AGILE SOFTWARE CORP
Form 10-Q
December 09, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 31, 2004

OR

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

For the transition period from ______ to ______

Commission file number 000-27071

AGILE SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**77-0397905**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

6373 San Ignacio Avenue, San Jose, California 95119-1200

(Address of principal executive office)

(408) 284-4000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes x No ¨

The number of shares of common stock of the Registrant issued and outstanding as of October 31, 2004 was 52,771,836.

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AGILE SOFTWARE CORPORATION

FORM 10-Q

OCTOBER 31, 2004

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AGILE SOFTWARE CORPORATION

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	October 31, 2004	April 30, 2004 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 139,103	$ 113,069
Short-term investments	52,710	56,763
Accounts receivable, net of allowance for doubtful accounts of $1,603 and $1,512 as of October 31, 2004 and April 30, 2004, respectively	20,708	19,998
Other current assets	5,871	5,356
Total current assets	218,392	195,186
Long-term investment, net	43,992	68,389
Property and equipment, net	8,807	8,696
Goodwill	35,485	34,724
Intangible assets, net	4,055	5,456
Other assets	1,337	2,186
Total assets	$ 312,068	$ 314,637
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,165	$ 4,773
Accrued expenses and other current liabilities	16,778	16,298
Accrued restructuring, current	4,187	4,210
Deferred revenue	17,382	20,104
Total current liabilities	45,512	45,385
Accrued restructuring, non-current	913	2,376
Other non-current liabilities	5,167	5,382
Total liabilities	51,592	53,143
Commitments and contingencies (Note 7)		
Stockholders equity:		
Common stock	53	52

Additional paid-in capital	547,068	544,927
Notes receivable from stockholders	(77)	(83)
Unearned stock compensation	(564)	(1,139)
Accumulated other comprehensive loss	(1,078)	(432)
Accumulated deficit	(284,926)	(281,831)
Total stockholders equity	260,476	261,494
Total liabilities and stockholders equity	$ 312,068	$ 314,637

(1) Amounts as of April 30, 2004 have been derived from audited financial statements as of that date.

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

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AGILE SOFTWARE CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	**2003**	**2004**	**2003**
Revenues:				
License	$ 11,206	$ 8,243	$ 21,520	$ 15,627
Service	17,011	16,425	33,178	27,304
Total revenues	28,217	24,668	54,698	42,931
Cost of revenues:				
License	1,164	976	2,241	1,786
Service	7,960	7,794	15,439	12,553
Stock compensation	53	52	143	52
Acquisition-related compensation		256		256
Amortization of intangible assets	177	160	355	160
Total cost of revenues	9,354	9,238	18,178	14,807
Gross margin	18,863	15,430	36,520	28,124
Operating expenses:				
Sales and marketing:				
Other sales and marketing	11,037	9,563	21,214	17,671
Stock compensation	85	2,133	244	2,673
Research and development:				
Other research and development	5,507	5,892	10,822	11,176
Stock compensation	8	56	23	112
General and administrative:				
Other general and administrative	2,693	2,501	5,354	4,261
Stock compensation	51	457	123	491
Acquisition-related compensation		562		562
Amortization of intangible assets	390	756	1,046	756
Acquired in-process research and development		500		500
Restructuring and other charges		9,201	2,132	9,201
Total operating expenses	19,771	31,621	40,958	47,403
Loss from operations	(908)	(16,191)	(4,438)	(19,279)
Other income:				
Interest and other income, net	1,078	763	1,878	1,593
Income (loss) before provision for income taxes	170	(15,428)	(2,560)	(17,686)
Provision for income taxes	262	243	535	660

Net loss	$ (92)	$ (15,671)	$ (3,095)	$ (18,346)
Net loss per share:				
Basic and diluted	$ (0.00)	$ (0.31)	$ (0.06)	$ (0.37)
Weighted average shares	52,677	51,248	52,560	50,197

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

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AGILE SOFTWARE CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended October 31,	
	2004	**2003**
Cash flows from operating activities:		
Net loss	$ (3,095)	$ (18,346)
Adjustments to reconcile net loss to net cash used in operating activities:		
Acquired in-process technology		500
Provision for doubtful accounts	175	175
Depreciation and amortization	3,900	3,703
Stock compensation	533	3,328
Non-cash portion of restructuring and other charges	39	2,043
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(571)	(1,490)
Other assets, current and non-current	117	1,977
Accounts payable	2,213	(1,821)
Accrued expenses and other liabilities	(2,422)	4,243
Deferred revenue	(2,942)	(3,533)
Net cash used in operating activities	(2,053)	(9,221)
Cash flows from investing activities:		
Purchases of investments	(317,864)	(139,665)
Proceeds from maturities of investments	346,150	119,805
Cash paid in business combinations, net of cash acquired	(788)	(2,471)
Acquisition of property and equipment	(2,167)	(6,110)
Net cash provided by (used in) investing activities	25,331	(28,441)
Cash flows from financing activities:		
Payment of acquired capital lease obligations		(718)
Proceeds from issuance of common stock, net of repurchases	2,183	6,415
Repayment of notes receivable from stockholders	6	92
Net cash provided by financing activities	2,189	5,789
Effect of exchange rate changes on cash	567	(84)
Net increase (decrease) in cash and cash equivalents	26,034	(31,957)
Cash and cash equivalents at beginning of period	113,069	154,852
Cash and cash equivalents at end of period	$ 139,103	$ 122,895
Supplementary disclosure of cash flows information		
Cash paid during the period for taxes	$ 199	$ 217

Non-cash investing activities		
Common Stock issued in business combination	$	$ 15,634

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

AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Summary of Significant Accounting Policies:

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of Agile Software Corporation and its subsidiaries (Agile) have been prepared by us and reflect all adjustments (all of which are normal and recurring in nature) 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 period. Certain information and footnote 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 in accordance with the Securities and Exchange Commission s rules and regulations. These unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended April 30, 2004, included in our Annual Report on Form 10-K filed on July 14, 2004 with the Securities and Exchange Commission.

Concentrations of credit risk and significant customers

In the three and six months ended October 31, 2004 and 2003, none of our customers accounted for more than 10% of our total revenue. As of October 31, 2004 and April 30, 2004, none of our customers accounted for more than 10% of our net accounts receivable.

