

I2 TECHNOLOGIES INC
Form 10-Q
November 07, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2006

or

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)

One i2 Place 11701 Luna Road Dallas, Texas
(Address of principal executive offices)

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

75234
(Zip code)

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(469) 357-1000

(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 November 1, 2006, the Registrant had 20,948,945 shares of \$0.00025 par value Common Stock outstanding.

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i2 TECHNOLOGIES, INC.

QUARTERLY REPORT ON FORM 10-Q

September 30, 2006

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

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 124,955	\$ 112,882
Restricted cash	5,098	4,773
Accounts receivable, net	26,461	25,887
Deferred contract costs	311	311
Other current assets	15,028	19,219
Total current assets	171,853	163,072
Premises and equipment, net	11,639	14,056
Intangible assets, net	4,537	4,906
Goodwill	14,760	14,440
Non-current deferred tax asset	5,732	5,971
Total assets	\$ 208,521	\$ 202,445
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	\$ 11,564	\$ 11,766
Accrued liabilities	29,749	36,925
Accrued compensation and related expenses	18,552	23,847
Deferred revenue	89,105	99,870
Current portion of long-term debt	21,848	25,000
Total current liabilities	170,818	197,408
Total long-term debt, net	83,665	75,691
Total liabilities	254,483	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		
Series B 2.5% convertible preferred stock, \$1,000 par value, 150 shares authorized, 105 and 104 issued and outstanding at September 30, 2006 and December 31, 2005, respectively	101,578	100,065
	5	5

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Common stock, \$0.00025 par value, 2,000,000 shares authorized, 20,877 and 20,702 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively		
Warrants for common stock	3,125	3,125
Additional paid-in capital	10,434,109	10,420,262
Accumulated other comprehensive income (loss)	1,219	(1,147)
Accumulated deficit	(10,585,998)	(10,592,964)
Net stockholders' deficit	(45,962)	(70,654)
Total liabilities and stockholders' deficit	\$ 208,521	\$ 202,445

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Revenues:				
Software solutions	\$ 20,569	\$ 18,048	\$ 52,879	\$ 66,946
Services	27,007	23,272	77,023	78,433
Maintenance	23,745	24,268	70,080	75,582
Contract	33	899	99	19,299
Total revenues	71,354	66,487	200,081	240,260
Costs and expenses:				
Cost of revenues:				
Software solutions	3,271	3,013	9,121	11,399
Services and maintenance	25,156	24,445	73,002	79,786
Contract				1,575
Sales and marketing	12,307	8,035	35,976	41,558
Research and development	8,818	8,281	26,698	29,166
General and administrative	15,252	12,138	40,634	49,373
Restructuring charges and adjustments	(103)	(256)	(248)	11,357
Total costs and expenses	64,701	55,656	185,183	224,214
Operating income	6,653	10,831	14,898	16,046
Non-operating (expense) income, net:				
Realized gains on investments, net		34	501	11,034
Other expense, net	(504)	(2,998)	(1,358)	(12,779)
Total non-operating (expense) income, net	(504)	(2,964)	(857)	(1,745)
Income before income taxes	6,149	7,867	14,041	14,301
Income tax expense	1,595	2,436	4,906	5,843
Income from continuing operations	4,554	5,431	9,135	8,458
Income from discontinued operations, net of taxes.		3,960		8,666
Net income	\$ 4,554	\$ 9,391	\$ 9,135	\$ 17,124
Preferred stock dividend and accretion of discount	770	764	2,169	2,256
Net income applicable to common stockholders	\$ 3,784	\$ 8,627	\$ 6,966	\$ 14,868

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Net income per common share applicable to common stockholders:				
Total:				
Basic	\$ 0.15	\$ 0.34	\$ 0.28	\$ 0.63
Diluted	\$ 0.15	\$ 0.33	\$ 0.27	\$ 0.62
Discontinued operations				
Basic	\$	\$ 0.16	\$	\$ 0.37
Diluted	\$	\$ 0.15	\$	\$ 0.36
Continuing operations including preferred stock dividend and accretion of discount				
Basic	\$ 0.15	\$ 0.18	\$ 0.28	\$ 0.26
Diluted	\$ 0.15	\$ 0.18	\$ 0.27	\$ 0.26
Weighted-average common shares outstanding:				
Basic	25,370	25,063	25,271	23,739
Diluted	25,892	25,958	25,770	24,038

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Comprehensive income:				
Net income applicable to common stockholders	\$ 3,784	\$ 8,627	\$ 6,966	\$ 14,868
Other comprehensive income (loss):				
Unrealized gain on available-for-sale securities arising during the period		115		234
Foreign currency translation adjustments	173	193	2,366	(3,433)
Tax effect of other comprehensive income		(40)		(77)
Total other comprehensive income (loss)	173	268	2,366	(3,276)
Total comprehensive income	\$ 3,957	\$ 8,895	\$ 9,332	\$ 11,592

See accompanying notes to condensed consolidated financial statements.

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	Nine Months Ended September 30,	
	2006	2005
Cash flows provided by (used in) operating activities:		
Net income	\$ 9,135	\$ 17,124
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,609	5,791
Stock option expense	12,230	
Amortization of deferred compensation	482	706
Gain (loss) on extinguishment of debt	(3)	86
Gain on sale of discontinued operations		(2,176)
Gain on sale of securities	(501)	(11,000)
(Gain) loss on disposal of equipment	(46)	871
Reduction in provision for bad debts charged to costs and expenses	(266)	(90)
Deferred income taxes	782	(581)
Changes in operating assets and liabilities, excluding the effects of acquisitions:		
Accounts receivable, net	6	14,327
Deferred contract costs		1,580
Other current assets	3,868	4,780
Accounts payable	(77)	(1,791)
Accrued liabilities	(7,518)	413
Accrued compensation and related expenses	(5,094)	(9,901)
Deferred revenue	(9,802)	(35,565)
Net cash provided by (used in) operating activities	8,805	(15,426)
Cash flows (used in) provided by investing activities:		
Restrictions (added to) released from cash	(325)	2,636
Purchases of premises and equipment	(1,664)	(2,184)
Proceeds from sale of premises and equipment	143	2,653
Purchases of short-term investments		(95,950)
Proceeds from sale of short-term investments		228,656
Proceeds from sale of securities	501	11,000
Business acquisition	(569)	
Purchases of long-term investments		(1,000)
Net cash (used in) provided by investing activities	(1,914)	145,811
Cash flows provided by (used in) financing activities:		
Repurchase of debt	(3,149)	(21,529)
Proceeds from sale of convertible debt	7,500	
Payment of debt issuance costs	(483)	
Net proceeds from common stock issuance from options and employee stock purchase plans	1,133	391
Proceeds from sale of common stock, net of issuance costs		14,950
Net cash provided by (used in) financing activities	5,001	(6,188)

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Effect of exchange rates on cash	181	(2,516)
Net change in cash and cash equivalents	12,073	121,681
Cash and cash equivalents at beginning of period	112,882	133,273
Cash and cash equivalents at end of period	\$ 124,955	\$ 254,954
Supplemental cash flow information		
Interest paid	\$ 2,688	\$ 8,646
Income taxes paid (net of refunds received)	\$ 3,866	\$ 5,479
Schedule of non-cash financing activities		
Preferred stock dividend and accretion of discount	\$ 2,169	\$ 2,256

See accompanying notes to condensed consolidated financial statements.

