

AGILE SOFTWARE CORP  
Form 10-Q  
March 05, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended July 31, 2006

**OR**

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

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

Commission file number 000-27071

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**AGILE SOFTWARE CORPORATION**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of

incorporation or organization)

77-0397905  
(I.R.S. Employer

Identification No.)

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

(Address of principal executive office)

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(408) 284-4000

(Registrant's telephone number, including area code)

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

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

The number of shares of Common Stock of Agile Software Corporation issued and outstanding as of December 31, 2006 was 57,545,957.

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**AGILE SOFTWARE CORPORATION**

**FORM 10-Q**

**JULY 31, 2006**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****AGILE SOFTWARE CORPORATION****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

|                                                                                                                                         | <b>July 31,</b> | <b>April 30,</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------|-----------------|------------------|
|                                                                                                                                         | <b>2006</b>     | <b>2006 (1)</b>  |
| <b><u>ASSETS</u></b>                                                                                                                    |                 |                  |
| Current assets:                                                                                                                         |                 |                  |
| Cash and cash equivalents                                                                                                               | \$ 99,963       | \$ 126,749       |
| Short-term investments                                                                                                                  | 51,168          | 47,788           |
| Accounts receivable, net of allowance for doubtful accounts of \$1,817 and \$1,788 as of July 31, 2006 and April 30, 2006, respectively | 20,959          | 26,673           |
| Other current assets                                                                                                                    | 4,914           | 4,306            |
| Total current assets                                                                                                                    | 177,004         | 205,516          |
| Long-term investments                                                                                                                   | 41,793          | 28,762           |
| Property and equipment, net                                                                                                             | 8,863           | 8,697            |
| Intangible assets, net                                                                                                                  | 12,543          | 7,052            |
| Other assets                                                                                                                            | 1,810           | 1,593            |
| Goodwill                                                                                                                                | 75,165          | 66,687           |
| Total assets                                                                                                                            | \$ 317,178      | \$ 318,307       |
| <b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>                                                                                      |                 |                  |
| Current liabilities:                                                                                                                    |                 |                  |
| Accounts payable                                                                                                                        | \$ 7,107        | \$ 5,762         |
| Accrued expenses and other liabilities                                                                                                  | 16,591          | 17,399           |
| Accrued restructuring, current                                                                                                          | 1,588           | 2,067            |
| Deferred revenue                                                                                                                        | 29,727          | 29,037           |
| Total current liabilities                                                                                                               | 55,013          | 54,265           |
| Other non-current liabilities                                                                                                           | 5,684           | 5,753            |
| Total liabilities                                                                                                                       | 60,697          | 60,018           |
| Commitments and contingencies (Note 9)                                                                                                  |                 |                  |
| Stockholders' equity:                                                                                                                   |                 |                  |
| Common Stock                                                                                                                            | 58              | 58               |
| Additional paid-in capital                                                                                                              | 630,686         | 628,750          |
| Notes receivable from stockholders                                                                                                      | (48)            | (48)             |
| Accumulated other comprehensive loss                                                                                                    | (764)           | (728)            |
| Accumulated deficit                                                                                                                     | (373,451)       | (369,743)        |
| Total stockholders' equity                                                                                                              | 256,481         | 258,289          |

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|                                            |            |            |
|--------------------------------------------|------------|------------|
| Total liabilities and stockholders' equity | \$ 317,178 | \$ 318,307 |
|--------------------------------------------|------------|------------|

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- (1) Amounts as of April 30, 2006 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.

**Table of Contents****AGILE SOFTWARE CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)**

|                                        | <b>Three Months Ended<br/>July 31,</b> |             |
|----------------------------------------|----------------------------------------|-------------|
|                                        | <b>2006</b>                            | <b>2005</b> |
| <b>Revenues:</b>                       |                                        |             |
| License                                | \$ 10,103                              | \$ 13,401   |
| Service                                | 20,915                                 | 20,983      |
| Total revenues                         | 31,018                                 | 34,384      |
| <b>Cost of revenues:</b>               |                                        |             |
| License                                | 726                                    | 772         |
| Service (1)                            | 9,255                                  | 11,682      |
| Amortization of intangible assets      | 842                                    | 725         |
| Total cost of revenues                 | 10,823                                 | 13,179      |
| Gross margin                           | 20,195                                 | 21,205      |
| <b>Operating expenses:</b>             |                                        |             |
| Sales and marketing (1)                | 11,694                                 | 12,830      |
| Research and development (1)           | 9,225                                  | 8,221       |
| General and administrative (1)         | 4,392                                  | 3,446       |
| Amortization of intangible assets      | 667                                    | 602         |
| Acquired in-process technology         | 100                                    |             |
| Total operating expenses               | 26,078                                 | 25,099      |
| Loss from operations                   | (5,883)                                | (3,894)     |
| Interest and other income, net         | 2,344                                  | 870         |
| Loss before provision for income taxes | (3,539)                                | (3,024)     |
| Provision for income taxes             | 151                                    | 296         |
| Net loss                               | \$ (3,690)                             | \$ (3,320)  |
| Net loss per share:                    |                                        |             |
| Basic and diluted                      | \$ (0.07)                              | \$ (0.06)   |
| Weighted average shares                | 55,113                                 | 53,591      |

(1) The amounts in the lines above include stock compensation as follows:

|                          |        |       |
|--------------------------|--------|-------|
| Cost of service revenue  | \$ 215 | \$ 92 |
| Sales and marketing      | 834    | 413   |
| Research and development | 232    | 61    |

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General and administrative

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

**Table of Contents****AGILE SOFTWARE CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

|                                                                                                                          | <b>Three Months Ended<br/>July 31,</b> |                             |
|--------------------------------------------------------------------------------------------------------------------------|----------------------------------------|-----------------------------|
|                                                                                                                          | <b>2006</b>                            | <b>2005<br/>As Restated</b> |
| <b>Cash flows from operating activities:</b>                                                                             |                                        |                             |
| Net loss                                                                                                                 | \$ (3,690)                             | \$ (3,320)                  |
| Adjustments to reconcile net loss to net cash provided by operating activities:                                          |                                        |                             |
| Acquired in-process technology                                                                                           | 100                                    |                             |
| Provision for doubtful accounts                                                                                          |                                        | 16                          |
| Depreciation and amortization                                                                                            | 2,514                                  | 2,441                       |
| Stock compensation                                                                                                       | 1,887                                  | 764                         |
| Shares withheld in payment of employee tax withholding (see Note 8 - Stock Compensation for description of this payment) | (18)                                   |                             |
| Changes in operating assets and liabilities, net of acquisitions:                                                        |                                        |                             |
| Accounts receivable                                                                                                      | 7,015                                  | (409)                       |
| Other assets, current and non-current                                                                                    | 1,325                                  | (200)                       |
| Accounts payable                                                                                                         | 1,145                                  | (475)                       |
| Accrued expenses and other liabilities                                                                                   | (3,681)                                | 26                          |
| Deferred revenue                                                                                                         | (1,273)                                | 1,761                       |
| Net cash provided by operating activities                                                                                | 5,322                                  | 604                         |
| <b>Cash flows from investing activities:</b>                                                                             |                                        |                             |
| Purchases of investments                                                                                                 | (29,066)                               | (15,436)                    |
| Proceeds from maturities of investments                                                                                  | 12,686                                 | 12,097                      |
| Cash paid in business combinations, net of cash acquired                                                                 | (14,956)                               |                             |
| Acquisition of property and equipment                                                                                    | (1,025)                                | (1,226)                     |
| Net cash used in investing activities                                                                                    | (32,361)                               | (4,565)                     |
| <b>Cash flows from financing activities:</b>                                                                             |                                        |                             |
| Proceeds from issuance of common stock, net of repurchases                                                               | 48                                     | 57                          |
| Net cash provided by financing activities                                                                                | 48                                     | 57                          |
| Effect of exchange rate changes on cash                                                                                  | 205                                    | (500)                       |
| Net decrease in cash and cash equivalents                                                                                | (26,786)                               | (4,404)                     |
| Cash and cash equivalents at beginning of period                                                                         | 126,749                                | 81,760                      |
| Cash and cash equivalents at end of period                                                                               | \$ 99,963                              | \$ 77,356                   |

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



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### **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, 2006 ( fiscal 2006 ), included in our Annual Report on Form 10-K for fiscal 2006 ( Fiscal 2006 Form 10-K ) filed with the Securities and Exchange Commission.

#### **Concentrations of credit risk and significant customers**

In the three months ended July 31, 2006 and 2005, none of our customers accounted for more than 10% of total revenues. As of July 31, 2006, none of our customers accounted for more than 10% of net accounts receivable and as of April 30, 2006, one customer accounted for 16% of net accounts receivable.

### **NOTE 2 RESTATEMENT OF UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

On September 19, 2006, Agile announced that it had commenced a voluntary review of stock option grant practices through a Special Committee of one independent director appointed by the Audit Committee of the Board, with the assistance of independent legal counsel. The review covered options grants made to all employees, directors and non-employees during the period from the date of our initial public offering in August 1999 to July 2006. The Special Committee found instances in which incorrect measurement dates were used to account for certain option grants. In addition, the Company found that it did not appropriately account for certain other aspects of stock compensation. However, this finding did not result in a material adjustment to our historical condensed consolidated financial statements. The total cumulative adjustment to stock compensation expense resulting from these findings was \$69.6 million. Accordingly, in our Fiscal 2006 Form 10-K, the Company included restatements of the following previously filed financial statements and data (and related disclosures): (1) our condensed consolidated financial statements as of and for the fiscal years ended April 30, 2005 and 2004; (2) our selected condensed consolidated financial data as of and for the fiscal years ended April 30, 2005, 2004, 2003 and 2002; and (3) our unaudited quarterly financial data for all quarters in fiscal 2005. Please see Note 2, Restatement of Consolidated Financial Statements, and Note 16 Unaudited Quarterly Consolidated Financial Data, to the consolidated financial statements included in our Fiscal 2006 Form 10-K, and Management's Discussion & Analysis therein, for a detailed discussion of the effect of the restatements and a period-by-period reconciliation of the adjustments.