Stock compensation

We account for stock-based compensation arrangements for employees in accordance with provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, and comply with the disclosure provisions of Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Under APB Opinion No. 25, unearned compensation is based on the difference, if any, on the date of the grant, between the fair value of our common stock and the exercise price of the stock option granted. Unearned compensation is amortized and expensed in accordance with Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 28 using the accelerated method of amortization. If a stock option is unvested and cancelled due to the termination of employment of the optionee, any excess amortization recorded using the accelerated method over what would have been amortized on a straight-line basis is reversed in the period of cancellation, and classified as recovery.

We account for stock-based compensation arrangements for non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (EITF) No. 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. Under SFAS 123, the fair value of options issued to non-employees are calculated using the

Black-Scholes option pricing model and are recognized as an expense over the applicable service period of the related options using the accelerated method of amortization. As of July 31, 2004, we have fully amortized the expense related the fair value of options issued to non-employees.

Fair value disclosures

Under SFAS No. 123, we are required to provide pro forma information disclosing net income and earnings per share determined as if we had accounted for our stock-based compensation plans under the fair value method.

AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The fair value of options issued pursuant to our employee stock-based compensation plans at the grant date were calculated using the Black-Scholes option pricing model as prescribed by SFAS No. 123 with the following weighted average assumptions:

	Stock Option Plans			
	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Dividend yield				
Expected volatility	46%	67%	47%	68%
Average risk-free interest rate	3.33%	3.27%	3.59%	3.28%
Expected life (in years)	5	5	5	5

	Purchase Plan			
	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Dividend yield				
Expected volatility	45%	67%	46%	72%
Average risk-free interest rate	1.79%	1.04%	1.72%	1.03%
Expected life (in years)	.5	.5	.5	.5

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the use of assumptions, including the expected stock price volatility. We use volatility rates based upon our historical volatility rates. Based upon the above assumptions, the weighted average fair value per share of options granted under the stock option plans during the three months ended October 31, 2004 and 2003 was $4.23 and $5.00, respectively. The weighted average fair value per share of options granted under the stock option plans during the six months ended October 31, 2004 and 2003 was $4.16 and $5.02, respectively. The weighted average fair value per share of shares subject to purchase under the employee stock purchase plan during the three months ended October 31, 2004 and 2003 was $2.29 and $2.89, respectively. The weighted average fair value per share of shares subject to purchase under the employee stock purchase plan during the six months ended October 31, 2004 and 2003 was $2.49 and $2.61, respectively.

Had we recognized the fair value of our options issued under our stock-based compensation plans under the provisions of SFAS No. 123, our net loss would have been increased to the pro forma amounts below for the three and six months ended October 31, 2004 and 2003, respectively (in thousands, except per share amounts):

	Three Months Ended October 31,	
	2004	2003
Net loss as reported	$ (92)	$ (15,671)
Add: Employee stock-based compensation included in reported net loss	197	2,674
Less: Employee stock-based compensation under SFAS No. 123	(6,254)	(6,388)
Pro forma net loss	$ (6,149)	$ (19,385)
Net loss per share as reported, basic and diluted	$ (0.00)	$ (0.31)
Pro forma net loss per share, basic and diluted	$ (0.12)	$ (0.38)

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Six Months Ended October 31,	
	2004	**2003**
Net loss as reported	$ (3,095)	$ (18,346)
Add: Employee stock-based compensation included in reported net loss	537	3,113
Less: Employee stock-based compensation under SFAS No. 123	(10,957)	(12,226)
Pro forma net loss	$ (13,515)	$ (27,459)
Net loss per share as reported, basic and diluted	$ (0.06)	$ (0.37)
Pro forma net loss per share, basic and diluted	$ (0.26)	$ (0.55)

Unearned stock compensation

We record unearned stock compensation when we issue restricted common stock or options to purchase common stock with exercise prices below fair value at the date of grant. Stock compensation is recognized as an expense over the applicable vesting period of the related options, generally five years, using the accelerated method of amortization.

We remeasure the fair value of these options at each reporting period prior to vesting and then finally at the vesting dates of these options. As a result, stock compensation for non-employees fluctuates with the movement in the fair value of our common stock.

During the three and six months ended October 31, 2004 and 2003, we terminated employment of individuals for whom we had recorded unearned stock compensation and had recognized related expense on accelerated basis. Upon termination, we record as a recovery within the statements of operations the difference between the actual expenses recorded using the accelerated method and the expense that would have been recorded under the straight-line method. Additionally, during the three months ended October 31, 2004 and 2003, the termination of these individuals reduced unearned stock compensation, which would have been amortized to future expense, by $9,000 and $213,000, respectively. During the six months ended October 31, 2004 and 2003, we reduced unearned stock compensation, which would have been amortized to future expense, by $42,000 and $268,000, respectively.

Amortization of employee and non-employee stock options, and recoveries due to cancellations were as follows (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Amortization - employees	$ 200	$ 2,880	$ 542	$ 3,373
Amortization - non-employees		24	(4)	215
Recovery - employees	(3)	(206)	(5)	(260)
Total stock compensation	$ 197	$ 2,698	$ 533	$ 3,328

Note 2 Net Loss Per Share:

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is the same as basic net loss per share because the calculation of diluted net loss per share excludes potential dilutive shares of common stock since their effect is anti-dilutive. Potentially dilutive shares of common stock consist of unvested restricted common stock and shares of common stock issuable upon the exercise of outstanding stock options and warrants.

