

AGILE SOFTWARE CORP  
Form 10-Q  
March 13, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended January 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

**AGILE SOFTWARE CORPORATION**

(Exact name of registrant as specified in its charter)

|  |  |
|--|--|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization) | <b>77-0397905</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>6373 San Ignacio Avenue, San Jose, California 95119-1200</b>                      |  |

(Address of principal executive office)

**(408) 284-4000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

An accelerated filer

Or a non-accelerated filer

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

The number of shares of Common Stock of Agile Software Corporation issued and outstanding as of January 31, 2006 was 56,887,908.

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**AGILE SOFTWARE CORPORATION**

**FORM 10-Q**

**JANUARY 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>January 31,<br/>2006</b> | <b>April 30,<br/>2005 (1)</b> |
|--|-----------------------------|-------------------------------|
| <b>ASSETS</b>  |                             |                               |
| Current assets:  |                             |                               |
| Cash and cash equivalents  | \$ 102,078                  | \$ 81,760                     |
| Short-term investments   | 84,216                      | 93,444                        |
| Accounts receivable, net of allowance for doubtful accounts of \$1,823 and \$1,892 as of January 31, 2006 and April 30, 2005, respectively | 22,836                      | 26,899                        |
| Other current assets   | 4,784                       | 5,157                         |
| <b>Total current assets</b>  | <b>213,914</b>              | <b>207,260</b>                |
| Long-term investments  | 14,101                      | 23,176                        |
| Property and equipment, net  | 9,112                       | 10,067                        |
| Intangible assets, net   | 8,404                       | 12,735                        |
| Other assets   | 1,038                       | 1,127                         |
| Goodwill   | 66,713                      | 66,658                        |
| <b>Total assets</b>  | <b>\$ 313,282</b>           | <b>\$ 321,023</b>             |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                             |                               |
| Current liabilities:   |                             |                               |
| Accounts payable   | \$ 7,551                    | \$ 8,409                      |
| Accrued expenses and other liabilities   | 18,115                      | 16,275                        |
| Accrued restructuring, current   | 2,327                       | 2,010                         |
| Deferred revenue   | 26,483                      | 25,190                        |
| <b>Total current liabilities</b>   | <b>54,476</b>               | <b>51,884</b>                 |
| Accrued restructuring, non-current   | 321                         | 615                           |
| Deferred revenue, non-current  | 1,036                       | 1,647                         |
| Other non-current liabilities  | 4,820                       | 5,996                         |
| <b>Total liabilities</b>   | <b>60,653</b>               | <b>60,142</b>                 |
| Commitments and contingencies (Note 8)   |                             |                               |
| Stockholders' equity:  |                             |                               |
| Common Stock   | 57                          | 54                            |
| Additional paid-in capital   | 555,609                     | 551,846                       |
| Notes receivable from stockholders   | (77)                        | (77)                          |
| Unearned stock compensation  |                             | (526)                         |
| Accumulated other comprehensive loss   | 220                         | (1,391)                       |
| Accumulated deficit  | (303,180)                   | (289,025)                     |

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|  |            |            |
|--|------------|------------|
| Total stockholders' equity                 | 252,629    | 260,881    |
| Total liabilities and stockholders' equity | \$ 313,282 | \$ 321,023 |

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(1) Amounts as of April 30, 2005 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)**

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | January 31,<br>2006 | January 31,<br>2005 | January 31,<br>2006 | January 31,<br>2005 |
| <b>Revenues:</b>                                |                     |                     |                     |                     |
| License   | \$ 13,405           | \$ 12,455           | \$ 36,882           | \$ 33,975           |
| Service   | 19,397              | 17,825              | 61,783              | 51,003              |
| Total revenues                                  | 32,802              | 30,280              | 98,665              | 84,978              |
| <b>Cost of revenues:</b>                        |                     |                     |                     |                     |
| License   | 842                 | 1,243               | 2,449               | 3,484               |
| Service (1)                                     | 9,840               | 8,460               | 32,253              | 24,042              |
| Amortization of intangible assets               | 726                 | 178                 | 2,176               | 533                 |
| Total cost of revenues                          | 11,408              | 9,881               | 36,878              | 28,059              |
| Gross margin                                    | 21,394              | 20,399              | 61,787              | 56,919              |
| <b>Operating expenses:</b>                      |                     |                     |                     |                     |
| Sales and marketing (1)                         | 12,376              | 12,043              | 37,538              | 33,501              |
| Research and development (1)                    | 8,923               | 5,651               | 25,678              | 16,496              |
| General and administrative (1)                  | 3,239               | 2,942               | 9,553               | 8,419               |
| Amortization of intangible assets               | 627                 | 357                 | 1,856               | 1,403               |
| Restructuring charges                           | 1,729               |                     | 1,729               | 2,132               |
| Total operating expenses                        | 26,894              | 20,993              | 76,354              | 61,951              |
| Loss from operations                            | (5,500)             | (594)               | (14,567)            | (5,032)             |
| Interest and other income, net                  | 1,597               | 1,169               | 3,751               | 3,047               |
| Income (loss) before provision for income taxes | (3,903)             | 575                 | (10,816)            | (1,985)             |
| Provision for income taxes                      | 237                 | 285                 | 644                 | 820                 |
| Net income (loss)                               | \$ (4,140)          | \$ 290              | \$ (11,460)         | \$ (2,805)          |
| Net income (loss) per share:                    |                     |                     |                     |                     |
| Basic and diluted                               | \$ (0.08)           | \$ 0.01             | \$ (0.21)           | \$ (0.05)           |
| Weighted average shares                         |                     |                     |                     |                     |
| Basic   | 54,808              | 53,058              | 54,052              | 52,732              |
| Diluted   | 54,808              | 54,840              | 54,052              | 52,732              |

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(1) Effective May 1, 2005, Agile adopted FAS 123(R), Share-Based Payments, and uses the modified prospective method to value its share-based payments. Accordingly, for the three and nine months ended January 31, 2006, stock compensation was accounted under FAS 123(R), while for the three and nine months ended January 31, 2005, stock compensation was accounted under APB 25, Accounting for Stock Issued to Employees. See Note 7 - Stock Compensation. The amounts in the tables above includes stock compensation as follows:

|                                 |           |            |           |            |           |              |           |            |
|---------------------------------|-----------|------------|-----------|------------|-----------|--------------|-----------|------------|
| Cost of service revenue         | \$        | 144        | \$        | 36         | \$        | 417          | \$        | 179        |
| Sales and marketing             |           | 462        |           | 87         |           | 1,353        |           | 331        |
| Research and development        |           | 123        |           | 2          |           | 326          |           | 25         |
| General and administrative      |           | 207        |           | 34         |           | 611          |           | 157        |
| <b>Total stock compensation</b> | <b>\$</b> | <b>936</b> | <b>\$</b> | <b>159</b> | <b>\$</b> | <b>2,707</b> | <b>\$</b> | <b>692</b> |

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>Nine Months Ended</b> |                  |
|--|--------------------------|------------------|
|  | <b>January 31,</b>       |                  |
|  | <b>2006</b>              | <b>2005</b>      |
| <b>Cash flows from operating activities:</b>   |                          |                  |
| Net loss   | \$ (11,460)              | \$ (2,805)       |
| Adjustments to reconcile net loss to net cash provided by operating activities:  |                          |                  |
| Provision for doubtful accounts  | 16                       | 413              |
| Depreciation and amortization  | 7,239                    | 5,684            |
| Stock compensation   | 2,707                    | 692              |
| Non-cash portion of restructuring charges  | 265                      | 39               |
| Shares withheld in payment of employee withholding taxes (see Note 7 - Stock Compensation for description of this payment) | (2,695)                  |                  |
| Changes in operating assets and liabilities, net of acquisitions:  |                          |                  |
| Accounts receivable  | 3,663                    | (3,164)          |
| Other assets, current and non-current  | 357                      | (1,209)          |
| Accounts payable   | (691)                    | 1,254            |
| Accrued expenses and other liabilities   | 412                      | (2,679)          |
| Deferred revenue   | 935                      | 3,020            |
| <b>Net cash provided by operating activities</b>   | <b>748</b>               | <b>1,245</b>     |
| <b>Cash flows from investing activities:</b>   |                          |                  |
| Purchases of investments   | (32,123)                 | (92,071)         |
| Proceeds from maturities of investments  | 51,987                   | 133,350          |
| Cash paid in business combinations, net of cash acquired   | 245                      | (761)            |
| Acquisition of property and equipment  | (2,394)                  | (3,188)          |
| <b>Net cash provided by investing activities</b>   | <b>17,715</b>            | <b>37,330</b>    |
| <b>Cash flows from financing activities:</b>   |                          |                  |
| Proceeds from issuance of common stock, net of repurchases   | 1,582                    | 5,265            |
| Repayment of notes receivable from stockholders  |                          | 6                |
| <b>Net cash provided by financing activities</b>   | <b>1,582</b>             | <b>5,271</b>     |
| Effect of exchange rate changes on cash  | 273                      | 1,138            |
| <b>Net increase in cash and cash equivalents</b>   | <b>20,318</b>            | <b>44,984</b>    |
| Cash and cash equivalents at beginning of period   | 81,760                   | 45,337           |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 102,078</b>        | <b>\$ 90,321</b> |

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





**Table of Contents****AGILE SOFTWARE CORPORATION****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Note 1 Summary of Significant Accounting Policies:****Basis of presentation**

The accompanying unaudited condensed consolidated financial statements of Agile Software Corporation and its subsidiaries ( Agile ) have been prepared by us and reflect all adjustments (all of which are normal and recurring in nature) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in accordance with the Securities and Exchange Commission's rules and regulations. These unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended April 30, 2005, included in our Annual Report on Form 10-K filed on July 14, 2005 with the Securities and Exchange Commission ( 2005 10-K ).

**Concentrations of credit risk and significant customers**

In the three and nine months ended January 31, 2006 and nine months ended January 31, 2005, none of our customers accounted for more than 10% of our total revenue. In the three months ended January 31, 2005, one of our customers accounted for 11% of our total revenue. As of January 31, 2006 one of our customers accounted for 12% of our net accounts receivable. As of April 30, 2005, none of our customers accounted for more than 10% of our net accounts receivable.

**Note 2 Net Loss Per Share:**

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

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

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | January 31,<br>2006 | January 31,<br>2005 | January 31,<br>2006 | January 31,<br>2005 |
| <b>Numerator:</b>   |                     |                     |                     |                     |
| Net income (loss)   | \$ (4,140)          | \$ 290              | \$ (11,460)         | \$ (2,805)          |
| <b>Denominator (basic):</b>   |                     |                     |                     |                     |
| Weighted average shares   | 55,974              | 53,058              | 54,440              | 52,738              |
| Weighted average unvested shares of restricted common stock subject to repurchase | (1,166)             |                     | (388)               | (6)                 |
| Denominator for basic calculation   | 54,808              | 53,058              | 54,052              | 52,732              |
| <b>Denominator (diluted):</b>   |                     |                     |                     |                     |
| Weighted average shares   | 55,974              | 53,058              | 54,440              | 52,738              |
| Weighted average unvested shares of restricted common stock subject to repurchase | (1,166)             |                     | (388)               | (6)                 |

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|   |           |         |           |           |
|---|-----------|---------|-----------|-----------|
| Dilutive effect of employee stock options |           | 1,782   |           |           |
| Denominator for diluted calculation       | 54,808    | 54,840  | 54,052    | 52,732    |
| Net income (loss) per share:              |           |         |           |           |
| Basic and diluted                         | \$ (0.08) | \$ 0.01 | \$ (0.21) | \$ (0.05) |

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

|   | Three Months Ended  |               | Nine Months Ended   |               |
|---|---------------------|---------------|---------------------|---------------|
|   | January 31,<br>2006 | 2005          | January 31,<br>2006 | 2005          |
| Unvested common stock subject to repurchase | 1,748               |               | 1,748               |               |
| Options to purchase common stock            | 7,792               | 17,255        | 7,792               | 19,037        |
| <b>Total shares excluded</b>                | <b>9,540</b>        | <b>17,255</b> | <b>9,540</b>        | <b>19,037</b> |

**Note 3 Comprehensive Loss:**

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

|   | Three Months Ended  |                 | Nine Months Ended   |                   |
|---|---------------------|-----------------|---------------------|-------------------|
|   | January 31,<br>2006 | 2005            | January 31,<br>2006 | 2005              |
| Net income (loss)                       | \$ (4,140)          | \$ 290          | \$ (11,460)         | \$ (2,805)        |
| Other comprehensive gain (loss):        |                     |                 |                     |                   |
| Unrealized gain (loss) on investments   | 139                 | (422)           | 1,562               | (586)             |
| Foreign currency translation adjustment | (98)                | (29)            | 49                  | (511)             |
| <b>Other comprehensive gain (loss)</b>  | <b>\$ 41</b>        | <b>\$ (451)</b> | <b>\$ 1,611</b>     | <b>\$ (1,097)</b> |
| <b>Total comprehensive loss</b>         | <b>\$ (4,099)</b>   | <b>\$ (161)</b> | <b>\$ (9,849)</b>   | <b>\$ (3,902)</b> |

**Note 4 Business Combinations - Cimmetry:**

On February 3, 2005, we acquired substantially all of the assets and assumed certain liabilities of Cimmetry Systems, Inc. ( Cimmetry ), a privately held company. Cimmetry is a leading provider of visualization and collaboration solutions. Through the acquisition of Cimmetry we acquired visual collaboration software that has become an increasingly important element of PLM solutions. Under the terms of the acquisition, we paid approximately \$44.0 million in cash. We funded the consideration from our current investments. We had been partnering with Cimmetry for a number of years to solve critical viewing and collaboration issues and, prior to the acquisition, we integrated the Cimmetry software into our products under a license from Cimmetry.