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i2 TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Table dollars in thousands, except per share data)

(Unaudited)

1. Summary of Significant Accounting Policies

Nature of Operations. We are a provider of supply chain management solutions, including various 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. In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*—an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement applies to other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. We plan to adopt SFAS No. 157 beginning in the first quarter of 2008. We are currently evaluating the impact of SFAS No. 157 on our financial statements.

2. Investment Securities

We classify short-term time deposits and other liquid investments in debt securities with original maturities of less than three months as available-for-sale. We report these deposits and investments 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 September 30, 2006 and December 31, 2005 were as follows:

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	September 30,	December 31,
	2006	2005
Short-term time deposits	4,033	\$ 7,244
Commercial paper	102,392	28,094
	\$ 106,425	\$ 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

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 \$3.1 million as of September 30, 2006, are as follows:

2006	\$ 4,209
2007	13,431
2008	10,414
2009	8,521
2010	3,541
Thereafter	672
Total	\$ 40,788

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 September 30, 2006 and December 31, 2005.

	September 30,	December 31,
	2006	2005
Convertible subordinated notes, 5.25% annual rate payable semi-annually, due December 15, 2006	\$ 21,848	\$ 25,000
Senior convertible notes, 5% annual rate payable semi-annually, due November 15, 2015	86,250	78,750
Unamortized discount on 5% notes	(2,585)	(3,059)
Total debt	\$ 105,513	\$ 100,691
Less current portion	21,848	25,000
Total long-term debt, net	\$ 83,665	\$ 75,691
Capitalized debt issuance costs, net	\$ 4,494	\$ 4,906

Debt issuance costs are recorded in intangible assets, net of accumulated amortization.

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

During May 2006, we repurchased \$2.0 million of our 5.25% convertible notes at approximately par value.

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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 September 30, 2006, \$0.1 million related to office closure and consolidation, net of estimated sublease income, remains in our restructuring accrual related to the 2005 restructuring plan.

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 September 30, 2006, \$0.3 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.

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 September 30, 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 plans		(50)	(50)
Cash payments	(6)	(358)	(364)
Remaining accrual balance at March 31, 2006	\$ 228	\$ 935	\$ 1,163
Adjustments to 2001 and 2002 restructuring plans	(36)	(59)	(95)
Cash payments		(294)	(294)
Remaining accrual balance at June 30, 2006	\$ 192	\$ 582	\$ 774
Adjustments to 2001 and 2002 restructuring plans		(103)	(103)
Cash payments		(112)	(112)
Remaining accrual balance at September 30, 2006	\$ 192	\$ 367	\$ 559

The accrual for office closure and consolidation of \$0.4 million at September 30, 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 \$0.7 million. The remaining payments related to restructured facilities extend into the third quarter of 2007. The remaining payments related to employee severance and termination extend into the first quarter of 2008.

6. Net Income Per Common Share

Net Income Per Common Share. Basic net income per common share was computed by dividing net income applicable to common stockholders by the weighted average number of common shares outstanding for the reporting period following the two-class method. 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 all periods presented, the effect of the convertible preferred stock is included in the calculation of basic net income per share.

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Diluted net income per common share includes the dilutive effect of stock options, share rights awards and warrants granted using the treasury stock method, and the effect of contingently issuable shares earned during the period and shares issuable under the conversion feature of our convertible debt 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. In 2004, the Emerging Issues Task Force EITF issued Abstract No. 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share* (EITF 04-08). 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 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.

The following is a reconciliation of the number of shares used in the calculation of basic net income per share under the two-class method and diluted earnings per share and the number of anti-dilutive shares excluded from such computations for the three months and the nine months ended September 30, 2006 and 2005:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Common and common equivalent shares outstanding using two-class method - basic:				
Weighted average common shares outstanding	20,822	20,626	20,760	19,339
Participating convertible preferred stock	4,548	4,437	4,511	4,400
Total common and common equivalent shares outstanding using two-class method - basic	25,370	25,063	25,271	23,739
Effect of dilutive securities:				
Outstanding stock option and share right awards	522	895	499	299
Convertible debt				
Weighted average common and common equivalent shares outstanding - diluted	25,892	25,958	25,770	24,038
Anti-dilutive shares excluded from calculation:				
Outstanding stock option and share right awards	1,537	2,897	1,481	3,074
Warrants	484		484	
Convertible debt	23	326	24	326
Total anti-dilutive shares excluded from calculation	2,044	3,223	1,989	3,400

7. Segment Information, International Operations and Customer Concentrations

We operate our business in one segment, supply chain management solutions. Our supply chain management solutions are 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,

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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		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
United States	\$ 43,149	\$ 35,580	\$ 113,388	\$ 118,951
International revenue:				
Non-U.S. Americas	2,379	2,843	8,952	7,083
Europe, Middle East and Africa	13,823	14,618	37,621	70,560
Greater Asia Pacific	12,003	13,446	40,120	43,666
Total international revenue	28,205	30,907	86,693	121,309
Total Revenue	\$ 71,354	\$ 66,487	\$ 200,081	\$ 240,260

%

International revenue as percent of total revenue	40%	46%	43%	50
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During the periods presented, no individual customer accounted for more than 10% of total revenues.

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

	September 30, 2006	December 31, 2005
United States	\$ 28,172	\$ 30,438
Europe, Middle East and Africa	252	468
Greater Asia Pacific	2,512	2,496
Total Long-Lived Assets	\$ 30,936	\$ 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

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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.

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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 covered 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 and on October 12, 2006 the SEC settled the civil charges against Mr. Beecher. The SEC's action against Mr. Brady continues.