In connection with our restatement, we assessed generally whether there were other matters which should have been corrected in our previously issued financial statements. As a result, Agile made certain adjustments in our Fiscal 2006 Form 10-K to our previously filed consolidated statement of cash flows for fiscal year 2005, and the consolidated statements of cash flows included within our unaudited quarterly financial data for each of the quarters in fiscal 2005 and the first three quarters in fiscal 2006. These adjustments were primarily the result of errors in the calculation of the effect of exchange rate changes on cash balances, which principally resulted in reclassifications between cash provided by (used in) operating activities and the effect of exchange rate changes on cash. These adjustments had no impact on the total change in cash and cash equivalents within the consolidated statements of cash flows, the consolidated statements of operations or the consolidated balance sheets for the affected periods. The effects of this restatement on the Company's consolidated financial statements for the three months ended July 31, 2005 are reflected in this Form 10-Q.

### **NOTE 3 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 potentially 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.

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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 |            |
|--------------------------------------------------------------------------------------|--------------------|------------|
|                                                                                      | July 31,           |            |
|                                                                                      | 2006               | 2005       |
| <b>Numerator:</b>                                                                    |                    |            |
| Net loss                                                                             | \$ (3,690)         | \$ (3,320) |
| <b>Denominator:</b>                                                                  |                    |            |
| Weighted average shares                                                              | 57,690             | 53,591     |
| Weighted average unvested shares of common stock subject to forfeiture or repurchase | (2,577)            |            |
| Denominator for basic and diluted calculation                                        | 55,113             | 53,591     |
| <b>Net loss per share:</b>                                                           |                    |            |
| Basic and diluted                                                                    | \$ (0.07)          | \$ (0.06)  |

The following table sets forth, as of the dates indicated below, potentially 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):

|                                                           | Three Months Ended |        |
|-----------------------------------------------------------|--------------------|--------|
|                                                           | July 31,           |        |
|                                                           | 2006               | 2005   |
| Unvested common stock subject to forfeiture or repurchase | 2,546              |        |
| Options to purchase common stock                          | 8,277              | 19,158 |
| Total shares excluded                                     | 10,823             | 19,158 |

## NOTE 4 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 (in thousands):

|                                         | Three Months Ended |            |
|-----------------------------------------|--------------------|------------|
|                                         | July 31,           |            |
|                                         | 2006               | 2005       |
| Net loss                                | \$ (3,690)         | \$ (3,320) |
| Other comprehensive gain (loss):        |                    |            |
| Unrealized gain on investments          | 30                 | 1,068      |
| Foreign currency translation adjustment | (66)               | 242        |
| Other comprehensive gain (loss)         | \$ (36)            | \$ 1,310   |
| Total comprehensive loss                | \$ (3,726)         | \$ (2,010) |

## NOTE 5 BUSINESS COMBINATIONS

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On June 30, 2006, we acquired Prodika, Inc. ( Prodika ), a provider of PLM solutions for the consumer packaged goods ( CPG ) industry, particularly the food and beverage sector. Under the terms of the acquisition, we paid \$15.0 million in cash to acquire all of the outstanding capital stock of Prodika. In addition, we may have to pay additional consideration, in the form of an earnout, of up to \$12.5 million, subject to our recording certain license revenues, from sales of certain products, through January, 2008. We have funded the \$15.0 million upfront portion of the purchase price from our cash and investments and expect to fund any earnout payments from the same source. Prior to the acquisition, we had no direct relation with Prodika.

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The transaction was accounted for under the purchase method of accounting and, accordingly, the results of operations of Prodika are included in the accompanying consolidated statements of operations since the acquisition date. Pro forma results of operations have not been presented because the effects were not material to our overall results.

The aggregate purchase price for the Prodika 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 see table below. The net tangible assets acquired and liabilities assumed in the acquisition, as discussed further below, were recorded at the fair value, which approximated the carrying amounts at the acquisition date. 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 ), we 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 included discount factors ranging from 20% to 22%, estimates of revenue growth, maintenance renewal rates, cost of sales, operating expenses and taxes. Through the acquisition of Prodika, we have acquired product lifecycle management solutions for the consumer packaged goods industry, particularly the food and beverage sector. This is consistent with our strategy to expand the capability and functionality of our solutions and expand into additional vertical markets. These factors have contributed to a purchase price in excess of fair market value of the Prodika identified tangible and intangible assets acquired. The excess purchase price was allocated to goodwill. Any additional consideration paid subsequent to the acquisition pursuant to the earnout will be allocated to goodwill.

The aggregate purchase price for the Prodika 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):

|                                          |           |
|------------------------------------------|-----------|
| Tangible assets acquired:                |           |
| Cash and cash equivalents                | \$ 216    |
| Accounts receivable                      | 1,172     |
| Prepaid expenses and other assets        | 1,894     |
| Property and equipment                   | 328       |
| Liabilities assumed:                     |           |
| Accounts payable                         | (143)     |
| Accrued expenses and other liabilities   | (2,210)   |
| Deferred revenue                         | (1,663)   |
| Identifiable intangible assets acquired: |           |
| In-process research and development      | 100       |
| Other identifiable intangible assets:    |           |
| Developed technology                     | 4,200     |
| Customer relationships                   | 2,800     |
| Goodwill                                 | 8,478     |
| Total                                    | \$ 15,172 |

**NOTE 6 GOODWILL AND INTANGIBLE ASSETS****Goodwill**

The activity within goodwill, for the three months ended July 31, 2006, is as follows (in thousands):

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|                              |           |
|------------------------------|-----------|
| Balance as of April 30, 2006 | \$ 66,687 |
| Prodika goodwill             | 8,478     |
| Balance as of July 31, 2006  | \$ 75,165 |

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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):

|                        | July 31, 2006         |                          |                     | April 30, 2006        |                          |                     |
|------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                        | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Intangible Assets:     |                       |                          |                     |                       |                          |                     |
| Developed technologies | \$ 13,400             | \$ (5,708)               | \$ 7,692            | \$ 9,200              | \$ (4,866)               | \$ 4,334            |
| Customer relationships | 9,682                 | (5,691)                  | 3,991               | 6,882                 | (5,094)                  | 1,788               |
| Trademarks             | 1,200                 | (360)                    | 840                 | 1,200                 | (300)                    | 900                 |
| Non-compete agreements | 1,280                 | (1,260)                  | 20                  | 1,280                 | (1,250)                  | 30                  |
|                        | \$ 25,562             | \$ (13,019)              | \$ 12,543           | \$ 18,562             | \$ (11,510)              | \$ 7,052            |

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; Trademarks five years; Non-compete agreements one to two years. No significant residual value is estimated for the intangible assets.

As of July 31, 2006, the estimated future amortization expense of acquired identifiable intangible assets is as follows (in thousands):

| Fiscal Years:                |           |
|------------------------------|-----------|
| 2007 (remaining nine months) | \$ 4,473  |
| 2008                         | 4,928     |
| 2009                         | 2,573     |
| 2010                         | 569       |
| Total                        | \$ 12,543 |

### NOTE 7 RESTRUCTURING CHARGES

From time to time, management has initiated various restructurings of our operations and facilities. 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 second quarter of fiscal 2003, we recorded a restructuring charge of \$5.2 million (the 2003 Restructuring ). The 2003 Restructuring consisted primarily of the consolidation of excess facilities and abandonment of certain assets in connection with the consolidation of excess facilities. As of July 31, 2006, \$497,000 of the 2003 Restructuring obligations remained, which represents costs related to excess facilities.

In the first quarter of fiscal 2005, we terminated approximately 15% of our employees worldwide and consolidated our Chinese development centers into a single location (the 2005 Restructuring ). In connection with the 2005 Restructuring, we recorded a restructuring charge of \$2.1 million. As of July 31, 2006, \$420,000 of the 2005 Restructuring obligations remained, which represents costs related to severance.

During the third and fourth quarters of fiscal 2006, we terminated 40 employees and consolidated excess facilities in Massachusetts and the United Kingdom (the 2006 Restructuring ). In connection with these actions, we incurred a



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restructuring charge of \$2.4 million, which is comprised of severance payments of \$2.1 million and facilities and asset abandonment costs of \$233,000. Additionally, we reassessed our previous assumptions underlying our 2003 Restructuring related to the excess facilities charges, and, as a result, recorded an additional expense of \$93,000 related to the 2003 Restructuring. As of July 31, 2006, \$773,000 of the 2006 Restructuring obligations remained.

We review quarterly the assumptions used in estimating our restructuring charges, principally sublease income expectations for excess facilities and employee termination expenses. We currently do not expect our existing restructuring estimates and assumptions to change materially.

**Summary of Restructuring Obligations**

The significant activity within and components of the restructuring charges during the three months ended July 31, 2006 are as follows (in thousands):

|                                                | Employee<br>Termination<br>Costs | Facility-Related<br>Costs | Total    |
|------------------------------------------------|----------------------------------|---------------------------|----------|
| Restructuring obligations at April 30, 2006    | \$ 1,529                         | \$ 744                    | \$ 2,273 |
| Cash payments                                  | (405)                            | (178)                     | (583)    |
| Restructuring obligations at July 31, 2006 (1) | \$ 1,124                         | \$ 566                    | \$ 1,690 |
| Accrued restructuring, current                 |                                  |                           | \$ 1,588 |
| Accrued restructuring, non-current             |                                  |                           | 102      |
|                                                |                                  |                           | \$ 1,690 |

(1) The remaining employee termination and facility-related obligations are expected to be paid through our quarter ending October 31, 2007.

