

MANHATTAN ASSOCIATES INC

Form 10-K/A

March 01, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

**FORM 10-K/A
(Amendment No. 1)**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission File Number: 000-23999
Manhattan Associates, Inc.
(Exact Name of Registrant As Specified in Its Charter)**

Georgia
*(State or Other Jurisdiction of
Incorporation or Organization)*

58-2373424
(I.R.S. Employer Identification No.)

**2300 Windy Ridge Parkway, Suite 700
Atlanta, Georgia**
(Address of Principal Executive Offices)

30339
(Zip Code)

Registrant's telephone number, including area code: **(770) 955-7070**

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

Title of Each Class

Name of Each Exchange on Which Registered

None

None

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

Common Stock, \$.01 par value per share

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

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

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. (Check one)

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, based upon the closing sales price of the Common Stock on June 30, 2004 as reported by the Nasdaq Stock Market, was approximately \$919,214,409. As of March 14, 2005, the Registrant had outstanding 29,591,324 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's definitive Proxy Statement for the Annual Meeting of Shareholders to be held May 20, 2005 is incorporated by reference in Part III of this Form 10-K/A to the extent stated herein.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (Form 10-K/A) to our Annual Report on Form 10-K for the year ended December 31, 2004, initially filed with the U.S. Securities and Exchange Commission on March 16, 2005 (Original Filing), reflects a restatement (Restatement) of our Consolidated Financial Statements for the years ended December 31, 2000 through December 31, 2004. The determination by management to restate those financial statements was made as a result of net income in those years being overstated by a total of approximately \$7.4 million, resulting primarily from an error in the method of computing our research and development income tax credit following a small acquisition in 1998 and for not providing the appropriate liability for sales taxes in certain states (Restatement Items). Although it is possible to recover some, if not all, of the lost tax credits through a retroactive relief request from the Internal Revenue Service and some of the sales taxes from our customers who contractually agreed to be responsible for these taxes, the amount of recovery cannot be estimated precisely and at this time collection is not considered probable.

This Form 10-K/A only amends and restates Items 6, 7, 8 and 9A of Part II of the Original Filing, and references to this Form 10-K have been revised to refer to this Form 10-K/A. Except for the items described above, no other information in the Original Filing, including the exhibits thereto, is amended hereby. The foregoing items have not been updated to reflect other events occurring after the Original Filing or to modify or update those disclosures affected by subsequent events. In addition, Item 15 of Part IV of the Original Filing has been amended to contain the consent of our independent registered public accounting firm and currently dated certifications from our Chief Executive Officer and Chief Financial Officer, as required by Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, and Section 906 of the Sarbanes-Oxley Act of 2002. An updated consent of our independent registered public accounting firm and the certifications of our Chief Executive Officer and Chief Financial Officer are attached to this Form 10-K/A as Exhibits 23.1, 31.3, 31.4, and 32.2.

This Form 10-K/A is being filed to reflect and effect the Restatement for the affected periods, and as such, our previously issued consolidated financial statements and related financial information for the years ended December 31, 2000 through December 31, 2004 should no longer be relied upon.

Forward-Looking Statements

In addition to historical information, this Annual Report may contain forward-looking statements relating to Manhattan Associates, Inc. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are delays in product development, undetected software errors, competitive pressures, technical difficulties, market acceptance, availability of technical personnel, changes in customer requirements and general economic conditions. Additional factors are set forth in Safe Harbor Compliance Statement for Forward-Looking Statements included as Exhibit 99.1 to the Annual Report on Form 10-K. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results. Our Annual Report on Form 10-K is available through our Web site at www.manh.com.

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You should read the following selected consolidated financial data in conjunction with our restated Consolidated Financial Statements and related Notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K/A. The statement of income data for the years ended December 31, 2002, 2003 and 2004, and the balance sheet data as of December 31, 2003 and 2004, are derived from, and are qualified by reference to, the audited financial statements included elsewhere in this Form 10-K/A. The statement of income data for the years ended December 31, 2000 and 2001, and the balance sheet data as of December 31, 2000, 2001 and 2002, are derived from the audited financial statements not included herein, as adjusted for the Restatement Items. Historical results are not necessarily indicative of results to be expected in the future.

