The period-to-period comparisons of financial results are not necessarily indicative of future results.

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|                          | Six Months          |                       |                   |             |
|--------------------------|---------------------|-----------------------|-------------------|-------------|
|                          | Six Months<br>Ended | Percent of<br>Revenue | Ended             | Percent of  |
|                          | June 30, 2007       |                       | June 30, 2006     | Revenue     |
| SOP 97-2 recognition     | \$ 5,785            | 4%                    | \$ 12,041         | 9%          |
| SOP 81-1 recognition     | 7,457               | 6%                    | 9,725             | 8%          |
| Recurring items          | 11,603              | 9%                    | 10,544            | 8%          |
| Total software solutions | 24,845              | 19%                   | 32,310            | 25%         |
| Services                 | 60,248              | 46%                   | 50,017            | 39%         |
| Maintenance              | 43,027              | 33%                   | 46,335            | 36%         |
| Contract                 | 2,450               | 2%                    | 66                |             |
| <b>Total revenues</b>    | <b>\$ 130,570</b>   | <b>100%</b>           | <b>\$ 128,728</b> | <b>100%</b> |

The following table sets forth the change in our different revenue categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                          | Change 2007 versus 2006<br>6 Months Ended June 30,<br>\$ |           |
|--------------------------|--|-----------|
|                          | Change   | % Change  |
| SOP 97-2 recognition     | \$ (6,256)   | -52%      |
| SOP 81-1 recognition     | (2,268)  | -23%      |
| Recurring items          | 1,059  | 10%       |
| Total software solutions | (7,465)  | -23%      |
| Services                 | 10,231   | 20%       |
| Maintenance              | (3,308)  | -7%       |
| Contract                 | 2,384  | 3612%     |
| <b>Total revenues</b>    | <b>\$ 1,842</b>  | <b>1%</b> |

Total software solutions revenue decreased \$7.5 million for the six months ended June 30, 2007 compared to the same period in 2006. Overall we experienced lower software solutions revenue in the six months ended June 30, 2007 due to less current period bookings being recognized as revenue and a lower number and smaller size of projects being recognized under percentage of completion accounting, when compared to the same period in 2006. The components of the changes in software solutions is explained below. See the discussion above entitled *Backlog and Deferred revenue* for information related to how backlog impacts current period revenue.

The primary cause of the decline in revenue recognized under SOP 97-2 for the six months ended June 30, 2007 is due to the recognition in the six months ended June 30, 2006 of \$2.1 million related to a contract signed in 2001 that was pending resolution of a customer claim, that was not repeated in the comparable period of 2007. In addition we experienced a decrease of revenue recognized from prior period bookings of \$3.3 million and a decrease of \$1.0 million of revenue recognized from current period bookings when compared to the same period in 2006. During the six months ended June 30, 2007 we recognized revenue related to 36 contracts at an average of \$0.2 million per contract compared to 42 contracts an average of \$0.3 million per contract in the comparable period of 2006.

The primary cause of the decline in revenue recognized under SOP 81-1 for the six months ended June 30, 2007 is due to a decline in the number and size of projects generating revenue as compared to the same period in 2006, due primarily to the continued decline in our backlog. Revenue recognized under SOP 81-1 relates to work performed and milestones met during the applicable period on projects booked in prior periods. During the six months ended June 30, 2007 we recognized revenue under 25 projects at an average of \$0.3 million per project compared to 26 projects at an average of \$0.4 million per project in the comparable period of 2006. See the discussion above entitled *Backlog and Deferred revenue* for information related to how backlog impacts current period revenue.



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The increase in revenue from recurring items for the six months ended June 30, 2007 was primarily driven by the signing of a significant subscription transaction in the third quarter of 2006. This increase is partially offset by the renewal of two Supply Chain Leader transactions, one at a lower renewal rate and one that was determined to be, in substance, a maintenance renewal and is now being classified as such.

The 20% increase in services revenue for the six months ended June 30, 2007 is reflective of our increased hiring of services personnel, which began in the first quarter of 2006, and resulted in an increase in billable hours of approximately 20%.

The decrease in maintenance revenue during the six months ended June 30, 2007 resulted from customers not renewing their maintenance agreements or customers renewing on less favorable terms, with such decreases not being offset by initial maintenance agreements.

*International Revenue.* Our international revenues included in the categories discussed above are primarily generated from customers located in Europe, Asia, Latin America and Canada. International revenue totaled \$28.0 million, or 43% of total revenue, in the three months ended June 30, 2007 compared to \$29.3 million, or 45% of total revenue, in the same period in 2006, and totaled \$55.5 million, or 43% of total revenue, in the six months ended June 30, 2007 compared to \$58.5 million, or 45% of total revenue, in the same period in 2006. International revenue remained relatively consistent, as a percentage of total revenue, in the three-month and six-month periods ended June 30, 2007 and June 30, 2006.