Indemnification Agreements

In November 2002, the FASB issued 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 of our obligations under certain guarantees and indemnifications in our interim and annual consolidated financial statements. The following is a summary of the agreements that we have determined are within the scope of FIN 45 as of September 30, 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 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 \$4.0 million and \$1.8 million of expense for legal fees and expenses for current and former employees during the three months ended September 30, 2006 and 2005, respectively, and approximately \$9.2 million and \$3.8 million of such expense during the nine months ended September 30, 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 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 our 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 not recorded any liability associated with this indemnification, as we are not aware of any pending or threatened infringement actions that are probable losses. We believe the estimated fair value of these intellectual property indemnification clauses is minimal. If we believe a liability associated with any of the aforementioned 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 condensed consolidated financial statements.

Table of Contents*Internal Revenue Service Audit*

We are currently appealing the results of an Internal Revenue Service (IRS) examination 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 Appeals Division. The IRS has not issued an assessment with respect to any monetary penalties claimed to be owed by the company and the company presently is seeking a full statutory abatement of any such penalties that might be assessed. The amount of any such penalties and related interest 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 and interest during the appeals process. The future assessment of a penalty, in addition to the tax and interest already assessed, in an amount up to \$2.4 million is possible but, in our view, not probable, and no amount has been accrued at September 30, 2006.

On March 31, 2006, we received additional assessments totaling approximately \$1.1 million, primarily related to similar transfer pricing adjustments for the Indian statutory fiscal year ended March 31, 2003. We are currently appealing these additional assessments and have filed, but not yet received approval for, a Stay of Demand for Payment.

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 all of the assessments discussed above and expect the ultimate resolution will not exceed the tax contingency reserves we have established for these matters.

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. During the nine months ended September 30, 2006, we recorded a \$2.0 million reduction to general and administrative expense in connection with a reassessment of our litigation reserves.

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 our 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 a participating employee and automatically ends upon termination of employment. Unless extended or terminated earlier, 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 options. 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.

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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 ten years after the date of grant. Prior to March 2001, options granted under the Discretionary Option Grant Program generally vested in four equal annual increments. Options granted after March 2001 generally vest 1% on the date of grant, 24% on the first anniversary of the grant date and the remaining options vest in 36 equal monthly increments thereafter. 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, such as restricted stock units 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. Options granted to eligible non-employee Board members under the Automatic Option Grant Program vest in three equal annual installments, with the first such installment vesting one year from the option grant date.

The 1995 Plan has an automatic share increase feature whereby the number of shares of our 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 our common stock outstanding on the last trading day in December of the immediately preceding calendar year, plus (b) the total number of shares of our 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 1,600,000 shares of our common stock or such lesser number of shares of our common stock as determined by our Board of Directors in its discretion. 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. Through September 30, 2006, we have reserved a total of 11,824,212 shares of our common stock for issuance under the plan. 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 earlier, 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 ten years after the date of grant. Prior to March 2001, options granted under the Discretionary Option Grant Program generally vested 25% on the first anniversary of the grant date with the remaining options vesting in 36 equal monthly increments. Options granted after March 2001 generally vest 1% on the date of grant, 24% on the first anniversary of the grant date and the remaining options vest in 36 equal monthly increments thereafter. 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.

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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. We have assumed the stock option plans of various companies we have acquired. While our stockholders approved some of the acquisitions, our stockholders have not specifically approved any of the assumed stock option plans. A total of 1,500,000 shares of our common stock have been reserved for issuance under the assumed plans.

In April 2006, we announced that we filed an exchange offer with the SEC under which eligible employees had the opportunity to exchange certain stock options for restricted stock units. We offered 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 issued in exchange for a properly tendered eligible option was based on exchange ratios that depended on the exercise price of the tendered option. The exchange ratios represented the number of option shares to be exchanged for one restricted stock unit and ranged from 5-for-1 to 72-for-1. The exchange offer expired on May 31, 2006; 797 employees were eligible to participate and 549 employees participated, 1,033,498 options were tendered and cancelled, and 133,033 restricted stock units were issued under such exchange offer. Through the nine months ended September 30, 2006, we recorded \$1.8 million of expense related to the amortization of the grant date fair value of options subject to exchange and the restricted stock units issued. We recorded approximately \$0.2 million of expense during the three month period ended September 30, 2006 related to the amortization of restricted stock units issued. An additional approximately \$1.6 million of expense associated with the restricted stock units will be recognized over the remainder of the two-year vesting period of those awards.

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 the fair market value per share of our common stock on the date of grant.

We recorded approximately \$3.8 million and \$12.7 million of total stock based compensation expense for the three-month period and the nine-month period ended September 30, 2006, respectively, as required by the provisions of SFAS No. 123(R). Included in the stock compensation expense was \$0.3 million and \$0.5 million in restricted stock expense for the three months and nine months ended September 30, 2006, respectively. Due to our net operating losses, there was no tax expense or benefit recorded in connection with our stock-based compensation expense. 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 and nine months ended September 30, 2006 is as follows:

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	Three Months Ended	Nine Months Ended
	September 30, 2006	September 30, 2006
Cost of services and maintenance	\$ 685	\$ 2,397
Sales and marketing	992	3,227
Research and development	950	3,295
General and administrative	1,156	3,794
Total	\$ 3,783	\$ 12,713

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 income and net income per share for the three months ended September 30, 2005 and our net loss and net loss per share for the nine-month period ended September 30, 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:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income applicable to common stockholders	\$ 8,627	\$ 14,868
Add: Total stock-based employee compensation expense included in reported net income	249	706
Less: Total stock-based employee compensation expense determined under fair value based method for all awards	(5,805)	(25,130)
Pro forma net income (loss)	\$ 3,071	\$ (9,556)
Net income (loss) per common share - Basic		
As reported	\$ 0.34	\$ 0.63
Pro forma	\$ 0.12	\$ (0.40)
Net income (loss) per common share - Diluted		
As reported	\$ 0.33	\$ 0.62
Pro forma	\$ 0.12	\$ (0.40)

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 Three Months Ended September 30,		ESPP Shares Three Months Ended September 30,		Stock Options Nine Months Ended September 30,		ESPP Shares Nine Months Ended September 30,	
	2006	2005	2006	2005	2006	2005	2006	2005
Expected term (years)	4	4	0.5	0.5	4	4	0.5	0.5
Volatility factor	0.87	1.02	0.68	0.91	0.93	1.05	0.59	0.84
Risk-free interest rate	5.01%	3.98%	4.93%	3.89%	4.85%	3.84%	4.77%	3.83%
Dividend yield	0%	0%	0%	0%	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 the 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.