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	**2003**	**2004**	**2003**
Numerator:				
Net loss	$ (92)	$ (15,671)	$ (3,095)	$ (18,346)
Denominator:				
Weighted average shares	52,689	51,382	52,578	50,348
Weighted average unvested shares of restricted common stock subject to repurchase	(12)	(134)	(18)	(151)
Denominator for basic and diluted calculation	52,677	51,248	52,560	50,197
Net loss per share:				
Basic and diluted	$ (0.00)	$ (0.31)	$ (0.06)	$ (0.37)

The following table sets forth, as of the dates indicated below, potential dilutive shares of common stock that are not included in the diluted net loss per share calculation above because to do so would be anti-dilutive (in thousands):

	As of October 31,	
	2004	**2003**
Unvested common stock subject to repurchase	12	124
Options to purchase common stock	19,132	18,405
Total shares excluded	19,144	18,529

Note 3 Comprehensive Loss:

Comprehensive loss, which is reflected as a component of stockholders equity, includes net loss, unrealized gains or losses on investments, and foreign currency translation adjustments, as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Net loss	$ (92)	$ (15,671)	$ (3,095)	$ (18,346)
Other comprehensive loss:				
Unrealized gain (loss) on investments	180	1	(164)	(162)
Foreign currency translation adjustment	(263)	(84)	(482)	(84)
Other comprehensive loss	(83)	(83)	(646)	(246)
Total comprehensive loss	$ (175)	$ (15,754)	$ (3,741)	$ (18,592)

AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 4 Business Combinations:

During fiscal 2004, we acquired TRADEC, Inc. (Tradec) and Eigner US Inc. (Eigner). Each transaction was accounted for under the purchase method of accounting and, accordingly, the results of operations of each acquisition are included in the accompanying unaudited condensed consolidated statements of operations for all periods or partial periods subsequent to their respective acquisition date.

The net tangible assets acquired and liabilities assumed in each acquisition, as discussed further below, were recorded at their fair values, which approximated their carrying amounts at the respective acquisition dates. We determined the valuation of the identifiable intangible assets using future revenue assumptions and a valuation analysis from an independent appraiser. The amounts allocated to the identifiable intangible assets were determined through established valuation techniques accepted in the technology and software industries. In calculating the value of the acquired in-process research and development (IPR&D), the independent appraiser gave consideration to relevant market size and growth factors, expected industry trends, the anticipated nature and timing of new product introductions by us and our competitors, individual product sales cycles, and the estimated lives of each of the products derived from the underlying technology. The value of the acquired IPR&D reflects the relative value and contribution of the acquired research and development. Consideration was given to the stage of completion, the complexity of the work completed to date, the difficulty of completing the remaining development, costs already incurred, and the expected cost to complete the project in determining the value assigned to the acquired IPR&D. The amounts allocated to the acquired IPR&D were immediately expensed in the period the acquisition was completed because the projects associated with the IPR&D efforts had not yet reached technological feasibility and no future alternative uses existed for the technology. The income approach, which includes an analysis of the cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the other identifiable intangible assets. Key assumptions used in analyzing the expected cash flows from the other identifiable intangible assets included discount rates ranging from 19% to 31% for Eigner and Tradec, and our estimates of revenue growth, maintenance renewal rates, cost of sales, operating expenses and taxes. The purchase price in excess of the identified tangible and intangible assets was allocated to goodwill.

Tradec

On September 30, 2003, we acquired all of the outstanding capital stock of Tradec, which developed cost management software solutions. These solutions enable manufacturing companies to reduce direct material costs, increase productivity and improve supplier performance. The acquisition enhanced our current cost management product offering by leveraging Tradec s domain expertise for addressing key aspects of direct materials cost and performance management. Through the acquisition, we delivered increased analytics capabilities and supplier collaboration for our customers to drive product profitability. The financial terms of the transaction were not material to our financial statements.

Eigner

On August 11, 2003, we acquired all of the outstanding capital stock of Eigner, a provider of complementary product lifecycle management solutions. The acquisition of Eigner provided us with a stronger presence in the automotive supply chain, industrial equipment, aerospace, and defense industries, as well as in certain geographic markets.

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The total purchase price of $19.3 million consisted of $2.8 million in cash, the issuance of 1.8 million shares of Agile common stock valued at $15.6 million, and $894,000 in direct transaction costs. The value of the share consideration ($8.71/share) was based upon the average of the closing market prices of Agile common stock on the three trading days before and three trading days after the announcement of the acquisition on August 5, 2003.

In connection with the acquisition of Eigner, we paid approximately $1.5 million in hiring bonuses to certain persons who were employees of Eigner at the date of the acquisition and agreed to pay approximately $1.7 million in retention bonuses to certain persons who were employees of Eigner at the date of the acquisition and who remained employees of Agile for six months following completion of this acquisitions. These bonuses were paid in February 2004 and were recorded as acquisition-related compensation in fiscal 2004.

Also in connection with the Eigner acquisition, we implemented a plan to terminate approximately 10% of the combined company workforce, for a total of 63 employees, to eliminate duplicative activities and reduce the cost structure of the combined company. The terminations included 30 Eigner employees and 33 Agile employees, and were made across all business functions and geographic regions. Net of these terminations, our overall headcount increased by 89 employees as a result of the Eigner acquisition. The estimated cost for related severance, benefits, payroll taxes and other associated costs totaled $3.3 million, of which $2.2 million was related to the termination of the Eigner employees and $1.1 was related to the termination of the Agile employees. Both the hiring bonuses and the severance related costs for the Eigner employees, totaling $3.7 million, were accrued for at the time of the acquisition and have been recognized as a liability assumed in the business combination. The severance-related costs for the Agile employees of $1.1 million were included in restructuring and other charges during the second quarter of fiscal 2004 (see Note 6 Restructuring and Other Charges for additional information). The Eigner and Agile employee termination obligations were fully paid as of April 30, 2004.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The aggregate purchase price for the Eigner acquisition has been allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition as follows (in thousands):

	Eigner
Tangible assets acquired:	
Cash and cash equivalents	$ 3,015
Accounts receivable	2,478
Property and equipment	1,361
Other assets	2,098
Liabilities assumed:	
Accounts payable	(5,670)
Accrued expenses and other liabilities	(12,590)
Deferred revenue	(3,956)
Identifiable intangible assets acquired:	
In-process research and development	500
Other identifiable intangible assets:	
Existing technology	1,300
Customer relationships	4,000
Non-compete agreements	1,200
Goodwill	25,549
Total	$ 19,285

Pro forma financial information

The following table presents certain unaudited pro forma combined financial information for Eigner, Tradec, and us for the three and six months ended October 31, 2003, as if the acquisitions had occurred on May 1, 2003, after giving effect to certain purchase accounting adjustments (in thousands, except per share amounts):

	Three Months Ended October 31, 2003	Six Months Ended October 31, 2003
Pro forma net revenue	$ 25,369	$ 50,720

Pro forma net loss	$ (17,113)	$ (22,202)
Pro forma net loss per basic and diluted share	$ (0.33)	$ (0.43)
Pro forma shares outstanding	51,443	51,192

These results are presented for illustrative purposes only and are not necessarily indicative of the actual operating results or financial position that would have occurred if the transactions had been consummated on May 1, 2003.