The transaction was accounted for under the purchase method of accounting and, accordingly, the results of operations of Cimmetry have been included in the accompanying condensed 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.

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The aggregate purchase price for the Cimmetry 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 the 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 23%, estimates of revenue growth, maintenance renewal rates, cost of sales, operating expenses and taxes. The purchase price in excess of the identified tangible and intangible assets was allocated to goodwill.

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The aggregate purchase price for the Cimmetry 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):

|  | <b>Cimmetry</b> |
|--|-----------------|
| Tangible assets acquired:                |                 |
| Cash and cash equivalents                | \$              |
| Accounts receivable                      | 3,528           |
| Property and equipment                   | 135             |
| Other assets                             | 140             |
| Liabilities assumed:                     |                 |
| Accounts payable                         | (353)           |
| Accrued expenses and other liabilities   | (1,087)         |
| Deferred revenue                         | (1,524)         |
| Identifiable intangible assets acquired: |                 |
| In-process research and development      | 1,700           |
| Other identifiable intangible assets:    |                 |
| Developed technology                     | 6,600           |
| Customer relationships                   | 2,400           |
| Trademark                                | 1,200           |
| Non-compete agreements                   | 80              |
| Goodwill                                 | 31,228          |
| <br>Total                                | <br>\$ 44,047   |

**Note 5 Goodwill and Intangible Assets:****Goodwill**

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

|  | <b>(in thousands)</b> |
|--|-----------------------|
| Balance as of April 30, 2005                   | \$ 66,658             |
| Cimmetry purchase price allocation adjustments | 55                    |
| <br>Balance as of January 31, 2006             | <br>\$ 66,713         |

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

As at January 31, 2006, \$31.2 million of goodwill is deductible for tax purpose.



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

|                        | January 31, 2006      |                          |                     | April 30, 2005        |                          |                     |
|------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                        | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Intangible Assets:     |                       |                          |                     |                       |                          |                     |
| Developed technologies | \$ 9,200              | \$ (4,141)               | \$ 5,059            | \$ 9,200              | \$ (1,965)               | \$ 7,235            |
| Customer relationships | 6,882                 | (4,537)                  | 2,345               | 7,182                 | (2,892)                  | 4,290               |
| Trademark              | 1,200                 | (240)                    | 960                 | 1,200                 | (60)                     | 1,140               |
| Non-compete agreements | 1,280                 | (1,240)                  | 40                  | 1,280                 | (1,210)                  | 70                  |
|                        | \$ 18,562             | \$ (10,158)              | \$ 8,404            | \$ 18,862             | \$ (6,127)               | \$ 12,735           |

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

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

| <b>Fiscal Years:</b>          |          |
|-------------------------------|----------|
| 2006 (remaining three months) | \$ 1,352 |
| 2007                          | 4,037    |
| 2008                          | 2,595    |
| 2009                          | 240      |
| 2010                          | 180      |
| Total                         | \$ 8,404 |

**Note 6 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 January 31, 2006, \$666,000 of the 2003 Restructuring obligations remained, which represents costs related to excess facilities.

During the second quarter of fiscal 2004, we recorded restructuring charges of \$8.7 million (the 2004 Restructuring) as follows:



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

In connection with our acquisition of Eigner US, Inc. during the second quarter of fiscal 2004, we recorded an additional restructuring charge of \$1.2 million, primarily related to the severance, benefits, payroll taxes and other associated costs of the termination of 33 Agile employees.

As of January 31, 2006, none of the 2004 Restructuring obligations remained.

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

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recorded a restructuring charge of \$2.1 million. As of January 31, 2006, \$420,000 of the 2005 Restructuring obligations remained, which represents costs related to severance.

In the third quarter of fiscal 2006, we announced a further restructuring involving termination of 18 employees and closure of our facility in Massachusetts ( 2006 Restructuring ). In connection with these actions, we incurred a restructuring charge of approximately \$1.6 million, which is comprised of severance payments of approximately \$1.4 million and facilities and asset abandonment costs of approximately \$191,000. 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 our 2003 Restructuring. As of January 31, 2006, \$1.5 million of the 2006 Restructuring obligations remained, which represents costs related to employee termination and excess facilities.

We review the assumptions used in estimating our restructuring charges, principally sublease income expectations for excess facilities and employee termination expenses, quarterly. 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 nine months ended January 31, 2006 are as follows (in thousands):

|   | Employee<br>Termination<br>Costs | Facility-<br>Related Costs | Asset<br>Abandonment<br>Costs | Total    |
|---|----------------------------------|----------------------------|-------------------------------|----------|
| Restructuring obligations at April 30, 2005   | \$ 420                           | \$ 2,205                   | \$                            | \$ 2,625 |
| 2006 Restructuring charges                    | 1,445                            | 200                        | 84                            | 1,729    |
| Cash payments                                 | (85)                             | (1,537)                    |                               | (1,622)  |
| Non-cash charges                              |                                  |                            | (84)                          | (84)     |
| Restructuring obligations at January 31, 2006 | \$ 1,780                         | \$ 868                     | \$                            | \$ 2,648 |
| Accrued restructuring, current                |                                  |                            |                               | \$ 2,327 |
| Accrued restructuring, non-current            |                                  |                            |                               | 321      |
|   |                                  |                            |                               | \$ 2,648 |

The remaining employee termination and facility-related obligations are expected to be paid through the quarter ending January 31, 2008.

**Note 7 Stock Compensation**

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), *Share-Based Payment*, effective May 1, 2005. SFAS 123R requires the recognition of the fair value of stock compensation in net income. 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 is accounted for as an equity instrument. Prior to May 1, 2005, we followed Accounting Principles Board ( APB ) Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for our stock compensation.

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We elected the modified prospective method in adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. Our unearned stock compensation balance of \$526,000 as of April 30, 2005, which was accounted for under APB 25, was reclassified into our additional paid-in-capital upon the adoption of SFAS 123R. In addition, the unrecognized expense of awards not yet vested at the date of adoption is recognized in net income in the periods after the date of adoption using the same valuation method (*i.e.* Black-Scholes) and assumptions determined under the original provisions of SFAS 123, *Accounting for Stock-Based Compensation*, as disclosed in our previous filings. The cumulative effect of the change in accounting principle from APB 25 to SFAS 123R was not material.

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## AGILE SOFTWARE CORPORATION

## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Under the provisions of SFAS 123R, we recorded \$936,000 and \$2,707,000 of stock compensation on our unaudited condensed consolidated statement of operations for the three and nine months ended January 31, 2006, respectively. We utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted after the adoption of SFAS 123R, with the following weighted-average assumptions:

|                                 | Three Months Ended |          | Nine Months Ended |          |
|---------------------------------|--------------------|----------|-------------------|----------|
|                                 | January 31, 2006   |          | January 31, 2006  |          |
|                                 | Stock              | Purchase | Stock             | Purchase |
|                                 | Option Plan        | Plan     | Option Plan       | Plan     |
| Dividend yield                  |                    |          |                   |          |
| Expected volatility             | 56%                | 34%      | 61%               | 34%      |
| Average risk-free interest rate | 4.37%              | 4.30%    | 3.98%             | 3.76%    |
| Expected life (in years)        | 4.5                | .5       | 4.5               | .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 grant. The expected life calculation is based on the observed and expected time to post-vesting exercise and forfeitures of option by our employees.

Based on the above assumptions, the weighted-average fair values of the options granted under the stock option plans (excluding options issued under the option exchange discussed below) and shares subject to purchase under the employee stock purchase plan for the three months ended January 31, 2006 were \$4.60 and \$1.69, respectively. The weighted-average fair values of the options granted under the stock option plans (excluding the option exchange discussed below) and shares subject to purchase under the employee stock purchase plan for the nine months ended January 31, 2006 were \$4.70 and \$1.71, 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.

SFAS 123R requires us to present pro forma information for the comparative period prior to the adoption as if we had accounted for all our employee stock options under the fair value method of the original SFAS 123. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation in the prior-year periods (dollars in thousands, except per-share data).

|  | Three Months Ended |         | Nine Months Ended |          |
|--|--------------------|---------|-------------------|----------|
|  | January 31, 2005   |         | January 31, 2005  |          |
| Net loss as reported   | \$                 | 290     | \$                | (2,805)  |
| Add: employee stock compensation included in reported net loss |                    | 159     |                   | 696      |
| Less: employee stock compensation under SFAS No. 123           |                    | (5,446) |                   | (16,403) |

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|  |    |         |    |          |
|--|----|---------|----|----------|
| Pro forma net loss                               | \$ | (4,997) | \$ | (18,512) |
| Net loss per basic and diluted share as reported | \$ | 0.01    | \$ | (0.05)   |
| Pro forma net loss per basic and diluted share   | \$ | (0.09)  | \$ | (0.35)   |

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During the three months ended January 31, 2005, 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 were \$4.20 and \$1.99, respectively. During the nine months ended January 31, 2005, 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 were \$4.17 and \$2.31, respectively. We utilized the Black-Scholes valuation model for estimating these fair values, with the following weighted-average assumptions:

|                                 | Three Months Ended |               | Nine Months Ended |               |
|---------------------------------|--------------------|---------------|-------------------|---------------|
|                                 | January 31, 2005   |               | January 31, 2005  |               |
|                                 | Option Plan        | Purchase Plan | Option Plan       | Purchase Plan |
| Dividend yield                  |                    |               |                   |               |
| Expected volatility             | 43%                | 38%           | 44%               | 40%           |
| Average risk-free interest rate | 3.75%              | 2.63%         | 3.61%             | 2.36%         |
| Expected life (in years)        | 5                  | .5            | 5                 | .5            |

The amortization of stock compensation under SFAS 123R for the period after its adoption, and under APB 25 or SFAS 123 (pro forma disclosure) for the period prior to its adoption was done in accordance with Financial Accounting Standard Board ( FASB ) Interpretation ( FIN ) No. 28 (i.e. accelerated method). Total compensation cost of options and restricted stocks granted but not yet vested, as of January 31, 2006, was \$6.1 million, which is expected to be recognized over the weighted average period of 1.7 years.

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

|                               | Shares Available for Grant | Number Outstanding | Weighted                         | Weighted                                   | Aggregate |
|-------------------------------|----------------------------|--------------------|----------------------------------|--|-----------|
|                               |                            |                    | Average Exercise Price per Share | Average Remaining Contractual Term (years) |           |
| Balance at April 30, 2005     | 6,993                      | 19,323             | \$ 9.24                          |  |           |
| Options authorized            | 1,000                      |                    |                                  |  |           |
| Options granted               | (4,665)                    | 4,665              | 0.81                             |  |           |
| Options exercised             |                            | (3,647)            | 0.13                             |  |           |
| Options canceled              | 12,549                     | (12,549)           | 10.68                            |  |           |
| Unvested shares repurchased   |                            |                    |                                  |  |           |
| Balance at January 31, 2006   | 15,877                     | 7,792              | \$ 6.13                          | 7.1  | \$ 7,441  |
| Exercisable, January 31, 2006 |                            | 5,476              | \$ 7.15                          | 7.1  | \$ 3,838  |

(1)

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The aggregate intrinsic value on this table was calculated based on the positive difference between the closing price of our common stock on January 31, 2006 (i.e. \$6.43) and the exercise price of the underlying options. During the three and nine month periods ended January 31, 2006, the total intrinsic value of stock options exercised was \$17.6 million and \$22.2 million, respectively.