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A combined summary of activity, including restricted stock units in our 1995 Plan, 2001 Plan and our assumed stock option plans during the three months and nine months ended September 30, 2006 is as follows (in thousands, except per share amounts and contractual life):

	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	(351)	253.92		
Outstanding balance, March 31, 2006	5,121	\$ 64.28	7.04	\$ 16,465
Options exercisable at March 31, 2006	2,693	\$ 110.73	5.03	\$ 4,015
Granted				
Grant price = fair market value	538	\$ 12.93		
Grant price > fair market value	7	16.12		
Restricted stock units, grant price < fair market value (1)	133			
Exercised	(10)	7.67		
Converted (1)	(1,033)	162.43		
Forfeited	(238)	11.82		
Expired	(416)	142.10		
Outstanding balance, June 30, 2006	4,102	\$ 26.18	8.03	\$ 8,051
Options exercisable at June 30, 2006	1,590	\$ 47.67	6.10	\$ 2,922
Granted				
Grant price = fair market value	78	\$ 15.23		
Restricted stock units, grant price < fair market value	276			
Exercised	(83)	4.56		
Forfeited	(50)	11.66		
Expired	(105)	116.76		
Outstanding balance, September 30, 2006	4,218	22.62	8.11	\$ 28,058
Options exercisable at September 30, 2006	1,693	\$ 39.50	6.56	\$ 8,397
Weighted average of fair value of options granted during 2006	\$ 11.16			

(1) Issued/converted pursuant to the tender offer announced in April 2006 described above.

In connection with stock option and restricted stock awards, we recognized compensation expense of \$3.8 million and \$0.3 million for the three months ended September 30, 2006 and September 30, 2005, respectively, and recognized compensation expense of \$12.7 million and \$0.8 million for the nine months ended September 30, 2006 and September 30, 2005, respectively. Total compensation cost related to nonvested awards not yet recognized was \$24.1 million at September 30, 2006. The expense is expected to be recognized over a weighted-average period of 1.6 years. The

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weighted-average grant-date fair value of options granted during the three-month periods ended September 30, 2006 and September 30, 2005 was \$14.31 and \$11.93, respectively, and the weighted-average grant-date fair value of options granted during the nine-month periods ended September 30, 2006 and September 30, 2005, was \$11.16 and \$6.90, respectively. The total fair value of options vested during the three-month periods ended September 30, 2006 and September 30, 2005 was \$2.9 million and \$3.7 million, respectively, and the total fair value of options vested during the nine-month periods ended September 30, 2006 and September 30, 2005 was \$8.4 million and \$15.5 million, respectively. The aggregate intrinsic value of options exercised during the three-month and nine-month periods ended September 30, 2006 and September 30, 2005, was \$1.0 million and \$1.8 million, respectively. The intrinsic value of a stock option is the amount by which the fair market value of the underlying stock exceeds the exercise price of the option. When we issue shares upon 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 September 30, 2006, and change during the nine-month period then ended is presented below:

	Nonvested	Weighted Average Grant Date
	Shares	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 unvested balance, March 31, 2006	2,447	\$ 9.83
Granted		
Grant price = fair market value	533	\$ 8.71
Grant price < fair market value	133	12.55
Grant price > fair market value	6	8.10
Vested	(340)	7.89
Forfeited	(238)	9.19
Outstanding unvested balance, June 30, 2006	2,541	\$ 10.06
Granted		
Grant price = fair market value	78	\$ 9.99
Restricted stock units, grant price < fair market value	276	15.53
Vested	(292)	10.42
Forfeited	(50)	9.35
Outstanding unvested balance, September 30, 2006	2,553	\$ 10.52

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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) were reclassified 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 were reclassified as services revenue. Similarly, the previously reported cost of development services were reclassified such that the cost is allocated to cost of software solutions and cost of services, as appropriate.

Our presentation of reimbursable expense revenue also changed. Historically, we 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.

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The following chart illustrates the previous and current classifications of revenue and expense for the three and nine months ended September 30, 2005:

	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2005
Revenue		
Previous Classification		
Software licenses	\$ 12,213	\$ 28,022
Development services	7,193	44,085
Contract	899	19,299
Services	19,876	65,461
Reimbursable expense	2,038	7,811
Maintenance	24,268	75,582
Total revenue	\$ 66,487	\$ 240,260
Current Classification		
Software solutions	\$ 18,048	\$ 66,946
Services	23,272	78,433
Maintenance	24,268	75,582
Contract	899	19,299
Total revenue	\$ 66,487	\$ 240,260

	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2005
Cost of Revenues		
Previous Classification		
Software licenses	\$ 843	\$ 4,176
Development services	3,002	10,921
Contract	1,575	1,575
Reimbursable expense	2,038	7,811
Services and Maintenance	21,575	68,277
Total cost of revenues	\$ 27,458	\$ 92,760
Current Classification		
Software solutions	\$ 3,013	\$ 11,399
Services and maintenance	24,445	79,786
Contract	1,575	1,575
Total cost of revenues	\$ 27,458	\$ 92,760

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

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

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We have historically 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 would eventually impair our ability to support our operations and adversely affect our liquidity.

Our \$21.8 million of 5.25% convertible subordinated notes mature and will become due and payable on December 15, 2006.

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 increases in demand in the market for information technology or 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 new-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.

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

Table of Contents**Overview**

We are a provider of 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.

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 Topic 13, Revenue Recognition*, .

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

	Three Months		Three Months		Nine Months		Nine Months	
	Ended		Ended		Ended		Ended	
	September 30, 2006	Percent of Revenue	September 30, 2005	Percent of Revenue	September 30, 2006	Percent of Revenue	September 30, 2005	Percent of Revenue
SOP 97-2 recognition	\$ 3,359	5%	\$ 7,248	11%	\$ 15,400	8%	\$ 12,402	5%
SOP 81-1 recognition	5,814	8%	5,835	9%	15,539	8%	38,927	16%
Recurring items	11,396	16%	4,965	7%	21,940	11%	15,617	7%
Total software solutions	20,569	29%	18,048	27%	52,879	27%	66,946	28%
Services	27,007	38%	23,272	35%	77,023	38%	78,433	33%
Maintenance	23,745	33%	24,268	37%	70,080	35%	75,582	31%
Contract	33		899	1%	99		19,299	8%
Total revenues	\$ 71,354	100%	\$ 66,487	100%	\$ 200,081	100%	\$ 240,260	100%

Total revenues increased \$4.9 million, or 7%, for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, and decreased \$40.2 million, or 17%, for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. These revenue changes are discussed below.

