I2 TECHNOLOGIES INC
Form 10-K/A
August 09, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

Amendment No. 1 to Form 10-K

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

For the fiscal year ended December 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 0-28030

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**75-2294945**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
One i2 Place 11701 Luna Road Dallas, Texas	**75234**
(Address of principal offices)	**(Zip code)**

Registrant s telephone number, including area code: (469) 357-1000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.00025 par value

Preferred Share Purchase Rights

(Title of Class)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

As of June 30, 2004, the last business day of the Registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of Common Stock held by non-affiliates, based upon the closing price of the Common Stock as reported in the Pink Sheets, was approximately $255.8 million (affiliates being, for these purposes only, directors, executive officers and holders of more than 5% of the Registrant s Common Stock).

As of March 1, 2005, the Registrant had approximately 18,608,359 outstanding shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Selected designated portions of the Registrant s definitive Proxy Statement to be filed on or before May 2, 2005 in connection with the Registrant s 2005 Annual Meeting of stockholders are incorporated by reference into Part III of this Annual Report.

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Explanatory Note

We are filing this Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 for the purpose of amending our consolidated financial statements. We have reviewed our classification of investments in auction rate securities on our balance sheet. Auction rate securities are long-term bonds that resemble short-term instruments and provide liquidity because their interest rates are reset periodically, usually every 7, 28 or 35 days. The rate is reset by a modified Dutch auction process and investors can sell or buy the securities on those auction dates. Based on our review, we have determined that our auction rate securities should be classified as short-term investments instead of cash equivalents, and that purchases and sales of these securities should be reflected as investing activities on our cash flow statement. Similarly, we have determined that it is appropriate to reflect changes in restricted cash balances as investing activities in our cash flow statement.

As a result, the Consolidated Balance Sheets and the Consolidated Statements of Cash Flows and related disclosures in this Form 10-K/A have been restated to give effect to these reclassifications. These reclassifications did not have an impact on our total current assets, our total assets, or our net income (loss) or net income (loss) per share for any period presented.

Pursuant to Rule 12b-15 under the Securities and Exchange Act of 1934, as amended, this Amendment No. 1 also contains Item 7 of Part II, as amended, Item 9A of Part II, as amended, new exhibits and financial statement schedules as identified in Item 15 of Part IV, as amended, and new certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. This Amendment No. 1 contains only the sections and exhibits to the Form 10-K that are being amended. The sections of and exhibits to the Form 10-K as originally filed, which are not included herein, are unchanged and continue in full force and effect as originally filed. This Amendment No. 1 speaks of the date of the original filing of the Form 10-K and has not been updated to reflect events occurring subsequent to the original filing date.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical or current facts, including, without limitation, statements about our business strategy, plans, objectives and future prospects, are forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from these expectations, which could have a material adverse effect on our business and thereby cause our stock price to decline. Such risks and uncertainties include, without limitation, the following:

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

Our $316.8 million of debt matures in December 2006. Accordingly, we anticipate seeking additional private or public debt or equity financing, which could also have a dilutive effect on our stockholders. However, we may not be able to obtain debt or equity financing on satisfactory terms, or at all.

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

We 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 also harm our business and impair our liquidity.

We may not be competitive and increased competition could seriously harm our business.

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

We have been and continue to be subject to claims pertaining to the quality of our products and services, and questions regarding our financial viability. These claims and perceptions, if unresolved or not addressed, could seriously harm our business and our stock price.

Restructuring initiatives are being executed, and such activities pose risks to our business.

Our financial results have varied and may continue to vary significantly from quarter to quarter and we may again fail to meet expectations, which might negatively impact the price of our stock.

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 express relate to us, our customers or our management are intended to identify forward-looking statements.

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

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Overview

We are a provider of enterprise supply chain management solutions, including various supply chain software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by improving agility, managing variability, reducing complexity, improving operational visibility, increasing operating velocity as well as integrating planning and execution. Our offerings help customers maximize efficiency in relation to sourcing, supply, demand, fulfillment and logistics performance. Our application software is often licensed in conjunction with other offerings including content and services we provide such as business optimization and technical consulting, training, solution maintenance, content management, software upgrades and development.