### *Stock Option Acceleration*

On April 30, 2005, our Board of Directors approved the acceleration of the vesting of stock options held by employees and officers under its stock option plans with an exercise price of \$6.76 or higher. Options held by non-employee directors were excluded from the vesting acceleration. The closing price of the Company's common stock on April 28, 2005, the last trading day before approval of acceleration, was \$6.58. The accelerated options are immediately exercisable by employees without any employment-related restriction, but as a condition to the acceleration and to avoid any unintended personal benefits, we also imposed a holding period on shares underlying the accelerated options that will require all optionees to refrain from selling any shares acquired upon the exercise of the options until the date on which such shares would have vested under the options' original vesting terms.

The primary purpose of the accelerated vesting was to reduce future compensation expense associated with the accelerated stock options upon the planned adoption of SFAS 123R. The acceleration eliminated approximately \$24.7 million in future compensation charges we would otherwise have taken with respect to the accelerated options. Based on its consideration of the expense savings and the current intrinsic and perceived value of the accelerated stock options, the Company's Board of Directors believes that the acceleration is in the best interests of the Company and its shareholders. The

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**AGILE SOFTWARE CORPORATION**

**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Board of Directors further believes that the acceleration is consistent with anticipated changes in the Company's overall equity compensation approach, which are expected to include a reduced use of stock options.

***Option Exchange/Shares Withheld***

On July 11, 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 new options vest over a period of approximately two years (one-third on December 1, 2005, one-third on September 1, 2006 and one-third on June 1, 2007). Participation in the offer was voluntary, and was limited to then-current employees. Non-employee members of the board of directors were not eligible to participate. At the time the offer was made, there were options to purchase 19.1 million shares outstanding, of which options to purchase approximately 14 million shares were eligible for exchange in the exchange offer.

On midnight of August 19, 2005, the exchange offer expired. Of the approximately 14 million options eligible to participate in the exchange offer, approximately 11.6 million options were surrendered and exchanged into approximately 3.9 million new options, with an exercise price equal to our common stock par value of \$0.001, on the next business day (August 22, 2005). As a result of the exchange, our total number of options outstanding (overhang) decreased by approximately 7.7 million. For financial accounting purposes, the exchange resulted in an additional stock compensation of \$315,000, which will be recognized over the approximately two-year vesting term of the new options or restricted stock.

These new options granted to U.S. employees (including U.S. taxpayers employed in India) were immediately exercisable for restricted stock and could only be exercised through November 30, 2005. The restricted stock also vests over the same period of approximately two years. Each time the restricted stock purchased on exercise of a new option vests, we will 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. On the first vesting date of December 1, 2005, we withheld 388,000 shares of restricted stock for this purpose, and paid approximately \$2.4 million to the Internal Revenue Service and state tax authorities for the withholding tax obligations due on the vested shares. The amount of this tax payment, together with other tax obligations of approximately \$300,000 incurred as a result of other option exercises during the period, for an aggregate cash payment of \$2.7 million, is included as an adjustment to our accumulated deficit and under cash flows from operating activities for the nine months ended January 31, 2006.

***Unearned stock compensation***

Prior to the adoption of SFAS 123R, we recorded unearned stock compensation when we issued restricted common stock or options to purchase common stock with exercise prices below fair value at the date of grant. Stock compensation was recognized as an expense over the applicable vesting period of the related options, generally five years.

During the three and nine months ended January 31, 2005, we terminated employment of individuals for whom we had recorded unearned stock compensation and had recognized related expense on an accelerated basis. Upon termination, we recorded as a recovery within the statements of operations the difference between the actual expenses recorded using the accelerated method and the expense that would have been recorded under the straight-line method. Additionally, during the three and nine months ended January 31, 2005, the termination of these individuals reduced unearned stock compensation, which would have been amortized to future expense, by \$2,000 and \$44,000, respectively.



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

|                              | <b>Three Months Ended</b> | <b>Nine Months Ended</b> |
|------------------------------|---------------------------|--------------------------|
|                              | <b>January 31, 2005</b>   | <b>January 31, 2005</b>  |
| Amortization - employees     | \$ 161                    | \$ 703                   |
| Amortization - non-employees |                           | (4)                      |
| Recovery - employees         | (2)                       | (7)                      |
| Total stock compensation     | \$ 159                    | \$ 692                   |

**Note 8 Commitments and Contingencies:****Indemnification obligations**

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

**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 Southern District of New York challenging over 300 other initial public offerings and secondary offerings conducted in 1999 and 2000. Those cases have been consolidated for pretrial purposes before the Honorable Judge Shira A. Scheindlin. On July 15, 2002, the Agile Defendants (as well as all other issuer defendants) filed a motion to dismiss the complaint. On February 19, 2003, the Court ruled on the motions to dismiss. The Court denied the motions to dismiss claims under the Securities Act of 1933 in all but 10 of the cases. In the case involving the Company, these claims were dismissed as to the initial public offering, but not the secondary offering. The Court denied the motion to dismiss the claim under Section 10(a) of the Securities Exchange Act of 1934 against the Company and 184 other issuer defendants, on the basis that the amended complaints in these cases alleged that the respective

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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.

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The Court has granted preliminary approval of the settlement and set a final approval hearing date of April 24, 2006.

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 or results of operations.

**Note 9 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.

The following geographic information is presented for the three and nine months ended January 31, 2006 and 2005 (in thousands):

|               | Three Months Ended |           | Nine Months Ended |           |
|---------------|--------------------|-----------|-------------------|-----------|
|               | January 31,        |           | January 31,       |           |
|               | 2006               | 2005      | 2006              | 2005      |
| Revenues:     |                    |           |                   |           |
| North America | \$ 22,787          | \$ 20,996 | \$ 70,096         | \$ 57,207 |
| Europe        | 8,160              | 7,675     | 23,781            | 21,909    |
| Asia-Pacific  | 1,855              | 1,609     | 4,788             | 5,862     |
|               | \$ 32,802          | \$ 30,280 | \$ 98,665         | \$ 84,978 |

No single customer has accounted for 10% or more of total revenues for the three and nine months ended January 31, 2006 and for the nine months ended January 31, 2005. In the three months ended January 31, 2005, one of our customers accounted for 11% of our total revenue.

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

|                    | January 31, | April 30, |
|--------------------|-------------|-----------|
|                    | 2006        | 2005      |
| Long-lived assets: |             |           |
| North America      | \$ 7,483    | \$ 8,335  |
| Europe             | 1,123       | 1,401     |
| Asia-Pacific       | 506         | 331       |
|                    | \$ 9,112    | \$ 10,067 |



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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 to 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 are forward-looking statements. Our actual results and the timing of certain events may differ materially from those reflected in or contemplated by 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 Annual Report of Form 10-K, filed on July 14, 2005. 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.

### **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 time-to-market and revenue, reduce costs, improve product quality, achieve 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 2006.

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

We sold our first PLM product in 1996. At that time, our offering consisted of a single product. Over time, we added new products and features and functionality to our existing products, both through internal development and acquisition. In January 2004, we began shipping Agile 9, our most comprehensive PLM product offering to date. Agile 9 provides extensive new features and capabilities, as well as an enterprise technology platform providing customers a broader, deeper PLM solution.

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

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

Electronics and high technology;

Industrial products;

Life sciences;

Consumer-packaged goods; and

Others.

#### ***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 December 2002:

*oneRev, Inc. ( oneRev ),* acquired in December 2002;

*ProductFactory, Inc. ( ProductFactory ),* acquired in March 2003;

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

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

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

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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. The results of all of these acquisitions are included in our statements of operations beginning as of the respective acquisition date.

### ***Restructurings***

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

In fiscal 2003, we evaluated economic conditions and initiated a restructuring of our operations. During the second quarter of fiscal 2003, we recorded a restructuring charge of \$5.2 million, primarily related to the consolidation of excess facilities and the abandonment of excess property and equipment;

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

During the second quarter of fiscal 2004, in connection with our acquisition of Eigner, we recorded an additional restructuring charge of \$1.2 million, primarily related to a reduction of 33 employees to eliminate duplicative activities and reduce the cost structure of the combined company;

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

During the third quarter of fiscal 2006, we terminated a further 18 employees and closed our facility in Massachusetts ( 2006 Restructuring ). In connection with these actions, we incurred a restructuring charge of approximately \$1.6 million, which is comprised of severance payments of approximately \$1.4 million and facilities and asset abandonment costs of \$191,000. 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 a result of our 2006 Restructuring effort, we expect to realize approximately \$800,000 of reduction per quarter in our cost of service revenue and operating expenses.

### **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 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 increased as a result of the addition of revenue from Cimmetry, which we acquired in February 2005. We were able to achieve the following results in the third quarter of fiscal 2006:

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We recorded third quarter total revenues of \$32.8 million, an 8% increase from total revenues of \$30.3 million in the prior-year period.

Our license revenue for the third quarter was \$13.4 million, an 8% increase from license revenue of \$12.5 million in the prior-year period.



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Even after the inclusion of \$2.7 million of shares withheld in payment of employee withholding taxes (see Note 7 – Stock Compensation), we still had positive operating cash flows for the nine months ended January 31, 2006 of \$748,000. In addition, we maintained a cash and investments balance as of January 31, 2006 of \$200.4 million.

We released Agile 9.2 in December 2005, our most up-to-date and comprehensive offering of a PLM product. Due to the amortization of the intangible assets acquired as a result of the Cimmetry acquisition 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. Achieving and sustaining profitable results, even on a non-GAAP basis, 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, investments, prepaid software license fees, restructuring reserves, sales commission, stock options, and business combinations and acquired intangible assets, which are described below. In addition, please refer to Note 1 of our audited consolidated financial statements in our 2005 10-K for further discussion of our significant accounting policies.

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), *Share-Based Payment*, effective May 1, 2005. SFAS 123R is a new and very complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility and expected option lives, as well as expected option forfeiture rates, to value equity-based compensation. There is little experience or guidance available with respect to developing these assumptions and models. There is also uncertainty as to how the standard will be interpreted and applied as more companies adopt the standard and companies and their advisors gain experience with the standard. SFAS 123R requires the recognition of the fair value of stock compensation in net income. Refer to Note 7 – Stock Compensation in our notes to our unaudited condensed consolidated financial statements included elsewhere in this quarterly report on form 10-Q for more discussion of our adoption of SFAS 123R.

Additional information about these critical accounting policies may be found in the Management’s Discussion & Analysis of Financial Condition and Results of Operations section included in our Annual Report on Form 10-K for the fiscal year ended April 30, 2005. There have been no changes to these critical accounting policies subsequent to April 30, 2005, other than the adoption of SFAS 123R.

