

I2 TECHNOLOGIES INC
Form 10-Q/A
August 24, 2006
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A

Amendment No. 1 to Form 10-Q

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

For the quarterly period ended March 31, 2006

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

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

75-2294945
(I.R.S. Employer
Identification No.)

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One i2 Place

11701 Luna Road

Dallas, Texas
(Address of principal executive offices)

(469) 357-1000

75234
(Zip code)

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 May 3, 2006, the Registrant had 20,768,872 shares of \$0.00025 par value Common Stock outstanding.

Table of Contents

i2 TECHNOLOGIES, INC.

QUARTERLY REPORT ON FORM 10-Q/A

March 31, 2006

TABLE OF CONTENTS

| | Page |
|---|-------------|
| PART I <u>FINANCIAL INFORMATION</u> | |
| Item 1. <u>Financial Statements (Unaudited)</u> | 4 |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2006 (as restated) and December 31, 2005</u> | 4 |
| <u>Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three months ended March 31, 2006 (as restated) and 2005</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2006 (as restated) and 2005</u> | 7 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 8 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 21 |
| Item 4. <u>Controls and Procedures</u> | 29 |
| PART II. <u>OTHER INFORMATION</u> | |
| Item 6. <u>Exhibits</u> | 31 |
| <u>SIGNATURES</u> | 32 |

Table of Contents

Explanatory Note

We are filing this Amendment No. 1 on Form 10-Q/A to our Quarterly Report on Form 10-Q for the three months ended March 31, 2006 for the purpose of amending our unaudited condensed consolidated financial statements. During the quarter ended June 30, 2006, we reviewed the accounting for our December 2005 acceleration of vesting of certain outstanding stock options with an exercise price of \$45.00 and above in relation to the tender offer for the exchange of certain employee stock options that was completed in May 2006. Based on our review, we have determined that the acceleration of vesting on those stock options was not a substantive modification. The stock options that were subject to the acceleration of vesting were also among the awards included in the tender offer where unvested restricted stock units were offered in exchange for the options. As a result, the Company will recognize compensation based on the grant-date fair value of those awards over the original remaining service period until the date of completion of the tender offer. Under this approach, the completion of the May 2006 tender offer, rather than the December 2005 vesting acceleration, represents the modification date of the awards. The unrecognized non-cash compensation cost associated with awards not tendered for exchange was recognized on the expiration of the tender offer due to the stock options becoming fully vested at that point. The unrecognized non-cash compensation cost associated with awards tendered for exchange will be recognized over the two-year vesting period of the restricted stock units. We did not recognize any incremental compensation cost related to this modification as the fair value of the restricted stock units equates to the fair value of the unvested stock options.

The result of the foregoing is an increase to non-cash stock compensation expense of approximately \$0.6 million for the three months ended March 31, 2006. An additional expense of approximately \$1.0 million related to this matter has been recorded in our financial statements for the three months ended June 30, 2006. In addition, approximately \$1.8 million of non-cash compensation expense associated with the modified awards will be recognized over the remainder of the two-year vesting period of those awards. The unaudited condensed consolidated financial statements and related disclosures in this Form 10-Q/A have been restated to reflect the increase to non-cash stock compensation expense for the three months ended March 31, 2006. This restatement did not have an impact on our total current assets, our total assets or our cash flows for any period presented. This restatement decreased net income \$0.6 million for the three months ended March 31, 2006.

Pursuant to Rule 12b-15 under the Securities and Exchange Act of 1934, as amended, this Amendment No. 1 also contains Item 2 of Part I, as amended, Item 4 of Part I, as amended, and new certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. This Amendment No. 1 contains only the sections and exhibits to the Form 10-Q that are being amended. The sections of and exhibits to the Form 10-Q as originally filed, which are not included herein, are unchanged and continue in full force and effect as originally filed. This Amendment No. 1 speaks as of the date of the original filing of the Form 10-Q and has not been updated to reflect events occurring subsequent to the original filing date.

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

| | March 31, 2006 (as Restated, see Note 11) | December 31, 2005 |
|--|--|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 109,227 | \$ 112,882 |
| Restricted cash | 5,903 | 4,773 |
| Accounts receivable, net | 22,732 | 25,887 |
| Deferred contract costs | 311 | 311 |
| Other current assets | 18,373 | 19,219 |
| Total current assets | 156,546 | 163,072 |
| Premises and equipment, net | 13,295 | 14,056 |
| Deferred issuance costs and other assets, net | 5,154 | 4,906 |
| Goodwill | 14,760 | 14,440 |
| Non-current deferred tax asset | 5,373 | 5,971 |
| Total assets | \$ 195,128 | \$ 202,445 |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| Current liabilities: | | |
| Accounts payable | \$ 10,569 | \$ 11,766 |
| Accrued liabilities | 33,452 | 36,925 |
| Accrued compensation and related expenses | 14,907 | 23,847 |
| Deferred revenue | 93,678 | 99,870 |
| Current portion of long-term debt | 23,860 | 25,000 |
| Total current liabilities | 176,466 | 197,408 |
| Long-term debt | 83,349 | 75,691 |
| Total liabilities | 259,815 | 273,099 |
| 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 | | |
| | 100,077 | 100,065 |

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Series B 2.5% convertible preferred stock, \$1,000 par value, 150 shares authorized, 104 issued and outstanding

| | | |
|--|----------------|----------------|
| Common stock, \$0.00025 par value, 2,000,000 shares authorized, 20,703 shares issued and outstanding | 5 | 5 |
| Warrants for common stock | 3,125 | 3,125 |
| Additional paid-in capital | 10,424,667 | 10,420,262 |
| Accumulated other comprehensive loss | (735) | (1,147) |
| Accumulated deficit | (10,591,826) | (10,592,964) |
| Net stockholders' deficit | (64,687) | (70,654) |
| Total liabilities and stockholders' deficit | \$ 195,128 | \$ 202,445 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**I2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****(In thousands, except per share data)****(unaudited)**

| | Three Months Ended March 31, | |
|--|---|--------------------|
| | 2006 | 2005 |
| | (as restated, see Note 11) | |
| Revenues: | | |
| Software solutions | \$ 16,922 | \$ 25,409 |
| Services | 23,874 | 27,627 |
| Maintenance | 23,214 | 25,818 |
| Contract | 33 | 3,057 |
| Total revenues | 64,043 | 81,911 |
| Costs and expenses: | | |
| Cost of revenues: | | |
| Software solutions | 3,403 | 4,927 |
| Services and maintenance | 23,471 | 28,685 |
| Sales and marketing | 11,096 | 18,368 |
| Research and development | 8,947 | 11,800 |
| General and administrative | 13,538 | 25,643 |
| Restructuring charges and adjustments | (50) | 11,848 |
| Total costs and expenses | 60,405 | 101,271 |
| Operating income (loss) | 3,638 | (19,360) |
| Non-operating income (expense), net | 157 | (4,760) |
| Income (loss) before income taxes | 3,795 | (24,120) |
| Income tax expense | 2,014 | 1,582 |
| Income (loss) from continuing operations | 1,781 | (25,702) |
| Income from discontinued operations, net of taxes | | 1,210 |
| Net income (loss) | \$ 1,781 | \$ (24,492) |
| Preferred stock dividend and accretion of discount | 629 | 743 |
| Net income (loss) applicable to common shareholders | \$ 1,152 | \$ (25,235) |
| Net income (loss) per common share applicable to common shareholders: | | |
| Total: | | |
| Basic | \$ 0.05 | \$ (1.36) |
| Diluted | \$ 0.04 | \$ (1.36) |

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| | | |
|--|---------|-----------|
| Discontinued operations | | |
| Basic | \$ | \$ 0.06 |
| Diluted | \$ | \$ 0.06 |
| Continuing operations including preferred stock dividend and accretion of discount | | |
| Basic | \$ 0.05 | \$ (1.42) |
| Diluted | \$ 0.04 | \$ (1.42) |
| Weighted-average common shares outstanding: | | |
| Basic | 25,195 | 18,613 |
| Diluted | 25,653 | 18,613 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**I2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****(In thousands, except per share data)****(unaudited)**