Application of Critical Accounting Policies and Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and judgments related to the application of certain accounting policies.

While we base our estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates. We consider accounting estimates to be critical to our reported financial results if (i) the accounting estimate requires us to make assumptions about matters that are uncertain and (ii) different estimates that we reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on our financial statements.

We consider our policies for revenue recognition to be critical due to the continuously evolving standards and industry practice related to revenue recognition, changes to which could materially impact the way we report revenues. Accounting polices related to: allowance for doubtful accounts, deferred taxes, goodwill and intangible assets, loss contingencies, and restructuring charges are also considered to be critical as these policies involve considerable subjective judgment and estimation by management. Critical accounting policies, and our procedures related to these policies, are described in detail below. Also see *Note 1 Summary of Significant Accounting Policies* in our Notes to Consolidated Financial Statements.

Revenue Recognition. We derive revenues from licenses of our software and related services, which include assistance in implementation, integration, customization, maintenance, training and consulting. We recognize revenue for software and related services in accordance with *Statement of Position (SOP) 81-1, Accounting for Certain Construction Type and Certain Production Type Contracts, SOP 97-2, Software Revenue Recognition,* as modified by *SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions,* and SEC *Staff Accounting Bulletin (SAB) 101, Revenue Recognition, and SAB 103, Update of Codification of Staff Accounting Bulletins.*

Software License Revenue. Under SOP 97-2, software license revenues are generally recognized upon delivery, provided persuasive evidence of an arrangement exists, fees are fixed or determinable and collection is deemed probable. We evaluate each of these criteria as follows:

Evidence of an arrangement: We consider a non-cancelable agreement signed by the customer to be evidence of an arrangement.

Delivery: Delivery is considered to occur when media containing the licensed programs is provided to a common carrier or, in the case of electronic delivery, the customer is given access to the licensed programs. Our typical end user license agreement does not include customer acceptance provisions.

Fixed or determinable fee: We consider the fee to be fixed or determinable if the fee is not subject to refund or adjustment and the payment terms are within our normal established practices. If the fee is not fixed or determinable, we recognize the revenue as amounts become due and payable.

Collection is deemed probable: We conduct a credit review for significant transactions at the time of the arrangement to determine the credit-worthiness of the customer. Collection is deemed probable if we expect that the customer will pay amounts under the arrangement as payments become due. If we determine that collection is not probable, we defer the revenue and recognize the revenue upon receipt of cash.

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Revenue for license arrangements that include one or more additional elements (i.e., services and maintenance) to be delivered at a future date is generally recognized using the residual method. Under the residual method, the fair value of the undelivered element(s) is deferred, and the remaining portion of the arrangement fee is recognized as license revenue. If fair values have not been established for the undelivered element(s), all revenue associated with the arrangement is deferred until all element(s) have been delivered or the fair value of the undelivered elements has been determined. Fair value for an individual element within an arrangement may be established when that element, when contracted for separately, is priced in a consistent manner. Fair value for our maintenance and consulting services has been established based on of our maintenance renewal rates and consulting billing rates, respectively. Arrangements that include a right to unspecified future products are accounted for as subscriptions and recognized ratably over the term of the arrangement. License fees from reseller arrangements are generally based on the sublicenses granted by the reseller and recognized when the license is sold to the end customer. Licenses to our content databases are recognized over the term of the content database license.

Development Services. Development services revenue includes both license fees for our software products and fees related to services to customize or enhance the software so that the software performs in accordance with specific customer requirements. As our services are essential to provide the required functionality, we recognize revenue from these arrangements in accordance SOP 81-1 using either the percentage-of-completion method or the completed contract method. The percentage-of-completion method is used when the required services are quantifiable, based on the estimated number of labor hours necessary to complete the project, and under that method revenues are recognized using labor hours incurred as the measure of progress towards completion but is limited to revenue that has been earned by the attainment of any milestones included in the contract. The completed contract method is used when the required services are not quantifiable, and under that method revenues are recognized only when we have satisfied all of our product and/or service delivery obligations to the customer.