*Customer Concentration.* During the periods presented, no individual customer accounted for more than 10% of total revenues.

**Cost of Revenues**

The following table sets forth cost of revenues and the gross margins of selected items reflected in our condensed consolidated statements of operations and comprehensive income for the three months ended June 30, 2007 and June 30, 2006. The period-to-period comparisons of financial results are not necessarily indicative of future results.

|                                     | Three Months                              |                 |                           |                 |
|-------------------------------------|---|-----------------|---------------------------|-----------------|
|                                     | Three Months<br>Ended<br>June 30,<br>2007 | Gross<br>Margin | Ended<br>June 30,<br>2006 | Gross<br>Margin |
| Software solutions                  | \$ 2,175                                  | 81%             | \$ 2,447                  | 84%             |
| Services and maintenance            | 27,267                                    | 49%             | 24,376                    | 51%             |
| Amortization of acquired technology | 6   |                 |                           |                 |
| <b>Total cost of revenues</b>       | <b>\$ 29,448</b>                          |                 | <b>\$ 26,823</b>          |                 |

The following table sets forth the change in our different cost of revenue categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                                     | Change 2007 versus 2006<br>3 months ended June 30, |            |
|-------------------------------------|--|------------|
|                                     | \$ Change  | % Change   |
| Software solutions                  | \$ (272)   | -11%       |
| Services and maintenance            | 2,891  | 12%        |
| Amortization of acquired technology | 6  |            |
| <b>Total cost of revenues</b>       | <b>\$ 2,625</b>                                    | <b>10%</b> |

*Cost of Software Solutions.* These costs consist of:

Salaries and other related costs of employees who provide essential services to customize or enhance the software for the customer



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Commissions paid to non-customer third parties in connection with joint marketing and other related agreements, which are generally expensed when they become payable

Royalty fees associated with third-party software utilized with our technology. Such royalties are generally expensed when the products are shipped; however, royalties associated with fixed cost arrangements are generally expensed over the period of the arrangement

The cost of user product documentation

The cost of delivery of software

Provisions for the estimated costs of servicing customer claims, which we accrue on a case-by-case basis

The decrease in costs of software solutions for the three-month period ended June 30, 2007 primarily relates to a decrease in the number of hours worked on projects requiring essential services, which is reflected in our lower software solutions revenues for the 2007 period.

*Cost of services and maintenance.* These costs consist of expenses associated with the delivery of non-essential services, support services, such as telephone support, and unspecified upgrades/enhancements provided on a when-and-if-available basis.

The increase in cost of services and maintenance for the three-month period ended June 30, 2007 is primarily related to increased services personnel to support our growing services business. Average services and maintenance headcount increased 12% for the three months ended June 30, 2007 as compared to the same period in 2006. For the three months ended June 30, 2007 employee-related costs increased \$1.8 million and travel and entertainment expense increased of \$0.3 million, as compared to the same period in 2006.

*Amortization of Acquired Technology.* In connection with our business acquisitions, we acquired developed technology that we offer as a part of our solutions. In accordance with applicable accounting standards, the amortization of acquired technology is included as a part of our cost of revenues because it relates to software products that are marketed to potential customers.

|                                     | Six Months                           |                 |                        |                 |
|-------------------------------------|--------------------------------------|-----------------|------------------------|-----------------|
|                                     | Six Months<br>Ended<br>June 30, 2007 | Gross<br>Margin | Ended<br>June 30, 2006 | Gross<br>Margin |
| Software solutions                  | \$ 4,649                             | 81%             | \$ 5,850               | 82%             |
| Services and maintenance            | 54,047                               | 48%             | 47,846                 | 50%             |
| Amortization of acquired technology | 12                                   |                 |                        |                 |
| <b>Total cost of revenues</b>       | <b>\$ 58,708</b>                     |                 | <b>\$ 53,696</b>       |                 |

The following table sets forth the change in our different cost of revenue categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                                     | 6 Months Ended June 30, |          |
|-------------------------------------|-------------------------|----------|
|                                     | \$ Change               | % Change |
| Software solutions                  | \$ (1,201)              | -21%     |
| Services and maintenance            | 6,201                   | 13%      |
| Amortization of acquired technology | 12                      |          |

**Total cost of revenues**

\$ 5,012

9%

The decrease in costs of software solutions for the six-month period ended June 30, 2007 primarily relates to a decrease in the number of hours worked on projects requiring essential services, which is reflected in our lower software solutions revenues for these periods.