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2006 | 2005 |
| | (as restated, see Note 11) | |
| Comprehensive income (loss): | | |
| Net income (loss) applicable to common shareholders | \$ 1,152 | \$ (25,235) |
| Other comprehensive income (loss): | | |
| Unrealized gain on available-for-sale securities arising during the period | | 4 |
| Foreign currency translation adjustments | 412 | (1,496) |
| Total other comprehensive income (loss) | 412 | (1,492) |
| Total comprehensive income (loss) | \$ 1,564 | \$ (26,727) |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**I2 TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(unaudited)**

| | Three Months Ended March 31 | |
|--|------------------------------------|-------------|
| | 2006 | 2005 |
| | (as restated, see Note 11) | |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 1,781 | \$ (24,492) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation and amortization | 1,814 | 1,713 |
| Stock option expense | 4,261 | |
| Amortization of deferred compensation | 138 | 188 |
| Gain on sale of securities | (501) | |
| (Gain) loss on disposal of equipment | (29) | 718 |
| Provision (credit) for bad debts charged to costs and expenses | (34) | 163 |
| Deferred income taxes | 905 | 230 |
| Changes in operating assets and liabilities, excluding the effects of acquisitions: | | |
| Accounts receivable, net | 3,254 | 3,431 |
| Other current assets | 625 | (491) |
| Accounts payable | (1,181) | 964 |
| Accrued liabilities | (4,049) | 15,873 |
| Accrued compensation and related expenses | (8,916) | (4,991) |
| Deferred revenue | (6,042) | 1,189 |
| Net cash used in operating activities | (7,974) | (5,505) |
| Cash flows from investing activities: | | |
| Restrictions (added to) released from cash | (1,130) | 1,720 |
| Purchases of premises and equipment | (578) | (1,008) |
| Proceeds from sale of premises and equipment | 141 | |
| Purchases of short-term investments | | (20,000) |
| Proceeds from sale of short-term investments | | 16,850 |
| Proceeds from sale of securities | 501 | |
| Business acquisition | (569) | |
| Purchases of long-term investments | | (500) |
| Net cash used in investing activities | (1,635) | (2,938) |
| Cash flows from financing activities: | | |
| Repurchase of debt | (1,140) | |
| Proceeds from sale of convertible debt | 7,500 | |
| Payment of debt issuance costs | (493) | |
| Net proceeds from common stock issuance from options and employee stock purchase plans | 6 | 8 |
| Net cash provided by financing activities | 5,873 | 8 |
| Effect of exchange rates on cash | 81 | (1,319) |

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| | | |
|--|------------|------------|
| Net change in cash and cash equivalents | (3,655) | (9,754) |
| Cash and cash equivalents at beginning of period | 112,882 | 133,273 |
| Cash and cash equivalents at end of period | \$ 109,227 | \$ 123,519 |
| Supplemental cash flow information | | |
| Income taxes paid (net of refunds received) | \$ 1,769 | \$ 1,380 |
| Schedule of non-cash financing activities | | |
| Preferred stock dividend and accretion of discount | \$ 629 | \$ 743 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**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 enterprise supply chain management solutions, including various supply chain 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 help customers maximize efficiency in relation to sourcing, supply, demand, fulfillment and logistics performance. Our application software is often bundled with other offerings, including services 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 discussed in Note 5, *Restructuring Charges and Adjustments*, and Note 8, *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, 2006. 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, 2005 filed on March 15, 2006 with the SEC (2005 Annual Report on Form 10-K).

Recent Accounting Pronouncements. None.

2. Investment Securities

Short-term time deposits and other liquid investments in debt securities with original maturities of less than three months when acquired by us are classified as cash and cash equivalents in the condensed consolidated balance sheets. The estimated fair value of these investments approximates their carrying value. Investment securities reported as cash and cash equivalents at March 31, 2006 and December 31, 2005 were as follows:

| | March 31, 2006 | December 31, 2005 |
|--------------------------|-------------------|----------------------|
| Short-term time deposits | \$ 7,951 | \$ 7,244 |
| Commercial paper | 53,478 | 28,094 |
| | \$ 61,429 | \$ 35,338 |

In addition to our short-term investments, 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. As a result of significant declines in the expected realizable amounts of these investments, in previous periods we wrote off the book value of all these investments as the decline in fair value was considered other than temporary.

3. Leases

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We lease our office facilities and certain office equipment under operating leases that expire at various dates through 2011. We have renewal options for most of our operating leases. Future minimum lease payments under our non-cancellable operating leases, including lease payments for restructured facilities without consideration of offsetting estimated sublease income of \$4.3 million from the restructured facilities (See *Note 5, Restructuring Charges and Adjustments*, for more details) as of March 31, 2006 are as follows:

| | |
|------------|-----------|
| 2006. | \$ 12,441 |
| 2007 | 12,356 |
| 2008 | 9,923 |
| 2009 | 8,309 |
| 2010 | 3,530 |
| Thereafter | 626 |
| Total | \$ 47,185 |

Table of Contents**4. Borrowings and Debt Issuance Costs**

The following table summarizes the outstanding debt and related debt issuance cost recorded on our condensed consolidated balance sheet at March 31, 2006 and December 31, 2005.

| | March 31, 2006 | December 31, 2005 |
|--|-------------------|----------------------|
| Convertible subordinated notes, 5.25% annual rate payable semi-annually, due December 15, 2006 | \$ 23,860 | \$ 25,000 |
| Senior convertible notes, 5% annual rate payable semi-annually, due November 15, 2015 | 83,349 | 75,691 |
| Total debt | \$ 107,209 | \$ 100,691 |
| Less current portion | 23,860 | 25,000 |
| Long-term debt | \$ 83,349 | \$ 75,691 |
| Capitalized debt issuance costs, net | \$ 5,088 | \$ 4,906 |

During January 2006, the remaining \$7.5 million of the over allotment option associated with our 5% senior convertible notes was exercised and we received net proceeds of \$7.0 million.

During March 2006, we repurchased approximately \$1.1 million of our 5.25% convertible notes at par.

5. Restructuring Charges and Adjustments

2005 Restructuring Plan. On March 30, 2005, we implemented a restructuring plan to resize our infrastructure and reduce our overhead to improve efficiencies and reduce operating expense. The restructuring included the involuntary termination of 184 employees and closing or partially vacating four office locations. These activities are being accounted for in accordance with SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities. As of March 31, 2006, \$0.3 million related to office closure and consolidation, net of estimated sublease income, remains in our restructuring accrual related to the 2005 restructuring plans.

2001 and 2002 Restructuring Plans. We initiated global restructuring plans in 2001 and 2002 to reduce our operating expenses and to bring them into alignment with our expected revenue levels. The plans included the elimination of certain employee positions and the reduction of office space and related overhead expenses. As of March 31, 2006, \$0.6 million related to office closure and consolidation, net of estimated sublease income, remains in our restructuring accrual related to the 2001 and 2002 restructuring plans.

Table of Contents

Consolidated Restructuring Accrual. The following table summarizes the 2006 restructuring related payments and accruals, and the components of the remaining restructuring accruals, included in accrued liabilities, at March 31, 2006 and December 31, 2005:

| | Employee Severance and Termination | Office Closure and Consolidation | Total |
|---|---|---|--------------|
| December 31, 2005 | \$ 234 | \$ 1,343 | \$ 1,577 |
| Adjustments to 2001 and 2002 restructuring plan | | (50) | (50) |
| Cash payments | (6) | (358) | (364) |
| Remaining accrual balance at March 31, 2006 | \$ 228 | \$ 935 | \$ 1,163 |

The accrual for office closure and consolidation of \$0.9 million at March 31, 2006 represents future payments to be made for facilities that we have exited as part of our restructuring plans. This accrual is net of estimated sublease income of \$1.3 million. The remaining payments related to restructured facilities extend into the third quarter of 2007.

6. Net Income (Loss) Per Common Share

Net Income (Loss) Per Common Share. Basic net income (loss) per common share was computed by dividing net income (loss) applicable to common shareholders by the weighted average number of common shares outstanding for the reporting period following the two-class method. Under the two-class method, participating convertible securities are required to be included in the calculation of basic net income when the effect is dilutive. Accordingly, for the three-month period ended March 31, 2006, the effect of the convertible preferred stock is included in the calculation of basic net income per share. The convertible preferred stock was anti-dilutive for the three-months ended March 31, 2005, and was therefore excluded from the two-class method calculation of basic earnings per share.

Diluted net income (loss) 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 and convertible preferred stock using the if-converted method. 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. Therefore, for the three month period ended March 31, 2005 the basic and diluted net loss per common share are the same. 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. The effect of the convertible debt is anti-dilutive for the periods ended March 31, 2006 and March 31, 2005. The effect of our convertible preferred stock is included in basic net income per share under the two-class method per EITF 03-6, *Participating Securities and the Two-Class Method* under FASB Statement No. 128 Earnings per Share, therefore, it is similarly included in diluted income per share when the effect is dilutive.