	Year Ended December 31,				
	2000 (unaudited)	2001 (unaudited)	2002	2003	2004
	(In thousands, except per share data)				
Statement of Income Data (1):					
Revenue:					
Software and hosting fees	\$ 26,190	\$ 35,436	\$ 40,233	\$ 43,229	\$ 49,886
Services	81,085	97,510	110,516	129,320	141,492
Hardware and other	31,344	27,760	22,675	23,417	23,541
Recovery (allowance) relating to bankrupt customer (2)		(4,328)	2,297	848	
Total revenue	138,619	156,378	175,721	196,814	214,919
Costs and expenses:					
Cost of software and hosting fees	1,239	1,455	1,927	4,470	4,085
Amortization of acquired developed technology	250	1,500	1,500	1,999	2,079
Cost of services	34,299	42,372	46,611	54,218	65,853
Cost of hardware and other	26,345	23,092	19,027	20,123	20,071
Research and development	16,106	19,413	20,780	26,982	28,822
Sales and marketing	18,051	22,334	26,413	31,200	34,049
General and administrative	17,268	20,186	22,136	24,117	26,855
In-process research and development and acquisition-related charges	3,001		1,470	885	
Restructuring charge				893	
Amortization of acquisition-related intangibles	915	3,740	272	1,433	1,496
Total costs and expenses	117,474	134,092	140,136	166,320	183,310
Income from operations	21,145	22,286	35,585	30,494	31,609
Other income, net	2,718	2,059	2,801	2,746	3,257
Income before income taxes	23,863	24,345	38,386	33,240	34,866
Income tax expense	9,153	9,197	14,781	12,659	13,232
Net income	\$ 14,710	\$ 15,148	\$ 23,605	\$ 20,581	\$ 21,634

Diluted net income per share	\$ 0.48	\$ 0.49	\$ 0.78	\$ 0.67	\$ 0.70
Shares used in computing diluted net income per share	30,453	30,742	30,451	30,882	31,067

	2000	2001	December 31, 2002	2003	2004
	(In thousands)				
Balance Sheet Data (1):					
Cash, cash equivalents and investments	\$ 67,667	\$ 104,189	\$ 121,857	\$ 155,403	\$ 172,656
Working capital	67,933	97,926	119,790	154,858	133,628
Total assets	153,540	182,179	221,864	266,608	290,239
Long-term portion of capital lease obligations and note payable	5,866	2,182	240	288	148
Total shareholders equity	106,994	137,127	179,618	224,158	239,017

- (1) The amounts above have been adjusted to reflect the Restatement Items for all periods presented. The restatement resulted from an error in the method of computing our research and development income tax credit following a small acquisition in 1998 and for not providing the appropriate liability for sales taxes in certain states. See Note 2 of Notes to Consolidated Financial Statements for further details on the restatement.
- (2) In connection with a significant customer filing for bankruptcy under Chapter 11 of the United States Bankruptcy Code, an allowance of \$4.3 million was recorded to effectively defer revenues arising in the fourth quarter of 2001 from the significant customer, but unpaid at the time of the bankruptcy declaration. In the fourth quarter of 2002 and the second quarter of 2003, \$2.3 million and \$0.8 million of the receivable was recovered, respectively. See Note 1 of Notes to Consolidated Financial Statements for further details.

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Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

All statements, trend analyses and other information contained in the following discussion relative to markets for our products and trends in revenue, gross margins and anticipated expense levels, as well as other statements including words such as anticipate, believe, plan, estimate, expect, and intend and other similar expressions forward-looking statements. These forward-looking statements are subject to business and economic risks and uncertainties, and our actual results of operations may differ materially from those contained in the forward-looking statements.

The following management's discussion and analysis of financial condition and results of operations set forth in this Item 7 is restated to reflect the correction of errors that were contained in our Consolidated Financial Statements and other financial information for the years ended December 31, 2002, 2003 and 2004 as discussed below and in Note 2 of the restated Consolidated Financial Statements set forth in Item 8. The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our restated Consolidated Financial Statements and the related notes thereto.

Business

We are a global leader in providing supply chain execution and optimization solutions. Our integrated logistics solutions leverage a comprehensive set of applications that can be implemented as an integrated whole or as individual point solutions to better manage the supply chain. This platform for logistics is comprised of various applications including warehouse management, transportation management, distributed order management, reverse logistics and trading partner management along with Radio Frequency Identification (RFID) and performance management. Our solution offering is comprised of software, services, and hardware.

Our warehouse management solutions (WMS) manage the processes that take place within the distribution center, from receipt of goods to fulfillment of orders, and include applications for optimizing labor and slotting. With our transportation management solutions (TMS), companies can optimally procure, plan and execute transportation services across transportation modes, such as air, ship and ground. Our distributed order management solution enables companies to balance supply with demand and source goods to meet customer needs in a timely and cost effective manner. With our reverse logistics management solutions, companies can effectively manage the returns process and improve net asset recovery. Our trading partner management solutions (TPM) provide Web-based synchronization between trading partners, improving communication and visibility across the entire supply chain. Our RFID solutions offer a flexible, scalable and modular solution that provide an integration and reporting platform between RFID chip readers and supply chain execution and enterprise resource planning systems. Finally, our performance management applications include event management, alerting and reporting modules, which use analytic tools and alerting processes to monitor and proactively respond to events within the supply chain cycle, analyze historical and operational data and generate reports.

In addition to our software solutions, we also offer a variety of services to enhance the value we provide customers. Our offerings include design, configuration, implementation, training, product assessment, customer support, hardware, consulting services and software enhancement subscriptions.