The increase in cost of services and maintenance for the six-month period ended June 30, 2007 is primarily related to increased services personnel to support our growing services business. Average services and maintenance headcount

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increased 12% for the six months ended June 30, 2007 as compared to the same period in 2006. For the six-month period ended June 30, 2007, employee-related costs increased \$4.1 million and travel and entertainment increased \$0.7 million, as compared to the same period in 2006.

*Amortization of Acquired Technology.* In connection with our business acquisitions, we acquired developed technology that we offer as a part of our solutions. In accordance with applicable accounting standards, the amortization of acquired technology is included as a part of our cost of revenues because it relates to software products that are marketed to potential customers.

**Operating Expenses**

The following table sets forth operating expenses and the percentages of total revenue for those operating expenses as reported in our condensed consolidated statements of operations and comprehensive income. The period-to-period comparisons of financial results are not necessarily indicative of future results.

|                                       | Three Months                              |                       |                           |                       |
|---------------------------------------|---|-----------------------|---------------------------|-----------------------|
|                                       | Three Months<br>Ended<br>June 30,<br>2007 | Percent of<br>Revenue | Ended<br>June 30,<br>2006 | Percent of<br>Revenue |
| Sales and marketing                   | \$ 12,957                                 | 20%                   | \$ 12,573                 | 19%                   |
| Research and development              | 8,750                                     | 13%                   | 8,932                     | 14%                   |
| General and administrative            | 10,549                                    | 16%                   | 11,843                    | 18%                   |
| Amortization of intangibles           | 25  |                       |                           |                       |
| Restructuring charges and adjustments | (49)                                      |                       | (95)                      |                       |
| <b>Total operating expenses</b>       | <b>\$ 32,232</b>                          |                       | <b>\$ 33,253</b>          |                       |

The following table sets forth the change in our different operating expense categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                                       | Change 2007 versus 2006<br>3 months ended June 30, |            |
|---------------------------------------|--|------------|
|                                       | \$ Change  | % Change   |
| Sales and marketing                   | \$ 384   | 3%         |
| Research and development              | (182)  | -2%        |
| General and administrative            | (1,294)  | -11%       |
| Amortization of intangibles           | 25   |            |
| Restructuring charges and adjustments | 46   | 48%        |
| <b>Total operating expenses</b>       | <b>\$ (1,021)</b>                                  | <b>-3%</b> |

*Sales and Marketing Expense.* These expenses consist primarily of personnel costs, commissions, office facilities, travel and promotional events such as trade shows, seminars, technical conferences, advertising and public relations programs. For the three-month period ended June 30, 2007, average sales and marketing head count increased 3% compared to the same period in 2006 resulting in a corresponding increase in expense.

*Research and Development Expense.* These expenses consist of costs related to software development and product enhancements to existing software. Software development costs are expensed as incurred until technological feasibility has been established, at which time such costs are capitalized until the product is available for general release to customers. To date, the establishment of technological feasibility of our products and general release of such software has substantially coincided. As a result, software development costs qualifying for capitalization have been insignificant; therefore, we have not capitalized any software development costs other than those recorded in connection with our acquisitions. The primary component of research and development expense is employee-related cost. Our average headcount remained relatively consistent

during the periods presented as reflected by the consistent level of expense.

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*General and Administrative Expense.* These expenses include the personnel and other costs of our finance, legal, accounting, human resources, information systems and executive departments, as well as external legal costs. For the three-month period ended June 30, 2007 average general and administrative head count increased 3%, compared to the same period in 2006. General and administrative expense for the three months ended June 30, 2007 decreased due to a decline in legal expense of \$1.7 million partially offset by increases in employee-related costs of \$0.8 million, compared to the same period in 2006.

*Amortization of Intangible Assets and Impairment of Intangible Assets.* From time to time, we have sought to enhance our product offerings through technology and business acquisitions. When an acquisition of a business is accounted for using the purchase method, the amount of the purchase price is allocated to the fair value of assets acquired, net of liabilities assumed. Any excess purchase price is allocated to goodwill. Intangible assets are amortized over their estimated useful lives, while goodwill is only written down if it is deemed to be impaired.