**NOTE 8 STOCK COMPENSATION**

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), *Share-Based Payments*, as interpreted by SEC Staff Accounting Bulletin ( SAB ) No. 107, effective May 1, 2005. SFAS 123R requires the recognition of the fair value of stock compensation in net income (loss). We recognize the stock compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. All of our stock compensation awards are accounted for as equity instruments.

Under the provisions of SFAS 123R, we recorded \$1.9 million of stock compensation expense in our consolidated statement of operations for the three months ended July 31, 2006. We utilized the Black-Scholes valuation model for estimating the fair value of the equity awards granted after the adoption of SFAS 123R, with the following weighted-average assumptions:

|                                 | Stock Option Plans<br>Three Months Ended<br>July 31, |       | Stock Purchase Plan<br>Three Months Ended<br>July 31, |       |
|---------------------------------|------------------------------------------------------|-------|-------------------------------------------------------|-------|
|                                 | 2006                                                 | 2005  | 2006                                                  | 2005  |
| Dividend yield                  |                                                      |       |                                                       |       |
| Expected volatility             | 54%                                                  | 67%   | 35%                                                   | 37%   |
| Average risk-free interest rate | 4.71%                                                | 3.58% | 4.76%                                                 | 3.24% |
| Expected life (in years)        | 5.0                                                  | 4.5   | 0.5                                                   | 0.5   |

The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. Expected volatility is based on the combination of historical volatility of our common stock over the period commensurate with the expected life of the options and the mean historical implied volatility from traded options with a term of 180 days or greater measured over one year. The risk-free interest rate is derived from the average U.S. Treasury Strips rate during the period, which approximates the rate in effect at the time of



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grant. The expected life calculation is based on the observed and expected time to post-vesting exercise and forfeitures of option by our employees.

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Based on the above assumptions, the weighted-average fair values of the options granted under the stock option plans and shares subject to purchase under the employee stock purchase plan for the three months ended July 31, 2006 was \$5.46 and \$1.77, respectively.

Based on our historical experience of pre-vesting option cancellations, we have assumed an annualized forfeiture rate of 15% for our options. Under the true-up provisions of SFAS 123R, we will record additional expense if the actual forfeiture rate is lower than we estimated, and will record a recovery of prior expense if the actual forfeiture is higher than we estimated.

Total compensation cost of fair market value options granted and par value options exercised, but not yet vested, as of July 31, 2006, was \$10.2 million, which is expected to be recognized over a weighted average period of 1.6 years. Refer to Note 12 Employee Benefit Plans of our Fiscal 2006 Form 10-K for discussion of our stock plans.

The amortization of stock compensation under SFAS 123R is recorded in accordance with Financial Accounting Standard Board ( FASB ) Interpretation ( FIN ) No. 28 (i.e., accelerated method).

The following table summarizes activity under all stock option plans (in thousands, except for per share and contractual term amounts):

|                                  | Shares Available<br>for Grant | Number<br>Outstanding | Weighted Average<br>Exercise Price per<br>Share | Weighted Average<br>Remaining<br>Contractual Term<br>(years) | Aggregate<br>Intrinsic<br>Value<br>(1) |
|----------------------------------|-------------------------------|-----------------------|-------------------------------------------------|--------------------------------------------------------------|----------------------------------------|
| Balance at April 30, 2006        | 14,974                        | 7,958                 | \$6.23                                          |                                                              |                                        |
| Options authorized (2)           | 1,000                         |                       |                                                 |                                                              |                                        |
| Options granted                  | (554)                         | 554                   | 2.69                                            |                                                              |                                        |
| Options exercised                |                               | (17)                  | 2.76                                            |                                                              |                                        |
| Options canceled                 | 218                           | (218)                 | 5.14                                            |                                                              |                                        |
| Unvested shares repurchased      |                               |                       |                                                 |                                                              |                                        |
| Balance at July 31, 2006         | 15,638                        | 8,277                 | \$6.03                                          | 6.4                                                          | \$ 6,376                               |
| Exercisable at July 31, 2006 (3) |                               | 7,144                 | \$6.27                                          | 6.4                                                          | \$ 4,426                               |

- (1) The aggregate intrinsic value on this table was calculated based on the positive difference between the closing price of our common stock on July 31, 2006 (i.e. \$5.87) and the exercise price of the underlying options.
- (2) Under our 1995 Stock Option Plan, the number of shares available for grant is automatically increased on the first day of each fiscal year by the lesser of 1.0 million shares per year, or 5% of the number of shares of our common stock which were issued and outstanding on the last day of the preceding fiscal year or a number of shares determined by our Board of Directors.
- (3) Includes options to purchase 329,000 shares of common stock that are exercisable prior to vesting. Shares purchased prior to vesting are subject to reacquisition by Agile in the event of termination of the optionee's employment prior to such shares vesting. During the three months ended July 31, 2006, the total intrinsic value of stock options exercised was \$66,000.

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### ***Option Exchange***

In July 2005, Agile extended an offer to exchange outstanding options with an exercise price of \$6.76 per share or greater for new options with an exercise price of \$0.001. The exchange ratio in the offer was one new option share for each three old option shares tendered for exchange. The exchange offer expired in August 2005. Of the approximately 14 million options eligible to participate in the exchange, approximately 11.6 million options were surrendered and exchanged into approximately 3.9 million new options. For financial accounting purposes, the exchange resulted in an additional stock compensation expense of \$315,000, which is being recognized over the approximately two-year vesting term of the new options.

These new options granted to U.S. employees were immediately exercisable for restricted stock and could only be exercised through November 30, 2005. On each vesting date of the restricted stock, we withhold sufficient shares to cover the

minimum statutory tax withholding requirements, based on the market value of our common stock at the time of vesting. As a result, the number of shares of restricted stock outstanding will decrease by the number of shares withheld to cover the tax obligation arising on each vesting date, and Agile will make a cash payment to the Internal Revenue Service and state tax authorities to cover the applicable withholding taxes.

## **NOTE 9 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 software products operate substantially in accordance with specifications. Historically, minimal costs have been incurred related to product warranties, and, accordingly, no accruals for warranty costs have been made.

We, as permitted under Delaware law and in accordance with our Bylaws, indemnify our officers, directors and members of our senior management for certain events or occurrences, subject to certain limits, while they were serving at our request in such capacity. In this regard, we have received, or expect to receive, requests for indemnification by certain current and former officers and directors with respect to potential liability in connection with our review of our historic stock option granting practices and the related restatement, related governmental inquiries, and shareholder derivative litigation and class action litigation described below. The maximum amount of potential future indemnification is unknown and potentially unlimited; however, we have directors' and officers' liability insurance policies that enable us to recover a portion of future indemnification claims paid, subject to retentions, conditions and limitations of the policies. As a result of this insurance coverage, we believe that the fair value of these indemnification claims is not material.

### **Litigation**

#### ***Shareholder derivative lawsuits***

On December 5, 2006, a purported shareholder filed a derivative action in the Federal District Court for the Northern District of California, titled *Meek v. Stolle et al.*, No. C06-7343 RS. Subsequently, three additional derivative actions, with essentially the same allegations as the first, were filed in the same court. Each of the lawsuits is a shareholder derivative lawsuit, brought purportedly on our behalf. Each complaint names as defendants certain directors and current and former officers. The complaints, when read together, allege that the individual defendants caused or allowed backdated stock options to be granted from August 1999 through October 2003, in violation of the federal securities laws and their fiduciary duties to the company and its shareholders. No specific amounts of damages were alleged, although the complaints seek rescission of the options alleged to be backdated and the recovery of profits from the defendants' sales of company stock. It is expected that all of these derivative actions will be consolidated into one action. The Company's board of directors and management intend to review the allegations of the action(s) and will respond in a manner the Board considers to be in the best interests of the shareholders.

#### ***IPO securities class action 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).



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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.

The Company is aware that similar allegations have been made in other lawsuits filed in the Federal District Court in the Southern District of New York (the Court) 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.

The Court has granted preliminary approval of the settlement. It held a hearing on April 24, 2006 to consider final approval of the settlement, and will issue a ruling at some time in the future. On December 5, 2006, the Second Circuit Court of Appeals (which oversees the Court) issued a decision in *In re Initial Public Offering Securities Litigation*, WL 3499937 (2d Cir. Dec. 5, 2006), reversing the Court's ruling certifying six of the cases in the consolidated proceedings as class actions. On December 14, 2006, the Court agreed to stay all proceedings, including consideration of the settlement, pending a decision from the Second Circuit on whether it will hear further argument on the class certification issue.

We are also subject to various other claims and legal actions 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, results of operations, or cash flows.

### **Other commitments**

In connection with our acquisition of Eigner US Inc. (Eigner) in August 2003, we assumed a commitment to purchase consulting services from a vendor to Eigner, which commitment, totaling \$273,000, provides for quarterly payments through the first quarter of our fiscal year ending April 30, 2008.

## **NOTE 10 SEGMENT AND GEOGRAPHIC INFORMATION**

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

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The following geographic information is presented for the three-months ended July 31, 2006 and 2005 (in thousands, except percentages):

|               | As percentage of   |           |                    |      |
|---------------|--------------------|-----------|--------------------|------|
|               | Three Months Ended |           | total revenue      |      |
|               | July 31,           |           | Three Months Ended |      |
|               | 2006               | 2005      | July 31,           | 2005 |
| Revenues:     |                    |           |                    |      |
| North America | \$ 20,627          | \$ 24,686 | 67%                | 72%  |
| Europe        | 8,254              | 8,860     | 26                 | 26   |
| Asia-Pacific  | 2,137              | 838       | 7                  | 2    |
|               | \$ 31,018          | \$ 34,384 | 100%               | 100% |

No single customer accounted for 10% or more of total revenues for the three months ended July 31, 2006 or 2005.