Contract Revenue. 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 previously completed restatement of our consolidated financial statements for the years ended 2001 and 2000 and the first three quarters of 2002. As of December 31, 2004, $54.2 million of revenue deferred as a result of the restatement remains on our balance sheet as deferred revenue.

Services Revenue. Services revenue is primarily derived from fees for implementation, integration, consulting and training services and is generally recognized when services are performed. Contractual terms may include the following payment arrangements: fixed fee, full-time equivalent, milestone, and time and material. In order to recognize service revenue, the following criteria must be met:

Signed agreement- The agreement must be signed by the customer.

Fixed Fee- The signed agreement must specify the fees to be received for the services.

Delivery has occurred- Delivery is substantiated by time cards and where applicable, supplemented by an acceptance from the customer that milestones as agreed in the statement of work has been met.

Collectibility is probable- We conduct a credit review for significant transactions at the time of the engagement to determine the credit-worthiness of the customer. We monitor collections over the term of each project, and if a customer becomes delinquent, the revenue may be deferred.

Reimbursable Expenses. Reimbursable expense revenue represents travel expenses incurred by our consultants and billed to our customers for reimbursement pursuant to a signed agreement. Recognition of this revenue follows the same policies as for services revenue.

Maintenance Revenue. Maintenance revenue consists of fees generated by providing software maintenance, upgrades and support to customers, such as telephone support and new releases of software and updated user documentation. A customer typically prepays maintenance and support fees for an initial period, and the related revenue is deferred and generally recognized over the term of such initial period. Maintenance is renewable by the customer on an annual basis thereafter. Rates for maintenance, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the contract.

Royalties and Affiliate Commissions. Royalties paid for third-party software products integrated with our technology are expensed when the products are shipped. Commissions payable to affiliates in connection with sales assistance are generally expensed when the commission becomes payable. Accrued royalties payable totalled $2.9 million and $3.2 million as of December 31, 2004 and 2003, respectively, while accrued affiliate commissions payable totalled $0.8 million and $0.6 million as of December 31, 2004 and 2003, respectively.

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Concurrent Transactions. We occasionally enter into transactions which are concluded at or about the same time as other arrangements with the same customer. These concurrent transactions are accounted for under Accounting Principles Board (APB) Opinion No. 29, *Accounting for Non-monetary Transactions*, as interpreted by EITF 01-02 *Interpretations of APB Opinion No. 29.* Generally, the recognition of a gain or loss on the exchange is measured based on the fair value of the assets involved to the extent that the fair value can be reasonably determined. A transaction that is not a culmination of the earnings process is based on the net book value of the asset relinquished.

Warranty. We generally warrant that our products will function substantially in accordance with documentation provided to customers. We accrue for warranty claims on a case-by-case basis; however, due to the unique nature of each claim and lack of a settlement history, estimating the necessary accrual involves an element of uncertainty.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is a reserve established through a provision for bad debts charged to expense and represents our best estimate of probable losses resulting from non-payment of amounts recorded in the existing accounts receivable portfolio. In estimating the allowance for doubtful accounts, we consider our historical write-off experience, accounts receivable aging reports, the credit-worthiness of individual customers, economic conditions affecting specific customer industries and general economic conditions, among other factors. Should any of these factors change, our estimate of probable losses due to bad debts could also change, which could affect the level of our future provisions for bad debts.