*Restructuring Expense.* The expense for the periods presented reflects adjustments to the accrual based on changes in estimates.

|                                       | Six Months                           |                       |                        |                       |
|---------------------------------------|--------------------------------------|-----------------------|------------------------|-----------------------|
|                                       | Six Months<br>Ended<br>June 30, 2007 | Percent of<br>Revenue | Ended<br>June 30, 2006 | Percent of<br>Revenue |
| Sales and marketing                   | \$ 24,654                            | 19%                   | \$ 23,669              | 18%                   |
| Research and development              | 17,555                               | 13%                   | 17,879                 | 14%                   |
| General and administrative            | 20,928                               | 16%                   | 25,381                 | 20%                   |
| Amortization of intangibles           | 28                                   |                       |                        |                       |
| Restructuring charges and adjustments | (75)                                 |                       | (145)                  |                       |
| <b>Total operating expenses</b>       | <b>\$ 63,090</b>                     |                       | <b>\$ 66,784</b>       |                       |

The following table sets forth the change in our different operating expense categories on a dollar and percentage basis. Explanations for the changes are provided below the table.

|                                       | Change 2007 versus 2006<br>6 Months Ended June 30, |             |
|---------------------------------------|--|-------------|
|                                       | \$<br>Change                                       | %<br>Change |
| Sales and marketing                   | \$ 985   | 4%          |
| Research and development              | (324)  | -2%         |
| General and administrative            | (4,453)  | -18%        |
| Amortization of intangibles           | 28   |             |
| Restructuring charges and adjustments | 70   | 48%         |
| <b>Total operating expenses</b>       | <b>\$ (3,694)</b>                                  | <b>-6%</b>  |

*Sales and Marketing Expense.* These expenses consist primarily of personnel costs, commissions, office facilities, travel and promotional events such as trade shows, seminars, technical conferences, advertising and public relations programs. For the six-month period ended June 30, 2007, average sales and marketing head count increased 6% , compared to the same period in 2006. Sales and marketing expense for the six months ended June 30, 2007 increased primarily due to increases in travel and entertainment costs of \$0.4 million and employee-related costs of \$0.2 million compared to the comparable period in 2006.

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*Research and Development Expense.* These expenses consist of costs related to software development and product enhancements to existing software. Software development costs are expensed as incurred until technological feasibility has been established, at which time such costs are capitalized until the product is available for general release to customers. To date, the establishment of technological feasibility of our products and general release of such software has substantially coincided. As a result, software development costs qualifying for capitalization have been insignificant; therefore, we have not capitalized any software development costs other than those recorded in connection with our acquisitions. The primary component of research and development expense is employee-related cost. Our average headcount remained relatively consistent during the periods presented as reflected by the consistent level of expense.

*General and Administrative Expense.* These expenses include the personnel and other costs of our finance, legal, accounting, human resources, information systems and executive departments, as well as external legal costs. For the six-month period ended June 30, 2007 average general and administrative head count increased 3% compared to the same period in 2006. General and administrative expense for the six months ended June 30, 2007 decreased due to a decline in legal expense of \$3.4 million partially offset by an increase in employee-related costs of \$1.7 million, compared to the same period in 2006.

*Amortization of Intangible Assets and Impairment of Intangible Assets.* From time to time, we have sought to enhance our product offerings through technology and business acquisitions. When an acquisition of a business is accounted for using the purchase method, the amount of the purchase price is allocated to the fair value of assets acquired, net of liabilities assumed. Any excess purchase price is allocated to goodwill. Intangible assets are amortized over their estimated useful lives, while goodwill is only written down when it is deemed to be impaired.

*Restructuring Expense.* The expense for the periods presented reflects adjustments to the accrual, based on changes in estimates.

**Non-operating (expense) income, net**

Non-operating (expense) income, net, was as follows:

|  | <b>Three Months</b>                                 |                                    |
|--|---|------------------------------------|
|  | <b>Three Months<br/>Ended<br/>June 30,<br/>2007</b> | <b>Ended<br/>June 30,<br/>2006</b> |
| Interest income                                    | \$ 1,302  | \$ 1,172                           |
| Interest expense                                   | (1,236)   | (1,532)                            |
| Realized gains (losses) on investments, net        |   | 6                                  |
| Foreign currency hedge and transaction losses, net | (74)  | 177                                |
| Other expense, net                                 | (231)   | (333)                              |
| <b>Total non-operating expenses, net</b>           | <b>\$ (239)</b>                                     | <b>\$ (510)</b>                    |

Total non-operating expense, net decreased \$0.3 million for the three months ended June 30, 2007 as compared to the same period in 2006.

Interest income increased in the three-month period ended June 30, 2007 compared to the same period in 2006 due to higher interest rates earned on invested balances. The average rate earned for the three months ended June 30, 2007 increased 66 basis points. This increase was partially offset by lower average balances of invested funds. For the three months ended June 30, 2007 average funds invested decreased 4%.

Interest expense decreased for the three-month period ended June 30, 2007 as compared to the same period in 2006 due to lower debt levels following the retirement of our remaining 5.25% convertible subordinated notes in December 2006.