Table of Contents

The following is a reconciliation of the number of shares used in the calculation of basic net income (loss) per share under the two-class method and diluted earnings (loss) per share and the number of anti-dilutive shares excluded from such computations for the three months ended March 31, 2006 and 2005:

| | Three Months Ended March 31, | |
|---|---|---------------|
| | 2006 | 2005 |
| Common and common equivalent shares outstanding using two-class method - basic: | | |
| Weighted average common shares outstanding | 20,703 | 18,613 |
| Participating convertible preferred stock | 4,492 | |
| Total common and common equivalent shares outstanding using two-class method - basic | 25,195 | 18,613 |
| Effect of dilutive securities: | | |
| Outstanding stock option and share right awards | 437 | |
| Warrants associated with 5% debt | 21 | |
| Weighted average common and common equivalent shares outstanding - diluted | 25,653 | 18,613 |
| Anti-dilutive share excluded from calculation: | | |
| Outstanding stock option and share right awards | 2,757 | 3,954 |
| Participating convertible preferred stock | | 4,320 |
| Convertible debt | 301 | 320 |
| Total anti-dilutive shares excluded from calculation | 3,058 | 8,594 |

7. Segment Information, International Operations and Customer Concentrations

We operate our business in one segment, supply chain management solutions designed to help enterprises optimize business processes both internally and among trading partners. SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, establishes standards for the reporting of information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, who is our Chief Executive Officer (CEO), in deciding how to allocate resources and in assessing performance.

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 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 March 31, | |
|--------------------------------|-------------------------------------|------------------|
| | 2006 | 2005 |
| United States | \$ 34,836 | \$ 42,162 |
| Non-U.S. Americas | 3,482 | 1,935 |
| Europe, Middle East and Africa | 12,418 | 25,724 |
| Greater Asia Pacific | 13,307 | 12,090 |
| Total Revenue | \$ 64,043 | \$ 81,911 |

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Revenues from international operations totaled \$29.2 million and \$39.7 million during the three months ended March 31, 2006 and 2005, respectively. During the three months ended March 31, 2006, no individual customer accounted for more than 10% of total revenues. During the three months ended March 31, 2005, one customer accounted for approximately 10% of total revenues.

Table of Contents

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

| | March 31, 2006 | December 31, 2005 |
|--------------------------------|-------------------|----------------------|
| United States | \$ 30,230 | \$ 30,438 |
| Europe, Middle East and Africa | 351 | 468 |
| Greater Asia Pacific | 2,628 | 2,496 |
| Total Long Lived Assets | \$ 33,209 | \$ 33,402 |

8. Commitments and Contingencies*Governmental Investigations and Actions*

Beginning in the fall of 2001, we and certain members of our Board of Directors received a series of communications from a former officer containing a variety of allegations generally related to revenue recognition and financial reporting, among other things. Our Board of Directors directed our Audit Committee to conduct an internal investigation of these allegations. In November 2002, we reported to the SEC and publicly disclosed the results of that investigation, as well as certain related allegations made during the fall of 2002 by the former officer and another former officer. Thereafter, the staff of the SEC opened an informal inquiry into these allegations and other matters relating to our financial reporting.

In January 2003, our ongoing investigation turned up information that persuaded management and the Audit Committee that material adjustments to our previously issued financial statements might be required and that our consolidated financial statements for the years ended December 31, 2001 and 2000 should be re-audited. The cumulative impact of the revenue adjustments required by the re-audit was to reduce revenue by \$359.7 million, which was comprised of \$127.3 million of revenue that was reversed and \$232.4 million of revenue that was deferred for possible recognition in the future. In March 2003, we were advised that the SEC had issued a formal order of investigation to determine whether there had been violations of the federal securities laws by the company and/or others involved with the company in connection with matters relating to the restatement of our consolidated financial statements.

On June 9, 2004, the company settled the SEC enforcement proceedings. Without admitting or denying the SEC's substantive findings against it, the company consented to a cease-and-desist order requiring future compliance with specific provisions of the federal securities laws and paid a \$10.0 million civil penalty, which was included in general and administrative expense, in our financial statements for the year ended December 31, 2004.

The settlement of the SEC enforcement proceedings covers the company only. On July 15, 2005, the SEC filed a civil action against three former officers of the company: Gregory A. Brady, William M. Beecher and Reagan L. Lancaster. The complaint relates to events that occurred prior to the restatement of the company's financial statements in 2003. On March 23, 2006, the SEC settled the civil charges against Mr. Lancaster. The SEC's investigation continues as to other individuals and entities. We continue to cooperate with the staff of the SEC and we are also cooperating with the U.S. Attorney's Office for the Northern District of Texas, which is also investigating certain matters relating to the 2003 restatement of our consolidated financial statements.

Customer Litigation

On September 30, 2004, we were served with a complaint in a suit filed in the District Court of Dallas County, Texas by Kmart Corporation against the company, Sanjiv Sidhu, our current Chairman and former Chief Executive Officer and President, and Gregory Brady, our former Chief Executive Officer and President. The complaint alleges fraudulent inducement, breach of contract, breach of fiduciary duty, rescission and unjust enrichment in relation to the license agreement, dated as of September 29, 2000, between our company and Kmart. Certain of the allegations in Kmart's complaint are purportedly similar to the subject of the cease-and-desist order entered into by the company in connection with the June 9, 2004 settlement of the SEC enforcement proceedings related to the company's 2003 restatement as well as the allegations made by the SEC in the subsequent civil action brought against three former officers of the company on July 15, 2005. The complaint states that Kmart paid in excess of \$40.0 million for software and technology and in excess of \$10.0 million for implementation services in connection with the license agreement. On May 9, 2006, the company and Messrs. Sidhu and Brady entered into a definitive agreement to settle this litigation. Pursuant to the terms of the agreement, the total cash settlement was \$10.0 million, which included \$5.0 million covered by our insurance carrier and \$5.0 million paid by the company. In addition, the company granted Kmart a license to use certain of the company's software and the

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company agreed to provide maintenance for some of the company's software licensed by Kmart. We were fully accrued for our portion of the cash settlement as of March 31, 2006.

Table of Contents

Indemnification Agreements

In November 2002, the FASB issued Interpretation No. 45, or FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee or indemnification. FIN 45 also requires additional disclosure by a guarantor in our interim and annual consolidated financial statements about our obligations under certain guarantees and indemnifications. The following is a summary of the agreements that we have determined are within the scope of FIN 45 as of March 31, 2006.

We have entered into 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. Pursuant to these agreements, we have paid 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 and may continue to do so in the future.

We have also entered into agreements regarding the advancement of costs with certain officers and employees. Pursuant to these agreements, we have advanced fees and expenses incurred by such officers and employees in connection with the governmental investigations and actions related to the 2003 restatement of our consolidated financial statements and other matters, and may continue to do so in the future.

The maximum potential amount of future payments we could be required to make under these indemnification agreements and the agreements for the advancement of costs 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. We incurred approximately \$2.0 million and \$0.8 million of expense for legal fees and expenses for current and former employees during the first quarters of 2006 and 2005, respectively.

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 licensee 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 cannot obtain the right to use, replace or modify the software or service in a commercially feasible 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 recorded no 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 indemnifications becomes probable and the amount of the liability is reasonably estimable or the maximum amount of a range of loss is reasonably estimable, then an appropriate liability will be recorded in our consolidated financial statements.

Internal Revenue Service Audit

We currently are being examined by the Internal Revenue Service (IRS) regarding matters relating to the timing of the company's remittance of withholding taxes, which were previously remitted, associated with the exercise of certain stock options by employees in the 2000 tax year. The company has filed a protest regarding the IRS's position on the matter and the protest is being reviewed by the IRS. The IRS has not issued an assessment with respect to any monetary penalties claimed to be owed by the company and the company presently intends to seek a full statutory abatement of any such penalties that might be assessed. The amount of such assessment could be significant.

India Tax Assessments

On March 29, 2005, we were notified by the Office of the Addl. Commissioner of Income-Tax in India of tax and interest assessments of approximately \$2.4 million and \$0.9 million, respectively, related to transfer pricing adjustments between our affiliated companies for the Indian statutory fiscal year ended March 31, 2002. The Office of the Addl. Commissioner of Income-Tax has asserted that intercompany charges from our Indian subsidiaries to our U.S. and Dutch subsidiaries were understated during this period. We were required to pay, and have paid, the assessed tax during the appeals process. The future assessment of a penalty, in addition to the tax and interest, in an amount up to \$2.4 million is possible but not probable and no amount has been accrued at March 31, 2006.