Deferred Taxes. Deferred tax assets and liabilities represent estimated future tax amounts attributable to the differences between the carrying amounts of assets and liabilities in the consolidated financial statements and their respective tax bases. These estimates are computed using the tax rates in effect for the applicable period. Realization of our deferred tax assets is, for the most part, dependent upon our U.S. consolidated tax group of companies having sufficient federal taxable income in future years to utilize our net operating loss carryforwards before they expire. Because we did not believe we would earn sufficient taxable income to utilize all of the deferred tax assets, during the second quarter of 2002, we recorded a valuation allowance for all of our remaining deferred tax assets. This resulted in a $887.3 million charge to income tax expense. We adjust our deferred tax valuation allowance on a quarterly basis in light of certain factors, including our financial performance. As of December 31, 2004, we still have a valuation allowance for all of our remaining domestic deferred tax assets. During the quarter ended December 31, 2004, we released approximately $5.7 million of valuation allowance related to foreign operations due to the likelihood that certain foreign deferred tax assets will be fully utilized in the future. Release of the valuation allowance is recorded as a benefit to income tax expense. As of December 31, 2004, approximately $6.3 million of valuation allowance remains related to foreign deferred tax assets. Despite the valuation allowance, these deferred tax assets and the future tax-deductible benefits related to these deferred tax assets will remain available to offset future taxable income over the remaining useful lives of the underlying deferred tax assets.

Goodwill. On January 1, 2002, in accordance with Statement of Financial Accounting Standard (SFAS) No. 142 Goodwill and Intangible Assets, we ceased amortizing goodwill and adopted a new policy for measuring goodwill for impairment. While no goodwill impairment was recorded in conjunction with the adoption of the new accounting standard, we previously recorded an impairment charge of approximately $4.2 billion of goodwill in the third quarter of 2001 prior to the adoption of SFAS No. 142. Under our new policy, we will test for impairment once annually, or more frequently if an event occurs or circumstances change that may indicate that the fair value of our reporting unit is below its carrying value. Goodwill is tested for impairment using a two-step approach. The first step is to compare the fair value of the reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired and the second step is not required. If the fair value of the reporting unit is less than its carrying amount, the second step of the impairment test measures the amount of the impairment loss, if any. The second step of the impairment test is to compare the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized equal to that excess. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination, whereby the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price. The excess purchase price over the amounts assigned to assets and liabilities would be the implied fair value of goodwill.

As stated above, we currently operate as a single reporting unit and all of our goodwill is associated with the entire

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company. Accordingly, we generally assume that the minimum fair value of our single reporting unit is our market capitalization, which is the product of (i) the number of shares of common stock issued and outstanding and (ii) the market price of our common stock.

Loss Contingencies. There are times when non-recurring events occur that require management to consider whether an accrual for a loss contingency is appropriate. Accruals for loss contingencies typically relate to certain legal proceedings, customer and other claims and litigation. As required by SFAS No. 5, we determine whether an accrual for a loss contingency is appropriate by assessing whether a loss is deemed probable and can be reasonably estimated. We analyze our legal proceedings, warranty and other claims and litigation based on available information to assess potential liability. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results assuming a combination of litigation and settlement strategies. The adverse resolution of any one or more of these matters over and above the amounts that have been estimated and accrued in the current consolidated financial statements could have a material adverse effect on our business, results of operations and financial condition.

Restructuring Charges. We recognize restructuring charges consistent with applicable accounting standards. We reduce charges for obligations on leased properties with estimated sublease income. Furthermore, we analyze current market conditions, including current lease rates in the respective geographic regions, vacancy rates and costs associated with subleasing, when evaluating the reasonableness of future sublease income. The accrual for office closure and consolidation is an estimate that assumes certain facilities will be subleased or the underlying leases will otherwise be favorably terminated prior to the contracted lease expiration date. Significant subjective judgment and estimates must be made and used in calculating future sublease income. While the current accrual represents our best estimate of our expected costs to exit these obligations, variances between our expected and actual sublease income may result in significant restructuring charge adjustments in future periods.

Revenues

The following table sets forth revenues and the percentages of total revenues of selected items reflected in our Consolidated Statements of Operations. The year-to-year comparisons of financial results are not necessarily indicative of future results.

Total revenues decreased $105.6 million, or 21%, in 2004 and decreased $413.4 million, or 46%, in 2003. Details of our revenues are presented below.