The following table presents our long-lived assets by geographic location, as of the balance sheet dates (in thousands):

|                    | July 31,<br>2006 | April 30,<br>2006 |
|--------------------|------------------|-------------------|
| Long-lived assets: |                  |                   |
| North America      | \$ 7,227         | \$ 7,135          |
| Europe             | 1,058            | 1,084             |
| Asia-Pacific       | 578              | 478               |
|                    | \$ 8,863         | \$ 8,697          |

## NOTE 11 SUBSEQUENT EVENTS

### Nasdaq Delisting

As a result of the delayed filing of our periodic reports with the SEC, on September 13, 2006, we received a Nasdaq staff determination letter indicating that we had failed to comply with the filing requirement for continued listing set forth in Nasdaq Marketplace Rule 4310(c)(14), due to our failure to timely file our Annual Report on Form 10-K for fiscal 2006, and that our securities are, therefore, subject to delisting from the Nasdaq Global Market. We received and announced two additional Nasdaq staff determination letters with respect to our failure to timely file our Quarterly Reports on Form 10-Q for the first and second quarters of fiscal 2007. We requested and subsequently attended a hearing before the Nasdaq Listing Qualifications Panel ( Listing Panel ), which was held on September 14, 2006, to appeal the staff determination and presented a plan to cure both filing deficiencies and regain compliance. On October 11, 2006, Nasdaq notified us that the exception had been granted, and that it would continue to list our shares on the Nasdaq Global Market, provided that we file our Form 10-K for fiscal 2006, our Form 10-Q for the first quarter of fiscal 2007, and all required restatements on or before January 8, 2007. Although we were unable to meet this condition by January 8, 2007, the Nasdaq Listing and Hearing Review Council (Listing Council), pursuant to its discretionary authority under Marketplace Rule 4807(b), has decided to review the decision of the Listing Panel, and has stayed the decision to suspend our securities from trading, pending further action by the Listing Council. Our stock will continue to be listed on the Nasdaq Global Market pending the decision by the Listing Council on our request for a further extension within which to comply with the listing rules. Upon the filing of our Form 10-K for fiscal 2006 and our Form 10-Q for our quarters ended July 31, 2006 and October 31, 2006, we will be current with our filing requirements under the Securities and Exchange Act of 1934 and, as a result, expect that we should no longer be subject to delisting from the Nasdaq Global Market.

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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). 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 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 words are used to identify 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 differences include, but are not limited to, those discussed in the Risk Factors section included below in this Quarterly Report on Form 10-Q as well as in the Risk Factors section included in our Form 10-K for the year ended April 30, 2006 ( "Fiscal 2006 Form 10-K" ) filed with the Securities and Exchange Commission. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto appearing elsewhere in this report. Our fiscal year ends on April 30 of each year.

#### **Restatement of Unaudited Condensed Consolidated Financial Statements**

On September 19, 2006, Agile announced that it had commenced a voluntary review of stock option grant practices through a Special Committee of one independent director appointed by the Audit Committee of the Board, with the assistance of independent legal counsel. The review covered options grants made to all employees, directors and non-employees during the period from the date of our initial public offering in August 1999 to July 2006. The Special Committee found instances in which incorrect measurement dates were used to account for certain option grants. In addition, the Company found that it did not appropriately account for certain other aspects of stock compensation. However, this finding did not result in a material adjustment to our historical condensed consolidated financial statements. The total cumulative adjustment to stock compensation expense resulting from these findings was \$69.6 million. Accordingly, in our Fiscal 2006 Form 10-K, the Company included restatements of the following previously filed financial statements and data (and related disclosures): (1) our condensed consolidated financial statements as of and for the fiscal years ended April 30, 2005 and 2004; (2) our selected condensed consolidated financial data as of and for the fiscal years ended April 30, 2005, 2004, 2003 and 2002; and (3) our unaudited quarterly financial data for all quarters in fiscal 2005. Please see Note 2, Restatement of Consolidated Financial Statements, and Note 16 Unaudited Quarterly Consolidated Financial Data, to the consolidated financial statements included in our Fiscal 2006 Form 10-K, and Management's Discussion & Analysis therein, for a detailed discussion of the effect of the restatements and a period-by-period reconciliation of the adjustments.

In connection with our restatement, we assessed generally whether there were other matters which should have been corrected in our previously issued financial statements. As a result, Agile made certain adjustments in our Fiscal 2006 Form 10-K to our previously filed consolidated statement of cash flows for fiscal year 2005, and the consolidated statements of cash flows included within our unaudited quarterly financial data for each of the quarters in fiscal 2005 and the first three quarters in fiscal 2006. These adjustments were primarily the result of errors in the calculation of the effect of exchange rate changes on cash balances, which principally resulted in reclassifications between cash provided by (used in) operating activities and the effect of exchange rate changes on cash. These adjustments had no impact on the total change in cash and cash equivalents within the consolidated statements of cash flows, the consolidated statements of operations or the consolidated balance sheets for the affected periods. The effects of this restatement on the Company's consolidated financial statements for the three months ended July 31, 2005 are reflected in this Form 10-Q.

#### **Review of Taiwan Sales Office Operations**

In addition to the restatement described above as a result of our review of our historical stock option grant practices, our consolidated financial statements included in this Form 10-Q reflect adjustments to our financial information previously reported in our press release, dated May 25, 2006, for the quarter and fiscal year ended April 30, 2006 ( "Press Release" ). The adjustments arose out of an investigation by our Audit Committee, as reported in our Form 8-K filed with the SEC on July 14, 2006, into certain transactions entered into by our Taiwan sales office. The investigation initially centered upon confirmation of the validity of a specific sale transaction. It was subsequently expanded to include a review of all material revenue transactions entered into by the Taiwan sales office during fiscal years 2004 through 2006 and our relationship with, and transactions entered into with and by, a reseller in Taiwan. The investigation involved interviews with key employees, resellers and customers, and review of documentation and computer files, including emails.

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Upon the conclusion of this investigation we determined that approximately \$632,000 of revenue that we had previously announced, in the Press Release, as revenue recognized for the fourth quarter of fiscal 2006, would be more appropriately recognized during the first quarter of fiscal 2007. The \$632,000 of revenue is included in revenue for the first quarter of fiscal 2007, and is reflected in our financial statements included in this Form 10-Q. We determined that recognizing this revenue in the first quarter of fiscal 2007 was more appropriate than in the fourth quarter of fiscal 2006, based primarily on certain information uncovered during the investigation, but unknown to us at the time we first announced our results for the fourth quarter of fiscal 2006. This information includes (i) the fact that the reseller entity through which the sale occurred was partially owned by individuals who were, or who were related to, employees of our Taiwan sales office, and (ii) statements made during interviews of representatives of the end-user created uncertainty as to whether the end-user placed the order for the software with the reseller during the fourth quarter of fiscal 2006 or the first quarter of fiscal 2007. Thus, although at the time we announced our preliminary financial results for the fourth quarter of fiscal 2006, we had evidence of sell-through from the reseller to the end-user consistent with our revenue recognition policy, upon receipt of this additional information we deferred recognizing this revenue until June 2006, when additional evidence of sell-through from the reseller to the end-user was received. As a result of the investigation, the Company's management identified and reported to our Audit Committee and independent registered public accounting firm material weaknesses in the Company's internal control over financial reporting as of April 30, 2006, as discussed in Item 9A of our Form 10-K for fiscal 2006 and Item 4 of this Form 10-Q.

These matters were time-consuming, required us to incur significant additional expenses, relating to legal, accounting, tax and other professional services, estimated to be approximately \$4.0 million over the first three quarters of fiscal 2007, of which approximately \$900,000 was incurred and expensed in the three months ended July 31, 2006. We expect to incur significant expenses of the same nature through the remainder of fiscal 2007 in connection with the reviews and restatement, which will adversely affect our results of operations and cash flows in that period.

## **Business Overview**

We develop and sell an integrated suite of product lifecycle management ( PLM ) software products and offer related business consulting and implementation services. Substantially all of our revenues are derived from the license of software products under software license agreements and from the delivery of associated professional and maintenance services. Our solutions enable our customers to accelerate their products time-to-market, reduce costs, improve product quality, manage regulatory compliance and drive innovation throughout the product lifecycle.

We believe that understanding the following key developments is helpful to an understanding of our operating results for fiscal 2007.

### ***Increased Product Breadth***

Over time, we have been able to expand the capability and functionality of our solutions and expand into additional vertical markets. Our initial offering consisted of a single product focused on the electronics and high technology vertical market. Over time, we have added new products and features and functionality to our existing products, both through internal development and acquisition, and expanded into additional vertical markets. With our acquisition of Prodika in June 2006, we expanded our focus in the consumer packaged goods market, particularly in the food and beverage industry. We currently focus on providing PLM solutions to companies in the electronics and high technology, life sciences, consumer packaged goods, automotive, aerospace and defense, industrial products and other industries. Our Agile 9 suite of products is our most comprehensive PLM product offering to date, and provides extensive features and capabilities, as well as an enterprise class and standards based technology platform. Agile e6 products are focused on organizing and managing product design assets to support globally distributed engineering teams in the automotive, aerospace and defense, and industrial products industries. Our Prodika products are focused on providing a comprehensive, end-to-end solution to consumer packaged goods companies, particularly in the food and beverage industry. Our Agile Advantage product is designed to provide the benefits important to small and medium sized enterprises. Our Cimmetry products are focused on enabling the use of two-dimensional and three-dimensional mechanical CAD and electronic CAD and design automation information across the extended enterprise.