Table of Contents

On March 31, 2006, we received assessments totaling approximately \$1.1 million, primarily related to similar transfer pricing adjustments for the Indian statutory fiscal year ended March 31, 2003.

We believe the Indian tax authorities' position regarding our intercompany transactions to be without merit and that all intercompany transactions were conducted at appropriate pricing levels. Accordingly, we have appealed the assessed tax and expect the ultimate assessment will not exceed the tax contingency reserves we have established for these matters.

Japan Tax Examination

In January 2006, the tax examination by the National Tax Agency in Japan regarding withholding taxes on intercompany payments made by our subsidiary in Japan was concluded, and no assessment was made against us.

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 over and above the amount, if any, that has been estimated and accrued in our consolidated financial statements could have a material adverse effect on our business, financial condition, results of operations or cash flows.

9. Stock-Based Compensation Plans.

Employee Stock Purchase Plans. We maintain stock purchase plans for the benefit of our employees and the employees of our wholly-owned subsidiaries. The purchase plans are designed to allow eligible employees to purchase shares of common stock through periodic payroll deductions. Payroll deductions may not exceed 15% of a participant's base salary, and employees may purchase a maximum of 320 shares per purchase period under the purchase plans. The purchase price per share is 85% of the lesser of the fair market value of our common stock at the start of the purchase period or the fair market value at the end of the purchase period. Participation may be terminated at any time by the employee and automatically ends upon termination of employment. Unless extended, or terminated, the plan will terminate on the last business day in April 2011.

1995 Stock Option/Stock Issuance Plan. The 1995 Stock Option/Stock Issuance Plan, a stockholder approved stock-based compensation plan, replaced our original 1992 Stock Plan. All options outstanding under the 1992 Plan were incorporated into the 1995 Plan; however, all outstanding options under the 1992 Plan continue to be governed by the terms and conditions of the existing option agreements for those grants. The 1995 Plan is divided into three equity programs: (i) the Discretionary Option Grant Program, (ii) the Stock Issuance Program and (iii) the Automatic Option Grant Program.

The Discretionary Option Grant Program provides for the grant of incentive stock options to employees and for the grant of nonqualified stock options to employees, directors and consultants. Exercise prices may not be less than 100% and 85% of the fair market value per share of our common stock on the date of grant for incentive options and nonqualified stock options, respectively. Options granted under this program generally expire after ten years. Prior to March 2001, options granted under the Discretionary Option Grant Program generally vested in four equal annual increments; however, since March 2001, options granted generally vest 1% on the date of grant and then 24% on the first anniversary of the grant date. The remaining options vest in 36 equal monthly increments. Some options granted under the Discretionary Option Grant Program may be immediately exercisable, subject to a right of repurchase at the original exercise price for all unvested shares.

The Stock Issuance Program provides for the issuance of shares of our common stock to any person at any time, at such prices and on such terms as established by the plan administrator. The purchase price per share cannot be less than 85% of the fair market value of our common stock on the issuance date. Shares of our common stock may also be issued pursuant to share right awards that entitle the recipients to receive those shares upon the attainment of designated performance goals or the satisfaction of specified service requirements.

The Automatic Option Grant Program provides that each person who is first elected or appointed as a non-employee member of our Board of Directors shall automatically be granted nonqualified options to purchase 6,000 shares of our common stock at the fair market value on the date of grant. On the date of each Annual Meeting of Stockholders, each non-employee member of the Board of Directors will automatically be granted additional options to purchase 4,250 shares of our common stock, subject to certain conditions. The vesting period for option grants to eligible non-employee Board members under the Automatic Grant Program occurs in three equal annual installments, with the first such installment vesting one year from the option grant date.

Table of Contents

The 1995 Plan has an automatic share increase feature whereby the number of shares of common stock reserved for issuance under the plan will automatically increase on the first trading day of January each calendar year by an amount equal to 5.0% of the sum of (a) the total number of shares of common stock outstanding on the last trading day in December of the immediately preceding calendar year, plus (b) the total number of shares of common stock repurchased by us on the open market during the immediately preceding calendar year pursuant to a stock repurchase program. In no event shall any such annual increase exceed 1.6 million shares of common stock or such lesser number of shares of common stock as determined by our Board of Directors in its discretion. Through March 31, 2006, we have reserved a total of 11,824,212 shares of common stock for issuance under the plan. Based upon the number of shares reserved for issuance under the plan at December 31, 2005, we limited the number of additional shares reserved in January 2006 to 10,000, during the second quarter of 2005. The number of shares for which an individual may receive options, stock appreciation rights and other stock-based awards in his or her initial year of hire is limited to 1,000,000. Unless extended or terminated, the plan will terminate on October 14, 2014.

2001 Non-officer Stock Option/Stock Issuance Plan. In March 2001, the Board of Directors adopted the 2001 Non-officer Stock Option/Stock Issuance Plan. Based on the provisions of the 2001 Plan, its adoption did not require stockholder approval and accordingly such approval was not obtained. Under the provisions of this plan, 800,000 shares have been reserved for issuance. The 2001 Plan is divided into two equity programs: (i) the Discretionary Option Grant Program and (ii) the Stock Issuance Program.

The Discretionary Option Grant Program provides for the grant of nonqualified stock options to non-officer employees and consultants. Exercise prices may be less than, equal to, or greater than the fair market value per share of our common stock on the date of grant. Options granted under this program generally expire after ten years and generally vest 25% on the first anniversary of the grant date with the remaining options vesting in 36 equal monthly increments; however, since March 2001, options granted generally vest 1% on the date of grant and then 24% on the first anniversary of the grant date. The remaining options vest in 36 equal monthly increments. Some options granted under this program may be immediately exercisable, subject to a right of repurchase at the original exercise price for all unvested shares.

The Stock Issuance Program provides for the issuance of shares of our common stock to non-officer employees and consultants at any time, at such prices and on such terms as established by the plan administrator. Shares of our common stock may also be issued pursuant to share right awards that entitle the recipients to receive those shares upon the attainment of designated performance goals or the satisfaction of specified service requirements.

Assumed Stock Option Plans. In connection with the acquisitions of various companies, we have assumed the stock option plans of each acquired company. While our stockholders approved some of the acquisitions, our stockholders have not specifically approved any of the assumed stock option plans. A total of 1.5 million shares of our common stock have been reserved for issuance under the assumed plans.

Effective January 1, 2006, we adopted SFAS No. 123(R), *Share-Based Payment*, which is a revision to SFAS No. 123, *Accounting for Stock Based Compensation*, using the modified prospective method of transition. Under the provisions of SFAS No. 123(R), the estimated fair value of share based awards granted under stock incentive plans are recognized as compensation expense over the vesting period. Using the modified prospective method, compensation expense is recognized beginning with the effective date of adoption of SFAS No. 123(R) for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and that remain unvested on the date of adoption.

Prior to January 1, 2006, we accounted for stock based compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (*APB 25*), and its related interpretations. Under the provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value at the date of grant.

We recorded approximately \$4.4 million of total stock based compensation expense for the three month period ended March 31, 2006 as required by the provisions of SFAS No. 123(R). Included in the stock compensation expense was \$0.1 million in restricted stock expense. This amount includes the effect of our restatement as discussed in Note 11. The stock-based compensation expense is calculated on a straight-line basis over the vesting periods of the related options. This charge had no impact on our reported cash flow. The allocation of the stock-based compensation expense for the three months ended March 31, 2006 is as follows:

| | Three Months Ended March 31, 2006 |
|----------------------------------|--|
| Cost of services and maintenance | \$ 767 |
| Sales and marketing | 1,105 |

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| | |
|----------------------------|----------|
| Research and development | 1,124 |
| General and administrative | 1,404 |
| Total | \$ 4,400 |

Table of Contents

Under the modified prospective method of SFAS No. 123(R), we are not required to restate prior financial statements to reflect expensing of share-based compensation. As required by SFAS No. 123(R), we have presented pro forma disclosures of our net loss and net loss per share for the three-month period ended March 31, 2005 assuming the estimated fair value of the options granted prior to January 1, 2006 was amortized to expense over the option-vesting period as illustrated below:

| | |
|---|---------------------------|
| | March 31, 2005 |
| Net loss applicable to common shareholders | \$ (25,235) |
| Add: Total stock-based employee compensation expense included in reported net income | 188 |
| Less: Total stock-based employee compensation expense determined under fair value based method for all awards | (10,978) |
| Pro forma net loss | \$ (36,025) |
| Net income (loss) per common share - Basic and Diluted: | |
| As reported | |
| Basic and diluted | \$ (1.36) |
| Pro forma | |
| Basic and diluted | \$ (1.94) |

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 Shares | |
|-------------------------|---------------------------|-------------|---------------------------|-------------|
| | Three Months Ended | | Three Months Ended | |
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| Expected term (years) | 4 | 4 | 0.5 | 0.5 |
| Volatility factor | 1.00 | 1.08 | 0.99 | 0.60 |
| Risk-free interest rate | 4.6% | 3.7% | 4.5% | 3.5% |
| Dividend yield | 0% | 0% | 0% | 0% |

The Black-Scholes option-pricing model requires the input of highly subjective assumptions. We continue to assess the assumptions and methodologies used to calculate estimated fair value of share-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies, which could materially impact our fair value determinations.