	2004	Percent of Revenue	2003	Percent of Revenue	2002	Percent of Revenue
Software products	$ 18,076	5%	$ 27,308	5%	$ 45,239	5%
License & Content subscriptions and other recurring revenue	40,472	10%	38,122	8%	43,390	5%
Software licenses	$ 58,548	15%	$ 65,430	13%	$ 88,629	10%
Development services	$ 30,673	8%	$ 26,782	5%	$ 13,154	1%
Contract	72,877	19%	126,488	26%	514,601	57%
Services	100,022	26%	126,558	26%	132,441	14%
Reimbursable expenses	10,450	3%	13,574	3%	14,833	2%
Maintenance	116,764	29%	136,097	27%	144,718	16%

Total revenues	$ 389,334	100%	$ 494,929	100%	$ 908,376	100%

Software Licenses. Software license revenue includes amounts related to software license sales, licensed content subscriptions and other revenues classified as license revenue. Software license revenue decreased $ 6.9 million, or 11%, in 2004 and $23.2 million, or 26%, in 2003.

Revenue from software product licenses decreased $9.2 million, or 34%, and $17.9 million, or 40%, during 2004 and 2003, respectively. The decrease in revenue from software product sales during 2004 and 2003 resulted from a decline in sales arising from deal execution challenges, reduction in sales and marketing capacity and increased competition and related pricing pressures. An additional factor contributing to the decline in license revenue in 2004 and 2003 was an increased number of transactions sold with development services, as well as our focus on selling new technologies that

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increases the likelihood of customization or enhancements to our software. In both cases, the fees received for the license, together with any other fees for customization and enhancements, are classified as development services. The decrease in revenue from software product sales during 2003 was also partially related to a weaker macroeconomic environment in the first half of 2003 which involved a significant decrease in technology and capital spending, and extended the decision cycles of many potential customers. We were particularly affected because we have historically derived a large percentage of our revenue from the high-tech industry, which was more significantly impacted by the poor economic conditions.

Our recent financial performance, negative cash flow, the 2003 restatement of our consolidated financial statements, the related SEC investigation and securities class action lawsuits and the de-listing of our common stock from The NASDAQ National Market have led our customers and prospects to voice concern about our continued financial viability, which has continued to contribute to our revenue decline. Despite our efforts to generate demand and develop growth, our success has been limited, and there can be no assurance that our business will stabilize or that we will be able to develop revenue growth from software products.

Revenue from licensed content subscriptions and other recurring revenue classified as software license revenue increased $2.4 million, or 6%, during 2004, and decreased $5.3 million, or 12%, during 2003. The increase in 2004 was due primarily to three large supply chain leader transactions which resulted in recurring revenue of $6.1 million in 2004. These transactions, which each have terms of three years or more, include rights to certain current and future products that may become available during the term of each respective contract. The revenues related to our subscription arrangements are recognized ratably over the term of the arrangement. Although we may pursue additional transactions of this nature, there can be no assurance that their impact will offset any further declines in revenue from licensed content subscriptions and other recurring revenue transactions.

The decline in revenue from licensed content subscription and other recurring revenue in 2003 was primarily attributable to a decline in the market for content subscriptions and increased competition in the market, which has resulted in downward price pressure and a decline in content subscription renewals.

Our account teams, led by sales representatives and consulting managers, are responsible for most of our software license and development services revenue. Although we believe direct sales will continue to account for most of our software license and development services revenue for the foreseeable future, we plan to continue developing indirect sales through, or in conjunction with, sales alliances, distributors, resellers and other indirect channels. There can be no assurance that our efforts to further expand indirect sales of our software products and content subscriptions will be successful or will continue in the future.

Development Services. Revenue from development services projects increased $3.9 million, or 15%, in 2004 and $13.6 million, or 104%, in 2003. The increase in revenue from development services is a result of an increase in demand for customization of our software along with increased sales of new technologies that are more likely to involve customization or enhance the software. Based on our historical trends, we expect development services to continue to fluctuate on a quarterly basis due to the timing of revenue recognition on these projects. In any period, development services revenue is dependent upon a variety of factors, including:

- the volume of development services transactions booked during the current and preceding periods;
- the number and availability of our internal developers 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.