Note 5 Goodwill and Intangible Assets:

Goodwill

The change in carrying amount of goodwill for the six months ended October 31, 2004, is as follows (in thousands):

Balance as of April 30, 2004	$ 34,724
Earnout payments (1)	761
Balance as of October 31, 2004	$ 35,485

(1) Earnout payments represent payments made during the six months ended October 31, 2004 to the former ProductFactory stockholders related to the acquisition by the Company completed on March 27, 2003. Such payment represented the final payment due in connection with the ProductFactory acquisition.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is no longer subject to amortization. Rather, we evaluate goodwill for impairment at least annually or more frequently if events and changes in circumstances suggest that the carrying amount may not be recoverable.

Intangible Assets

The components of acquired identifiable intangible assets are as follows (in thousands):

	October 31, 2004			April 30, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible Assets:						
Developed technologies	$ 2,600	$ (1,074)	$ 1,526	$ 2,600	$ (720)	$ 1,880
Cutomer relationships	4,482	(1,953)	2,529	4,482	(1,239)	3,243
Non-compete agreements	1,200	(1,200)		1,200	(867)	333
	$ 8,282	$ (4,227)	$ 4,055	$ 8,282	$ (2,826)	$ 5,456

All of our acquired identifiable intangible assets are subject to amortization and have approximate original estimated weighted-average useful lives as follows: Developed technologies three to five years; Customer relationships three years; Non-compete agreements one year. No significant residual value is estimated for the intangible assets.

As of October 31, 2004, the estimated future amortization expense for acquired identifiable intangible assets is as follows (in thousands):

Fiscal Years:	
2005 (remaining six months)	$ 1,069
2006	2,138
2007	755
2008	93
Total	$ 4,055

Note 6 Restructuring and Other Charges:

From time to time during Agile s existence, management has initiated various restructurings of our operating capabilities and capacity. These restructurings have been taken primarily in response to redundant or excess capacity brought about by acquisitions and/or significant changes in economic conditions and market demand. During the

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

second quarter of fiscal 2003, we recorded restructuring and other charges of $7.8 million (the 2003 Restructuring). The 2003 Restructuring consisted primarily of the consolidation of excess facilities, abandonment of certain assets in connection with the consolidation of excess facilities, and a write-down of non-refundable prepaid software licenses. As of October 31, 2004, $1.7 million of the 2003 Restructuring obligations remained, which represents costs related to excess facilities.

During the second quarter of fiscal 2004, we recorded restructuring and other charges of $9.2 million (the 2004 Restructuring) as follows:

In connection with our move to our new headquarters in San Jose, California, during the second quarter of fiscal 2004, we recorded restructuring and other charges of $7.5 million, which was comprised of (i) $5.5 million related to the fair value of the remainder of our outstanding lease commitments for properties that we vacated in September 2003, net of the fair value of estimated sublease income and net of deferred rent of $581,000 related to the vacated properties, and (ii) $2.0 million related to the abandonment of certain long-lived assets, including leasehold improvements, furniture and fixtures, and computer equipment.

In connection with our acquisition of Eigner during the second quarter of fiscal 2004, we recorded additional restructuring and other charges of $1.7 million. As discussed in Note 4 Business Combinations - Eigner, above, we terminated 33 Agile employees and recorded restructuring and other charges of $1.1 million for the related severance, benefits, payroll taxes and other associated costs. We recorded an additional $623,000 of other charges related to the write-down of certain other assets, including a $471,000 impairment of non-refundable prepaid software license fees for which we determined that the carrying value exceeded its net realizable value as a result of our decision to discontinue selling the products in which the third party licensed software was embedded.

As of October 31, 2004, $2.7 million of the 2004 Restructuring obligations remained, which represents costs related to excess facilities.

In the first quarter of fiscal 2005, we announced a further restructuring involving termination of employment of approximately 15% of our employees worldwide and consolidation of our Chinese development centers into a single location (the 2005 Restructuring). In connection with the 2005 Restructuring, we recorded restructuring and other charges of $2.1 million. As of October 31, 2004, $695,000 of the 2005 Restructuring obligation remained, which represents costs related to severance and excess facilities.

We review the assumptions used in estimating our restructuring charges, principally, sublease income expectations for excess facilities and employee termination expenses, quarterly. Based upon this review, we did not make any adjustments to our prior restructuring estimates and assumptions during the quarter ended October 31, 2004. Furthermore, we currently do not expect our existing restructuring estimates and assumptions to change materially.

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Summary of Restructuring Obligations

The significant activity within and components of the restructuring and other charges as of October 31, 2004 are as follows (in thousands):

	Employee Termination Costs	Facility-Related Costs	Asset Abandonment Costs	Other Charges	Total
Restructuring obligations at April 30, 2004	$	$ 6,586	$	$	$ 6,586
2005 Restructuring charges (1)	1,643	366	10	113	2,132
Cash payments	(1,132)	(2,363)		(84)	(3,579)
Non-cash charges			(10)	(29)	(39)
Restructuring obligations at October 31, 2004 (2)	$ 511	$ 4,589	$	$	$ 5,100
Accrued restructuring, current					$ 4,187
Accrued restructuring, non-current					913
					$ 5,100

(1) The 2005 restructuring charges and related obligations were recorded at fair value, after giving effect to the fair value of the related obligations, in accordance with SFAS No. 146.

(2) The remaining employee termination obligations and other charges are expected to be paid through the quarter ending April 30, 2005. The remaining facility-related obligations are expected to be paid through the quarter ending January 31, 2008.

Note 7 Commitments and Contingencies:

Indemnification obligations

Our software license agreements typically provide for indemnification of customers for intellectual property infringement claims. To date, no such claims have been filed against us. We also warrant to customers that our software products operate substantially in accordance with specifications. Historically, minimal costs have been incurred related to product warranties, and as such no accruals for warranty costs have been made. In addition, we are obligated to indemnify our officers and directors under the terms of indemnity agreements entered into with them, as well as pursuant to our certificate of incorporation, bylaws, and applicable Delaware law. To date, we have not incurred any material costs related to these obligations.