Table of Contents

A combined summary of activity in our 1995 Plan, 2001 Plan and our assumed stock option plans is as follows (in thousands, except per share amounts):

| | Number of Options | Weighted Average Exercise Price | Weighted Remaining Contractual Life (Years) | Aggregate Intrinsic Value |
|--|----------------------|---------------------------------------|---|---------------------------------|
| Outstanding balance, December 31, 2005 | 5,261 | \$ 78.66 | | |
| Granted | | | | |
| Grant price = Fair Market Value | 293 | 15.88 | | |
| Exercised | (1) | 9.16 | | |
| Forfeited | (81) | 11.87 | | |
| Expired | (346) | 253.92 | | |
| Outstanding balance, March 31, 2006 | 5,125 | \$ 64.28 | 7.05 | \$ 16,465 |

Options exercisable at March 31, 2006 2,693 \$ 110.73 5.03 \$ 4,015

In connection with stock option awards, including restricted stock, we recognized compensation expense of \$4.4 million, including the effect of the restatement discussed in Note 11, and \$0.2 million in the three months ended March 31, 2006 and March 31, 2005, respectively. Total compensation cost not yet recognized related to nonvested awards was \$24.8 million at March 31, 2006. The expense is expected to be recognized over a weighted-average period of 1.8 years. The weighted-average, grant-date fair value of options granted during the three-month period ended March 31, 2006 and March 31, 2005 was \$11.28 and \$6.73, respectively. The total fair value of options vested during the three-month period ended March 31, 2006 and March 31, 2005 was \$1.1 million and \$6.1 million, respectively. The aggregate intrinsic value of options exercised during the three-month periods ended March 31, 2006 and March 31, 2005, was less than \$0.1 million in each period. The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option. When we issue shares related to stock option exercises, our policy is to first issue any available treasury shares and then issue new shares.

A summary of unvested stock option and restricted stock shares as of March 31, 2006, and change during the three-month period then ended is presented below:

| | Nonvested Shares | Weighted Average Grant Date Fair Value |
|-------------------------------------|---------------------|--|
| Unvested balance, December 31, 2005 | 2,370 | \$ 9.57 |
| Granted | | |
| Grant price = Fair Market Value | 288 | 11.28 |
| Vested | (130) | 8.50 |
| Forfeited | (81) | 9.37 |
| Outstanding balance, March 31, 2006 | 2,447 | \$ 9.83 |

10. Reclassification of Certain Revenue and Expense

During the fourth quarter of 2005, we underwent an internal review of our revenue classifications. As a result of this review, we implemented an alternative classification of revenue previously reported as development services to more closely reflect the presentation of revenue by our peers and consistent with our sales model.

Fees associated with licensing of our products, as well as any fees received to deliver the licensed functionality (for example, the provision of essential services) are classified under software solutions revenue along with core license and recurring license revenue. Fees received to customize or enhance a previously purchased licensed product that resulted from arrangements negotiated and executed subsequent to the license arrangement are classified as services revenue. Similarly, the previously reported cost of development services is reclassified such that the cost is allocated to cost of software solutions and cost of services, as appropriate.

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Our presentation of reimbursable expense revenue has also changed. Historically, we have stated the related revenue and expense amounts separately on our Consolidated Statement of Operations. Beginning with the fourth quarter of 2005, we adopted the industry practice of including reimbursable expense revenue in services revenue, and the related costs in cost of services.

Table of Contents

The following chart illustrates the previous and current classifications of revenue and costs of revenue for the quarter ended March 31, 2005:

| | For the Three Months Ended March 31, 2005 |
|--------------------------|--|
| Revenue | |
| Previous Classification | |
| Software Licenses | \$ 6,780 |
| Development Services | 20,064 |
| Contract | 3,057 |
| Services | 23,558 |
| Reimbursable expense | 2,634 |
| Maintenance | 25,818 |
| Total revenue | \$ 81,911 |
| Current Classification | |
| Software solutions | \$ 25,409 |
| Services | 27,627 |
| Maintenance | 25,818 |
| Contract | 3,057 |
| Total revenue | \$ 81,911 |
| Costs of Revenue | |
| Previous Classification | |
| Software Licenses | \$ 1,790 |
| Development Services | 4,601 |
| Reimbursable expense | 2,634 |
| Services and Maintenance | 24,587 |
| Total revenue | \$ 33,612 |
| Current Classification | |
| Software solutions | \$ 4,927 |
| Services and Maintenance | 28,685 |
| Total revenue | \$ 33,612 |

11. Restatement of Financial Statements

Subsequent to the issuance of our condensed consolidated financial statements for the quarter ended March 31, 2006, we reviewed the accounting for our December 2005 acceleration of vesting of certain outstanding stock options with an exercise price of \$45.00 and above in relation to the tender offer for the exchange of certain employee stock options that was completed in May 2006. (See Note 12 for discussion of the tender offer.) Based on our review, we have determined that the acceleration of vesting on those stock options was not a substantive modification. The stock options that were subject to the acceleration of vesting were also among the awards included in the tender offer where unvested restricted stock units were offered in exchange for the options. As a result, the Company will recognize compensation based on the grant-date fair value of those awards over the original remaining service period until the date of completion of the tender offer. Under this approach, the completion of the May 2006 tender offer, rather than the December 2005 vesting acceleration, represents the modification date of the awards. The unrecognized non-cash compensation cost associated with awards not tendered for exchange was recognized on the expiration of the tender offer due to the stock options becoming fully vested at that point. The unrecognized non-cash compensation cost associated with awards tendered for exchange will be recognized over the two-year vesting period of the restricted stock units. We did not recognize any incremental compensation cost related to this modification as the fair value of the restricted stock units equates to the fair value of the unvested stock options.

Table of Contents

The result of the foregoing is an increase to non-cash stock compensation expense of approximately \$0.6 million from the amounts previously reported for the three months ended March 31, 2006. An additional expense of approximately \$1.0 million related to this matter has been recorded in our financial statements for the three months ended June 30, 2006. In addition, approximately \$1.8 million of non-cash compensation expense associated with the modified awards will be recognized over the remainder of the two-year vesting period of those awards.

The accompanying condensed consolidated financial statements have been restated to reflect the increase to non-cash stock compensation expense for the three months ended March 31, 2006. This restatement did not have an impact on our total current assets, our total assets or our cash flows for any period presented. This restatement decreased net income \$0.6 million for the three months ended March 31, 2006.