**Table of Contents****Results of Operations**

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

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | January 31,<br>2006 | January 31,<br>2005 | January 31,<br>2006 | January 31,<br>2005 |
| <b>Revenues:</b>                                |                     |                     |                     |                     |
| License   | 41%                 | 41%                 | 37%                 | 40%                 |
| Service   | 59                  | 59                  | 63                  | 60                  |
| Total revenues                                  | 100                 | 100                 | 100                 | 100                 |
| <b>Cost of revenues:</b>                        |                     |                     |                     |                     |
| License   | 3                   | 4                   | 2                   | 4                   |
| Service   | 30                  | 28                  | 33                  | 28                  |
| Amortization of intangible assets               | 2                   | 1                   | 2                   | 1                   |
| Total cost of revenues                          | 35                  | 33                  | 37                  | 33                  |
| Gross margin                                    | 65                  | 67                  | 63                  | 67                  |
| <b>Operating expenses:</b>                      |                     |                     |                     |                     |
| Sales and marketing:                            | 38                  | 39                  | 38                  | 39                  |
| Research and development:                       | 27                  | 19                  | 26                  | 19                  |
| General and administrative:                     | 10                  | 10                  | 10                  | 10                  |
| Amortization of intangible assets               | 2                   | 1                   | 2                   | 2                   |
| Restructuring and other charges                 | 5                   |                     | 2                   | 3                   |
| Total operating expenses                        | 82                  | 69                  | 78                  | 73                  |
| Loss from operations                            | (17)                | (2)                 | (15)                | (6)                 |
| Interest and other income, net                  | 5                   | 4                   | 4                   | 4                   |
| Income (loss) before provision for income taxes | (12)                | 2                   | (11)                | (2)                 |
| Provision for income taxes                      | 1                   | 1                   | 1                   | 1                   |
| Net loss  | (13)%               | 1%                  | (12)%               | (3)%                |

Effective May 1, 2005, Agile adopted FAS 123(R), Share-Based Payments, and uses the modified prospective method to value its share-based payments. Accordingly, for the three and nine months ended January 31, 2006, stock compensation was accounted under FAS 123(R), while for the three and nine months ended January 31, 2005, stock compensation was accounted under APB 25, Accounting for Stock Issued to Employees. See Note 7 - Stock Compensation. The amounts in the tables above includes stock compensation as follows:

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

|                          |    |    |    |    |
|--------------------------|----|----|----|----|
| Total stock compensation | 2% | 1% | 3% | 1% |
|--------------------------|----|----|----|----|

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

#### Revenues

Total revenues for the three months ended January 31, 2006 increased by \$2.5 million, or 8%, from the prior-year period. This increase was attributable to the acquisition of Cimmetry, and the increased product offering associated with the acquisition. To a lesser extent, the increase was also attributable to revenue from Europe, partially offset by a decrease in other North American revenue. Total revenues for the nine months ended January 31, 2006 increased by \$13.7 million, or 16%, from the prior-year period. This increase was primarily attributable to the acquisition of Cimmetry, and the increased product offering associated with the acquisition, as well as other increases in revenue in North America.

In the three and nine months ended January 31, 2006 and in the nine months ended January 31, 2005, none of our customers accounted for more than 10% of our total revenue. In the three months ended January 31, 2005, one of our customers accounted for 11% of our total revenue. As of January 31, 2006 one of our customers accounted for 12% of our net accounts receivable. As of April 30, 2005, none of our customers accounted for more than 10% of our net accounts receivable.

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

|               | Three Months Ended |           | Nine Months Ended |           |
|---------------|--------------------|-----------|-------------------|-----------|
|               | January 31, 2006   | 2005      | January 31, 2006  | 2005      |
| Revenues:     |                    |           |                   |           |
| North America | \$ 22,787          | \$ 20,996 | \$ 70,096         | \$ 57,207 |
| Europe        | 8,160              | 7,675     | 23,781            | 21,909    |
| Asia-Pacific  | 1,855              | 1,609     | 4,788             | 5,862     |
|               | \$ 32,802          | \$ 30,280 | \$ 98,665         | \$ 84,978 |

During the three months ended January 31, 2006 and 2005, revenues from customers located outside of North America were approximately 31% of total revenues. During the nine months ended January 31, 2006 and 2005, revenues from customers located outside of North America were approximately 29% and 33% of total revenues, respectively. Revenues from customers located outside of North America during those periods were derived primarily from sales to customers in Europe.

**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 and nine months ended January 31, 2006 and 2005.

|                                   | Three Months Ended |           |          | Nine Months Ended |           |          |
|-----------------------------------|--------------------|-----------|----------|-------------------|-----------|----------|
|                                   | January 31, 2006   | 2005      | % Change | January 31, 2006  | 2005      | % Change |
| License revenue                   | \$ 13,405          | \$ 12,455 | 8%       | \$ 36,882         | \$ 33,975 | 9%       |
| As a percentage of total revenues | 41%                | 41%       |          | 37%               | 40%       |          |

The increase in license revenue in absolute dollars during the three and nine months ended January 31, 2006, when compared to the prior-year period, was due to the addition of revenue from Cimmetry and, to a lesser extent, an increase in revenue in Europe, partially offset by a decrease in other North American license revenue due to relatively lower average deal size. A majority of Cimmetry's revenue is derived from customers located in North America.

We are not in a position to estimate how license revenue for the three months ending April 30, 2006 will compare to license revenue for the previous quarter, given the lack of predictability of closing licensing transactions in any particular quarter.

**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 and nine months ended January 31, 2006 and 2005.

|  | Three Months Ended                 |      |          | Nine Months Ended                  |      |          |
|--|------------------------------------|------|----------|------------------------------------|------|----------|
|  | January 31, 2006                   | 2005 | % Change | January 31, 2006                   | 2005 | % Change |
|  | (in thousands, except percentages) |      |          | (in thousands, except percentages) |      |          |

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|                              |                  |                  |           |                  |                  |            |
|------------------------------|------------------|------------------|-----------|------------------|------------------|------------|
| Professional service         | \$ 6,467         | \$ 7,004         | (8%)      | \$ 23,008        | 19,319           | 19%        |
| Maintenance                  | 12,930           | 10,821           | 19%       | 38,775           | 31,684           | 22%        |
| <b>Total service revenue</b> | <b>\$ 19,397</b> | <b>\$ 17,825</b> | <b>9%</b> | <b>\$ 61,783</b> | <b>\$ 51,003</b> | <b>21%</b> |

As a percentage of total revenues

59%

59%

63%

60%

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 positive or negative impact on service revenue of increasing or decreasing license 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 or decrease in maintenance revenue is generally smaller than the percentage of increase

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or decrease in license revenue in that period. Service revenue in our quarters ending January 31 are adversely affected by the impact of the holidays on the number of available working days during the quarter.

The increase in service revenue in absolute dollars for the three and nine months ended January 31, 2006, compared to the prior-year periods, was primarily derived from a \$2.0 million and \$6.2 million increase in North American maintenance revenue, respectively, approximately 60% of which was derived from Cimmetry and the remainder was derived from our other North American region. For the three months ended January 31, 2006, this increase was partially offset by the anticipated impact of the holidays, resulting in lower utilization, as well as a lower number of new professional service engagements started in our third quarter of fiscal 2006 as a result of lower second quarter license revenue. For the nine months ended January 31, 2006, professional service revenue also increased by \$3.7 million, primarily in our North American region.

For the three months ending April 30, 2006, we expect service revenue to increase slightly as a result of higher license revenue in the previous quarter.

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

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 and nine months ended January 31, 2006 and 2005.

|                                    | Three Months Ended                 |          |       | Nine Months Ended                  |          |       |
|------------------------------------|------------------------------------|----------|-------|------------------------------------|----------|-------|
|                                    | January 31,                        |          | %     | January 31,                        |          | %     |
|                                    | 2006                               | 2005     |       | 2006                               | 2005     |       |
|                                    | (in thousands, except percentages) |          |       | (in thousands, except percentages) |          |       |
| Cost of license revenue            | \$ 842                             | \$ 1,243 | (32%) | \$ 2,449                           | \$ 3,484 | (30%) |
| As a percentage of license revenue | 6%                                 | 10%      |       | 7%                                 | 10%      |       |

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

The decrease in cost of license revenue in absolute dollars and as a percentage of license revenue during the three and nine months ended January 31, 2006, when compared to the prior-year periods, was primarily due to our purchase of Cimmetry, which resulted in lowering the cost of embedded third-party software, as we had formerly licensed Cimmetry software to include in our products.

In the future, we expect cost of license revenue in absolute dollars to increase or decrease in direct relation to overall license revenue. We expect cost of license revenue as a percentage of license revenue to remain comparable to the results for the three months ended January 31, 2006. Actual results may fluctuate somewhat, depending upon the amount of third-party software sold in any particular 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 total revenues for the three and nine months ended January 31, 2006 and 2005.

|   | Three Months Ended                 |          |      | Nine Months Ended                  |           |      |
|---|------------------------------------|----------|------|------------------------------------|-----------|------|
|   | January 31,                        |          | %    | January 31,                        |           | %    |
|   | 2006                               | 2005     |      | 2006                               | 2005      |      |
|   | (in thousands, except percentages) |          |      | (in thousands, except percentages) |           |      |
| Cost of service revenue, excluding stock compensation | \$ 9,696                           | \$ 8,424 | 15%  | \$ 31,836                          | \$ 23,863 | 33%  |
| Stock compensation                                    | 144                                | 36       | 300% | 417                                | 179       | 133% |

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|   |          |          |     |           |           |     |
|---|----------|----------|-----|-----------|-----------|-----|
| Total cost of service revenue                                     | \$ 9,840 | \$ 8,460 | 16% | \$ 32,253 | \$ 24,042 | 34% |
| As a percentage of service revenue (excluding stock compensation) | 50%      | 47%      |     | 52%       | 47%       |     |

Our cost of service revenue includes salaries and related expenses for implementation, training services, and customer support organizations, costs of third parties contracted to provide implementation and maintenance services to customers and an allocation of overhead expenses, including rent and information technology expenses. In addition, cost of service revenue

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includes support and upgrade fees paid to third parties with respect to the third-party software integrated into or sold with our products for which our customers have purchased support from us. Stock compensation is explained separately under [Stock Compensation](#) below.

The increase in cost of service revenue, excluding stock compensation, in absolute dollars during the three and nine months ended January 31, 2006, when compared to the prior-year periods, was primarily related to the increase in service revenue. As a percentage of service revenue, cost of service revenue increased by 3% and 5%, respectively, in the three and nine months ended January 31, 2006, compared to the prior-year periods, primarily due to relatively lower utilization rate of our professional service personnel.

For the three months ending April 30, 2006, we expect cost of service revenue, excluding stock compensation, in absolute dollars to increase when compared to the results achieved in the three months ended January 31, 2006. As a percentage of service revenue, we expect cost of service revenue to be consistent with or slightly lower than the results achieved in the three months ended January 31, 2006.

**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 stock compensation, which is included in each of the sales and marketing, research and development, and general and administrative categories.

**Sales and Marketing**

The following table sets forth a summary of our sales and marketing expenses in absolute dollars and expressed as a percentage of total revenues for the three and nine months ended January 31, 2006 and 2005.

|  | Three Months Ended                 |                  |           | Nine Months Ended                  |                  |            |
|--|------------------------------------|------------------|-----------|------------------------------------|------------------|------------|
|  | January 31,                        |                  | %         | January 31,                        |                  | %          |
|  | 2006                               | 2005             |           | 2006                               | 2005             |            |
|  | (in thousands, except percentages) |                  | Change    | (in thousands, except percentages) |                  | Change     |
| Sales and marketing, excluding stock compensation                | \$ 11,914                          | \$ 11,956        | (0%)      | \$ 36,185                          | \$ 33,170        | 9%         |
| Stock compensation   | 462                                | 87               | 431%      | 1,353                              | 331              | 309%       |
| <b>Total sales and marketing</b>                                 | <b>\$ 12,376</b>                   | <b>\$ 12,043</b> | <b>3%</b> | <b>\$ 37,538</b>                   | <b>\$ 33,501</b> | <b>12%</b> |
| As a percentage of total revenues (excluding stock compensation) | 36%                                | 39%              |           | 37%                                | 39%              |            |

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. Stock compensation is explained separately under [Stock Compensation](#) below.

Sales and marketing expenses, excluding stock compensation, was flat in absolute dollar during the three months ended January 31, 2006, when compared to the prior-year period. Sales and marketing expenses, excluding stock compensation, decreased as a percentage of total revenues during the three months ended January 31, 2006. While our total commission expenses in the three months ended January 31, 2006 decreased due to a different mix of products, with lower average commission rates being sold during the quarter, our salaries and benefits increased, as a result of the addition of Cimmetry's sales and marketing personnel, to offset this decrease. The increase in sales and marketing expenses, excluding stock compensation, in absolute dollars during the nine months ended January 31, 2006, when compared to the prior-year period, was the result of \$2.5 million in increased personnel-related costs and \$664,000 in increased marketing expenses, primarily due to the addition of Cimmetry.

For the three months ending April 30, 2006, notwithstanding the expected cost savings as a result of our restructuring activities, we expect sales and marketing expenses, excluding stock compensation, in absolute dollars to increase when compared to the result achieved in the third quarter of fiscal 2006 due to costs related to our user conference and increases in commission expense.