Litigation

On or around October 25, 2001, a class action lawsuit was filed on behalf of holders of Agile securities in the Southern District of New York against Agile Software Corporation, Bryan D. Stolle and Thomas P. Shanahan (collectively the Agile Defendants) and others including underwriters Morgan Stanley and Deutsche Bank Securities. The case is now captioned *In re Agile Software, Inc. Initial Public Offering Securities Litigation*, 01 CIV 9413 (SAS), *related to In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS).

On or about April 19, 2002, plaintiffs electronically served an amended complaint. The amended complaint is brought purportedly on behalf of all persons who purchased the Company s common stock from August 19, 1999 through December 6, 2000. It names as defendants the Agile Defendants; and several investment banking firms that served as underwriters of the Company s initial public offering and secondary offering. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that : (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The amended complaint also alleges that false analyst reports were issued. No specific damages are claimed.

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company is aware that similar allegations have been made in other lawsuits filed in the Southern District of New York challenging over 300 other initial public offerings and secondary offerings conducted in 1999 and 2000. Those cases have been consolidated for pretrial purposes before the Honorable Judge Shira A. Scheindlin. On July 15, 2002, the Agile Defendants (as well as all other issuer defendants) filed a motion to dismiss the complaint. On February 19, 2003, the Court ruled on the motions to dismiss. The Court denied the motions to dismiss claims under the Securities Act of 1933 in all but 10 of the cases. In the case involving the Company, these claims were dismissed as to the initial public offering, but not the secondary offering. The Court denied the motion to dismiss the claim under Section 10(a) of the Securities Exchange Act of 1934 against the Company and 184 other issuer defendants, on the basis that the amended complaints in these cases alleged that the respective issuers had acquired companies or conducted follow-on offerings after the initial public offerings. As a consequence, the Court denied the motion to dismiss the Section 20(a) claims against the individual defendants. The motion to dismiss the Section 10(a) claims was granted with prejudice as to the individual defendants.

The Company has decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Agile Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims the Company may have against the underwriters. The Agile Defendants will not be required to make any cash payments in the settlement, unless the *pro rata* amount paid by the insurers in the settlement exceeds the limits of the insurance coverage, a circumstance which the Company does not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement.

We are also subject to various other claims arising in the ordinary course of business. In our opinion, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on our business, financial condition or results of operations.

Note 8 Segment and Geographic Information:

We have one operating segment, product lifecycle management solutions. We market our products in the United States and internationally through our direct sales force and through indirect distribution channels.

The following revenue by geographic information is presented for the three and six months ended October 31, 2004 and 2003 (in thousands, except percentages):

	Three Months Ended October 31,	As percentage of total revenue Three Months Ended October 31,

	2004	2003	2004	2003
Revenues:				
North America	$ 18,913	$ 14,850	67%	60%
Europe	7,253	6,849	26	28
Asia-Pacific	2,051	2,969	7	12
	$ 28,217	$ 24,668	100%	100%

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AGILE SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Six Months Ended October 31,		As percentage of total revenue Six Months Ended October 31,	
	2004	2003	2004	2003
Revenues:				
North America	$ 36,211	$ 28,618	66%	67%
Europe	14,234	8,529	26	20
Asia-Pacific	4,253	5,784	8	13
	$ 54,698	$ 42,931	100%	100%

The following long-lived assets by geographic information is presented as of the balance sheet dates (in thousands):

	October 31, 2004	April 30, 2004
Long-lived assets:		
North America	$ 7,013	$ 7,102
Europe	1,503	1,284
Asia-Pacific	291	310
	$ 8,807	$ 8,696

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Item 2. Management s Discussion & Analysis of Financial Condition and Results of Operations

The information in this discussion contains forward-looking statements (within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended) including statements about expected financial results and business, financial and operational trends in future periods. Such statements are based upon current expectations that involve risks and uncertainties, and we undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances occurring after the date of this report. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, anticipates, plans, expects, intends, and similar expressions are inte forward-looking statements. Our actual results and the timing of certain events may differ materially from those reflected in the forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed below under Risk Factors, as well as in the Risk Factors section included in our Annual Report on Form 10-K, filed on July 14, 2004 with the Securities and Exchange Commission. The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this report. Our fiscal year ends on April 30 of each year.

Business Overview

We develop and sell an integrated suite of product lifecycle management (PLM) software products and offer related business consulting and implementation services. Our solutions enable our customers to accelerate their time-to-market and revenue, reduce costs, improve product quality, ensure regulatory compliance and drive innovation throughout the product lifecycle. Albertson s. Inc., Alcatel, Bayer Consumer Healthcare, Boeing Service Company, Dell Computer Products, Flextronics International, GE Medical, Haemonetics, Harris Corporation, Hitachi Corporation, Johnson and Johnson, LeapFrog Enterprises, Lockheed Martin Missile and Fire Control, Magna Steyr, Siemens A&D, QUALCOMM Corporation, ThyssenKrupp Presta AG, Tyco Healthcare Group LP, Veritas Software Corporation and ZF are among the over 1200 customers that have licensed Agile PLM solutions.

We believe that understanding the following key developments is helpful to an understanding of our overall business.

Increased Product Breadth

We sold our first PLM product in 1996. At that time, our offering consisted of a single product. Over time, we have added features and functionality to our existing products as well as new products, both through internal development and acquisition. In January 2004, we began shipping Agile 9, our most comprehensive PLM product offering to date. Agile 9 provides extensive new features and capabilities, as well as an enterprise technology platform providing customers a broader, deeper PLM solution. In October 2004, we introduced Agile Advantage, a PLM product targeted to the needs of small and medium-sized enterprises (SMEs). Agile Advantage provides the features and functionality most sought after by SMEs, and is offered in licensing/pricing models that make PLM affordable for SMEs.

Expanded Industry Focus

We were initially focused on solutions targeted principally for customers operating in the electronics and high technology and, to a lesser extent, medical device industries. As we have grown our business and expanded our product suite, we have also expanded our industry focus. While the electronics and high technology industry still represent the single largest industry for us, we now have significant customers in all of the following industries:

- Electronics and high technology;
- Industrial products;
- Life sciences; and
- Others.