Following is a summary of the effects of the restatement described above (in thousands, except per share amounts):

Condensed Consolidated Balance Sheet

| | As of March 31, 2006 | | |
|----------------------------|---------------------------|------------|---------------|
| | As Previously Reported | Adjustment | As Restated |
| Additional paid-in-capital | \$ 10,424,058 | \$ 609 | \$ 10,424,667 |
| Accumulated deficit | (10,591,217) | (609) | (10,591,826) |

Table of Contents**Condensed Consolidated Statements of Operations and Comprehensive (Loss)**

| | Three Months Ended March 31, 2006 | | |
|---|-----------------------------------|------------|----------------|
| | As Previously Reported | Adjustment | As Restated |
| Costs and expenses: | | | |
| Costs of revenues: | | | |
| Services and maintenance | \$ 23,336 | \$ 135 | \$ 23,471 |
| Sales and marketing | 10,954 | 142 | 11,096 |
| Research and development | 8,698 | 249 | 8,947 |
| General and administrative | 13,455 | 83 | 13,538 |
| Total costs and expenses | 59,796 | 609 | 60,405 |
| Operating income (loss) | 4,247 | (609) | 3,638 |
| Income (loss) before income taxes | 4,404 | (609) | 3,795 |
| Net income (loss) | 2,390 | (609) | 1,781 |
| Net income (loss) applicable to common shareholders | 1,761 | (609) | 1,152 |
| Net income (loss) per common share applicable to common shareholders: | | | |
| Total: | | | |
| Basic | \$ 0.07 | \$ (0.02) | \$ 0.05 |
| Diluted | \$ 0.07 | \$ (0.03) | \$ 0.04 |
| Continuing operations including preferred dividend and accretion of discount: | | | |
| Basic | \$ 0.07 | \$ (0.02) | \$ 0.05 |
| Diluted | \$ 0.07 | \$ (0.03) | \$ 0.04 |
| Total comprehensive income (loss) | \$ 2,173 | \$ (609) | \$ 1,564 |

Condensed Consolidated Statements of Cash Flows

| | Three Months Ended March 31, 2006 | | |
|----------------------|-----------------------------------|------------|----------------|
| | As Previously Reported | Adjustment | As Restated |
| Net income (loss) | \$ 2,390 | \$ (609) | \$ 1,781 |
| Stock option expense | 3,652 | 609 | 4,261 |

Table of Contents

12. Subsequent Events

During April 2006, we repurchased approximately \$2.0 million of our 5.25% convertible notes.

In April 2006, we announced that we filed an exchange offer with the SEC under which eligible employees will have the opportunity to exchange certain stock options for restricted stock units. We are offering to exchange restricted stock units for outstanding options with exercise prices per share equal to or greater than \$45.00. The number of restricted stock units to be issued in exchange for a properly tendered eligible option will be based on exchange ratios that depend on the exercise price of the tendered option. The exchange ratios represent the number of option shares to be exchanged for one restricted stock unit and range from 5-for-1 to 72-for-1. Our CEO, CFO and members of our Board of Directors are not eligible to participate in the program. (See Note 9, Stock Based Compensation Plans and Note 11, Restatement of Financial Statements.)

On May 9, 2006, we entered into a definitive agreement to settle our outstanding litigation with Kmart. The total cash settlement was \$10.0 million, which included \$5 million covered by our insurance carrier and \$5 million to be paid by us, together with our granting Kmart a license to use certain of our software and agreeing to provide maintenance to some of our software licensed by Kmart. We were fully accrued for our portion of the cash settlement as of March 31, 2006.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations gives effect to the restatement of the condensed consolidated financial statements for the quarterly period ended March 31, 2006 as described in Note 11 to the condensed consolidated financial statements.

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.

Table of Contents

and thereby cause our stock price to decline. Such risks and uncertainties include, without limitation or ordering as to priority, the following:

We have experienced substantial negative operating cash flows and we may not achieve a sustained return to positive cash flow. A failure to control expenses, stabilize or grow revenues and achieve sustained positive cash flows will eventually impair our ability to support our operations and adversely affect our liquidity.

Our \$23.9 million of 5.25% convertible subordinated notes mature and will become due and payable on December 15, 2006. Although our current cash balances are sufficient to repay this debt, significant cash outflows in 2006 could impair our ability to do so.

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. We cannot assure you 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.

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. If we are unable to incur additional indebtedness, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations.

Our financial results have varied and may continue to vary significantly from quarter-to-quarter and we may fail to meet expectations, which might negatively impact the price of our stock. Our limited analyst coverage, which can result in wide variations in earnings estimates, can amplify this impact.

We may not benefit from increased demand in the market for information technology and an improving macroeconomic environment if we are unable to maintain or grow our market share, which would negatively impact our revenues and stock price.

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

We face risks related to ongoing governmental investigations and litigation that could have a material adverse effect on our relationships with customers and our business, financial condition and results of operations. We may face additional litigation in the future that could harm our business and impair our liquidity.

Further loss of key personnel, including customer-facing employees, may negatively affect our operating results and revenues and seriously harm our company.

Restructuring initiatives have been executed, and such activities pose risks to our business.

Other risks indicated below under the section captioned **Factors that May Affect Future Results** and in our other filings with the SEC. 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.

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

We are a provider of enterprise supply chain management solutions, including various supply chain 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 improving agility, managing variability, reducing complexity, improving operational visibility, increasing operating velocity as well as integrating planning and execution. Our offerings help customers maximize efficiency in relation to sourcing, supply, demand, fulfillment and logistics performance. Our application software is often licensed in conjunction with other offerings we provide such as business optimization and technical consulting, training, solution maintenance, software upgrades and development.

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

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, which is a revision to SFAS No. 123, Accounting for Stock Based Compensation. See *Note 9, Stock Based Compensation Plans*, in our Notes to Condensed Consolidated Financial Statements, for further discussion.

Revenues

We derive revenues from licenses of our software and related services, which include assistance in implementation, integration, customization, maintenance, training and consulting. 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*, and *SEC Staff Accounting Bulletin (SAB) 101, Revenue Recognition, and SAB 103, Update of Codification of Staff Accounting Bulletins*.

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 (loss). The period-to-period comparisons of financial results are not necessarily indicative of future results.

| | Three Months Ended March 31, 2006 | Percent of Revenue | Three Months Ended March 31, 2005 | Percent of Revenue |
|--|--------------------------------------|-----------------------|--------------------------------------|-----------------------|
| SOP 97-2 recognition | \$ 6,411 | 10% | \$ 1,337 | 2% |
| SOP 81-1 recognition and recurring items | 10,511 | 17% | 24,072 | 29% |
| Total software solutions | 16,922 | 27% | 25,409 | 31% |
| Services | 23,874 | 37% | 27,627 | 34% |
| Maintenance | 23,214 | 36% | 25,818 | 31% |
| Contract | 33 | | 3,057 | 4% |
| Total revenues | \$ 64,043 | 100% | \$ 81,911 | 100% |

Total revenues decreased \$17.9 million, or 22%, for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005. Details of our revenues are presented below.

Software Solutions. Software solutions revenue includes core license revenue, recurring license revenue, and fees received to develop the licensed functionality. Software solutions revenue recognized under SOP 97-2 was \$6.4 million during the first quarter of 2006, an increase of \$5.1 million, or 380%, when compared to the first quarter of 2005. We have experienced variability in the timing of recognition of revenue from software solutions under SOP 97-2 and expect this variability to continue. This variability is caused by the timing of contract execution, sales execution, delivery of localized versions of software solutions, and cash receipts for arrangements where significant uncertainty exists regarding collectibility of license fees. In addition, as we continue licensing our new products and determine that they can be implemented without essential services, those solution licenses are eligible for recognition under SOP 97-2 subject to consideration of the specific terms of each arrangement.

Software solutions revenue recognized under SOP 81-1 and other recurring items was \$10.5 million in the first quarter of 2006, compared to \$24.1 million in the first quarter of 2005, a decrease of \$13.6 million or 56%. This decrease is primarily attributable to \$8.5 million related to an agreement with Shell Global Solutions International B.V. (comprised of \$2.0 million of previously deferred revenue and \$6.5 million related to the settlement of outstanding contractual disputes) that was recognized in the first quarter of 2005. We have also experienced variability in the timing of recognition of revenue from software solutions under SOP 81-1 and other recurring revenue and expect this variability

Table of Contents

to continue. This variability is caused by the timing of development and delivery of licensed functionality, achievement of contractual milestones, cash receipts for arrangements where significant uncertainty exists regarding collectibility of fees, and the timing of signing new and renewal recurring revenue agreements. Another source of variability for software solutions revenue is our focus on selling new products, because there is a high likelihood of providing essential services associated with the new products. License fees received for these arrangements, together with fees for the essential services, are recognized under SOP 81-1 over the period in which the services are performed instead of being recognized upon delivery of the software.

Services. Services revenue is primarily derived from fees for implementation, integration, consulting and training services and is generally recognized when services are performed. In addition, services revenue includes fees received from arrangements to customize or enhance previously purchased licensed software. Services revenue also includes reimbursable expense revenue, with the related costs of reimbursable expenses included in cost of services.

Revenue from services projects decreased \$3.8 million, or 14%, during the three months ended March 31, 2006 over the comparable period in 2005. Based on our historical trends, we expect services to continue to fluctuate on a quarterly basis due to the timing of booking new projects and the timing of revenue recognition on these projects. In any period, services revenue is dependent upon a variety of factors, including:

the volume of services transactions booked during the current and preceding periods;

the number and availability of services 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.