### ***Expanded Industry Focus***

Our strategy is industry-focused with product capabilities tailored to the requirements of our target industries. 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, including into the automotive supply chain, aerospace and defense, and industrial product markets. In June 2006, we acquired Prodika, a premier provider of collaborative PLM solutions for consumer packaged goods. With this acquisition, we continue to execute on our strategy of differentiation and market leadership through industry verticals. We believe that consumer packaged goods is one of the largest untapped PLM markets, with little penetration by packaged PLM solutions. While the electronics and high





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technology industry still represents the single largest industry for us, we now have significant customers in all of the following industries:

Electronics and High Technology;

Life Sciences;

Consumer Packaged Goods;

Automotive;

Aerospace and Defense; and

Industrial Products.

## ***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 since August 2003:

*Eigner US Inc.* ( *Eigner* ), acquired in August 2003;

*TRADEC, Inc.* ( *TRADEC* ), acquired in September 2003;

*Cimmetry Systems, Inc.* ( *Cimmetry* ), acquired in February 2005; and

*Prodika, Inc.* ( *Prodika* ), acquired in June 2006.

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 automotive supply chain, industrial equipment, aerospace and defense industries, as well as in certain geographic markets, such as the Central European region. Through the acquisition of TRADEC, we acquired additional functionality to our existing products, as well as new customers. Through the acquisition of Cimmetry, we acquired visual collaboration software that has become an increasingly important element of PLM solutions. As a result of our acquisition of Prodika, we have acquired product lifecycle management solutions for the consumer packaged goods industry, particularly the food and beverage sector. The results of each of these acquisitions are included in our statements of operations, beginning as of the respective acquisition date. Consequently, our consolidated results of operations for the three months ended July 31, 2006 and 2005 include the revenue and expenses related to Eigner, TRADEC and Cimmetry. Our consolidated results of operations for the three months ended July 31, 2006 also includes approximately one month of revenues and expenses related to Prodika.

## **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 revenue is comprised of fees charged for the use of our products licensed under perpetual arrangements. Our service revenue is comprised of fees charged for implementation services and fees charged for post-contract customer support (i.e., technical

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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, or maintenance, 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.

Our year-over-year revenues decreased due to a shortfall in license and related service revenues, primarily in North America. This shortfall was partially offset by an additional \$1.0 million of license revenue in Asia-Pacific, which includes the adjustment of \$632,000 of revenue resulting from the investigation of our Taiwan sales office discussed above, as well as an increase in worldwide maintenance revenue of \$1.4 million. The following also occurred in the quarter:

In June 2006, we completed our acquisition of Prodika, expanding our presence in the consumer packaged goods market.

We improved service margins year-over-year by \$2.3 million, or 25%.

We maintained a cash and investments balance as of July 31, 2006 of \$192.9 million, which represents a decrease of \$10.4 million compared to the balance as of April 30, 2006. This decrease was due to the acquisition of Prodika for \$15.0 million, partially offset by positive operating cash flows of \$5.3 million.

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Due to the amortization of the intangible assets acquired as a result of the Cimmetry and Prodika acquisitions and the adoption of SFAS No. 123R effective in our first quarter of fiscal 2006, we will likely not be profitable on a GAAP basis for the foreseeable future. In addition, we have incurred significant additional expenses, relating to legal, accounting, tax and other professional services in connection with the review of our stock option grant practices and the investigation of our Taiwan sales office, estimated to be approximately \$4.0 million over the first three quarters of fiscal 2007, of which approximately \$900,000 was incurred and expensed in the three months ended July 31, 2006. We expect to incur significant expenses of the same nature through the remainder of fiscal 2007 in connection with these matters, which will adversely affect our results of operations and cash flows in that period. Achieving and sustaining profitable results will depend upon a combination of careful expense management coupled with higher revenue levels. Many of our expenses are relatively fixed in the short term and there can be no assurance that we will be able to maintain expenses at target levels, or that our revenues will increase. As a result, there can be no assurance that we will achieve or maintain profitable operations in the future.

### **Critical Accounting Policies**

We have prepared our condensed consolidated financial statements in accordance with accounting principals 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, stock compensation, and business combinations and acquired intangible assets. Discussion of these critical accounting policies may be found in the

Management's Discussion & Analysis of Financial Condition and Results of Operations section included in our Form 10-K for fiscal 2006. There have been no changes to these critical accounting policies subsequent to April 30, 2006.

### **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.

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|                                        | Three Months Ended<br>July 31, |       |
|----------------------------------------|--------------------------------|-------|
|                                        | 2006                           | 2005  |
| <b>Revenues:</b>                       |                                |       |
| License                                | 33%                            | 39%   |
| Service                                | 67                             | 61    |
| Total revenues                         | 100                            | 100   |
| <b>Cost of revenues:</b>               |                                |       |
| License                                | 2                              | 2     |
| Service (1)                            | 30                             | 34    |
| Amortization of intangible assets      | 3                              | 2     |
| Total cost of revenues                 | 35                             | 38    |
| Gross margin                           | 65                             | 62    |
| <b>Operating expenses:</b>             |                                |       |
| Sales and marketing (1)                | 38                             | 37    |
| Research and development (1)           | 30                             | 24    |
| General and administrative (1)         | 14                             | 10    |
| Amortization of intangible assets      | 2                              | 2     |
| Acquired in-process technology         |                                |       |
| Total operating expenses               | 84                             | 73    |
| Loss from operations                   | (19)                           | (11)  |
| Interest and other income, net         | 7                              | 2     |
| Loss before provision for income taxes | (12)                           | (9)   |
| Provision for income taxes             |                                | 1     |
| Net loss                               | (12)%                          | (10)% |

(1) The amounts in the lines above include stock compensation as follows:

|                            |    |   |
|----------------------------|----|---|
| Cost of service revenue    | 1% | % |
| Sales and marketing        | 3  | 1 |
| Research and development   | 1  |   |
| General and administrative | 2  | 1 |

## Comparison of the Three Months Ended July 31, 2006 and 2005

### Revenues

Our revenues by geographic region for the three months ended July 31, 2006 and 2005 are as follows (in thousands, except percentages):

|               | Three Months<br>Ended<br>July 31, 2006 | Change<br>\$ | %     | Three Months<br>Ended<br>July 31, 2005 |
|---------------|----------------------------------------|--------------|-------|----------------------------------------|
| North America | \$ 20,627                              | \$ (4,059)   | (16)% | \$ 24,686                              |
| Europe        | 8,254                                  | (606)        | (7)%  | 8,860                                  |

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|                |           |            |       |           |
|----------------|-----------|------------|-------|-----------|
| Asia-Pacific   | 2,137     | 1,299      | 155%  | 838       |
| Total revenues | \$ 31,018 | \$ (3,366) | (10)% | \$ 34,384 |

Total revenues for the three months ended July 31, 2006 decreased by \$3.4 million, or 10% from the prior-year period. This decrease was the result of decreases in North America license revenue and Europe professional service revenue,

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partially offset by an increase in Asia-Pacific license revenue, which includes the adjustment of \$632,000 of revenue resulting from the investigation of our Taiwan sales office discussed above. During the three months ended July 31, 2006 and 2005, revenues from customers located outside of North America were approximately 33% and 28% of total revenues, respectively.

In the three months ended July 31, 2006 and 2005, none of our customers accounted for more than 10% of total revenues.

**License Revenue**

The following table sets forth a summary of our license revenue, in absolute dollars and expressed as a percentage of total revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                   | Three Months<br>Ended | Change           | Three Months<br>Ended |
|-----------------------------------|-----------------------|------------------|-----------------------|
|                                   | July 31, 2006         | \$ %             | July 31, 2005         |
| License revenue                   | \$ 10,103             | \$ (3,298) (25)% | \$ 13,401             |
| As a percentage of total revenues | 33%                   |                  | 39%                   |

The decrease in license revenue in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, was primarily related to a decrease in the North American region of \$4.3 million, due principally to the lack of significant transactions in the period, offset by a \$1.0 million increase from Asia-Pacific, which includes the adjustment of \$632,000 of revenue resulting from the investigation of our Taiwan sales office discussed above.

**Service Revenue**

The following table sets forth a summary of our service revenue in absolute dollars and expressed as a percentage of total revenues for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                   | Three Months<br>Ended | Change           | Three Months<br>Ended |
|-----------------------------------|-----------------------|------------------|-----------------------|
|                                   | July 31, 2006         | \$ %             | July 31, 2005         |
| Professional service              | \$ 7,011              | \$ (1,456) (17)% | \$ 8,467              |
| Maintenance                       | 13,904                | 1,388 11%        | 12,516                |
| Total service revenue             | \$ 20,915             | \$ (68) (0)%     | \$ 20,983             |
| As a percentage of total revenues | 67%                   |                  | 61%                   |

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 the initial license sale. As a result, the impact of license revenue on service revenue tends to be delayed by one to two quarters. Additionally, as our maintenance revenue in any given period is derived from a larger customer base than our license revenue in that period, the percentage of increase in maintenance revenue is generally smaller than any percentage of increase in license revenue.

The slight decrease in service revenue in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, resulted from a \$1.5 million decrease in professional services, primarily in Europe, and, to a lesser extent, North America. These decreases in both regions resulted from large engagements winding down and fewer significant license transactions generating significant follow-on service engagements. The decreases were offset by a \$1.4 million increase in maintenance in all regions, as our customer base expands.

**Cost of Revenues****Cost of License Revenue**

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The following table sets forth a summary of our cost of license revenue, in absolute dollars and expressed as a percentage of license revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                    | Three Months<br>Ended | Change  |      | Three Months<br>Ended |
|------------------------------------|-----------------------|---------|------|-----------------------|
|                                    | July 31,<br>2006      | \$      | %    | July 31,<br>2005      |
| Cost of license revenue            | \$ 726                | \$ (46) | (6)% | \$ 772                |
| As a percentage of license revenue | 7%                    |         |      | 6%                    |



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Our cost of license revenue includes license fees due to third parties for technology integrated into or sold with our products, the cost of order processing and fulfillment and the amortization of capitalized software development costs.