The market interest rates on investments and the relative exchange values of foreign currencies are influenced by the monetary and fiscal policies of the governments in the countries in which we operate. The nature, timing and extent



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of any impact on our financial statements resulting from changes in those governments' policies are not predictable. Risks associated with market interest rates and foreign exchange rates are discussed below under the section captioned "Sensitivity to Market Risks."

|  | Six Months<br>Ended<br>June 30, 2007 | Six Months<br>Ended<br>June 30, 2006 |
|--|--------------------------------------|--------------------------------------|
| Interest income                                    | \$ 2,648                             | \$ 2,218                             |
| Interest expense                                   | (2,476)                              | (3,072)                              |
| Realized gains (losses) on investments, net        |                                      | 591                                  |
| Foreign currency hedge and transaction losses, net | (191)                                | (39)                                 |
| Other expense, net                                 | (553)                                | (51)                                 |
| <b>Total non-operating expenses, net</b>           | <b>\$ (572)</b>                      | <b>\$ (353)</b>                      |

Total non-operating expense, net increased \$0.2 million for the six months ended June 30, 2007 as compared to the same period in 2006.

Interest income increased in the six-month period ended June 30, 2007 compared to the same periods in 2006 due to higher interest rates earned on invested balances. The average rate earned for the six months ended June 30, 2007 increased 98 basis points. This increase was partially offset by lower average balances of invested funds. For the six months ended June 30, 2007 average funds invested decreased 6%.

Interest expense decreased for the six-month period ended June 30, 2007 as compared to the same period in 2006 due to lower debt levels following the retirement of our remaining 5.25% convertible subordinated notes in December 2006.

Other expense net increased approximately \$0.5 million for the six-month period ended June 30, 2007 as compared to the same period in 2006. Included in this change is the impact of \$0.4 million of sales tax refunds received in the first quarter of 2006.

**Provision for Income Taxes**

We recognized income tax expense of approximately \$0.7 million for the three months ended June 30, 2007 and \$1.3 million for the three months ended June 30, 2006, representing effective income tax rates of 24.1% and 31.6%, respectively. Factors that affect income tax expense include, among others, the effect of foreign operations, state income taxes (net of federal income tax benefits), non-deductible meals and entertainment, research and development tax credits, and the effect of foreign withholding taxes. Income tax expense included the effect of foreign withholding taxes of \$1.0 million for the three months ended June 30, 2007 and \$0.8 million for the three months ended June 30, 2006. Foreign withholding taxes are recorded when incurred, normally upon receipt of payments from certain non-US customers, and affect our income tax expense due to our domestic valuation allowance. Accordingly, our effective income tax rates during the three months ended June 30, 2007 and June 30, 2006, as well as the six months ended June 30, 2007 and June 30, 2006, differ from the U.S. statutory rate primarily due to changes in our valuation allowance. In addition, income tax expense for the three months ended June 30, 2007 includes a benefit of approximately \$0.8 million related to the favorable resolution of a tax examination in the United Kingdom.

As part of the process of preparing unaudited condensed consolidated financial statements, we are required to estimate our full-year income and the related income tax expense in each jurisdiction in which we operate. Changes in the geographical mix or estimated level of annual pre-tax income can impact our effective tax rate. This process involves estimating our current tax liabilities in each jurisdiction in which we operate, including the impact, if any, of additional taxes resulting from tax examinations, as well as making judgments regarding the recoverability of deferred tax assets. To the extent recovery of deferred tax assets is not likely based on, among other things, our estimation of future taxable income in each jurisdiction, a valuation allowance is established. Tax liabilities can involve complex issues and may require an extended period to resolve. See *Note 13, Income Taxes*, in our Notes to Consolidated Financial Statements in our 2006 Annual Report on Form 10-K, for additional information regarding our income taxes.



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### **Contractual Obligations**

During the three-month period ended June 30, 2007, there were no material changes outside the ordinary course of business in the specified contractual obligations set forth in our 2006 Annual Report on Form 10-K.

### **Off-Balance-Sheet Arrangements**

As of June 30, 2007, we did not have any significant off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### **Liquidity and Capital Resources**

Our working capital was \$39.0 million at June 30, 2007 compared to \$17.4 million at December 31, 2006, an improvement of \$21.7 million or 125%. The improvement resulted from an \$18.7 million decrease in current liabilities (comprised of decreases of \$7.3 million in accrued compensation and related expenses, \$5.3 million in accrued liabilities, \$4.4 million in accounts payable and \$1.8 million in deferred revenue) and an increase of \$2.9 million in current assets (comprised of an increase of \$3.2 million in cash, including restricted cash, and an increase of \$0.6 million in accounts receivable, partially offset by a decrease of \$0.9 million in other current assets).