Maintenance. Maintenance revenue decreased \$2.6 million, or 10%, during the three months ended March 31, 2006 compared to the same period in 2005. The decrease in maintenance revenue during the three-month period ended March 31, 2006 resulted from a continuing decline in both the number of and dollar amount for maintenance renewals, mainly due to cost cutting efforts by our customers, less favorable renewal terms and lower volumes and dollar amounts for software solutions bookings. There can be no assurance that maintenance revenues will improve, or even remain at current levels.

Contract. Contract revenue consists of fees generated from license, services, and maintenance revenue attributable to those transactions for which we determined to change the accounting from revenue recognition under SOP 97-2 to contract accounting under SOP 81-1 in connection with the 2003 restatement of our consolidated financial statements for the years ended December 31, 2001 and 2000 and the first three quarters of 2002. Contract revenue is not indicative of the current performance of our business, as it reflects the recognition of deferred revenues for which cash was collected in prior periods. Contract revenue decreased \$3.0 million, or 99%, for the three months ended March 31, 2006 compared to the same period in 2005. The decrease in contract revenue during the first quarter of 2006 is a result of the lower level of deferred transactions and the occurrence of fewer events that allow the recognition of these revenues. As of March 31, 2006, the deferred contract revenue balance was \$7.5 million, comprised of three deferred transactions. In the future, we expect contract revenue to continue to fluctuate on a quarterly basis due to the timing of events allowing recognition of this remaining deferred revenue.

International Revenue. Our international revenues, included in the categories discussed above, are primarily generated from customers located in Europe, Greater Asia Pacific and Canada. International revenue totaled \$29.2 million, or 46% of total revenue, during the three months ended March 31, 2006 and \$39.7 million, or 49% of total revenue, during the comparable period in 2005. This decrease is primarily attributable to \$8.5 million related to an agreement with Shell Global Solutions International B.V. recorded as revenue in the first quarter of 2005.

Customer Concentration. During the three months ended March 31, 2006, no individual customer accounted for more than 10% of total revenues. During the three months ended March 31, 2005, one customer accounted for approximately 10% of total revenues.

Costs of Revenues

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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 (loss). The period-to-period comparisons of financial results are not necessarily indicative of future results.

Table of Contents

| | Three Months Ended March 31, 2006 | | Three Months Ended March 31, 2005 | |
|-------------------------------|--------------------------------------|--------------|--------------------------------------|--------------|
| | | Gross Margin | | Gross Margin |
| Software solutions | \$ 3,403 | 80% | \$ 4,927 | 81% |
| Services and maintenance | 23,471 | 50% | 28,685 | 46% |
| Total cost of revenues | \$ 26,874 | | \$ 33,612 | |

Cost of Software Solutions. Cost of software solutions consists of:

Commissions paid to non-customer third parties in connection with joint marketing and other related agreements. Such commissions 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.

User product documentation.

Costs related to reproduction and delivery of software.

Provisions for estimated costs related to service customer claims. We accrue for customer claims on a case-by-case basis.

Salaries and other related costs of employees who provide essential services to customize or enhance the software for the customer. Cost of software solutions decreased \$1.5 million, or 31%, during the three months ended March 31, 2006 compared to the same period in 2005. The decrease is partly due to renegotiated prepaid third-party royalty agreements resulting in a lower expense run rate.

Cost of Services and Maintenance. Cost of services and maintenance includes expenses related to implementation, training, and customization and enhancement of previously licensed software solutions, as well as providing telephone support, upgrades and updated user documentation. Cost of services and maintenance decreased \$5.2 million, or 18%, during the three months ended March 31, 2006 compared to the same period in 2005. This decrease was partially offset by non-cash stock option expense of \$0.8 million in the three months ended March 31, 2006. Services and maintenance headcount decreased 15%, excluding subcontractors, from March 31, 2005 to March 31, 2006, which contributed to a significant decrease in the compensation-related expenses incurred by the services and maintenance organization.

Operating Expenses

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

| | Three Months Ended March 31, 2006 | | Three Months Ended March 31, 2005 | |
|---------------------------------------|--------------------------------------|-----------------------|--------------------------------------|-----------------------|
| | | Percent of Revenue | | Percent of Revenue |
| Sales and marketing | \$ 11,096 | 17% | \$ 18,368 | 22% |
| Research and development | 8,947 | 14% | 11,800 | 14% |
| General and administrative | 13,538 | 21% | 25,643 | 31% |
| Restructuring charges and adjustments | (50) | | 11,848 | 15% |

| | | | | |
|---------------------------------|----|--------|----|--------|
| Total operating expenses | \$ | 33,531 | \$ | 67,659 |
|---------------------------------|----|--------|----|--------|

Sales and Marketing Expense. Sales and marketing expense consists primarily of personnel costs, employee commissions, office facilities, travel, and promotional events such as trade shows, seminars, technical conferences, advertising and public relations programs. Sales and marketing expense decreased \$7.3 million, or 40%, for the three months ended March 31, 2006 compared to the same period in 2005. The decrease was partially offset by non-cash stock option expense of \$1.1 million in the three months ended March 31, 2006. The decrease was primarily due to reductions in headcount and reduced commissions based on lower bookings. We had a 34% decrease in the number of sales and marketing personnel between March 31, 2005 and March 31, 2006.

Table of Contents

Research and Development Expense. Research and development expense consists of costs related to continued 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.

Research and development expenses decreased \$2.9 million, or 24%, for the three months ended March 31, 2006 compared to the same period in 2005. This decrease was partially offset by non-cash stock option expense of \$1.1 million, in the three months ended March 31, 2006. The decrease was primarily caused by a 43% decrease in the number of our research and development personnel between March 31, 2005 and March 31, 2006, the continuation of our initiative to have the majority of our development personnel located in India, and a reduction in the usage of third-party contractors. As of March 31, 2006, approximately 62% of our research and development employees were located in India.

General and Administrative Expense. General and administrative expense includes the personnel and other costs of our finance, legal, accounting, human resources, information systems and executive departments, as well as external legal litigation costs. General and administrative expense decreased \$12.1 million, or 47%, for the three months ended March 31, 2006 compared to the same period in 2005. The decrease was primarily related to an accrual made in March 2005 of approximately \$10.0 million for the estimated settlement of certain outstanding contingent liabilities. We also had a 14% decrease in the number of general and administrative personnel between March 31, 2005 and March 31, 2006. The decrease was partially offset by non-cash stock option expense of \$1.3 million and the increased cost of our executive department in the three month period ended March 31, 2006. Over the near term and perhaps for much longer, and regardless of the outcome, we expect to incur significant fees and expenses relating to the on-going governmental investigations and the other litigation we face.

Restructuring Expense. Restructuring expense decreased \$11.9 million for the three months ended March 31, 2006 compared to the same period in 2005. This decrease reflects the impact of the announcement we made on March 30, 2005, a restructuring plan to resize our infrastructure and reduce our overhead to improve efficiencies and reduce operating expense. The restructuring included involuntarily terminating 184 employees and closing or partially vacating four office locations. During the first quarter of 2005, we recorded a restructuring charge of \$11.8 million.

Non-operating Expense, Net

Non-operating expense, net, was as follows:

| | Three Months Ended March 31, 2006 | Three Months Ended March 31, 2005 |
|--|--------------------------------------|--------------------------------------|
| Interest income | \$ 1,046 | \$ 1,404 |
| Interest expense | (1,540) | (4,158) |
| Realized gains (losses) on investments, net | 586 | (95) |
| Foreign currency hedge and transaction losses, net | (216) | (1,210) |
| Other income (expense), net | 281 | (701) |
| Total non-operating income (expense), net | \$ 157 | \$ (4,760) |

The decrease in interest income over the comparable periods is the result of the lower average balances of invested funds in the first quarter of 2006 when compared to the first quarter of 2005, partially offset by higher average interest rates earned on invested funds. The decrease in interest expense during the first quarter of 2006 compared to the first quarter of 2005 is a result of lower debt levels from the retirement of \$286 million of our 5.25% convertible subordinated notes due December 15, 2006. The realized gains on investments are primarily due to the liquidation of our previous investment in two privately-held start-up companies in the first quarter of 2006. Foreign currency losses decreased approximately \$1.0 million due to the U.S. dollar being generally flat during the first quarter of 2006. Other income (expense), net includes a refund of sales taxes of approximately \$0.4 million received in the first quarter of 2006.

Table of Contents

Provision for Income Taxes

We recognized income tax expense, predominately foreign taxes, of \$2.0 million and \$1.6 million during the three months ended March 31, 2006 and March 31, 2005, respectively, representing effective income tax rates of 53.1% in the 2006 period and (6.9)% in the 2005 period. The effective tax rates vary from the U.S. federal statutory rate primarily due to fluctuations in our valuation allowance.