Cost of license revenue in absolute dollars during the three months ended July 31, 2006, when compared to the prior-year period, was essentially flat. The increase in cost of license revenue as a percentage of license revenue was primarily due to the increase in sales of products which included more embedded third-party software than we had sold in the prior-year period.

### Cost of Service Revenue

The following table sets forth a summary of our cost of service revenue, in absolute dollars and expressed as a percentage of license revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                                             | Three Months<br>Ended | Change     |       | Three Months<br>Ended |
|-------------------------------------------------------------|-----------------------|------------|-------|-----------------------|
|                                                             | July 31,<br>2006      | \$         | %     | July 31, 2005         |
| Cost of service revenue                                     | \$ 9,040              | \$ (2,550) | (22)% | \$ 11,590             |
| Stock compensation                                          | 215                   | 123        | 134%  | 92                    |
| Total cost of service revenue, including stock compensation | \$ 9,255              | \$ (2,427) | (21)% | \$ 11,682             |
| As a percentage of service revenue                          | 44%                   |            |       | 56%                   |

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 and maintenance renewal 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 embedded into or sold with our products for which our customers have purchased support from us.

The decrease in total cost of service revenue in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, was due to a \$1.7 million decrease in employee costs, resulting from headcount reductions in our professional services organization in our fiscal 2006 restructuring, and a \$1.3 million decrease in third-party consulting costs, partially offset by increased compensation as we invest in our support organization. Through this combination of restructuring and cost management, we more effectively utilized our existing resources, and were able to deliver the same level of service revenues at a substantially reduced cost. As a percentage of service revenue, total cost of service revenue decreased by 12 percentage points in the three months ended July 31, 2006, compared to the prior-year period, due to improved professional service margins as a result of the cost reductions mentioned above.

### 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 expense, which is included in each of the sales and marketing, research and development, and general and administrative categories.

**Table of Contents*****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 months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                                         | Three Months<br>Ended | Change     |       | Three Months<br>Ended |
|---------------------------------------------------------|-----------------------|------------|-------|-----------------------|
|                                                         | July 31, 2006         | \$         | %     | July 31, 2005         |
| Sales and marketing                                     | \$ 10,860             | \$ (1,558) | (13)% | \$ 12,417             |
| Stock compensation                                      | 834                   | 422        | 102%  | 413                   |
| Total sales and marketing, including stock compensation | \$ 11,694             | \$ (1,136) | (9)%  | \$ 12,830             |
| As a percentage of total revenues                       | 38%                   |            |       | 37%                   |

In addition to the common recurring expenditures mentioned above, our sales and marketing expenses include expenditures specific to the sales group, such as sales related commissions, and expenditures specific to the marketing group, such as public relations and advertising, trade shows, marketing collateral and materials, and customer user group meetings, net of fees assessed, if any, for attendance.

The decrease in total sales and marketing expenses in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, was primarily due to a \$800,000 decrease in sales commissions and bonuses associated with lower license revenue and a decrease in headcount resulting from our fiscal 2006 restructuring, a one-time \$400,000 benefit from an employment tax settlement in the United Kingdom and a \$200,000 decrease in outside service costs, partially offset by a \$300,000 increase in stock compensation expense resulting principally from new options granted in the fourth quarter of fiscal 2006.

***Research and Development***

The following table sets forth a summary of our research and development expenses, in absolute dollars and expressed as a percentage of total revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                                              | Three Months<br>Ended | Change   |      | Three Months<br>Ended |
|--------------------------------------------------------------|-----------------------|----------|------|-----------------------|
|                                                              | July 31,<br>2006      | \$       | %    | July 31,<br>2005      |
| Research and development                                     | \$ 8,993              | \$ 833   | 10%  | \$ 8,160              |
| Stock compensation                                           | 232                   | 171      | 280% | 61                    |
| Total research and development, including stock compensation | \$ 9,225              | \$ 1,004 | 12%  | \$ 8,221              |
| As a percentage of total revenues                            | 30%                   |          |      | 24%                   |

In addition to the common recurring expenditures mentioned above, our research and development expenses consist of costs associated with the development of new products, enhancements to existing products, and quality assurance procedures. These costs primarily consist of employee salaries, benefits, consulting costs and the cost of software development tools and equipment.

The increase in total research and development expenses in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, resulted principally from a \$700,000 increase in compensation and benefit costs related to work being performed on the next releases of our products, primarily our Agile 9 suite of products, and a \$200,000 increase in stock compensation expense resulting principally from new options granted in the fourth quarter of fiscal 2006.

***General and Administrative***

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The following table sets forth a summary of our general and administrative expenses, in absolute dollars and expressed as a percentage of total revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                                                | Three Months<br>Ended |        | Change |  | Three Months<br>Ended |
|----------------------------------------------------------------|-----------------------|--------|--------|--|-----------------------|
|                                                                | July 31,<br>2006      | \$     | %      |  | July 31,<br>2005      |
| General and administrative                                     | \$ 3,786              | \$ 538 | 17%    |  | \$ 3,248              |
| Stock compensation                                             | 606                   | 408    | 206%   |  | 198                   |
| Total general and administrative, including stock compensation | \$ 4,392              | \$ 946 | 27%    |  | \$ 3,446              |
| As a percentage of total revenues                              | 14%                   |        |        |  | 10%                   |

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In addition to the common recurring expenditures mentioned above, our general and administrative expenses consist primarily of compensation and benefits costs, including stock compensation, for executive, finance, human resources, legal and administrative personnel, bad debt expense, and other costs associated with being a publicly held company, including SEC and Sarbanes-Oxley compliance (which, in this quarter, included substantial costs relating to the investigation of our Taiwan sales office), director compensation and, from time to time, litigation expenses.

The increase in total general and administrative expenses, in absolute dollars during the three months ended July 31, 2006, compared to the prior-year period, was due to \$900,000 in outside consulting and legal fees, relating primarily to investigations, principally with respect to our Taiwan sales office, and a \$400,000 increase in stock compensation expense resulting principally from new options granted in the fourth quarter of fiscal 2006, offset by a decrease in other consulting costs, primarily related to a decrease in Sarbanes-Oxley compliance costs.

We expect total general and administrative expenses to include significant costs associated with, or resulting from, the investigations described above for the remainder of fiscal 2007.

### Amortization of Intangible Assets

The following table sets forth a summary of our amortization of intangible assets, in absolute dollars and expressed as a percentage of total revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                   | Three Months Ended | Change     | Three Months Ended |
|-----------------------------------|--------------------|------------|--------------------|
|                                   | July 31, 2006      | \$ %       | July 31, 2005      |
| Amortization of intangible assets | \$ 1,509           | \$ 182 14% | \$ 1,327           |
| As a percentage of total revenues | 5%                 |            | 4%                 |

The increase in the amortization of intangible assets, in absolute dollars, during the three months ended July 31, 2006, compared to the prior-year period, was primarily related to the acquisition of Prodika in June 2006.

We have made selective acquisitions of assets and businesses, including certain intangible assets. Intangible assets consist of developed technologies, customer relationships, trademarks and non-compete agreements acquired as part of our acquisitions. Intangible assets are subject to amortization and have original estimated weighted-average useful lives, ranging from one to five years. No significant residual value is estimated for the intangible assets.

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

|                        | July 31, 2006         |                          |                     | April 30, 2006        |                          |                     |
|------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                        | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Intangible Assets:     |                       |                          |                     |                       |                          |                     |
| Developed technologies | \$ 13,400             | \$ (5,708)               | \$ 7,692            | \$ 9,200              | \$ (4,866)               | \$ 4,334            |
| Customer relationships | 9,682                 | (5,691)                  | 3,991               | 6,882                 | (5,094)                  | 1,788               |
| Trademark              | 1,200                 | (360)                    | 840                 | 1,200                 | (300)                    | 900                 |
| Non-compete agreements | 1,280                 | (1,260)                  | 20                  | 1,280                 | (1,250)                  | 30                  |
|                        | \$ 25,562             | \$ (13,019)              | \$ 12,543           | \$ 18,562             | \$ (11,510)              | \$ 7,052            |

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As of July 31, 2006, the estimated future amortization expense of acquired intangible assets is as follows (in thousands):

| <b>Fiscal Years:</b>         |           |
|------------------------------|-----------|
| 2007 (remaining nine months) | \$ 4,473  |
| 2008                         | 4,928     |
| 2009                         | 2,573     |
| 2010                         | 569       |
| Total                        | \$ 12,543 |

We may continue purchasing assets or businesses to accelerate industry or geographic expansion, or increase the features and functions of our products available to our customers. These purchase transactions may result in the creation of additional intangible assets that leads to a corresponding increase in our amortization expense in future periods. In addition, in connection with preparing financial statements for each reporting period, we analyze whether our intangible assets have been impaired and should be written down or off. Our future operating performance could be impacted by the future amortization and/or impairment of intangible assets.

**Interest and Other Income, Net**

The following table sets forth a summary of our interest and other income, net, in absolute dollars and expressed as a percentage of total revenues, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                                   | Three Months<br>Ended<br>July 31,<br>2006 | Change   |      | Three Months<br>Ended<br>July 31,<br>2005 |
|-----------------------------------|-------------------------------------------|----------|------|-------------------------------------------|
|                                   | \$                                        | \$       | %    | \$                                        |
| Interest and other income, net    | \$ 2,344                                  | \$ 1,474 | 169% | \$ 870                                    |
| As a percentage of total revenues | 8%                                        |          |      | 2%                                        |

Interest and other income, net consists of interest earned on cash, cash equivalents, and investments as well as foreign exchange transaction gains and losses and other miscellaneous non-operating transactions.