Our working capital balance at June 30, 2007 and December 31, 2006 included deferred revenue. At June 30, 2007 and December 31, 2006, we had approximately \$72.3 million and \$74.0 million, respectively, of deferred revenue recorded as a current liability, representing pre-paid revenue for all of our different revenue categories. Our deferred revenue balance includes a margin to be earned when it is recognized, so the conversion of the liability to revenue will require cash outflows that are less than the amount of the liability.

Our cash and cash equivalents increased \$1.6 million during the six months ended June 30, 2007. This increase is the result of \$5.1 million of cash provided by operating activities and \$1.7 million of cash provided by financing activities, partially offset by \$5.0 million of cash used in investing activities.

During the six months ended June 30, 2007, cash provided by operating activities was approximately \$5.1 million. Management tracks projected cash collections and projected cash outflows to monitor short-term liquidity requirements and to make decisions about future resource allocations and take actions to adjust our expenses with the goal of remaining cash flow positive from operations on an annual basis. Based on the timing of license bookings and maintenance renewals as well as working capital changes, cash flow from operations is typically seasonally stronger in the second and fourth quarters.

Cash used in investing activities was approximately \$5.0 million during the six months ended June 30, 2007. We had cash outflows related to investing activities consisting of a business acquisition of \$2.1 million, an increase in restricted cash of \$1.7 million and purchases of property, plant and equipment of \$1.2 million.

During the six months ended June 30, 2007, cash provided by financing activities was approximately \$1.7 million. We had cash inflows from financing activities of \$3.0 million consisting of the proceeds from the issuance of common stock upon the exercise of stock options and under our employee stock purchase plan, partially offset by cash outflows of \$1.3 million from the scheduled dividend paid on our outstanding preferred stock.

At June 30, 2007, we had a net cash balance of \$33.1 million compared to a net cash balance of \$30.2 million at December 31, 2006. We define net cash as the sum of our total cash and cash equivalents and restricted cash minus our total short-term and long-term debt.

We maintain a \$15.0 million letter of credit line. We are charged fees of 0.375% per year on the face amount of any outstanding letters of credit and 0.15% per year on the average daily-unused amount of the line. Under this line, we are required to maintain restricted cash in a depository account maintained by the lender to secure letters of credit issued in connection with the line. The line has no financial covenants and expires on December 15, 2008. As of June 30, 2007, \$3.9 million in letters of credit were outstanding under this line and \$5.1 million in restricted cash was pledged as collateral.

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We had \$86.3 million in face value of our 5% senior convertible notes outstanding at June 30, 2007. Holders of our senior convertible notes have the right to require us to repurchase all or any portion of the senior convertible notes on November 15, 2010 and may convert the senior convertible notes at any time on or after May 15, 2010. In addition, holders of the senior convertible notes may convert the senior convertible notes prior to May 15, 2010 upon the occurrence of any of the following events:

if the senior convertible notes have been called for redemption;

upon certain dividends or distributions to all holders of our common stock;

upon the occurrence of specified corporate transactions constituting a fundamental change (the occurrence of a change in control or a termination of trading, each as defined in the indenture governing our senior convertible notes);

if the average of the trading prices for the senior convertible notes during any five consecutive trading-day period is less than 98% of the average of the conversion values for the senior convertible notes (the product of the last reported sale price of our common stock and the conversion rate) during that period; or

at any time after May 15, 2008 if the closing sale price of our common stock is equal to or greater than \$23.21 for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter.

Upon conversion of the senior convertible notes, we will be required to satisfy our conversion obligation with respect to the principal amount of the senior convertible notes to be converted in cash, with any remaining amount to be satisfied in shares of our common stock.

The indenture governing the 5% senior convertible notes contains a debt incurrence covenant that places restrictions on the amount and type of additional indebtedness that we can incur. Such covenant specifies that we shall not, and that we shall not permit any of our subsidiaries to, directly or indirectly, incur or guarantee or assume any indebtedness other than permitted indebtedness. Permitted indebtedness is defined in the indenture to include, among others, the following categories of indebtedness: (i) all indebtedness outstanding on November 23, 2005; (ii) indebtedness under the senior convertible notes; (iii) indebtedness under our \$15.0 million letter of credit line; (iv) between \$25.0 million and \$50.0 million of additional senior secured indebtedness (the maximum permitted amount to be determined by application of a formula contained in the indenture); and (v) at least \$100.0 million of additional subordinated indebtedness (the maximum permitted amount to be determined by application of a formula contained in the indenture).