**Table of Contents****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 and nine months ended January 31, 2006 and 2005.

|  | Three Months Ended                 |                 |            | Nine Months Ended                  |                  |            |
|--|------------------------------------|-----------------|------------|------------------------------------|------------------|------------|
|  | January 31,                        |                 | %          | January 31,                        |                  | %          |
|  | 2006                               | 2005            |            | 2006                               | 2005             |            |
|  | (in thousands, except percentages) |                 | Change     | (in thousands, except percentages) |                  | Change     |
| Research and development, excluding stock compensation           | \$ 8,800                           | \$ 5,649        | 56%        | \$ 25,352                          | \$ 16,471        | 54%        |
| Stock compensation   | 123                                | 2               | 6050%      | 326                                | 25               | 1204%      |
| <b>Total research and development</b>                            | <b>\$ 8,923</b>                    | <b>\$ 5,651</b> | <b>58%</b> | <b>\$ 25,678</b>                   | <b>\$ 16,496</b> | <b>56%</b> |
| As a percentage of total revenues (excluding stock compensation) | 27%                                | 19%             |            | 26%                                | 19%              |            |

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 of existing products, including translation and localization, and quality assurance procedures. These additional costs consist primarily of consulting costs and the cost of software development tools and equipment. To date, all software development costs in research and development have been expensed as incurred because the expenses incurred after achieving technological feasibility have been immaterial. Stock compensation is explained separately under *Stock Compensation* below.

The increase in research and development expenses, excluding stock compensation, in absolute dollars and as a percentage of revenue during the three months ended January 31, 2006, when compared to the prior-year period, was primarily related to (a) \$1.6 million in increased compensation and benefits, primarily resulting from the addition of the Cimmetry workforce and, to a lesser extent, from increased spending on our existing products, and (b) \$1.5 million in increased outside consulting fees related to work being performed on the next releases of our products, primarily our Agile 9 suite of products. The increase in research and development expenses, excluding stock compensation, in absolute dollars and as a percentage of revenue during the nine months ended January 31, 2006, when compared to the prior-year period, was primarily related to (a) \$5.2 million in increased compensation and benefits resulting from the addition of the Cimmetry workforce, and to a lesser extent, from increased spending on our existing products, and (b) \$3.4 million in increased outside consulting fees related to work being performed on the next releases of our products, primarily our Agile 9 suite of products.

For the three months ending April 30, 2006, we expect research and development expenses, excluding stock compensation, in absolute dollars to increase slightly when compared with our results for the three months ended January 31, 2006, as we continue to invest in our products.

**General and Administrative**

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 and nine months ended January 31, 2006 and 2005.

|  | Three Months Ended                 |                 |            | Nine Months Ended                  |                 |            |
|--|------------------------------------|-----------------|------------|------------------------------------|-----------------|------------|
|  | January 31,                        |                 | %          | January 31,                        |                 | %          |
|  | 2006                               | 2005            |            | 2006                               | 2005            |            |
|  | (in thousands, except percentages) |                 | Change     | (in thousands, except percentages) |                 | Change     |
| General and administrative, excluding stock compensation         | \$ 3,032                           | \$ 2,908        | 4%         | \$ 8,942                           | \$ 8,262        | 8%         |
| Stock compensation   | 207                                | 34              | 509%       | 611                                | 157             | 289%       |
| <b>Total general and administrative</b>                          | <b>\$ 3,239</b>                    | <b>\$ 2,942</b> | <b>10%</b> | <b>\$ 9,553</b>                    | <b>\$ 8,419</b> | <b>13%</b> |
| As a percentage of total revenues (excluding stock compensation) | 9%                                 | 10%             |            | 9%                                 | 10%             |            |

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 and director compensation.

Stock compensation is explained separately under [Stock Compensation](#) below.

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General and administrative expenses, excluding stock compensation, in absolute dollars during the three and nine months ended January 31, 2006, increased by \$124,000 and \$ 680,000, respectively, when compared to the prior-year periods, primarily due to the addition of Cimmetry's expense.

For the three months ending April 30, 2006, we expect general and administrative expenses, excluding stock compensation, to remain essentially flat or decrease slightly in absolute dollars, when compared with our results for the three months ended January 31, 2006.

**Stock Compensation**

The following table sets forth a summary of our stock compensation expenses in absolute dollars and expressed as a percentage of total revenues for the three and nine months ended January 31, 2006 and 2005.

|                                   | Three Months Ended  |                                  |             | Nine Months Ended   |                      |             |
|-----------------------------------|---------------------|----------------------------------|-------------|---------------------|----------------------|-------------|
|                                   | January 31,<br>2006 | 2005<br>(in<br>thousands, except | %<br>Change | January 31,<br>2006 | 2005<br>percentages) | %<br>Change |
| Stock compensation:               |                     |                                  |             |                     |                      |             |
| Cost of revenues                  | \$ 144              | \$ 36                            | 300%        | \$ 417              | \$ 179               | 133%        |
| Sales and marketing               | 462                 | 87                               | 431%        | 1,353               | 331                  | 309%        |
| Research and development          | 123                 | 2                                | 6050%       | 326                 | 25                   | 1204%       |
| General and administrative        | 207                 | 34                               | 509%        | 611                 | 157                  | 289%        |
| Total stock compensation          | \$ 936              | \$ 159                           | 489%        | \$ 2,707            | \$ 692               | 291%        |
| As a percentage of total revenues | 3%                  | 1%                               |             | 3%                  | 1%                   |             |

Stock compensation expenses include the amortization of the fair value of share-based payments made to employees, Board of Directors and consultants, primarily in the form of stock options and purchases under the employee stock purchase plan, as we adopted the provision of SFAS 123R on May 1, 2005 (see Note 7 - Stock Compensation). The fair value of stock options granted is recognized as an expense as the underlying stock options vest.

We use the modified prospective method to value our share-based payments under SFAS 123R. Accordingly, for the three and nine months ended January 31, 2006, we accounted for stock compensation under SFAS 123R while for the three and nine months ended January 31, 2005, we accounted for stock compensation under APB 25. Under APB 25, we were generally required to record compensation expense only if there were positive differences between the market value of our common stock and the exercise price of the options granted to employees as of the date of the grant. Under SFAS 123R, however, we record compensation expense for all share-based payments made to employees based on the fair value at the date of the grant. Therefore, stock compensation for the three and nine months ended January 31, 2006 is not comparable to the prior-year periods.

On July 11, 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 new options vest over a period of approximately two years (one-third on December 1, 2005, one-third on September 1, 2006 and one-third on June 1, 2007). Participation in the offer was voluntary, and was limited to then-current employees. Non-employee members of the board of directors were not eligible to participate. At the time the offer was made, there were options to purchase 19.1 million shares outstanding, of which options to purchase approximately 14 million shares were eligible for exchange in the exchange offer.

On midnight of August 19, 2005, the exchange offer expired. Of the approximately 14 million options eligible to participate in the exchange offer, approximately 11.6 million options were surrendered and exchanged into approximately 3.9 million new options, with an exercise price equal to our common stock par value of \$0.001, on the next business day (August 22, 2005). As a result of the exchange, our total number of options outstanding (overhang) decreased by approximately 7.7 million. For financial accounting purposes, the exchange resulted in an additional stock compensation of \$315,000, which will be recognized over the approximately two-year vesting term of the new options or restricted stock.

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For the three months ending April 30, 2006, we expect our stock compensation expense to increase when compared with our results for the three months ended January 31, 2006 due to the grant of new options.

**Table of Contents****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 and nine months ended January 31, 2006 and 2005.

|                                   | Three Months Ended                 |        |        | Nine Months Ended                  |          |        |
|-----------------------------------|------------------------------------|--------|--------|------------------------------------|----------|--------|
|                                   | January 31,                        |        | %      | January 31,                        |          | %      |
|                                   | 2006                               | 2005   |        | 2006                               | 2005     |        |
|                                   | (in thousands, except percentages) |        | Change | (in thousands, except percentages) |          | Change |
| Amortization of intangible assets | \$ 1,353                           | \$ 535 | 153%   | \$ 4,032                           | \$ 1,936 | 108%   |
| As a percentage of total revenues | 4%                                 | 2%     |        | 4%                                 | 2%       |        |

During fiscal 2005 and 2004, we 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 described above. 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):

|                        | January 31, 2006 |              |              | April 30, 2005 |              |              |
|------------------------|------------------|--------------|--------------|----------------|--------------|--------------|
|                        | Gross            |              | Net Carrying | Gross          |              | Net Carrying |
|                        | Carrying         | Accumulated  |              | Carrying       | Accumulated  |              |
|                        | Amount           | Amortization | Amount       | Amount         | Amortization | Amount       |
| Intangible Assets:     |                  |              |              |                |              |              |
| Developed technologies | \$ 9,200         | \$ (4,141)   | \$ 5,059     | \$ 9,200       | \$ (1,965)   | \$ 7,235     |
| Customer relationships | 6,882            | (4,537)      | 2,345        | 7,182          | (2,892)      | 4,290        |
| Trademark              | 1,200            | (240)        | 960          | 1,200          | (60)         | 1,140        |
| Non-compete agreements | 1,280            | (1,240)      | 40           | 1,280          | (1,210)      | 70           |
|                        | \$ 18,562        | \$ (10,158)  | \$ 8,404     | \$ 18,862      | \$ (6,127)   | \$ 12,735    |

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

| Fiscal Years:                 |          |
|-------------------------------|----------|
| 2006 (remaining three months) | \$ 1,352 |
| 2007                          | 4,037    |
| 2008                          | 2,595    |
| 2009                          | 240      |
| 2010                          | 180      |
| Total                         | \$ 8,404 |

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, which will lead 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.



**Table of Contents****Restructuring Charges**

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 and nine months ended January 31, 2006 and 2005.

|                                   | Three Months Ended                 |      |        | Nine Months Ended                  |          |        |
|-----------------------------------|------------------------------------|------|--------|------------------------------------|----------|--------|
|                                   |                                    |      |        |                                    |          |        |
|                                   | %                                  |      |        | %                                  |          |        |
|                                   | January 31,<br>2006                | 2005 | Change | January 31,<br>2006                | 2005     | Change |
|                                   | (in thousands, except percentages) |      |        | (in thousands, except percentages) |          |        |
| Restructuring and other charges   | \$ 1,729                           | \$   | 100%   | \$ 1,729                           | \$ 2,132 | (19%)  |
| As a percentage of total revenues | 5%                                 |      |        | 2% 3%                              |          |        |

Refer to Note 6 Restructuring Charges for a discussion of to our restructuring charges.

**Interest and Other Income (Expense), Net**

|                                   | Three Months Ended                 |          |        | Nine Months Ended                  |          |        |
|-----------------------------------|------------------------------------|----------|--------|------------------------------------|----------|--------|
|                                   |                                    |          |        |                                    |          |        |
|                                   | %                                  |          |        | %                                  |          |        |
|                                   | January 31,<br>2006                | 2005     | Change | January 31,<br>2006                | 2005     | Change |
|                                   | (in thousands, except percentages) |          |        | (in thousands, except percentages) |          |        |
| Interest and other income, net    | \$ 1,597                           | \$ 1,169 | 37%    | \$ 3,751                           | \$ 3,047 | 23%    |
| As a percentage of total revenues | 5% 4%                              |          |        | 4% 4%                              |          |        |

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 and nine months ended January 31, 2006, compared to the prior-year period, was due principally to higher interest rates, offset by lower average cash and investment balances principally due to the acquisition of Cimmetry. Additionally, as a result of the US Dollar strengthening against the Euro during the three months ended July 31, 2005, we recorded an unrealized loss from foreign currency translation of \$250,000 in that period, which was included in interest and other income, net, for the nine months ended January 31, 2006. See also Liquidity and Capital Resources below.

For the three months ending April 30, 2006, we expect interest and other income, net to increase as the interest income tracks the prevailing interest rates.

**Provision for Income Taxes**

|                            | Three Months Ended                 |        |        | Nine Months Ended                  |        |        |
|----------------------------|------------------------------------|--------|--------|------------------------------------|--------|--------|
|                            |                                    |        |        |                                    |        |        |
|                            | %                                  |        |        | %                                  |        |        |
|                            | January 31,<br>2006                | 2005   | Change | January 31,<br>2006                | 2005   | Change |
|                            | (in thousands, except percentages) |        |        | (in thousands, except percentages) |        |        |
| Provision for income taxes | \$ 237                             | \$ 285 | (17%)  | \$ 644                             | \$ 820 | (21%)  |
| Effective tax rate         | 6% 50%                             |        |        | 6% 41%                             |        |        |

Our provision for income taxes primarily reflects actual taxes associated with our international operations, since we incurred net losses in all periods presented. As a result, our effective tax rate for all periods presented above has heavily fluctuated and we do not believe that this effective tax rate is a useful indicator of future rates. Other than the provision for foreign taxes, and to a lesser extent, provision for state income taxes and US deferred tax liabilities, no provision for income taxes has been recorded 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 January 31, |            |
|--------------------------------------|-------------------|------------|
|                                      | 2006              | 2005       |
| Cash and cash equivalents            | \$ 102,078        | \$ 90,321  |
| Short-term and long-term investments | 98,317            | 151,019    |
|                                      | \$ 200,395        | \$ 241,340 |

On February 3, 2005, we acquired substantially all of the assets and assumed certain liabilities of Cimmetry for \$44.0 million in cash, which is reflected in our cash, cash equivalents and investments as of January 31, 2006. 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 January 31, 2006, our working capital was \$159.4 million and our days sales outstanding was 64 days.