Geographic Balance

Revenues. For the three and six months ended October 31, 2004, revenues from customers located outside of North America represented 33% and 34% of total revenues, respectively. While these results represent a better geographic revenue balance than we had prior to acquiring Eigner, revenues have been growing more rapidly in North America than in the international markets we serve. As a result, the percentage of total revenues represented by revenues from customers located outside of North America has been declining in recent quarters. We are focusing significant effort on expanding and developing our international sales force to both grow our overall revenue and to achieve a better geographic revenue balance.

Product Development. In addition to our development activities in San Jose, we established development centers in India and China in fiscal 2003 and, as a result of our acquisition of Eigner (as discussed below), we now have a development center in Germany.

Acquisitions

Our strategy has been, and continues to be, to expand our business both organically and through acquisitions of complementary products, technologies and companies. We have made the following acquisitions over the past two years:

- *oneRev, Inc.*, acquired in December 2002;
- *ProductFactory, Inc.,* acquired in March 2003;
- *Eigner US Inc.,* acquired in August 2003; and
- *TRADEC, Inc.*, acquired in September 2003.

Through the acquisition of ProductFactory, Inc. we acquired what is now our Product Portfolio Management product. Through the acquisition of Eigner we acquired what is now our Product Catalog, Requirements Management, Configuration Management, Engineering Collaboration and Maintenance, Repair and Overhaul products. Eigner also provided us with a stronger presence in the industrial products industries as well as in certain geographic markets, primarily the Central European. The acquisition of oneRev, Inc. and TRADEC, Inc. provided additional functionality to our existing products as well as new customers. The results of all of these acquisitions are included in our statements of operations beginning as of the respective acquisition dates.

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Restructurings

We have taken a number of actions to reduce our expense levels to better align our operations and cost structure with current and anticipated market conditions, as follows:

- Throughout the first half of fiscal 2003, we evaluated the economic conditions and initiated a restructuring of our operations. As a consequences, during the second quarter of fiscal 2003, we recorded restructuring and other charges of $7.8 million, primarily related to the consolidation of additional excess facilities, the abandonment of additional property and equipment and the further impairment of certain non-refundable prepaid license fees;

- During the second quarter of fiscal 2004, in connection with our move to our new headquarters in San Jose, California, we recorded restructuring and other charges of $7.5 million, primarily related to our outstanding lease commitments for properties that we vacated in September 2003 and the abandonment of certain related long-lived assets;

- During the second quarter of fiscal 2004, in connection with our acquisition of Eigner, we recorded additional restructuring and other charges of $1.7 million primarily related to a reduction of our workforce, elimination of duplicative activities and reduction of the cost structure of the combined company (see Note 6 Restructuring and Other Charges to our unaudited condensed consolidated financial statements); and

- During the first quarter of fiscal 2005, we terminated approximately 15% of our worldwide workforce and consolidated our Chinese development centers into a single location. In connection with these actions, we recorded restructuring and other charges of $2.1 million.

Overview of Our Results

We derive revenues from the license of software products under software license agreements and from the delivery of associated professional and maintenance services. Our license revenues are comprised of fees charged for the use of our products licensed primarily under perpetual and, to a lesser extent, under term-based arrangements. Our service revenue is comprised of fees charged for implementation services and fees charged for post-contract customer support (i.e., technical support and product updates). Our implementation services are typically provided over a period of three to six months subsequent to the signing of a software license arrangement. Post-contract customer support is generally purchased at the time of initial license purchase, and renewed annually thereafter. Post-contract customer support revenue is recognized ratably over the support period, generally 12 months.

Throughout fiscal 2004, 2003 and 2002, the primary factor that has negatively impacted our operations and financial performance has been weak demand for enterprise software resulting from weakness in the global and U.S. economies and the resulting more constrained technology-spending environment. Weak economic conditions persisted through most of fiscal 2004. Beginning in the fourth quarter of fiscal 2004, we began to see early evidence of strengthening demand for our products, particularly in North America. Signs of strengthening demand in North America continued in the first and second quarter of fiscal 2005. Demand outside of North America was somewhat soft primarily as a result of the general business slowdown in Europe during the summer months. While it is still too early to determine if this slow improvement in demand will continue, we continue to believe that demand has stabilized and is returning to modestly positive growth.

Recent highlights in our business include:

We recorded total revenues for the second quarter of fiscal 2005 of $28.2 million, a 14% increase from total revenues of $24.7 million in the second quarter of fiscal 2004. License revenue for the second quarter of fiscal 2005 was $11.2 million, a 36% increase from license revenue of $8.2 million in the second quarter of fiscal 2004.

We maintained a cash and investments balance as of October 31, 2004 of $235.8 million.

In January 2004, we delivered our most comprehensive product release to-date, Agile 9. This product release provides extensive new features and capabilities, as well as an enterprise technology platform providing customers a broader, deeper PLM solution.

In October 2004, we introduced Agile Advantage, a PLM product targeted to the needs of small and medium-sized enterprises (SMEs). Agile Advantage provides the features and functionality most sought after by SMEs, and is offered in licensing/pricing models that make PLM affordable for these customers.

Critical Accounting Policies

We have prepared our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our reported revenues, loss from operations, and net loss, as well as on the value of certain assets and liabilities on our balance sheet. These estimates, assumptions and judgments about future events and their effects on our results cannot be determined with certainty, and are made based upon our historical experience and on other assumptions that are believed to be reasonable under the circumstances. These estimates may change as new events occur or additional information is obtained, and we may periodically be faced with uncertainties, the outcomes of which are not within our control and may not be known for a prolonged period of time. The discussion and analysis of our financial condition and results of operations are based upon these statements. While there are a number of accounting policies, methods and estimates affecting our financial statements, areas that are particularly significant include revenue recognition, allowance for doubtful accounts and sales returns, investments, prepaid software license fees, restructuring reserves, sales commission, stock options and warrants, and business combinations and acquired intangible assets, which are described below. In addition, please refer to Note 1 of our unaudited condensed consolidated financial statements for further discussion of our significant accounting policies.