Contract. Contract revenue decreased $53.6 million, or 42%, during 2004 and $388.1 million, or 75%, during 2003. The decrease in contract revenue during 2004 and 2003 is a result of the lower level of deferred contract revenue remaining to be recognized, and fewer events occurring which would allow the recognition of this revenue. In the future, we continue to expect significantly reduced contract revenue due to the fact that the revenue deferred from prior periods has substantially decreased. As of December 31, 2004, the deferred contract revenue balance was $54.2 million. We expect contract revenues to continue to fluctuate significantly on a quarterly basis due to the timing of revenue recognition events.

Services. Services revenue decreased $26.5 million, or 21%, in 2004 and $5.9 million, or 4%, in 2003. The decrease in services revenue during 2004 and 2003 was primarily due to the lower volume of license sales, which led to fewer

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implementations, and competitive rate pressures on consulting engagements. Additionally, as we focus on new technologies that involve providing services to customize or enhance the software requested by our customers, fees received in conjunction with providing those services are classified as development services revenue as described above.

During 2004, we continued to see downward trends in consulting rates due in part to pressure from offshore competition and the reduced information technology spending of our customers. Additionally, the increased use of our consultants in India has caused our global blended consulting rates to continue to decrease during 2004 similar to what we experienced in 2003. There can be no assurance that the rates we charge for consulting and implementation services will improve, or even remain at current levels. The market for information technology consulting services is challenging and we are affected by these market conditions. Accordingly, services revenue may continue to decline unless and until we experience a sustained increase in our software product licenses and maintain adequate resource capacity and capabilities. We also expect that services revenue will continue to fluctuate on a quarter-to-quarter basis, as revenue from the implementation of software is not generally recognized in the same period as the related license revenue. In any period, services revenue is dependent on a variety of factors, including:

- the volume of license transactions closed during the current and preceding periods;
- our customers upgrading to more recent software versions;
- customer decisions regarding implementations of licensed software, including utilization of internal resources or third-party systems integration firms;
- the number and availability of our internal service providers and consultants 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.

Reimbursable Expenses. Reimbursable expenses decreased $3.1 million, or 23%, in 2004 and $1.3 million, or 8%, in 2003. The decrease in reimbursable expenses during 2004 and 2003 is consistent with the decrease in our services revenue in these periods. Reimbursable expenses will generally fluctuate in direct relation to our services revenue.

Maintenance. Maintenance revenue decreased $19.3 million, or 14%, in 2004 and $8.6 million, or 6%, in 2003. The decrease in maintenance revenue during 2004 and 2003 resulted from a continuing decline in both the number and dollar amount of maintenance renewals mainly due to cost cutting efforts by our customers, less favorable renewal terms and lower volumes and dollar amounts of software license bookings. In addition, three large supply chain leader transactions closed during 2004 with customers that had previously utilized our software through perpetual license agreements and annual maintenance contracts. The combined license and maintenance fees recognized from these transactions in 2004 was accounted for as license subscription revenue, which is reported in our consolidated statement of operations as software license revenue. Maintenance revenue may continue to decrease as we continue to enter into these large recurring revenue transactions.

International Revenue. Our international revenues, included in the categories discussed above, are primarily generated from customers located in Europe, Asia and Canada. International revenue totalled $144.5 million, or 37% of total revenue, in 2004; $193.4 million, or 39% of total revenue, in 2003; and $336.2 million, or 37% of total revenue, in 2002. Although international revenues have remained relatively consistent as a percentage of total revenue, the decrease in the amount of international revenue during 2004 and 2003 was the result of declining demand for our enterprise application software, uncertainties related to our financial condition and the 2003 restatement of our consolidated financial statements, reductions in customer-facing employees, sales execution issues and increased competition, among other factors.

Customer Concentration. No individual customer accounted for more than 10% of annual revenues in 2004 or 2003. One customer accounted for 10.5% of revenues in 2002.