**Cash Flows**

In summary, our cash flows were as follows (in thousands):

|   | Nine Months Ended |          |
|---|-------------------|----------|
|   | January 31,       |          |
|   | 2006              | 2005     |
| Net cash provided by operating activities | \$ 748            | \$ 1,245 |
| Net cash provided by investing activities | 17,715            | 37,330   |
| Net cash provided by financing activities | 1,582             | 5,271    |

Cash provided by operating activities during the nine months ended January 31, 2006 consists of our net loss for the period of \$11.5 million, offset by non-cash items of \$10.2 million (primarily depreciation and amortization) and a net increase of approximately \$4.7 million in other operating assets and liabilities (primarily collection of accounts receivable). Additionally, we included \$2.7 million of tax withholding payments to the Internal Revenue Service and state tax authorities related to the vesting or exercise of our employee stock compensation (see Note 7 – Stock Compensation) in our cash flows from operating activities. Cash used in operating activities during the nine months ended January 31, 2005 was primarily due to our net loss for the period of \$2.8 million and a net decrease of approximately \$2.8 million in working capital, offset by non-cash items of \$6.8 million.

Cash provided by investing activities during the nine months ended January 31, 2006 resulted from \$19.9 million of net maturities of short-term and long-term investments, partially offset by \$2.4 million of purchases of property and equipment. Cash provided by investing activities during the nine months ended January 31, 2005 resulted from \$41.3 million of net maturities of short-term and long-term investments, partially offset by \$3.2 million of purchases of property and equipment.

Cash provided by financing activities during the nine months ended January 31, 2006 and 2005 was primarily due to the issuance of common stock through our employee stock purchase plan and the exercise of stock options totaling \$1.6 million and \$5.3 million, respectively. During the nine months ended January 31, 2006, our stock prices were relatively lower compared to prior periods, and as a result we experienced fewer exercises of our employee stock options. We expect cash provided by financing activities to decrease in future periods as we grant fewer stock options to our employees.

We anticipate that our operating expenses, particularly in sales and marketing and research and development, will constitute a material use of our cash resources over the next quarter, offset by anticipated collections of accounts receivable.

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As discussed in Note 7 Stock Compensation, on July 11, 2005, we 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 new options vest over a period of approximately two years (one-third on December 1, 2005, one-third on September 1, 2006 and one-third on June 1, 2007). New options granted to U.S. employees (including U.S. taxpayers employed in India) were immediately exercisable for restricted stock and could only be exercised until November 30, 2005. The restricted stock also vests over the same period of approximately two years. On the first vesting date of December 1, 2005, we withheld 388,000 shares of restricted stock for this purpose, and paid approximately \$2.4 million to the Internal Revenue Service and state tax authorities to cover the minimum statutory tax withholding requirements, based on the market value of our common stock at that time. For the next two vesting dates of the restricted stock (i.e. September 1, 2006 and June 1, 2007), we will withhold sufficient shares to cover the minimum

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statutory tax withholding requirements, based on the market value of our common stock at the time of vesting, and we will pay the related amount to the Internal Revenue Service and state tax authorities.

We may utilize cash resources to fund acquisitions of investments in complementary businesses, technologies or product lines. 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 resource expenditure requirements for at least the next twelve months.

### **Recent Accounting Pronouncements**

In November 2005, the FASB issued FASB Staff Position ( FSP ) FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments ( FSP 115-1 ), which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is effective for reporting periods beginning after December 15, 2005. We believe that the adoption of FSP 115-1 will not have a material impact on our consolidated financial statements.

In November 2005, FASB issued FSP FAS 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. Effective upon issuance, this FSP describes an alternative transition method for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC pool ) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). Companies have one year from the later of the adoption of SFAS 123(R) or the effective date of the FSP to evaluate their transition alternatives and make a one-time election. We are currently evaluating which transition method to adopt and the potential impact of this guidance on our financial statements.

In October 2005, FASB issued FSP FAS 123(R)-2, Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R). Under this guidance, companies may establish the grant date for a share-based award under SFAS 123(R) prior to the communication of the award terms to the recipient if the award is unilateral and the terms are communicated within a relatively short time period. The guidance provided by this FSP is effective upon initial adoption of SFAS 123(R) or in the first reporting period after the issuance of this FSP if a company has already adopted SFAS 123(R) and has issued interim financial statements. The adoption of this guidance did not have a material impact on our financial statements.

In May 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. We do not expect the adoption of SFAS 154 to have a material effect on our consolidated financial statements.

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**RISK FACTORS**

If any of the events described in the following risk factors occur, our business, financial condition or results of operations would likely suffer. In that event, the trading price of our common stock could decline. Any forward-looking statements set forth in this Report should be considered in light of the factors discussed below.

***Defects in Our Software Products Could Harm Our Reputation, Diminish Demand for Our Products, Be Costly to Remediate, Expose Us to Litigation and/or Cause Our Revenue to Decline***

Our software products are complex and may contain errors that may be detected at any point in the life of the product. This risk is more significant as it relates to new products, where there is limited experience with the product in customer environments, and increases with the complexity of the product in question.

We began shipping Agile 9 in January 2004 and released the latest update, Agile 9.2, during the quarter ending January 31, 2006. Agile 9 is a suite of products based on a newly developed architecture, and provides extensive new features and capabilities delivered on an enterprise technology platform. Agile 9 has also been developed to operate with a wider array of database, applications server and underlying technologies than were our prior products. Some of these underlying technologies are themselves relatively new and immature, both with respect to their stability and ability to integrate with other applications. In addition, more than was the case with our prior products, Agile 9 is being implemented to address a broader range of customer requirements. As can be expected with software as complex as Agile 9, in the course of customer implementation activities for Agile 9 with which we have been involved to date, we have encountered bugs and errors not identified during our pre-release testing. While we believe that these bugs or errors do not affect the functionality of Agile 9, in any material respect, and that Agile 9.2 has addressed many of such issues raised to date, these errors, and other errors we may find in Agile 9 or in any of the other products we sell, including Agile Advantage and OnDemand products, the recently released Agile e6 or our Cimmetry product line, could result in (i) lost or delayed revenue and market acceptance, (ii) injury to our reputation, (iii) increased service and warranty costs, including the potential need to provide services at reduced fees or no charge at all in order to address related customer concerns, and (iv) claims or litigation for breach of contract or warranty. Any of these adverse consequences, either alone or in conjunction with others, could have a material negative impact on our business and results of operations.

***If We Do Not Achieve a High Level of Customer Satisfaction, Our Customers May Not Purchase Additional Products from Us and Our Reputation in the Market Could Suffer, Adversely Impacting Our Ability to Attract New Customers***

The size of a new customer's initial order is often relatively small and may include a limited number of user licenses. In subsequent orders, customers typically add user licenses and/or additional products. We depend, to a significant extent, on sales of additional user licenses and products to our existing customers to grow our revenues. Therefore, it is important that our customers are satisfied with their initial product implementations and that they believe that expanded use of the product they purchased, or the purchase of additional products, will provide them with additional benefits.

Our products are generally integrated with many disparate systems operated by our customers. Through our professional services organization, we provide implementation services for our software on a fee-for-service basis. Implementations generally involve migrating data from existing systems, and configuring the Agile products to operate with the customers' existing computer systems and software. Agile 9, Agile 9.2, released in the quarter ending January 31, 2006, and the recently released Agile e6, each provide new product modules, and extensive new features and capabilities, and are designed to address a broader set of business objectives than were our prior products. Agile 9 and Agile e6 implementations may involve multiple products being deployed across multiple departments within the customers' organizations and configuring the Agile software to operate with a broader range of existing systems and software. As a result, implementations of Agile 9 and Agile e6 will often take longer than was the case with our earlier products, where only one product was deployed across a typically narrower user base. Longer implementations may cause the customer to delay placing or fail to place orders for additional licenses or products. This is particularly true where delays in implementation cause delays in the deployment and initial production use of our products.

The added product modules, features and functionality of our newer products has also meant that our newer products sometimes require more user training than was the case with our prior products. In addition, as is often the case with major software upgrades, customers who were accustomed to the user interfaces and commands of prior versions of our software have in some cases experienced dissatisfaction with the new user interfaces, and at having to learn the new commands and navigation tools of Agile 9. Such user experiences can lead to dissatisfaction with our products as a whole and delays in, or the customers' unwillingness to place, orders for additional licenses or products.



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Failure to maintain customer satisfaction for any reason could mean that follow-on orders would be delayed or may not occur at all, either of which would have a materially adverse effect on our results of operations.

***Our Quarterly Operating Results Fluctuate and are Difficult to Predict. The Timing of Large Orders is Highly Unpredictable. Our Expenses are Relatively Fixed in the Short Term. Unpredicted Revenue Shortfalls Could Disproportionately and Adversely Affect Operating Results. If Our Future Results are Below the Expectations of Public Market Analysts or Investors, the Price of Our Common Stock May Decline Significantly***

Our quarterly operating results have varied significantly in the past and are likely to vary significantly in the future. Our products have a complex and unpredictable sales cycle. The timing of large orders, which can account for a significant percentage of our total license revenue, remains unpredictable as a result of the overall economic conditions, cautious capital spending by businesses and customer expenditure approval processes. In addition, due to the longer implementation cycles associated with our newer products, follow-on orders from existing customers may not follow original orders as quickly as they have done in the past, thus making the timing of such orders harder to predict. If any large order anticipated for a particular quarter is not received in that quarter, or the related license revenue is not recognizable in that quarter, we may experience an unplanned shortfall in revenues. In contrast, our expense levels are relatively fixed in the near term and are based in part on expectations of future revenues. As a result, a revenue shortfall from estimated levels can cause a disproportionately adverse impact on our operating results for the quarter in which the revenue shortfall occurs.

Due to these and other factors, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indicators of our future performance. It is possible that in some future periods our results of operations may be below our guidance or the expectations of public market analysts and investors. If this were to occur, the price of our common stock would likely decline, potentially significantly.

***Competition Among Providers of Product Lifecycle Management Software May Increase, Particularly if Industry Consolidation Continues, Which May Cause Us to Reduce Prices, and Experience Resulting Reduced Gross Margins, or Lose Business to Competitors, Resulting Ultimately in a Loss of Market Share***

We believe that the market for product lifecycle management solutions is becoming increasingly competitive due to a number of factors, including: (i) consolidation in the product lifecycle management software industry; (ii) alliances among existing competitors; (iii) alliances between our competitors and systems integrators; and (iv) entry of new competitors. In addition, as a result of the increasing availability of offshore software development resources efforts, we have begun to face additional competition from customers and prospective customers custom development efforts. Finally, we continue to see pricing pressure from customers and prospects.

We have occasionally experienced pricing pressure on sales of our products, in circumstances in which competitors have offered to sell licenses at much lower cost in exchange for customer purchases of maintenance or other products or services from the competitor. In some situations, we believe competitors may have offered initial licenses at no cost in order to establish a relationship with the customer. We expect that these pressures will continue, particularly with the constraint in the capital budgets for purchases of enterprise software under which our customers are operating. In order to remain competitive, and retain or expand our market share, and to expand our sales into new industries, we may have to meet some of these demands for lower prices on our license fees, and offer initial licenses at low, or even no cost, to the customer.

There is a risk that, even as the economy improves overall, businesses may not increase their information technology spending commensurate with their business growth. Moreover, even in an environment of increasing information technology spending, we (and other PLM vendors) are not only competing for PLM opportunities, but also competing against unrelated internal projects and against vendors of unrelated products and services, all of whom are competing for the limited information technology spending by current and prospective customers. There can be no assurance that PLM in general or Agile in particular will compete favorably against other potential uses of information technology spending.