Additional information about these critical accounting policies may be found in the Management s Discussion & Analysis of Financial Condition and Results of Operations section included in our Annual Report on Form 10-K for the fiscal year ended April 30, 2004. There have been no changes to these critical accounting policies subsequent to April 30, 2004.

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Results of Operations

The following table sets forth selected unaudited condensed consolidated financial data for the periods indicated, expressed as a percentage of total revenues.

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Revenues:				
License	40%	33%	39%	36%
Service	60	67	61	64
Total revenues	100	100	100	100
Cost of revenues:				
License	4	4	4	4
Service	28	32	28	29
Stock compensation				
Acquisition-related compensation		1		1
Amortization of intangible assets	1	1	1	
Total cost of revenues	33	38	33	34
Gross margin	67	62	67	66
Operating expenses:				
Sales and marketing:				
Other sales and marketing	39	39	39	41
Stock compensation		9		6
Research and development:				
Other research and development	20	24	20	26
Stock compensation				
General and administrative:				
Other general and administrative	10	10	10	10
Stock compensation		2		1
Acquisition-related compensation		2		1
Amortization of intangible assets	1	3	2	2
Acquired in-process research and development		2		1
Restructuring and other charges		37	4	21
Total operating expenses	70	128	75	109
Loss from operations	(3)	(66)	(8)	(43)
Other income:				
Interest and other income, net	4	3	3	4
Income (loss) before provision for income taxes	1	(63)	(5)	(39)
Provision for income taxes	1	1	1	2

Net loss	(0)%	(64)%	(6)%	(41)%

Comparison of the Three and Six Months Ended October 31, 2004 and 2003

Revenues

Total revenues for the three months ended October 31, 2004 increased by 14% from the prior-year period. Total revenues for the six months ended October 31, 2004 increased by 27% from the prior-year period. These increases were primarily attributable to increases in both license and service revenue from both existing and new customers in North America and Europe, partially offset by decrease in revenues in Asia-Pacific. The increase in total revenues for the six months ended October 31, 2004 was also attributable to our acquisition of Eigner in the beginning of the second quarter of fiscal 2004.

Our quarterly operating results have varied significantly in the past and are likely to vary significantly in the future. Our products have a complex and unpredictable sales cycle. The timing of large orders, which continue to account for a significant percentage of our total license revenue, remains unpredictable. Recently, we have seen increasing interest in PLM, particularly in North America. At the same time, pricing remains challenging as customers are still cautious with their information technology spending. During the three and six months ended October 31, 2004, no one customer accounted for more than 10% of total revenues.

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Our revenues by geographic region for the three and six months ended October 31, 2004 and 2003 are as follows (in thousands, except percentages):

	Three Months Ended October 31,		As percentage of total revenue Three Months Ended October 31,	
	2004	**2003**	**2004**	**2003**
Revenues:				
North America	$ 18,913	$ 14,850	67%	60%
Europe	7,253	6,849	26	28
Asia-Pacific	2,051	2,969	7	12
	$ 28,217	$ 24,668	100%	100%

	Six Months Ended October 31,		As percentage of total revenue Six Months Ended October 31,	
	2004	**2003**	**2004**	**2003**
Revenues:				
North America	$ 36,211	$ 28,618	66%	67%
Europe	14,234	8,529	26	20
Asia-Pacific	4,253	5,784	8	13
	$ 54,698	$ 42,931	100%	100%

During the three months ended October 31, 2004 and 2003, revenues from customers located outside of North America represented approximately 33% and 40% of total revenues, respectively. Revenues from customers located outside of North America during the three months ended October 31, 2004 and 2003 were derived primarily from sales to customers in Europe and, to a lesser extent, the Asia-Pacific region. The increase in revenue from customers located in Europe in absolute dollars during the three months ended October 31, 2004 compared to the prior-year period resulted in part from a strengthening in european currencies in the current-year period in relation to the US dollar. The slight decrease in sales to customers located outside of North America during the three months ended October 31, 2004 compared to the prior-year period was primarily related to lower sales in Asia-Pacific region, particularly in Japan.

During the six months ended October 31, 2004 and 2003, revenues from customers located outside of North America represented approximately 34% and 33% of total revenues, respectively. Revenues from customers located outside of North America during the six months ended October 31, 2004 and 2003 were derived primarily from sales to customers in Europe and, to a lesser extent, the Asia-Pacific region. The increase in sales to customers located outside of North America during the six months ended October 31, 2004 compared to the same period in the prior year was primarily a result of our acquisition of Eigner in the beginning of the second quarter of fiscal 2004, as Eigner s customer base was concentrated in Europe, partially offset by lower sales in Asia-Pacific region, particularly in Japan.

While our recent results represent a better geographic revenue balance than we had prior to acquiring Eigner, revenues have been growing more rapidly in North America than in the international markets we serve. As a result, the percentage of total revenues represented by revenues from customers located outside of North America has been declining in recent quarters. We are focusing significant effort on expanding and developing our international sales force to both grow our overall revenue and to achieve a better geographic revenue balance.

License Revenue

	Three Months Ended October 31,		%	Six Months Ended October 31,		%
	2004	2003	Change	2004	2003	Change
	(in thousands, except percentages)			(in thousands, except percentages)		
License revenue	$ 11,206	$ 8,243	36%	$ 21,520	$ 15,627	38%
As a percentage of total revenues	40%	33%		39%	36%	

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The increase in license revenue in absolute dollars during the three months ended October 31, 2004 compared to the prior-year period was primarily due to increases in sales of our newer products to new and existing customers in North America, and to a lesser extent in Europe, partially offset by the decrease in sales in Asia Pacific region, particularly in Japan.

The increase in license revenue in absolute dollars during the six months ended October 31, 2004 compared to the prior-year period was primarily due to increases in sales of our newer products to new and existing customers in North America as well as the addition of Eigner products and customers, partially offset by the decrease in sales to customers in the Asia-Pacific region, particularly in Japan.

The increase in license revenue as a percentage of total revenues during the three and six months ended October 31, 2004 compared to the prior-year period was primarily due to a more significant increase in license revenue as discussed above compared to the increase in service revenue and the lag effect of service revenue as discussed below.