In addition to evaluating our performance based on total revenue, management also monitors total bookings and software solutions bookings as a performance measure. For a given period, we define bookings as the total value of non-contingent fees contracted for during such period. The value of total bookings was \$56.4 million for the three months ended September 30, 2006; \$75.4 million for the three months ended June 30, 2006, including platform technology bookings of \$10.5 million, and \$61.6 million for the three months ended March 31, 2006. Total bookings

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were not tracked for comparable periods in 2005. The value of software solutions bookings was \$7.9 million and \$4.9 million for the three months ended September 30, 2006 and September 30, 2005, respectively, and \$32.1 million and \$22.1 million for the nine months ended September 30, 2006 and September 30, 2005, respectively.

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

Software solutions revenue recognized under SOP 97-2 was \$3.4 million during the three months ended September 30, 2006, a decrease of \$3.9 million, or 54%, when compared to the three months ended September 30, 2005. Software solutions revenue recognized under SOP 97-2 was \$15.4 million during the nine months ended September 30, 2006, an increase of \$3.0 million, or 24%, when compared to the nine months ended September 30, 2005. The increase in software solutions revenue during the nine months ended September 30, 2006 primarily resulted from the recognition of \$2.1 million of revenue from a 2001 contract that was previously deferred pending the settlement of a customer claim, which occurred during the second quarter of 2006. We also recognized \$2.7 million of revenue during the three months ended March 31, 2006 related to two agreements that were valued individually in excess of \$1.0 million. We have experienced variability in the timing of recognition of revenue from software solutions under SOP 97-2 and we expect this variability to continue. Quarterly variability is caused by the amount of quarterly software solutions bookings, and whether the software solutions require essential services. Variability is also caused by the timing of cash receipts for arrangements where significant uncertainty exists regarding collectibility of license fees.

Software solutions revenue recognized under SOP 81-1 was \$5.8 million during the three months ended September 30, 2006 and three months ended September 30, 2005. Software solutions revenue recognized under SOP 81-1 was \$15.5 million for the nine months ended September 30, 2006, compared to \$38.9 million for the nine months ended September 30, 2005, a decrease of \$23.4 million or 60%. Revenue for the nine months ended September 30, 2005 included \$13.8 million of revenue recognized upon the achievement of significant contractual milestones on separate agreements and \$8.5 million of revenue related to an agreement with Shell Global Solutions International B.V.

We have experienced variability in the timing of recognition of revenue from software solutions under SOP 81-1 and expect this variability to continue. Since the majority of the SOP 81-1 revenue is recognized on a percentage of completion basis, our quarterly revenue is highly dependent on the amount of prior period bookings in our backlog, our progress toward completion of the development and delivery of licensed features and functionality, including the achievement of contractual milestones, and cash receipts for arrangements where significant uncertainty exists regarding collectibility of fees. Another source of variability for software solutions revenue is the mix of products included in our quarterly bookings. We are focused on selling new-generation solutions, where there is a high likelihood of providing essential services associated with the new products. Accordingly, the license fees received for these arrangements, together with fees for the essential services, will be recognized under SOP 81-1 over the period in which the services are performed instead of being recognized upon delivery of the software.

Revenue from recurring items, which was recognized under SOP 97-2, was \$11.4 million for the three-month period ended September 30, 2006 compared to \$5.0 million for the three-month period ended September 30, 2005, an increase of \$6.4 million or 128%. Included in the increase during the third quarter of 2006 was \$5.2 million of revenue recognized related to the \$10.5 million in platform technology bookings in the second quarter of 2006. This \$10.5 million of platform technologies revenue is being recognized ratably over the contractual six-month support term which concludes on December 31, 2006, since we determined that we do not currently have vendor specific objective evidence of fair value for support services in platform technology licensing transactions. Revenue from recurring items was \$21.9 million for the nine-month period ended September 30, 2006 compared to \$15.6 million for the nine-month period ended September 30, 2005, an increase of \$6.3 million or 40%. Recurring items include revenue from our supply chain leader and other subscription transactions, for which the revenue is deferred and recognized ratably over the contractual term of the transaction. Recurring revenue related to supply chain leader transactions for each of the three-month periods ended September 30, 2006 and September 30, 2005 was \$3.1 million and for the nine-month periods ended September 30, 2006 and September 30, 2005 was \$9.3 million, respectively. These supply chain leader transactions have varying lives and begin expiring in the second quarter of 2007.

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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 increased \$3.7 million, or 16%, during the three months ended September 30, 2006 over the comparable period in 2005. This growth in revenue is due to an increase in the average number of services personnel for the three months ended September 30, 2006 when compared to the comparable period in 2005, as well as more efficient utilization of our resources. The growth in average services headcount occurred in India, while average service headcount in non-India locations decreased. Services revenue decreased \$1.4 million, or 2%, during the nine months ended September 30, 2006 compared to the same period in 2005. This decrease reflects a decrease in the average number of services personnel for the nine months ended September 30, 2006 when compared to the nine months ended September 30, 2005, as we attempted to match the levels of services personnel with the market demand for our services, partially offset by more efficient utilization of our resources. 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 number and value 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 \$0.5 million, or 2%, during the three months ended September 30, 2006 compared to the same period in 2005, and decreased \$5.5 million, or 7%, during the nine months ended September 30, 2006 compared to the same period in 2005. The decrease in maintenance revenue during the three-month and nine-month periods resulted from a continuing decline in both the number and size of 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 not continue to decline.

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, 2000 and 2001 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 \$0.9 million, or 96%, for the three months ended September 30, 2006 compared to the same period in 2005, and decreased \$19.2 million, or 99%, for the nine months ended September 30, 2006 compared to the same period in 2005. The decrease in contract revenue during the nine-month period reflects \$14.3 million of revenue recognized in the second quarter of 2005 which was triggered upon resolution of an outstanding contractual dispute. The decrease also reflects the lower level of deferred transactions and the occurrence of fewer events that allow the recognition of these revenues. As of September 30, 2006, the deferred contract revenue balance was \$7.5 million, comprised of two 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 \$28.2 million, or 40% of total revenue, during the three months ended September 30, 2006 and \$30.9 million, or 46% of total revenue, during the comparable period in 2005. International revenue totaled \$86.7 million, or 43% of total revenue, during the nine months ended September 30, 2006 and \$121.3 million, or 50% of total revenue, during the comparable period in 2005. This decrease for the nine months ended September 30, 2006 includes \$8.5 million related to an agreement with Shell Global Solutions International B.V. recorded as revenue in the first quarter of 2005 and \$14.3 million of contract revenue recognized in the second quarter of 2005.