We may not be able to maintain our competitive position against current and potential competition, particularly competitors that have longer operating histories and significantly greater financial, technical, marketing, sales and other resources than we do and therefore may be able to respond more quickly than us to new or changing opportunities, technologies and customer requirements. Also, many current and potential competitors have greater name recognition and more extensive customer bases that could be leveraged to gain market share to our detriment. These competitors may be able to undertake more extensive promotional activities, adopt more aggressive pricing policies, and offer more attractive terms to purchasers than we can.

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These and other competitive factors could result in price reductions, reduced revenues and gross margins and lost market share and an inability to expand into new markets and industries, any one of which could materially and adversely affect our results of operations.

### ***The Market For Our Products Is Still Developing, and There Is Significant Uncertainty as to How Rapidly It Will Grow, If at All, and How Large It Will Become***

The market for PLM software products is still developing. Our customers and potential customers have not traditionally automated product lifecycle management solutions like we offer throughout their supply chains. As this is a relatively new market, we cannot be certain that this market will continue to develop and grow.

Many customers and prospective customers have already invested substantial resources in other methods of sharing product information during the manufacturing and supply process, most notably internally developed applications. These customers and prospective customers may be reluctant to adopt a new approach that may replace, limit or compete with their existing systems or methods. Moreover, customers and prospective customers have many competing demands placed on their available information technology budgets. There can be no assurance that PLM in general or Agile in particular will compete favorably against other potential uses of information technology spending.

We expect that we will continue to need to pursue intensive marketing and sales efforts to educate prospective customers about the uses and benefits of our products. Along with our direct efforts in these areas, we also rely upon relationships with consulting and integration partners to increase the market awareness of the existence and benefits of our PLM solutions. Currently, only a limited number of companies provide this type of market support for our products. These companies are not contractually obligated to promote our products, and they may have similar or more established relationships with our competitors. If these service providers reduce or discontinue their relationships with us, market acceptance of our products could be harmed.

As a result of these factors, demand for and market acceptance of our products is subject to a high level of uncertainty. If the PLM market fails to develop as we anticipate, or if our products do not receive wide acceptance, our ability to grow would be limited.

### ***If Our Service Revenue Increases As a Percentage of Total Revenues, Our Gross Margins Could Decrease; Demand for Our Services may Exceed Internal Capacity, Which Could Increase Reliance on Third-Party Subcontractors, Thus Adversely Impacting Gross Margin; We Currently Perform Some of Our Implementations on a Fixed-Price Basis, Which Could Cause Us to Incur More Costs Than We Expect***

We realize lower margins on service revenue, particularly with respect to professional services, than on license revenue. As a result, if service revenue increases as a percentage of total revenues, or if we increase our use of third parties to provide such services, our gross margins may decrease.

The profitability of our professional services is critically dependent on our ability to maintain a minimum average billing rate and a fairly high utilization level of professional services personnel. If we are unable to maintain or improve our billing and utilization rates, the profitability of our professional services activities, our service revenue and our overall profitability will suffer.

During fiscal 2005, demand for our services, principally implementation services for Agile 9, began to exceed the capacity of our internal services organization. As a result, we have had to engage third parties to subcontract all or a portion of the services engagements in some instances. The costs associated with using third parties are significantly higher than the costs associated with direct delivery of services. As a result, the use of third parties may adversely impact our services gross margins. We expect to continue to rely to a significant extent on third parties for the next few quarters, which will continue to adversely affect our gross margins. In addition, beginning in fiscal 2005 and continuing into fiscal 2006, we have been hiring additional personnel for our professional services organization. Newly hired services personnel require up-front training and take some time before becoming fully productive. Accordingly, the addition of a significant number of new services personnel can adversely affect services margins in the short term.

We may at times charge customers a fixed fee for installation services. If we underestimate the amount of time or resources required to install our products in fixed-fee situations, our gross margins could decline, adversely impacting our operating results.



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### ***Our Success Depends Upon Attracting and Retaining Qualified Employees***

Our success as a company is dependent, in part, upon our ability to attract and retain qualified employees. If we are unable to attract the qualified people we seek, or if we are unable to retain our existing employees, our customer satisfaction and therefore our business could suffer. In addition, if we are unable to retain our key sales executives, our revenue could be materially and adversely affected. Finally, in connection with the adoption of SFAS 123R, we are reviewing our overall equity compensation strategy, and anticipate issuing fewer stock options to our employees than we have in the past. These changes in approaches to employee compensation could adversely affect our ability to attract and retain the highly qualified personnel we need.

### ***We Have New Sales Representatives, Particularly in Our International Sales Force, Who Could Take Time to Reach Productivity, Which, Could Result in Lost or Delayed Sales***

We sell our products primarily through our direct sales force. As a result of reorganization activities and acquisitions, we have added a significant number of sales personnel in North America and in the international markets we serve over the past two fiscal years, and expect to continue to add sales personnel in the future. Concurrently with this activity, through the introduction of Agile 9 and the acquisitions we have made, our product offering has become significantly broader and more complex. Training existing and new sales personnel on the full range of products we offer is a substantial undertaking, and it generally takes six to twelve months for a new account executive to become fully productive. In addition, changes in account executives can also result in the need to reestablish relationships with existing customers. This can result in customer dissatisfaction, and lost or delayed sales, as customers become accustomed to their new account executives.

The ability of our entire sales force to effectively sell our full suite of products will be important to our growth. If the new members of our sales team are unable to quickly become fully productive, or if we cannot successfully cross-train our expanded sales force in our full suite of products, it may be difficult for us to sell our products, and we may lose sales opportunities and market share, take longer to close anticipated sales, and experience a shortfall in revenues.

### ***We Have Recently Made Several Acquisitions and Expect to Make Additional Acquisitions in the Future. If We Fail to Successfully Integrate the Acquired Companies, We May Not Achieve the Anticipated Benefits of the Acquisitions. If We Fail to Identify and Successfully Acquire Additional Products, Technologies and Companies, Our Long-Term Competitive Position May Be Adversely Affected***

In February 2005, we acquired substantially all of the business assets of Cimmetry, Inc., during fiscal 2004, we acquired Eigner US Inc. and TRADEC, Inc. and, during fiscal 2003, we acquired oneREV, Inc. and ProductFactory, Inc. While each of these acquisitions has resulted or is expected to result in benefits as a combined company, achieving the full benefits of each of these and any future acquisitions depends on many factors, including the successful and timely integration of the products, technologies, personnel, and operations of the acquired companies. These integration efforts are difficult and time consuming, especially considering the highly technical and complex nature of each company's products. We may encounter risks to our business as a result of such acquisitions, including:

Difficulties in integration of acquired personnel, operations, technologies or products;

Unanticipated acquisition costs, such as integration expenses and expenses associated with retiring excess facilities or other assets;

Diversion of management's attention from other business concerns;

Adverse effects on our existing business relationships with our customers and business partners, and the risk of losing the customers of acquired companies, particularly where, as is the case with our recent Cimmetry acquisition, those customers may compete with us;

Inability to retain key employees of acquired companies; and

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Difficulties and added expenses associated with bringing acquired companies into our internal control framework in a timely manner as may be required for on-going compliance with the Sarbanes-Oxley Act of 2002.

If we are unable to successfully and timely integrate acquired businesses, products or technologies, or to train, retain and motivate personnel from acquired companies, we may not receive the intended benefits of such acquisitions.

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Going forward, we believe that acquiring additional products, technologies and/or companies will be important to remaining competitive in the PLM marketplace. However, we may not be able to identify complementary acquisition targets or, even once targets are identified, we may not be able to reach agreement on the terms of acquisitions or complete the acquisitions. Acquisitions could cause us to issue dilutive equity securities, incur debt or contingent liabilities, amortize goodwill and other intangibles, write off in-process research and development and other acquisition-related expenses, any of which could adversely affect our financial condition and operating results.

### ***Uncertainty about the Impact of SFAS 123R Could Adversely Affect Us***

Effective in the first quarter of fiscal 2006, we adopted SFAS 123R, which will result in a significant difference in the way in which we account for equity-based compensation. SFAS 123R is relatively new and, has only recently been adopted by many companies. The impact of the adoption of SFAS 123R can vary from company to company. As a result, it may be difficult for analysts and others reviewing our financial statements to compare our financial statements to our prior period statements and to those of other companies. Our stock price could be adversely affected if, as a result of adoption of SFAS 123R, our financial performance compares unfavorably to other similarly situated companies.

SFAS 123R is a new and very complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding stock price volatility, option forfeiture rates and expected option lives, to build a model for valuing equity-based compensation. There is little available experience or guidance with respect to developing these assumptions and models. There is also uncertainty as to how the standard will be interpreted and applied as companies and their advisors gain experience with the standard.

There is a risk that, as we and others gain experience with SFAS 123R or as a result of subsequent accounting guidelines, we could determine that the assumptions or model we used requires modification. Any such modification could result in significantly different equity-based compensation charges in future periods and, potentially, could require us to correct such charges taken in prior periods.

### ***We Have a History of Losses and May Not Achieve or Maintain Profitability***

We have incurred annual losses in each of the years since we were formed. We incurred losses of \$4.1 million and \$11.5 million for the three and nine months ended January 31, 2006, respectively. As of January 31, 2006, we had an accumulated deficit of approximately \$303.2 million.

Due to the amortization of the intangibles as a result of the Cimmetry acquisition and the adoption of FAS 123R effective in our first quarter of fiscal 2006, we will likely not be profitable on a GAAP basis for the foreseeable future. Achieving and sustaining profitable results, even on a non-GAAP basis, will depend upon 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. There can also be no assurance that our revenues will increase. As a result, there can be no assurance that we will achieve or maintain profitable operations in the future.

### ***Software Product Development Is Inherently Complex, and We Could Experience Difficulties in Introducing New Products and Upgrades Which Could Result in Lost or Delayed Sales***

In addition to Agile 9, Agile Advantage, Agile e5/6 and the newly acquired Cimmetry products, our future financial performance also depends on our successful and timely development and introduction, and market acceptance, of other new and enhanced products, including products that we may introduce using technology that we acquire from other companies. The lifecycles of our products are difficult to predict because the market for our products is characterized by rapid technological change, changing customer needs and evolving industry standards.

Although our software products can be used with a variety of popular industry standard technology platforms, there may be future or existing platforms that achieve popularity in the marketplace that may not be architecturally compatible with our software product design. It may be necessary for us to invest significant resources to adapt our software if new or different platforms or operating environments become widely adopted in our current and prospective customer base. In addition, we believe that our software must be able to accommodate substantial numbers of users to achieve the level of market acceptance and customer satisfaction that we believe is critical to our success.

If we are unable to offer new and enhanced products as the market and technology evolve, if our products are not sufficiently scalable, or if we encounter development difficulties with new products we release, we may find it difficult to sell products to existing and prospective customers. Moreover, customers may delay purchasing decisions if they are aware that new or enhanced products are soon to be released. If we experience difficulties or delays in releasing new and enhanced



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products that customers are expecting, we may experience lost or delayed sales. Delays in releasing new and enhanced products could have a material negative impact on our results of operations, particularly in the periods when the new or enhanced products were expected to become available.

### ***We Have Significant International Operations, Which Expose Us to Risks Inherent in Conducting Business Activities in Geographies Outside of the United States***

Since early in fiscal 2003, we have had research and development operations in India and China. In August 2003, through our acquisition of Eigner, we began significant operations in Germany, and in February 2005 we began significant operations in Canada through our acquisition of Cimmetry. We also have sales offices located in many additional locations. In addition to the increase in our international operations, we derive a significant portion of our revenues from customers located outside of the United States. For example, during fiscal 2005, revenues from customers located outside of North America were approximately 31% of total revenues. We expect both our operations and revenues from outside of North America to represent a significant portion of our overall operations and fiscal 2006 revenues, respectively.

Our recent and expected international expansion subjects us to a number of risks associated with conducting operations internationally, including:

Difficulties in managing geographically disparate operations;

Longer sales cycles associated with educating foreign customers on the benefits of using our products;

Greater difficulty and longer time in collecting accounts receivable from customers located abroad;

Difficulty in providing customer support for our software in multiple time zones and languages;

Requirement, and cost of developing our software in multiple foreign languages;

Difficulties in enforcing agreements through foreign legal systems;

Unexpected changes in regulatory requirements that may limit our ability to export our software or sell into particular jurisdictions that impose multiple conflicting tax laws and regulations;

Political and economic instability, civil unrest or war;

Terrorist activities that impact international commerce;

Difficulties in protecting our intellectual property rights, particularly in countries where the laws and practices do not protect proprietary rights to as great an extent as do the laws and practices of the United States;

Changing laws and policies affecting economic liberalization, foreign investment, currency convertibility or exchange rates, taxation or employment; and

Nationalization of foreign owned assets, including intellectual property.