The increase in interest and other income, net during the three months ended July 31, 2006, compared to the prior-year period, was due principally to substantially higher interest rates and, to a lesser extent, the positive impact of remeasurements of unhedged foreign currency payables.

**Provision for Income Taxes**

The following table sets forth a summary of our provision for income taxes, in absolute dollars, for the three months ended July 31, 2006 and 2005 (in thousands, except percentages).

|                            | Three Months<br>Ended<br>July 31,<br>2006 | Change   |       | Three Months<br>Ended<br>July 31,<br>2005 |
|----------------------------|-------------------------------------------|----------|-------|-------------------------------------------|
|                            | \$                                        | \$       | %     | \$                                        |
| Provision for income taxes | \$ 151                                    | \$ (145) | (49)% | \$ 296                                    |
| Effective income tax rates | 4%                                        |          |       | 10%                                       |

The Company has incurred overall net losses in all fiscal years presented. Our provision for income taxes primarily reflects actual taxes associated with our international operations and deferred tax liabilities related to purchase price accounting allocations. As a result, our effective income tax rates have fluctuated and have not correlated to our operating income or loss. Other than the provision for foreign taxes and the

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deferred tax liability, no provision for income taxes has been recorded since our inception because we have incurred net losses in all periods. We have recorded a valuation allowance for the full amount of our net deferred tax assets, including our net operating loss carryforwards and tax credits, as sufficient uncertainty exists regarding our ability to realize the deferred tax asset balance.

**Table of Contents****Liquidity and Capital Resources****Overview**

Our principal source of liquidity consists of cash, cash equivalents and investments, as follows (in thousands):

|                                      | As of July 31, |            |
|--------------------------------------|----------------|------------|
|                                      | 2006           | 2005       |
| Cash and cash equivalents            | \$ 99,963      | \$ 77,356  |
| Short-term and long-term investments | 92,961         | 121,027    |
|                                      | \$ 192,924     | \$ 198,383 |

Our cash, cash equivalents, and investments are generally placed with high credit quality financial institutions, commercial companies and government agencies in order to limit the amount of credit exposure. As of July 31, 2006, our working capital was \$122.0 million and our days sales outstanding was 62 days.

**Cash Flows**

In summary, our cash flows for the three months ended July 31, 2006 and 2005 were as follows (in thousands):

|                                           | Three Months Ended July 31, |             |
|-------------------------------------------|-----------------------------|-------------|
|                                           | 2006                        | 2005        |
|                                           |                             | As Restated |
| Net cash provided by operating activities | \$ 5,322                    | \$ 604      |
| Net cash used in investing activities     | (32,361)                    | (4,565)     |
| Net cash provided by financing activities | 48                          | 57          |

Cash provided by operating activities during the three months ended July 31, 2006 consists of a net decrease of approximately \$4.5 million in other operating assets and liabilities (primarily a decrease of \$7.0 million in accounts receivable, offset by an increase of \$3.7 million in accrued expenses and other liabilities) and a net loss for the period of \$3.7 million, offset by non-cash items of \$4.5 million (primarily depreciation and amortization and stock compensation). Cash provided by operating activities during the three months ended July 31, 2005 consists of a net increase of approximately \$700,000 in other operating assets and liabilities, and a net loss for the period of \$3.3 million, partially offset by non-cash items of \$3.2 million (primarily depreciation and amortization).

Cash used in investing activities during the three months ended July 31, 2006 resulted principally from \$16.4 million of net purchases of short-term and long-term investments, \$15.0 million paid, net of cash acquired, in connection with the acquisition of Prodika, and \$1.0 million of purchases of property and equipment. Cash used in investing activities during the three months ended July 31, 2005 resulted principally from \$3.3 million of net purchases of short-term and long-term investments and \$1.2 million of purchases of property and equipment.

Cash provided by financing activities during the three months ended July 31, 2006 and 2005 was due to the issuance of common stock associated with the exercise of stock options.

We anticipate that our operating expenses will constitute a material use of our cash resources over the next twelve months, partially offset by anticipated collections of accounts receivable. We may also utilize cash resources to fund acquisitions of investments in complementary businesses, technologies or product lines. In addition, we will withhold shares to cover the minimum potential statutory withholding requirements on each of the vesting dates of our option exchange (during the quarter ended October 31, 2006) and annual performance grants (during the quarter ending April 30, 2007), and pay cash to the tax authorities in the amount of such requirements. We believe that our existing cash, cash equivalents and investments, together with our anticipated cash flows from operations, will be sufficient to meet our working capital and operating expenditure requirements for at least the next twelve months.

**Recent Accounting Pronouncements**

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measures* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), expands disclosures about fair value measurements, and applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the FASB anticipates that for some



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entities, the application of SFAS 157 will change current practice. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 157 will have a material impact on our financial position, results of operations, or cash flows.

In September 2006, the SEC Staff released Staff Accounting Bulletin ( SAB ) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance on the process of quantifying materiality of financial statement misstatements. SAB No. 108 is effective for fiscal years ending after November 15, 2006, with early application for the first interim period ending after November 15, 2006. We do not expect the adoption of SAB No. 108 will have a material impact on our financial position, results of operations, or cash flows.

In July 2006, FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109 ( FIN 48 ), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2008 fiscal year. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently in the process of evaluating the effect of FIN48 on our financial position and results of operations and, therefore, are unable to estimate the effect on our consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. This new standard replaces APB Opinion No. 20, *Accounting Changes in Interim Financial Statements*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and represents another step in the FASB's goal to converge its standards with those issued by the International Accounting Standards Board ( IASB ). Among other changes, SFAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a restatement. The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The adoption of SFAS No. 154 as of May 1, 2006 did not have a material impact on our consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### **Foreign Currency Risk**

We develop and market our products in North America, Europe, and the Asia-Pacific regions. As a result of our non-North American business activities, our financial results could be affected by factors such as changes in foreign currency exchange rates or economic conditions in foreign markets, and there is no assurance that exchange rate fluctuations will not harm our business in the future. We sell our products in certain countries, including Canada, Germany, Japan, Switzerland, United Kingdom and Taiwan, in the local currency for the respective country. This provides some natural hedging because most of the subsidiaries' operating expenses are denominated in their functional currencies. Regardless of this natural hedging, our results of operations may be adversely impacted by the exchange rate fluctuation. Although we will continue to monitor our exposure to currency fluctuations, and, where appropriate, may use financial hedging techniques in the future to minimize the effect of these fluctuations, we are not currently engaged in any financial hedging transactions.

#### **Interest Rate Risk**

Our interest income is sensitive to changes in the general level of U.S. short-term interest rates, particularly since all of our investments are in instruments with maturities of less than two years. The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our entire portfolio of cash in money market funds and investments with maturities of less than two years, which are not subject to significant market risk because the interest paid on such funds fluctuates with the prevailing interest rate.



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The table below represents principal (or notional) amounts and related weighted-average interest rates by year of maturity of our investment portfolio at July 31, 2006 (in thousands, except interest rates).

|                                | Maturing<br>within<br>12 months | Maturing<br>between<br>1 and 2 years | Total      |
|--------------------------------|---------------------------------|--------------------------------------|------------|
| Cash equivalents               | \$ 80,104                       | \$                                   | \$ 80,104  |
| Weighted average interest rate | 5.24%                           | %                                    | 5.24%      |
| Investments                    | \$ 51,168                       | \$ 41,793                            | \$ 92,961  |
| Weighted average interest rate | 4.33%                           | 5.24%                                | 4.74%      |
| Total investment securities    | \$ 131,272                      | \$ 41,793                            | \$ 173,065 |
| Weighted average interest rate | 4.89%                           | 5.24%                                | 4.97%      |

**Item 4. Controls and Procedures****Special Committee and Audit Committee Investigations**

**Stock Options Review.** On October 23, 2006, we concluded that prior period financial statements should be restated to record additional stock compensation expense, resulting from certain stock option grants in prior periods that were incorrectly accounted for under generally accepted accounting principles in the United States ( GAAP ). Our decision to restate our financial statements was based on a review by management and facts obtained during a voluntary independent review into our stock option grants and procedures that was conducted under the direction of a Special Committee of one independent director appointed by the Audit Committee of the Board, with the assistance of independent legal counsel. The review covered option grants made to all employees, directors and non-employees during the period from the date of our initial public offering in August 1999 to July 2006. The Special Committee found instances in which incorrect measurement dates were used to account for certain option grants. In addition, the Company found that it did not appropriately account for certain other aspects of stock compensation expense. However, this finding did not result in a material adjustment to our historical condensed consolidated financial statements. The total cumulative adjustment to stock compensation expense resulting from these findings was \$69.6 million. Accordingly, in our Form 10-K for the year ended April 30, 2006 ( Fiscal 2006 Form 10-K ), the Company included restatements of the following previously filed financial statements and data (and related disclosures): (1) our condensed consolidated financial statements as of and for the fiscal years ended April 30, 2005 and 2004; (2) our selected condensed consolidated financial data as of and for the fiscal years ended April 30, 2005, 2004, 2003 and 2002; and (3) our unaudited quarterly financial data for all quarters in fiscal 2005. Please see Note 2, Restatement of Consolidated Financial Statements, and Note 16 Unaudited Quarterly Consolidated Financial Data, to the consolidated financial statements included in our Fiscal 2006 Form 10-K, and Management's Discussion & Analysis therein, for a detailed discussion of the effect of the restatements and a period-by-period reconciliation of the adjustments.