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 pretax 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 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.

Contractual Obligations

During the three months ended March 31, 2006, there were no material changes outside the ordinary course of business in the specified contractual obligations set forth in our 2005 Annual Report on Form 10-K, as filed with the SEC on March 15, 2006.

Off-Balance-Sheet Arrangements

As of March 31, 2006, 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 deficit was \$19.9 million at March 31, 2006 compared to a working capital deficit of \$34.3 million at December 31, 2005, an improvement of \$14.4 million or 42%. The decrease in our working capital deficit resulted from a \$20.9 million decrease in current liabilities (comprised of decreases of \$8.9 million in accrued compensation and related expenses, \$6.2 million in deferred revenue, \$3.5 million in accrued liabilities, \$1.1 million in the current portion of long-term debt and \$1.2 million in accounts payable), partially offset by a \$6.5 million decrease in current assets (comprised of decreases of \$3.2 million in accounts receivable, \$2.5 million in cash, including restricted cash, and \$0.8 million in other current assets).

Included in the calculation of working capital is deferred revenue. At March 31, 2006, we had approximately \$93.7 million of deferred revenue recorded on our balance sheet, representing pre-paid revenue for all of our different revenue categories. For the three months ended March 31, 2006, we had an overall average gross margin of approximately 59%. Generally, deferred revenue includes a margin to be earned when it is recognized, so the conversion of the liability to revenue will require cash outflows that are generally less than the amount of the liability.

Cash and cash equivalents were \$109.2 million at March 31, 2006 compared to \$112.9 million at December 31, 2005, a decrease of \$3.7 million. The decrease in cash and cash equivalents was the result of \$8.0 million of cash used in operating activities and \$1.6 million of cash used in investing activities, which was partially offset by \$5.9 million of cash generated by financing activities.

We had negative cash flow from operating activities of \$8.0 million in the three months ended March 31, 2006. Cash outflows in the quarter included \$12.0 million of employee bonuses accrued in 2005, the payment of a \$2.7 million premium related to our 2006 director and officer insurance coverage as well as \$0.9 million of other pre-paid expenses.

We used approximately \$1.6 million of cash in investing activities. The primary uses of cash in investing activities were an increase in restricted cash of \$1.1 million and purchases of premises and equipment and a business acquisition of \$1.1 million. These uses of cash were partially offset by proceeds of \$0.5 million from the sale of securities.

The primary changes in cash from financing activities were the issuance of additional 5% senior convertible notes, providing net proceeds of approximately \$7.0 million, and the repurchase of approximately \$1.1 million of our 5.25% convertible subordinated notes at par.

We maintain a \$15.0 million letter of credit line with a fee equal to 0.375% per year on the face amount of the letters of credit and an unused commitment fee of 0.15% per year on the average daily-unused amount of the line. Under the 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 previously had an expiration date of May 1, 2006. During the first quarter, we renewed and extended this letter of credit line at the same

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terms and conditions to a new expiration date of December 15, 2008. As of March 31, 2006, \$2.5 million in letters of credit were outstanding under this line and \$5.3 million in restricted cash was pledged as collateral.

Table of Contents

In addition to assessing our liquidity based on working capital, management also considers our net cash balance, which we define as the sum of our total cash and cash equivalents and restricted cash minus our total short-term and long-term debt. At March 31, 2006, our outstanding short-term and long-term debt consisted of \$23.9 million of 5.25% convertible subordinated notes due in December 2006, and \$86.3 million face value of 5% senior convertible notes, due in 2015. Our net cash balance at March 31, 2006 was \$7.9 million compared to \$17.0 million at December 31, 2005, a decrease of \$9.1 million. We are obligated to pay approximately \$5.6 million of interest annually on our outstanding debt.

The \$23.9 million of our outstanding 5.25% convertible subordinated notes will mature and become due and payable on December 15, 2006. Holders of our 5% senior convertible notes have the right to require us to repurchase all or any portion of the senior convertible notes on November 15, 2010. In addition, holders of the 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. Upon conversion of the senior convertible notes, we will be required to satisfy our conversion obligation with respect to the principal amount of the 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 operating cash flows during the quarter ended March 31, 2006 and the three 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. Historically, we have financed our operations and met our capital expenditure requirements primarily through long-term borrowings and sales of equity securities. We are evaluating opportunities to obtain additional liquidity, including through the establishment of a working capital line of credit. In addition, we continue to consider strategic opportunities to raise additional capital through sales of common stock. However, we cannot assure you that we will be able to refinance any of our existing indebtedness, raise additional capital or obtain additional financing, particularly because of our existing levels of debt and the debt incurrence restrictions imposed by the indenture governing our 5% senior convertible notes. In the absence of such resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations.

Sensitivity to Market Risks

Foreign Currency Risk. Revenues originating outside of the United States totaled 46% and 49% of total revenues for the three months ended March 31, 2006 and March 31, 2005, respectively. Since we conduct business on a global basis in various foreign currencies, we are exposed to movements in foreign currency exchange rates. We have established a foreign currency-hedging program that utilizes 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.

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.

Table of Contents

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. The Federal Reserve Board increased the discount rate by 50 basis points between December 31, 2005 and March 31, 2006. As of March 31, 2006, the weighted-average yield on time deposits and debt securities we held was 4.36% compared to 3.70% for time deposits and debt securities held as of December 31, 2005.

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 also 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 all these investments as the decline in fair value was considered other than temporary. During the three months ended March 31, 2006, we liquidated two such investments for cash, resulting in a gain on sale of securities of \$0.5 million.

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. We formed a disclosure committee in 2002 that includes senior financial, operational and legal personnel charged with assisting our CEO and CFO in overseeing the accuracy and timeliness of our periodic reports filed under the Exchange Act and in evaluating regularly our disclosure controls and procedures. As disclosed in our initial filing of our Form 10-Q for the period ended March 31, 2006, based on this evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of March 31, 2006 in that they were designed 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. However, in connection with the filing of our Form 10-Q for the period ended June 30, 2006, our management, including our CEO and CFO, has re-evaluated our disclosure controls and procedures as of the end of the period covered by this report and has now determined that our disclosure controls and procedures were ineffective as of March 31, 2006 solely because of the material weakness described below.

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, other than the material weakness described below, or are reasonably likely to materially affect, our internal control over financial reporting.

As discussed in Note 11 to the attached unaudited condensed consolidated financial statements, subsequent to the issuance of the Company's condensed consolidated financial statements for the period ended March 31, 2006, we determined to change our original accounting for our December 2005 vesting acceleration of certain outstanding employee stock options and our subsequent tender offer for the exchange of certain employee stock options, which was completed in May 2006. The result is an increase to non-cash stock compensation expense of approximately \$0.6 million in the quarter ended March 31, 2006 as compared to the amount reported in our previously-filed Form 10-Q. This Form 10-Q/A includes restated financial statements to reflect the increase in non-cash stock compensation expense for the three

Table of Contents

months ended March 31, 2006. We have re-evaluated our internal controls in light of this restatement and concluded that the restatement resulted from a material weakness. Our internal controls include reviews of complicated unusual or non-routine transactions to ensure accurate and timely recording, including reviews with our board of directors and various external advisors as appropriate. We plan to recommend internal control enhancements to our audit committee prior to filing our Form 10-Q for the quarter ending September 30, 2006. These recommendations are expected to include additional reviews with external subject matter experts, including the SEC accounting staff when appropriate, to more proactively analyze complicated unusual or non-routine transactions in advance of concluding such transactions. Furthermore, we plan to enhance our internal expertise through additional hiring and training of qualified finance and accounting personnel.

Table of Contents

PART II. OTHER INFORMATION.

ITEM 6. EXHIBITS.

(a) *Exhibits*

| Exhibit Number | Description |
|-----------------------|--|
| 10.1 | Second Amendment to Employment Agreement, dated as of February 1, 2006, between i2 and Michael E. McGrath (filed as Exhibit 10.1 to i2's Current Report on Form 8-K filed on February 2, 2006) |
| 31.1 | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of Michael E. McGrath, Chief Executive Officer and President (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 Michael E. McGrath, Chief Executive Officer and President (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. |

Table of Contents

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 24, 2006

By: /s/ MICHAEL J. BERRY
Michael J. Berry
Executive Vice President, Finance and
Accounting, and Chief Financial Officer
(Principal Accounting and Financial Officer)