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Customer Concentration. During the periods presented, no individual customer accounted for more than 10% of total revenues. At September 30, 2006, no individual customer accounted for more than 10% of net accounts receivable. At December 31, 2005, one customer accounted for more than 10% of net accounts receivable.

Table of Contents**Cost of Revenues**

The following table sets forth cost of revenues and the gross margins of selected items reflected in our condensed consolidated statements of operations and comprehensive income. The period-to-period comparisons of financial results are not necessarily indicative of future results.

	Three Months Ended		Three Months Ended		Nine Months Ended		Nine Months Ended	
	Gross		Gross		Gross		Gross	
	September 30, 2006	Margin	September 30, 2005	Margin	September 30, 2006	Margin	September 30, 2005	Margin
Software solutions	\$ 3,271	84%	\$ 3,013	83%	\$ 9,121	83%	\$ 11,399	83%
Services and maintenance	25,156	50%	24,445	49%	73,002	50%	79,786	48%
Contract							1,575	92%
Total cost of revenues	\$ 28,427		\$ 27,458		\$ 82,123		\$ 92,760	

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 increased \$0.3 million, or 9%, during the three months ended September 30, 2006 compared to the same period in 2005, and decreased \$2.3 million, or 20%, during nine months ended September 30, 2006 compared to the same period in 2005. The decrease for the nine months ended September 30, 2006 is primarily 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 increased \$0.7 million, or 3%, during the three months ended September 30, 2006. This increase includes an increase of payroll related expenses of \$0.2 million, and an increase of non-cash stock compensation expense of \$0.6 million.

Cost of services and maintenance decreased \$6.8 million, or 9%, during the nine months ended September 30, 2006 compared to the same period in 2005. This decrease includes a decrease of \$3.3 million in payroll-related expenses, a decrease of \$2.3 million in travel and entertainment expense, and a decrease in expense related to subcontractors of \$1.7 million, partially offset by increases in non-cash stock compensation expense of \$2.4 million and other administrative and executive costs of \$0.3 million. Average services and maintenance headcount decreased for

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the nine months ended September 30, 2006 when compared to the nine months ended September 30, 2005, primarily related to restructuring activities in March 2005.

Cost of Contract. Cost of contract decreased \$1.6 million, or 100%, in the nine-month period ended September 30, 2006 compared to the same period in 2005. Because contract expense is recorded when the corresponding revenue is recognized, we expect cost of contract to vary. As of September 30, 2006, we had \$0.3 million remaining in deferred contract costs.

Table of Contents**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. The period-to-period comparisons of financial results are not necessarily indicative of future results.

	Three Months		Three Months		Nine Months		Nine Months	
	Ended	Percent	Ended	Percent	Ended	Percent	Ended	Percent
	September 30, 2006	of Total Revenue	September 30, 2005	of Total Revenue	September 30, 2006	of Total Revenue	September 30, 2005	of Total Revenue
Sales and marketing	\$ 12,307	17%	\$ 8,035	12%	\$ 35,976	18%	\$ 41,558	17%
Research and development	8,818	12%	8,281	12%	26,698	13%	29,166	12%
General and administrative	15,252	21%	12,138	18%	40,634	20%	49,373	21%
Restructuring charges and adjustments	(103)		(256)		(248)		11,357	5%
Total operating expenses	\$ 36,274		\$ 28,198		\$ 103,060		\$ 131,454	

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 increased \$4.3 million, or 53%, for the three months ended September 30, 2006 compared to the same period in 2005. This increase in expense includes increased payroll-related expenses of \$2.9 million, increased non-cash stock compensation expense of \$0.9 million and increased travel and entertainment expense of \$0.5 million.

Sales and marketing expense decreased \$5.6 million, or 13%, for the nine months ended September 30, 2006 compared to the same period in 2005. This decrease in expense includes a decrease of payroll-related expenses of \$6.3 million, a decrease in overhead allocations and other costs of \$1.4 million, a decrease in expenses related to trade shows and conferences of \$0.6 million and a decrease in travel and entertainment expense of \$0.5 million, partially offset by an increase in non-cash stock compensation expense of \$3.1 million.

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 increased \$0.5 million, or 6%, for the three months ended September 30, 2006 compared to the same period in 2005. This increase includes increased payroll-related expenses of \$1.2 million and increased non-cash stock compensation expense of \$0.9 million, partially offset by a decrease in overhead expense of \$1.5 million.

Research and development costs decreased \$2.5 million, or 8%, for the nine months ended September 30, 2006 compared to the same period in 2005. The decrease includes a decrease in overhead expense of \$3.6 million, a decrease in facilities expense of \$1.2 million, a decrease in communications expense of \$0.4 million and a decrease in travel and entertainment expense of \$0.3 million, partially offset by an increase of \$3.2 million in non-cash stock compensation expense.

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 increased \$3.1 million, or 26%, for the three months ended September 30, 2006 compared to the same period in 2005. This increase includes an increase in indemnification expense of \$2.2 million and increased non-cash stock compensation expense of \$1.1

million, partially offset by a decrease in payroll-related costs of \$0.1 million.

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General and administrative expense decreased \$8.7 million, or 18%, for the nine months ended September 30, 2006 when compared to the same period in 2005. This decrease includes an accrual made in March 2005 of approximately \$10.0 million for the estimated settlement of certain outstanding contingent liabilities. In addition, payroll-related costs decreased \$3.6 million. The decreases in the components of general and administrative expense were partially offset by an increase in non-cash stock compensation expense of \$3.6 million.

During the three and nine months ended September 30, 2006, we incurred indemnification expense of \$4.0 million and \$9.2 million, respectively. The indemnification expense for the nine months ended September 30, 2006 was partially offset by a reduction in our legal reserve of approximately \$2.0 million. 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 ongoing governmental investigations.

Restructuring Expense. During the first quarter of 2005, we recorded restructuring expense of \$11.8 million. The changes in the expense for the other periods presented reflect adjustments to the accrual, as necessary.