We have experienced negative cash flows for the quarters ended March 31, 2007, September 30, 2006 and March 31, 2006, and for each of the five years ended December 31, 2005, primarily due to sharp declines in our revenues and our historical inability to reduce our expenses to a level at or below the level of our revenues. We may be required to seek private or public debt or equity financing in order to support our operations, satisfy the conversion obligation with respect to our senior convertible notes and/or repay our senior convertible notes. The debt incurrence restrictions imposed by the indenture governing our senior convertible notes could restrict or impede our ability to incur additional debt. We may not be able to obtain additional debt or equity financing on satisfactory terms, or at all, and any new financing could have a substantial dilutive effect on our existing stockholders.

### **Sensitivity to Market Risks**

*Foreign Currency Risk.* Revenues originating outside of the United States, a portion of which are denominated in foreign currencies, totaled 43% for the three-month and six-month periods ended June 30, 2007 and 45% for the three-month and six-month periods ended June 30, 2006. Since we conduct business on a global basis in various foreign currencies, we are exposed to movements in foreign currency exchange rates. We utilize a foreign currency-hedging program that uses foreign currency forward exchange contracts to hedge various nonfunctional currency exposures. The objective of this program is to reduce the effect of changes in foreign currency exchange rates on our results of operations. Furthermore, our goal is to offset foreign currency transaction gains and losses recorded for accounting purposes with gains and losses realized on the forward contracts. Our hedging activities cannot completely protect us from the risk of foreign currency losses as our currency exposures are constantly changing and not all of these exposures are hedged. A large portion of our employee base is located in India, and as a result, a significant portion of our fixed expenses are denominated in the Indian Rupee (INR). Therefore, as the INR exchange rate fluctuates against the

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Dollar (USD), the resulting impact on our consolidated USD expenses can be significant. The INR appreciated by approximately 7% against the USD during the quarter ended June 30, 2007, which resulted in increased expenses of approximately \$0.4 million in the quarter.

*Interest Rate Risk.* Our investments are subject to interest rate risk. Interest rate risk is the risk that our financial condition and results of operations could be adversely affected due to movements in interest rates. We invest our cash in a variety of interest-earning financial instruments, including bank time deposits, money market funds and taxable and tax-exempt variable-rate and fixed-rate obligations of corporations, municipalities and local, state and national governmental entities and agencies. These investments are primarily denominated in U.S. Dollars. Cash balances in foreign currencies overseas are primarily operating balances and are generally invested in short-term time deposits of the local operating bank. Due to the demand nature of our money market funds and the short-term nature of our time deposits and debt securities portfolio, these assets are sensitive to changes in interest rates. The Federal Reserve Board influences the general direction of market interest rates in the U.S. where the majority of our cash and investments are held. As of June 30, 2007 and December 31, 2006, the weighted-average yield on time deposits and debt securities we held was 5.18%. If overall interest rates fell by 100 basis points in the third quarter of 2007, our interest income would decline approximately \$0.3 million for the quarter, assuming investment levels consistent with June 30, 2007 levels.

*Credit Risk.* Financial assets that potentially subject us to a concentration of credit risk consist principally of investments and accounts receivable. Cash on deposit is held with financial institutions with high credit standings. Debt security investments are generally in highly-rated corporations and municipalities as well as agencies of the U.S. government; however, a significant portion of these investments are in corporate debt securities, which carry a higher level of risk compared to municipal and U.S. government-backed securities. Our customer base consists of large numbers of geographically diverse enterprises dispersed across many industries. As a result, concentration of credit risk with respect to accounts receivable is not significant. However, we periodically perform credit evaluations for most of our customers and maintain reserves for potential losses. In certain situations we may seek letters of credit to be issued on behalf of some customers to mitigate our exposure to credit risk. We currently use foreign exchange contracts to hedge the risk associated with receivables denominated in foreign currencies. Risk of non-performance by counterparties to such contracts is minimal due to the size and credit standings of the financial institutions involved.

*Market Price Risk.* We have invested in several privately held companies, many of which can still be considered in the start-up or development stages or may no longer be viable or operational. As a result of significant declines in the expected realizable amounts of these investments, in previous periods we wrote off the book value of most of these investments as the decline in fair value was considered other than temporary.