**Taiwan sales office.** In addition to the restatement described above as a result of our review of our historical stock option grant practices, our consolidated financial statements included in this Form 10-Q reflect adjustments to our financial information previously reported in our press release, dated May 25, 2006, for the quarter and fiscal year ended April 30, 2006 ( Press Release ). The adjustments arose out of an investigation by our Audit Committee, as reported in our Form 8-K filed with the SEC on July 14, 2006, into certain transactions entered into by our Taiwan sales office. The investigation initially centered upon confirmation of the validity of a specific sale transaction. It was subsequently expanded to include a review of all material revenue transactions entered into by the Taiwan sales office during fiscal years 2004 through 2006 and our relationship with, and transactions entered into with and by, a reseller in Taiwan. The investigation involved interviews with key employees, resellers and customers, and review of documentation and computer files, including emails.

Upon the conclusion of this investigation we determined that approximately \$632,000 of revenue that we had previously announced, in the Press Release, as revenue recognized for the fourth quarter of fiscal 2006, would be more appropriately recognized during the first quarter of fiscal 2007. The \$632,000 of revenue is included in revenue for the first quarter of fiscal 2007, and is reflected in our financial statements included in this Form 10-Q. We determined that recognizing this revenue in the first quarter of fiscal 2007 was more appropriate than in the fourth quarter of fiscal 2006, based primarily on certain information uncovered during the investigation, but unknown to us at the time we first announced our results for the fourth quarter of fiscal 2006. This information includes (i) the fact that the reseller entity through which the sale occurred was partially owned by individuals who were, or who were



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related to, employees of our Taiwan sales office, and (ii) statements made during interviews of representatives of the end-user that created uncertainty as to whether the end user placed the order for the software with the reseller during the fourth quarter of fiscal 2006 or the first quarter of fiscal 2007. Thus, although at the time we announced our preliminary financial results for the fourth quarter of fiscal 2006, we had evidence of sell-through from the reseller to the end-user consistent with our revenue recognition policy, upon receipt of this additional information we deferred recognizing this revenue until June 2006, when additional evidence of sell-through from the reseller to the end user was received. As a result of the investigation, the Company's management identified and reported to our Audit Committee and independent registered public accounting firm material weaknesses in the Company's internal control over financial reporting as of April 30, 2006, as discussed in Item 9A of our Fiscal 2006 Form 10-K.

### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended ( "Exchange Act " )) as of July 31, 2006, which included an evaluation of disclosure controls and procedures applicable to the period covered by this Form 10-Q. Based on this evaluation, as a result of the material weaknesses in our internal control over financial reporting that we identified in our Fiscal 2006 Form 10-K, our management concluded that our disclosure controls and procedures were not effective, as of July 31, 2006, at the reasonable assurance level.

These material weaknesses related to our control environment in our Taiwan operations and our controls over reseller revenue. We did not identify any material weaknesses in our internal control over financial reporting as of April 30, 2006 as a result of our review of our historical stock option grants. In addition, we have concluded that our disclosure controls and procedures were effective as relating to our accounting for stock compensation expense as of July 31, 2006. In reaching this determination, management considered, among other things, the conclusions of the Special Committee that, while we used incorrect accounting measurement dates for certain historical stock option grants, those errors were not the result of fraud by current management, and no evidence was found raising concerns about the integrity of current management. In addition, our option grant practices improved significantly beginning in late 2003, when the last grant with a material measurement date discrepancy was made. As a result, management concluded that, although the historical control deficiencies in the accounting for stock compensation expense resulted in the restatements set forth in our Fiscal 2006 Form 10-K, as of July 31, 2006, there were effective controls designed and in place to ensure that information required to be disclosed in our reports filed or submitted under the Securities and Exchange Commission's rules and forms is recorded, processed, summarized and reported within the time periods specified under such rules and forms.

Notwithstanding our conclusion that our disclosure controls were not effective as of July 31, 2006, at the reasonable assurance level, as a result of the material weaknesses identified related to our control environment in our Taiwan operations and in our controls over reseller revenue, we believe our unaudited condensed consolidated financial statements presented in this Form 10-Q fairly present, in all material respects, the Company's financial position, results of operations and cash flows for all periods presented herein.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting or in other factors during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

### **Remediation of Material Weaknesses**

Since the end of our quarter ended July 31, 2006, we have taken significant actions to remediate the material weaknesses noted above, as follows: (i) our program of annual certification by our employees of compliance with our Code of Conduct has been modified to require each employee to certify that he or she is aware of, and familiar with, the Code, understands its contents, has fully complied with it and is not aware of any noncompliance therewith on the part of any other employees, and the Company has provided additional training to employees regarding the Code of Conduct; (ii) processes surrounding our quarterly certifications by our sales personnel have been modified to include additional certifications by employees concerning their understanding of, and compliance with, our revenue recognition policies, and the list of employees who provide certain other quarterly certifications has been expanded; (iii) our employee hiring background review procedures for all prospective employees now includes enhanced background review procedures; (iv) the policies concerning our qualification, retention, monitoring and evaluation of our resellers have been revised to require additional screening procedures in the review and evaluation of prospective resellers; and (v) our standard reseller agreements have been revised to require representations that the reseller is not aware of any conflicts of interest or other relationships between such reseller and us.



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**Limitations on the Effectiveness of Controls**

Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Notwithstanding these limitations, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives at the reasonable assurance level.

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### **PART II OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

##### **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 software products operate substantially in accordance with specifications. Historically, minimal costs have been incurred related to product warranties, and, accordingly, no accruals for warranty costs have been made.

We, as permitted under Delaware law and in accordance with our Bylaws, indemnify our officers, directors and members of our senior management for certain events or occurrences, subject to certain limits, while they were serving at our request in such capacity. In this regard, we have received, or expect to receive, requests for indemnification by certain current and former officers and directors with respect to potential liability in connection with our review of our historic stock option granting practices and the related restatement, related governmental inquiries, and shareholder derivative litigation and class action litigation described below. The maximum amount of potential future indemnification is unknown and potentially unlimited; however, we have directors' and officers' liability insurance policies that enable us to recover a portion of future indemnification claims paid, subject to retentions, conditions and limitations of the policies. As a result of this insurance coverage, we believe that the fair value of these indemnification claims is not material.

##### **Litigation**

##### ***Shareholder derivative lawsuits***

On December 5, 2006, a purported shareholder filed a derivative action in the Federal District Court for the Northern District of California, titled *Meek v. Stolle et al.*, No. C06-7343 RS. Subsequently, three additional derivative actions, with essentially the same allegations as the first, were filed in the same court. Each of the lawsuits is a shareholder derivative lawsuit, brought purportedly on our behalf. Each complaint names as defendants certain directors and current and former officers. The complaints, when read together, allege that the individual defendants caused or allowed backdated stock options to be granted from August 1999 through October 2003, in violation of the federal securities laws and their fiduciary duties to the company and its shareholders. No specific amounts of damages were alleged, although the complaints seek rescission of the options alleged to be backdated and the recovery of profits from the defendants' sales of company stock. It is expected that all of these derivative actions will be consolidated into one action. The Company's board of directors and management intend to review the allegations of the action(s) and will respond in a manner the Board considers to be in the best interests of the shareholders.

##### ***IPO securities class action 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.

The Company is aware that similar allegations have been made in other lawsuits filed in the Federal District Court in the Southern District of New York (the Court) 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,





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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.

The Court has granted preliminary approval of the settlement. It held a hearing on April 24, 2006 to consider final approval of the settlement, and will issue a ruling at some time in the future. On December 5, 2006, the Second Circuit Court of Appeals (which oversees the Court) issued a decision in *In re Initial Public Offering Securities Litigation*, WL 3499937 (2d Cir. Dec. 5, 2006), reversing the Court's ruling certifying six of the cases in the consolidated proceedings as class actions. On December 14, 2006, the Court agreed to stay all proceedings, including consideration of the settlement, pending a decision from the Second Circuit on whether it will hear further argument on the class certification issue.

We are also subject to various other claims and legal actions 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, results of operations, or cash flows.

### **Other commitments**

In connection with our acquisition of Eigner US Inc. (Eigner) in August 2003, we assumed a commitment to purchase consulting services from a vendor to Eigner, which commitment, totaling \$273,000, provides for quarterly payments through the first quarter of our fiscal year ending April 30, 2008.

### **Item 1A. Risk Factors**

There have been no material changes to our Risk Factors as previously disclosed in our Form 10-K for the fiscal year ended April 30, 2006.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not Applicable

### **Item 3. Defaults Upon Senior Securities**

Not Applicable

### **Item 4. Submission Of Matters To A Vote Of Security Holders**

Not Applicable

### **Item 5. Other Information**

Not Applicable

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**Item 6. Exhibits And Reports On Form 8-K**

(a) Exhibits

- 3.1 Certificate of Incorporation of Agile Software Corporation, as amended to date (1)
- 3.2 Certificate of Elimination and Certificate of Amendment (1)
- 3.3 Amended and Restated Bylaws of Agile Software Corporation (2)
- 4.1 Specimen Common Stock Certificate (1)
- 4.2 Form of Rights Agreement between Agile Software Corporation and Fleet National Bank, as Rights Agent (including, as Exhibit A, the form of Certificate of Designation, Preferences and Rights of the Terms of the Series A Preferred Stock, as Exhibit B, the form of Right Certificate, and, as Exhibit C, the Summary of Terms of Rights Agreement) (2)
- 31.1 Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Incorporated by reference to Agile's Registration Statement on Form S-1 (Reg. No. 333-81387), declared effective on August 19, 1999.
  - (2) Incorporated by reference to Agile's Current Report on Form 8-K (file No. 000-27071), filed on April 26, 2001.

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**SIGNATURES**

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

AGILE SOFTWARE CORPORATION

By: /s/ CAROLYN V. AVER  
Carolyn V. Aver

**Executive Vice President and**

**Chief Financial Officer**

**(Principal Accounting Officer)**

Date: March 5, 2007