Non-operating (expense) income, net

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

	Three Months Ended	Three Months Ended	Nine Months Ended	Nine Months Ended
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Interest income	\$ 1,553	\$ 2,215	\$ 3,771	\$ 5,351
Interest expense	(1,523)	(4,162)	(4,595)	(12,473)
Realized gains on investments, net		34	501	11,034
Foreign currency hedge and transaction losses, net	(207)	(443)	(245)	(3,946)
Other expense, net	(327)	(608)	(289)	(1,710)
Total non-operating (expense) income, net	\$ (504)	\$ (2,964)	\$ (857)	\$ (1,745)

The decrease in interest income over the three-month and nine-month periods ended September 30, 2006 is the result of the lower average balances of invested funds in the third quarter and first nine months of 2006 when compared to the third quarter and first nine months of 2005, partially offset by higher average interest rates earned on invested funds. The decrease in interest expense during the three-month and nine-month periods ended September 30, 2006 compared to the three-month and nine-month periods ended September 30, 2005 is a result of lower debt levels. The realized gains on investments during the nine months ended September 30, 2006 are primarily due to the liquidation of our previous investments in two privately-held start-up companies in the first quarter of 2006. In June 2005, we liquidated our ownership in one investment resulting in a gain on sale of securities of \$11.0 million. Foreign currency losses decreased approximately \$0.2 million for the three months ended September 30, 2006 compared to the three months ended September 30, 2005 and decreased approximately \$3.7 million for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005. These changes were due to favorable foreign currency exchange rate movements in 2006 when compared to 2005, and improved hedge effectiveness.

Provision for Income Taxes

We recognized income tax expense, predominately foreign taxes, of \$1.6 million and \$2.4 million during the three months ended September 30, 2006 and September 30, 2005, respectively, representing effective income tax rates of 25.9% in the 2006 period and 20.6% in the 2005 period. We recognized income tax expense of \$4.9 million and \$5.8 million during the nine months ended September 30, 2006 and September 30, 2005, respectively, representing effective income tax rates of 34.9% in the 2006 period and 25.4% in the 2005 period. The effective tax rates vary from the U.S. federal statutory rate primarily due to differentials in foreign income tax rates and fluctuations in our valuation allowance.

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

Contractual Obligations

During the nine-month period ended September 30, 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 September 30, 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 was \$1.0 million at September 30, 2006 compared to a working capital deficit of \$34.3 million at December 31, 2005, an improvement of \$35.3 million or 103%. The improvement resulted from a \$26.6 million decrease in current liabilities (comprised of decreases of \$10.8 million in deferred revenue, \$7.2 million in accrued liabilities, \$5.3 million in accrued compensation and related expenses, \$3.2 million in the current portion of long-term debt and \$0.2 million in accounts payable) and an increase of \$8.8 million in current assets (comprised of increases of \$12.4 million in cash, including restricted cash, and \$0.6 million in accounts receivable, partially offset by a decrease of \$4.2 million in other current assets).

Although we have a minimal working capital balance, included in the calculation of working capital is deferred revenue. At September 30, 2006, we had approximately \$89.1 million of deferred revenue recorded as a current liability, representing pre-paid revenue for all of our different revenue categories. Our deferred revenue balance includes a margin to be earned when it is recognized, so the conversion of the liability to revenue will require cash outflows that are generally less than the amount of the liability.

Cash and cash equivalents were \$125.0 million at September 30, 2006 compared to \$112.9 million at December 31, 2005, an increase of \$12.1 million. The increase in cash and cash equivalents was the result of \$8.8 million of cash provided by operating activities and \$5.0 million of cash provided by financing activities, partially offset by \$1.9 million of cash used in investing activities. Exchange rates had a positive impact on cash of \$0.2 million.

We had positive cash flow from operating activities of \$8.8 million in the nine months ended September 30, 2006. Cash inflows for the nine months included \$10.5 million for platform technology licensing. We are pursuing other similar transactions, but there can be no assurance we will be successful at entering into additional platform technology transactions. Cash outflows for the nine months included \$12.0 million of employee bonuses accrued in 2005 and \$8.0 million for bonuses accrued during 2006, \$5.0 million related to the settlement of our outstanding litigation with Kmart, and \$2.7 million related to our 2006 director and officer insurance premium. We pay the majority of our employee bonuses twice a year, in February and August. The aggregate amount of bonuses creates significant changes in operating cash flow each quarter. In addition, our cash collections tend to vary during the year, with the three-month period ended September 30 historically representing the quarter with the lowest collections due to the timing of maintenance renewals. Accordingly, we experienced negative cash flows from operating activities of \$3.3 million in the third quarter 2006.

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We used approximately \$1.9 million of cash in investing activities in the nine months ended September 30, 2006, including an increase in restricted cash of \$0.3 million and purchases of premises and equipment and a business acquisition aggregating \$2.2 million. These uses of cash were partially offset by proceeds of \$0.5 million from the sale of securities and \$0.1 million from the disposal of premises and equipment.

Our financing activities during the nine months ended September 30, 2006 included the issuance of additional 5% senior convertible notes, providing net proceeds of approximately \$7.0 million, and the repurchase of approximately \$3.2 million of our 5.25% convertible subordinated notes at approximately par.

We maintain a \$15.0 million letter of credit line. We are charged fees of 0.375% per year of the face amount of any outstanding letters of credit and 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 expires on December 15, 2008. As of September 30, 2006, \$3.2 million in letters of credit were outstanding under this line and \$4.5 million in restricted cash was pledged as collateral.

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 September 30, 2006, our outstanding short-term and long-term debt consisted of \$21.8 million of 5.25% convertible subordinated notes due in December 2006, and \$83.7 million of 5% senior convertible notes, net of unamortized discount, due in 2015. Our net cash balance at September 30, 2006 was \$24.5 million compared to \$17.0 million at December 31, 2005, an increase of \$7.5 million. We are obligated to pay approximately \$5.5 million of interest annually on our outstanding debt.

The \$21.8 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 experienced negative cash flows for the quarter ended September 30, 2006, for the quarter ended March 31, 2006 and for each of the five years ended December 31, 2005, primarily due to sharp declines in our revenues and our historical inability to reduce our expenses to a level at or below the level of our revenues. 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 may not 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.

Table of Contents**Sensitivity to Market Risks**

Foreign Currency Risk. Revenues originating outside of the United States totaled 40% and 46% of total revenues for the three months ended September 30, 2006 and September 30, 2005, respectively, and 43% and 50% for the nine months ended September 30, 2006 and September 30, 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.

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 100 basis points between December 31, 2005 and September 30, 2006. As of September 30, 2006, the weighted-average yield on time deposits and debt securities we held was 5.09% 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (Exchange Act), our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and

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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.