*Inflation.* Inflation has not had a material impact on our results of operations or financial condition.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

This information is included in the section captioned "Sensitivity to Market Risks," included in Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures.* As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (Exchange Act), our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. As defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures of our company that are designed to ensure that information required to be disclosed by our company in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by our company in the reports we file or submit under the Exchange Act is accumulated and communicated to our company's management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

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Based on this evaluation, our CEO and CFO concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by our company in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to provide reasonable assurance that such information is accumulated and communicated to our company's management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that any system of controls, however well designed and operated, is based in part upon certain assumptions and can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

***Changes in Internal Control over Financial Reporting.*** As required by Rule 13a-15(d) under the Exchange Act, our management, including our CEO and CFO, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on our evaluation, during our most recent fiscal quarter there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in *Note 7 Commitments and Contingencies* in our Notes to Condensed Consolidated Financial Statements is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

Other than as described below, there have been no material changes from the risk factors disclosed under the heading "Risk Factors" in Item 1A of our 2006 Annual Report on Form 10-K.

***Restructuring and Reorganization Initiatives Have Been Executed, And Such Activities Pose Significant Risks To Our Business.***

In late July 2007, we began restructuring initiatives involving reducing our workforce in an effort to achieve our profitability objectives. These activities pose significant risks to our business, including the risk that terminated employees will disparage the company, file legal claims against us related to their termination of employment, become employed by competitors or share our intellectual property or other sensitive information with others and that the reorganization will not achieve targeted efficiencies. The failure to retain and effectively manage our remaining employees or achieve our targeted efficiencies through the reorganization could increase our costs, adversely affect our development efforts and adversely affect the quality of our products and customer service. If customers become dissatisfied with our products or service, our maintenance renewals may decrease, our customers may take legal action against us and our sales to existing customers could decline, leading to reduced revenues. Failure to achieve the desired results of our restructuring and reorganization initiatives could harm our business, results of operations, cash flow and financial condition.

***Chief Executive Officer Succession***

Effective July 30, 2007, our Chief Executive Officer, Michael E. McGrath resigned and was replaced by an interim CEO, Pallab K. Chatterjee. Mr. Chatterjee has been our Executive Vice President, Solutions Operations and Chief Delivery Officer. Our Board of Directors is currently conducting a search for a permanent CEO. This transition to an interim CEO and then a permanent CEO could be a distraction to senior management, business operations and customers. The search for a permanent replacement could result in significant recruiting and relocation costs. If we fail to successfully attract and appoint a permanent, CEO with the appropriate level experience, we could experience harm in our business, results of operations, cash flow and financial condition.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On May 29, 2007, we held an annual meeting of our stockholders for the following purpose:

- 1.

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To elect Stephen P. Bradley and Richard L. Clemmer as Class I directors to serve until the annual stockholders meeting in 2010, and until their respective successors have been elected and qualified.

2. To approve an amendment to our 1995 Stock Option/Stock Issuance Plan to restructure the automatic grant program for our non-employee Board members and effect certain other changes.

Mr. Bradley was elected with 18,095,613 common shares voting for his election, all outstanding Series B preferred shares voting for his election, 372,852 common shares withholding their vote and 2,664,722 shares abstaining or broker non-votes. Mr. Clemmer was elected with 12,769,719 common shares voting for his election, all outstanding Series B preferred shares voting for his election, 5,698,747 common shares withholding their vote and 2,682,817 shares abstaining or broker non-votes. The terms of office of Harvey B. Cash, Michael E. McGrath and Lloyd G. Waterhouse, all Class II directors, and Sanjiv S. Sidhu and Jackson L. Wilson, Jr., both Class III directors, continued after the meeting

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The proposal to approve an amendment to our 1995 Stock Option/Stock Issuance Plan to restructure the automatic grant program for our non-employee Board members and effect certain other changes was approved with 6,007,340 common shares voting for the proposal, all outstanding Series B preferred shares voting for the proposal, 6,353,532 common shares voting against the proposal, 72,747 common shares abstaining and 8,718,164 broker non-votes.

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS.**

(a) *Exhibits*

**Exhibit**

**Number Description**

- |      |  |
|------|--|
| 31.1 | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of Pallab K. Chatterjee, Interim Chief Executive Officer (Principal Executive Officer) of i2.  |
| 31.2 | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of Michael J. Berry, Executive Vice President, Finance and Accounting, and Chief Financial Officer (Principal Accounting and Financial Officer) of i2.                       |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Pallab K. Chatterjee, Interim Chief Executive Officer (Principal Executive Officer) of i2.  |
| 32.2 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Michael J. Berry, Executive Vice President, Finance and Accounting, and Chief Financial Officer (Principal Accounting and Financial Officer) of i2. |



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**SIGNATURES**

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.

**i2 TECHNOLOGIES, INC.**

August 9, 2007

By: /s/ Michael J. Berry

Michael J. Berry  
Executive Vice President, Finance and Accounting, and Chief  
Financial Officer

(On behalf of the Registrant and as Principal Accounting and  
Financial Officer)