Service Revenue

	Three Months Ended October 31,		%	Six Months Ended October 31,		%
	2004	2003	Change	2004	2003	Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Professional service	$ 6,566	$ 6,530	1%	$ 12,315	9,182	34%
Maintenance	10,445	9,895	6%	20,863	18,122	15%
Total service revenue	$ 17,011	$ 16,425	4%	$ 33,178	$ 27,304	22%
As a percentage of total revenues	60%	67%		61%	64%	

Service revenue includes fees earned, and to a lesser extent, reimbursable expenses incurred in connection with consulting, software implementation and training services we provide to our customers as well as fees from software maintenance agreements we offer. Service revenue inherently lags behind the related license revenue as the service engagements and maintenance (and the related revenue) commence after initial license sale. As a result, the positive impact of increasing license revenue on service revenue tends to be delayed by one to two quarters.

The increase in service revenue in absolute dollars during the three months ended October 31, 2004 compared to the prior-year period was primarily due to the increase in maintenance revenue in Europe and North America as a result of the year over year growth of our installed customer base, partially offset by the decrease in both professional service and maintenance revenue in Asia-Pacific, particularly in Japan, and by a decrease in professional service revenue in Europe.

The increase in service revenue in absolute dollars during the six months ended October 31, 2004 compared to the prior-year period was primarily due to the increase in professional service and maintenance revenue in Europe and North America, primarily due to our acquisition of Eigner in the beginning of second quarter of fiscal 2004.

The decrease in service revenue as a percentage of total revenues during the three and six months ended October 31, 2004 compared to the prior-year period was primarily due to a more significant increase in license revenue as discussed above compared to the increase in service revenue.

Although demand for services is currently strong, we expect that service revenue for the three months ending January 31, 2005 to be comparable to the level achieved in the three months ended October 31, 2004 because of fewer billing days due to the holiday season during the third fiscal quarter.

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Cost of Revenues

Cost of License Revenue

	Three Months Ended October 31, 2004	Three Months Ended October 31, 2003	% Change	Six Months Ended October 31, 2004	Six Months Ended October 31, 2003	% Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Cost of license revenue	$ 1,164	$ 976	19%	$ 2,241	$ 1,786	25%
As a percentage of license revenue	10%	12%		10%	11%	

Our cost of license revenue includes license fees due to third parties for technology integrated into or sold with our products, and the cost of order fulfillment such as shipping and packaging.

The increase in cost of license revenue in absolute dollars during the three and six months ended October 31, 2004 when compared to the prior-year period was primarily due to our overall increase in license revenue. The decrease in cost of license revenues as a percentage of license revenue was due to the lower cost of third-party software embedded in Agile 9 compared to the earlier version of our products.

For the three months ending January 31, 2005, we expect cost of license revenue in absolute dollars to track our overall license revenue. For such period, we expect cost of license revenue as a percentage of license revenue to either remain comparable to, or decrease slightly when compared with, our results for the three months ended October 31, 2004. Over the longer term, we expect cost of license revenue as a percentage of license revenue to decrease from our historic levels due to the lower cost of third-party software embedded in our Agile 9 product. Actual results may fluctuate somewhat depending upon the amount of non-embedded third-party software sold in any particular period.

Cost of Service Revenue

	Three Months Ended October 31, 2004	Three Months Ended October 31, 2003	% Change	Six Months Ended October 31, 2004	Six Months Ended October 31, 2003	% Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Cost of service revenue	$ 7,960	$ 7,794	2%	$ 15,439	$ 12,553	23%
As a percentage of service revenue	47%	47%		47%	46%	

Our cost of service revenue includes salaries and related expenses for the implementation, training services, and customer support organizations, costs of third parties contracted to provide implementation services to customers and an allocation of overhead expenses, including rent, information technology and other overhead expenses. In addition, cost of service revenue includes support and upgrade fees paid to third parties with respect to the third-party software integrated into or sold with our products for which our customers have purchased support from us.

The increase in cost of service revenue in absolute dollars during the three months ended October 31, 2004 compared to the prior-year period was primarily related to incremental costs associated with third-party service providers we relied on to meet increased demand, particularly in regions where we have limited services resources.

The increase in cost of service revenues in absolute dollars during the six months ended October 31, 2004 compared to the prior year period was as a result of: (a) $1.4 million in incremental costs associated with third-party service providers we relied on to meet increased demand (particularly in regions where we have limited services resources); and (b) $1.4 million in increased personnel-related costs (including compensation and benefits, travel expenditures, and facilities and depreciation expense) resulting from an increase in service organization headcount, to a large extent due to the addition of the Eigner employees in the beginning of second quarter of fiscal 2004.

For the three months ending January 31, 2005, we expect cost of service revenue in absolute dollars to track with our service revenue and, as a percentage of service revenue, to be generally consistent with the results achieved in the three months ended October 31, 2004.

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Operating Expenses

We classify all charges to operating expense categories based on the nature of the expenditures. Although each category includes expenses that are unique to the category type, there are common recurring expenditures that are typically included in all operating expense categories, such as salaries, employee benefits, incentive compensation, bonuses, travel costs, communication, rent and other allocated facilities costs, information technology, and professional fees. Also included in our operating expenses is the amortization of stock compensation, that is included in each of the sales and marketing, research and development, and general and administrative categories.

As a result of our restructuring efforts, as discussed further under Restructuring and Other Charges below, we realized significant reduction in our operating expenses during the three and six months ended October 31, 2004. Specifically, during the three and six months ended October 31, 2004, our aggregate facilities and depreciation expenses decreased by $484,000 and $929,000 when compared to the same periods in the prior year, respectively. Significant portions of these costs savings are reflected in the Sales and Marketing, Research and Development and General and Administrative operating expenses through decreased facilities and depreciation expenses.

Sales and Marketing

The following table sets forth a summary of our sales and marketing expenses in absolute dollars and expressed as a percentage of total revenues for the three and six months ended October 31, 2004 and 2003, respectively, excluding the stock compensation which is explained separately under Stock Compensation (Recovery) below.

	Three Months Ended October 31,		%	Six Months Ended October 31,		%
	2004	**2003**	**Change**	**2004**	**2003**	**Change**
	(in thousands, except percentages)			(in thousands, except percentages)		
Sales and marketing, excluding stock compensation	$ 11,037	$ 9,563	15%	$ 21,214	$ 17,671	