In addition, prior to the acquisition of Eigner, most of our revenues have been denominated in United States dollars. In both Europe and Japan, an increasing portion of our revenue is denominated in local currencies (Euro, Swiss Francs or British Pounds in Europe, and Yen in Japan). As a result, we are exposed to greater risks in currency fluctuations. We currently do not engage in foreign exchange hedging activities, and therefore our international revenues and expenses are currently subject to the risks of foreign currency fluctuations. For example, we assumed a Euro-denominated obligation in connection with our acquisition of Eigner. As a result of the Euro strengthening against the US Dollar during fiscal 2004, we recorded an unrealized loss from foreign currency translation of \$639,000 related to this obligation. As a result of the US Dollar strengthening against the Euro during the three months ended July 31, 2005, we recorded an unrealized loss from foreign currency translation of \$250,000. While we are evaluating hedging strategies, we may continue to experience losses resulted from foreign currency fluctuations in the future.

We believe that continued expansion of our international operations will be necessary for our future success, and a key aspect to our business strategy has been and is to expand our sales and support organizations internationally. Therefore, we believe that we will need to commit additional significant resources to expand our international operations. If we are unable to

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successfully expand further in international markets on a timely basis, or if this expansion is more difficult than expected, we may not be able to achieve desired levels of revenue growth. In addition, due to the time delay between hiring sales personnel and such personnel becoming fully productive, expansion of our international operations could have the near term effect of increasing our cost structure without an immediate corresponding increase in revenues, thus adversely affecting our results of operations.

### ***Our Efforts to Expand Sales of Our Products to Other Industries May Not Succeed, Thereby Limiting Our Available Markets and Revenue Growth Potential***

We currently sell our products primarily to companies in the electronics/high technology, industrial (including automotive and aerospace), life sciences and consumer-packaged goods industries. We also market products to customers in additional industries, including retail and government. Although we have targeted enterprises in these other industries as potential customers, these potential customers may not be as willing to purchase our products as our customers in the electronic and high technology, industrial and life sciences industries have been. Targeting additional industries requires us to invest significant amounts in sales and marketing activities. If we are unable to expand into such other industries, we may not recover this investment, or maintain or increase sales of our software.

### ***If We Become Subject to Product Liability Litigation, It Could Be Time Consuming and Costly to Defend***

Since our products are used for mission critical applications in the supply chain, errors, defects or other performance problems could result in financial or other harm to our customers. For example, our products are designed to communicate information relating to changes in product specifications during the manufacturing process. If a supplier or other participant receives inaccurate or erroneous data, it is possible that it could claim it incurred damages based on its reliance on that data. Although our license agreements generally contain provisions designed to limit our exposure to product liability damages, existing or future laws or unfavorable judicial decisions could negate such limitation of liability provisions. While we carry product liability insurance, our insurance may not fully cover these claims. Product liability litigation, even if successfully defended, would be time-consuming and costly to defend and could harm our reputation and business.

### ***Changes in Global Business Conditions Could Adversely Affect Demand for Our Products and Services, Thereby Negatively Impacting Our Revenues and Results of Operations***

Our operating results have been adversely affected over the past few years by reduced levels of capital spending, overall weak economic conditions affecting our current and potential customers and political uncertainties such as the ongoing threat of terrorist strikes. The economic environment that we faced in fiscal 2004 and 2005 was uncertain, and that uncertainty continues in fiscal 2006. Because customers and potential customers are deferring and may continue to defer major infrastructure investments until general economic conditions improve, we may be especially prone to this weak economy, particularly as it relates to large license transactions. Although we have begun to see early evidence of strengthening demand, weak economic conditions may continue to adversely impact our business for at least the next few quarters.

### ***If We Are Unable to Protect Our Intellectual Property We May Lose a Valuable Asset, Experience Reduced Market Share or Incur Costly Litigation to Protect Our Rights; We May Also Be Subject to Intellectual Property Infringement Claims That, Even Without Merit, Could Be Costly to Defend or Settle***

Our success and ability to compete depends upon our proprietary technology, particularly the technology underlying our products. We rely on patent, trademark, trade secret and copyright laws to protect our intellectual property. Despite our efforts to protect our intellectual property, a third party could copy or otherwise obtain our software or other proprietary information without authorization.

We may have to resort to litigation to enforce our intellectual property rights, to protect our patents, trade secrets or know-how or to determine their scope, validity or enforceability. Enforcing or defending intellectual property rights is quite expensive, could cause the diversion of our resources, and may not prove successful. Our existing or future protective measures may prove inadequate to protect all of our proprietary rights, and any failure to enforce or protect such rights could cause us to lose a valuable asset. In addition, the laws of some countries do not protect our proprietary rights to as great an extent as do the laws of the United States, and we expect that it will become more difficult to monitor the use of our products or technologies as we increase our international presence.

We may, from time to time, be subject to claims of infringement of other parties' proprietary rights or claims that our own intellectual property rights are invalid. There has been a substantial amount of litigation in the software industry regarding intellectual property rights. It is possible that, in the future, third parties may claim that our current or potential future products





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infringe their intellectual property. We expect that software product developers and providers of electronic commerce solutions will increasingly be subject to infringement claims as the number of products and competitors in our industry grows and the functionality of PLM products begins to overlap with other software applications. Any infringement claims made against us, even without merit, could be time-consuming, result in costly litigation, or cause product shipment delays or negative publicity. In addition, if our products were found to infringe a third party's proprietary rights, we could be required to enter into royalty or licensing agreements in order to continue to be able to sell our products. Royalty or licensing agreements, if required, may not be available on terms acceptable to us and, if entered into, are likely to adversely affect our operating results.

***We Depend on Third-Party Licensed Technology That, if Lost, Could Result in Increased Cost or Delays in Sales of Our Products***

We license technology on a non-exclusive basis from many companies for use with our products. We utilize database management software from Oracle. Our customers can purchase this software directly from Oracle or from us. In addition, we integrate software into our products licensed from BEA and Oracle for application server technology, from Actuate for reporting capabilities, Spicer for document viewing and Cognos for analytics, as well as products from several other providers. We anticipate that we will continue to license technology from third parties in the future. Some of the software we license from third parties would be difficult to replace and may not continue to be available on commercially reasonable terms, if at all. The loss or inability to maintain any of these technology licenses could result in delays in the licensing of our products until equivalent technology is identified, licensed, and integrated. The increased use of third-party software could result in higher royalty payments and a loss of product differentiation and lower product gross margins.

***The Market Price of our Common Stock Has Been and May Continue to Be Volatile, Which Could Result in Substantial Losses for Individual Security Holders***

The market price for our common stock has been, and is likely to continue to be, highly volatile. During the nine months ended January 31, 2006, the high and low closing sales prices of our common stock were \$7.25 and \$5.88, respectively. Our stock price is subject to wide fluctuations in response to a number of factors, some of which are beyond our control.

In the past, following periods of volatility in the market price of their securities, many companies have been the subject of securities class action litigation. If, in addition to the pending litigation discussed elsewhere in which we are currently involved, we are involved in any additional securities class action suits, it could result in further, significant costs and diversion of our management's attention and resources, and could cause the prices of our securities to fall.

***Legislative Action and Potential New Accounting Pronouncements Could Cause our General and Administrative Expenses to Increase***

In order to comply with the Sarbanes-Oxley Act of 2002, as well as recent changes to listing standards by NASDAQ, and rules implemented by the Securities and Exchange Commission, we have had to hire additional personnel and utilize additional outside legal, accounting and advisory services, and may continue to require such additional resources in the future. These efforts cost \$1.3 million during fiscal 2005. Moreover, in the rapidly changing regulatory environment in which we now operate, there is significant uncertainty as to what will be required to comply with many of the new rules and regulations. As a result, we may be required to spend substantially more than we currently estimate, and may need to divert resources from other activities, as we develop our compliance plans.

***Provisions Contained in Our Charter Documents and in Certain Anti-Takeover Measures Adopted By Us May Delay or Prevent a Change in Our Control***

Provisions of our Delaware certificate of incorporation and bylaws and of Delaware law could make it more difficult for a third party to acquire us, even if a change in control would be beneficial to our stockholders. These provisions also may prevent changes in our management. We are subject to the provision of Section 203 of the Delaware General Corporation Law, which restricts certain business combinations with interested stockholders. The combination of these provisions may inhibit a non-negotiated merger or other business combination.

In addition, our Board of Directors has the authority to issue up to 10 million shares of Preferred Stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any Preferred Stock that may be issued in the future. The issuance of shares of Preferred Stock, while potentially providing desirable flexibility in connection with possible acquisitions and for other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. Further, in March 2001, our Board of Directors adopted a Preferred Stock purchase rights plan intended to guard against certain takeover tactics. The existence of this plan could also have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock.



**Table of Contents****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. In second half of fiscal 2004, we started to sell our products through some of our foreign subsidiaries, including those in Europe, Japan and Taiwan, in their functional currencies. 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. 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 classified as available-for-sale. In general, money market funds and investments with maturities of less than two years are not subject to significant market risk because the interest paid on such funds fluctuates with the prevailing interest rate.

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

|                                       | <b>Maturing<br/>within<br/>12 months</b> | <b>Maturing<br/>between<br/>1 and 2 years</b> | <b>Total</b> |
|---------------------------------------|--|---|--------------|
| Cash equivalents                      | \$ 87,162                                | \$  | \$ 87,162    |
| <i>Weighted average interest rate</i> | <i>4.38%</i>                             | <i>%</i>                                      | <i>4.38%</i> |
| Investments                           | \$ 71,741                                | \$ 14,101                                     | \$ 85,842    |
| <i>Weighted average interest rate</i> | <i>2.91%</i>                             | <i>4.38%</i>                                  | <i>3.15%</i> |
| Total investment securities           | \$ 158,903                               | \$ 14,101                                     | \$ 173,004   |
| <i>Weighted average interest rate</i> | <i>3.72%</i>                             | <i>4.38%</i>                                  | <i>3.77%</i> |

**Item 4. Controls and Procedures  
Evaluation of Our Disclosure Controls and Internal Controls**

Under the supervision and with the participation of our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act ), as of the end of the period covered by this report (the Evaluation Date ). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, to their knowledge and belief, our disclosure controls and procedures were effective.

There have been no changes in our internal controls over financial reporting identified in connection with the evaluation described above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting, except as follows. In connection with its review of the compliance procedures set forth in our policies to be followed in the

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investigation of reported violations, we have agreed that any report that may be made that appears to involve a complaint or a concern regarding our financial disclosures, internal accounting controls, questionable auditing or accounting matters or practices or other issues relating to our accounting or auditing, or any fraud, whether or not material, involving management or other employees who have a significant role in our internal controls, shall be immediately reported to the Chair of the Audit Committee.

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### **CEO and CFO Certifications**

Attached, as Exhibits 31.1 and 31.2, are two separate forms of certifications of the CEO and the CFO. The certifications attached as Exhibits 32.1 and 32.2 are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certifications ). The information contained in this Item 4 relates to the Controls Evaluation referred to in the Section 302 Certifications, and should be read with the Section 302 Certifications for a more complete understanding of the topics presented.

### **Disclosure Controls and Internal Controls**

Our management, including the CEO and CFO, has a responsibility for establishing and maintaining adequate disclosure and internal controls over our financial reporting. Disclosure Controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this quarterly report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Internal Controls are procedures that are designed with the objective of providing reasonable assurance that our transactions are properly authorized, our assets are safeguarded against unauthorized or improper use, and our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with GAAP.

### **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. Our CEO and CFO have concluded that our controls and procedures are, in fact, effective at the reasonable assurance level.

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**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

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

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

The Court has granted preliminary approval of the settlement and set a final approval hearing date of April 24, 2006.

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 or results of operations.

**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**  
None

**Item 5. Other Information**  
None

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

(a) Exhibits

- 10.2\* Employment Agreement with Jay Fulcher, dated February 22, 2006
- 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.

\* Management contract or compensatory plan

**Available Information**

We make available, free of charge, by link from our website at [www.agile.com](http://www.agile.com) our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after we have electronically filed or furnished such materials to the Securities and Exchange Commission. Information contained on our website is not part of this report.



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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 13, 2006