Costs of Revenues

The following table sets forth cost of revenues and the gross margins of selected items reflected in our Consolidated Statements of Operations. The year-to-year comparisons of financial results are not necessarily indicative of future results.

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	2004	Gross Margin	2003	Gross Margin	2002	Gross Margin
Software licenses	$ 10,864	81%	$ 6,656	90%	$ 2,976	97%
Development services	18,040	41%	23,261	13%	10,298	22%
Contract	4,718	94%	11,844	91%	147,522	71%
Amortization of acquired technology	369		580		15,156	
Services and maintenance	106,486	51%	135,844	48%	117,051	58%
Reimbursable expenses	10,450	0%	13,574	0%	14,833	0%
Total cost of revenues	$ 150,927		$ 191,759		$ 307,836	

Cost of Software Licenses. Cost of software licenses 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.

Costs related to user documentation.

Costs related to reproduction and delivery of software.

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

Cost of software licenses increased $4.2 million, or 63%, in 2004 and $3.7 million, or 124%, in 2003. The increase in 2004 is mainly due to a $1.8 million reversal of third party commission accruals in the third quarter of 2003 that were no longer payable, partially offset by increased royalty payments of approximately $1.7 million to one vendor in 2004, and a general increase in the fixed cost portion of our cost of license.

Cost of Development Services. The cost of development services includes the salary and other related costs of the employees or third parties that provide our services to customize or enhance the software for the customer together with third party royalties associated with the related license. Cost of development services decreased $5.2 million, or 22%, in 2004, and increased $12.9 million, or 126%, in 2003. The gross margin on development services will vary as a result of the timing of revenue recognition, which is impacted by the attainment of contractual milestones. The cost of development services was higher in 2003 than 2004 partially due to our decision to perform certain development services projects at a lower margin to offset the cost of our product development and pressures on the rates for our services. Specifically, during 2003 we incurred significant losses on one contract due to delays in achieving milestones. The increase in cost of development services in 2003 is primarily related to the increase in development services revenues.

Cost of Contract. Cost of contract decreased $7.1 million, or 60%, and $135.7 million, or 92%, in 2004 and 2003, respectively. Because contract expenses are recorded when the corresponding revenue is recognized, we expect cost of contract to vary significantly. As of December 31, 2004, we have $1.9 million remaining in deferred contract costs.

Amortization of Acquired Technology. In connection with our acquisitions in 2001 and 2000, we acquired developed technology that we offer as a part of our solutions. In accordance with applicable accounting standards, the amortization of acquired technology is included as a part of our cost of revenues because it relates to software products that are marketed to potential customers. Amortization of acquired technology decreased by approximately $0.2 million, or 36% in 2004 and $14.6 million, or 96%, in 2003. The decrease in 2003 resulted from a significant portion of our acquired technology becoming fully amortized in 2002. As of December 31, 2004, all of our acquired technology is fully amortized.

Cost of Services and Maintenance. Cost of services and maintenance includes costs associated with providing services to customers, including implementation and training, in addition to the cost of providing software maintenance to customers such as telephone support, upgrades and updated user documentation. The total cost of services and maintenance decreased $29.4 million, or 22%, in 2004 and increased $18.8 million or 16%, in 2003. Service and maintenance headcount decreased 11% in 2004, which contributed to a significant decrease in compensation-related expenses incurred by the services and maintenance organization. In addition, our increased utilization of India-based personnel to provide services and maintenance support has also caused a decrease in this expense.

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While the service and maintenance headcount decreased 21% during 2003, cost of services and maintenance increased in 2003 primarily because of the substantial amount of services expense recognized as cost of contract in 2002 as a result of the restatement of our consolidated financial statements in 2003.

Operating Expenses

	2004	Percent of Revenue	2003	Percent of Revenue	2002	Percent of Revenue
Sales and marketing	$ 79,700	20%	$ 90,781	18%	$ 198,825	22%
Research and development	70,660	18%	80,788	16%	173,064	19%
General and administrative	71,646	18%	105,710	21%	65,446	7%