Based on this evaluation, our management, including our CEO and CFO, has concluded that our disclosure controls and procedures continue to be ineffective as of the end of the period covered by this report solely because of the material weakness described in our Form 10-Q/A for the three months ended March 31, 2006 filed on August 24, 2006, and as discussed 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, except as described below, during our most recent fiscal quarter there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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. As a result of the material weakness and associated restatement reported in our Form 10-Q/A filed on August 24, 2006, we re-evaluated our internal controls and implemented internal control enhancements during the three months ended September 30, 2006. Those enhancements involve requirements for additional reviews internally and with external subject matter experts, including the SEC accounting staff when appropriate, to more proactively analyze complicated, unusual or non-routine transactions, and transactions involving significant judgments and estimates or changes therein, in advance of concluding and accounting for such transactions. Furthermore, we are taking steps to enhance our internal expertise and further remediate the material weakness through additional hiring and training of qualified finance and accounting personnel.

Table of Contents**PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The information set forth in *Note 8 Commitments and Contingencies* in our Notes to Condensed Consolidated Financial Statements is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Other than risk factors presented below, there have been no material changes from the risk factors disclosed under the heading *Risk Factors* in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005, (*Form 10-K*). The risk factors below update, and should be read in conjunction with, the risk factors disclosed in our Form 10-K.

Risks Related To Our Business

We Have Historically Experienced Substantial Negative Cash Flows And May Continue To Experience Such Negative Cash Flows, Which Would Have A Further Significant Adverse Effect On Our Business, Impair Our Ability To Support Our Operations And Adversely Affect Our Liquidity.

We experienced negative cash flows for the quarter ended September 30, 2006, for the quarter ended March 31, 2006 and for each of the five years ended December 31, 2005, due primarily 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. Additionally, in 2005 we disposed of operations that generated positive income and cash flow. We used the proceeds from these disposals to pay down existing debt. Although we implemented restructuring activities in early 2005 focused on, among other things, further reducing our workforce and decreasing continued development of the functionality of certain of our products, a failure to maintain expense levels, stabilize or grow revenues, achieve sustained positive cash flows and obtain additional equity or debt financing as needed will impair our ability to support our operations, adversely affect our liquidity and threaten our ability to repay our debts when they come due, which would have a material adverse effect on our business, results of operations, cash flow and financial condition as well as our stock price. Additionally, we continue to be obligated to pay approximately \$5.5 million annually in interest on our \$108.1 million face value of convertible notes. Continued negative cash flows and the adverse market perception associated therewith may continue to negatively affect our ability to sell our products and maintain existing customer relationships and may adversely affect our ability to obtain additional debt or equity financing on advantageous terms. There can be no assurance that we will be successful in obtaining or maintaining an adequate level of cash resources and we may be forced to act more aggressively in the future in the area of expense reduction in order to conserve cash resources.

We Have A Minimal Working Capital Balance And We May Require Additional Private Or Public Debt Or Equity Financing To Meet Working Capital Needs And To Repay Our Existing Debt When It Becomes Due. This May Have A Substantial Dilutive Effect On The Holdings Of Existing Stockholders. Such Financing May Only Be Available On Disadvantageous Terms, Or May Not Be Available At All. We Have \$21.8 million of 5.25% Convertible Subordinated Notes That Are Due In December 2006 And \$86.3 Million Face Value Of Our 5% Senior Convertible Notes Outstanding As Of September 30, 2006. Our Working Capital May Be Insufficient To Satisfy The Conversion Obligation With Respect To the Principal Amount Of the Senior Convertible Notes Upon Conversion.

At September 30, 2006, we had a positive working capital balance of \$1.0 million. Our cash position may decline in the future, due primarily to cash outflows associated with our operations, our debt service obligations and our prior restructuring activities. Unless we are able to maintain expense levels, stabilize or grow revenues and achieve sustained positive cash flows, our ability to support our operations and our liquidity may be further impaired. We may not be successful in obtaining or maintaining an adequate level of cash resources.

We have \$21.8 million of outstanding 5.25% convertible subordinated notes that will mature and become due and payable on December 15, 2006. In addition, we have \$86.3 million face value of our 5% senior convertible notes outstanding as of September 30, 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 senior convertible notes to be converted in cash, with any remaining amount to be satisfied in shares of our common stock.

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We may be required to seek additional private or public debt or equity financing in order to support our operations and repay our outstanding indebtedness. However, we may not be able to obtain debt or equity financing on satisfactory terms or at all, and any new financing will likely have a substantial dilutive effect on our existing stockholders.

Our 5% Senior Convertible Notes Contain Covenants That Restrict Our Ability To Incur Additional Indebtedness.

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. 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 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 high 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.

We May Not Be Able to Fully Realize The Benefits Of Our Deferred Tax Assets.

If we experience a change of ownership (as determined under Section 382 of the Internal Revenue Code) or do not achieve sufficient domestic federal taxable income in future years to utilize all or some of our net operating loss carryforwards and other tax attributes, utilization of such loss carryforwards and other tax attributes may be limited or they will expire, and we will be unable to fully realize the benefits of our deferred tax assets.

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, Results Of Operations, Cash Flow and Financial Condition And We May Face Additional Litigation In The Future That Could Also Harm Our Business.

In March 2003, the SEC issued a formal order of investigation to determine whether there had been violations of the federal securities laws by us and/or others involved with us in connection with matters relating to the 2003 restatement of our consolidated financial statements. The settlement of the SEC enforcement proceedings, announced on June 9, 2004 and described in *Note 8 Commitments and Contingencies* in our Notes to Condensed Consolidated Financial Statements, covered 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 and on October 12, 2006 the SEC settled the civil charges against Mr. Beecher. The SEC's action against Mr. Brady continues.

We are currently appealing the results of an Internal Revenue Service examination regarding matters relating to the timing of the company's remittance of withholding taxes associated with the exercise of stock options by employees in the 2000 tax year. We may face additional litigation in the future that could harm our business and impair our liquidity.

We are generally obligated, to the extent permitted by law, to indemnify our current and former directors and officers who are named as defendants in some of these lawsuits. Defending against existing and potential litigation and other proceedings may continue to require significant attention and resources of our management. We cannot assure you that the significant time and effort spent will not adversely affect our business, results of operations, cash flow and financial condition.

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Risks Related To Our Stock

The Price Of Our Common Stock May Decline Due To Shares Eligible For Future Sale.

Sales of substantial amounts of our common stock in the public market, or the appearance that a large number of our shares are available for sale, could adversely affect the market price for our common stock. In addition to the adverse effect a price decline could have on holders of common stock, that decline would likely impede our ability to raise capital by issuing additional shares of common stock or other equity securities.

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

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS.

(a) *Exhibits*

Exhibit

Number	Description
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of 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.

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SIGNATURES

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

November 6, 2006

i2 TECHNOLOGIES, INC.

By: /s/ Michael J. Berry
Michael J. Berry
Executive Vice President, Finance and Accounting, and

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

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