Application of Critical Accounting Policies and Estimates

The SEC defines critical accounting policies as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made estimates and judgments relating to certain amounts included in the financial statements. As a result, application of these accounting policies, could cause actual results to differ from these estimates.

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We have identified the following as our critical accounting policies:

Revenues and Revenue Recognition

Our revenue is derived from (i) Software and Hosting Fees, which consist of revenue from the licensing and hosting of software and revenue from funded research and development efforts; (ii) Services Revenue, which consist of fees from consulting, implementation and training services (collectively, professional services), plus customer support services and software enhancement subscriptions; and (iii) Hardware and Other Revenue, which consists of sales of hardware and reimbursed project expenses.

Revenue recognition rules for software companies are very complex. We recognize software fees in accordance with Statement of Position No. 97-2, Software Revenue Recognition (SOP 97-2), as amended by Statement of Position No. 98-9, Software Revenue Recognition, With Respect to Certain Transactions (SOP 98-9). Although we follow very specific and detailed guidelines in measuring revenue, the application of those guidelines requires judgment including: (i) whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence of fair value exists for those elements; (ii) whether customizations or modifications of the software are significant; and (iii) whether collection of the software fee is probable. Additionally, we specifically evaluate any other elements in our license transactions, including but not limited to options to purchase additional software at a future date, extended payment terms, functionality commitments not delivered with the software and existing outstanding receivable balances in making the determination of the amount and timing of revenue recognition.

Most of our software arrangements include professional services. Professional services revenues are generally accounted for separately from the software license revenues because the arrangements qualify as service transactions as defined by SOP 97-2. The most significant factors considered in determining whether the revenue should be accounted for separately include the nature of the services (*i.e.*, consideration of whether the services are essential to the functionality of the licensed product), degree of risk, availability of services from other vendors and timing of payments. We provide our professional services under services agreements on a time and material basis or based on a fixed-price and/or fixed-time arrangement. The revenues from our time and material based professional consulting and implementation services are recognized as the work is performed, provided that the customer has a contractual obligation to pay, the fee is non-refundable and collection is probable. Delays in project implementation will result in delays in revenue recognition. For our professional consulting services under fixed-price and/or fixed-time arrangements, we recognize the related revenues using the percentage-of-completion method, with progress-to-completion measured by using labor costs input compared to estimated cost of completion. Revisions to the estimates are reflected in the period in which changes become known. Project losses are provided for in their entirety in the period they become known, without regard to the percentage-of-completion. If we do not accurately estimate the resources required or the scope of work to be performed, or if we do not manage our projects properly within the planned periods of time, then future consulting margins on our projects may be negatively affected or losses on existing contracts may need to be recognized.

Hardware revenue is generated from the resale of a variety of hardware products, developed and manufactured by third parties, which are integrated with and complementary to our software solutions. These products include computer equipment, radio frequency terminal networks, RFID chip readers, bar code printers and scanners and other peripherals. We generally purchase hardware from our vendors only after receiving an order from a customer, and revenue is recognized upon shipment by the vendor to the customer.

Accounts Receivable

We continuously monitor collections and payments from our customers and maintain an allowance for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. Additions to the allowance for doubtful accounts generally represent a sales allowance on services revenue, which are recorded to operations as a reduction to services revenue. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Our top five customers in aggregate accounted for 16%, 16% and 14% of total revenue for each of the years ended December 31, 2002, 2003, and 2004, respectively. No single customer accounted for more than 10% of revenue in 2002, 2003 or 2004.

On January 22, 2002, a significant customer from 2001 filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code. As a result of the filing, the uncertainties around the bankruptcy proceedings and the

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ultimate timing of payment, we recorded an allowance of \$4.3 million in 2001 to effectively defer revenues arising in the fourth quarter of 2001 from the significant customer, but unpaid at the time of the bankruptcy declaration. We recorded a recovery of approximately \$2.3 million of the receivable in the fourth quarter of 2002. Upon receiving the final cash settlement in June 2003, subsequent to the significant customer emerging from bankruptcy, we recovered an additional \$848,000 of the receivable during the second quarter of 2003. The recoveries were recorded as separate revenue line items in the Consolidated Statements of Income and reductions to the allowance for doubtful accounts in the Consolidated Balance Sheets during the respective quarters.

Valuation of long-lived and intangible assets and goodwill

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), we do not amortize goodwill and other intangible assets with indefinite lives. Our long-lived and intangible assets and goodwill are subject to annual impairment tests, which require us to estimate the fair value of our business compared to the carrying value. The impairment reviews require an analysis of future projections and assumptions about our operating performance. Should such review indicate the assets are impaired, we would record an expense for the impaired assets.

Annual tests or other future events could cause us to conclude that impairment indicators exist and that our goodwill is impaired. For example, if we had reason to believe that our recorded goodwill and intangible assets had become impaired due to decreases in the fair market value of the underlying business, we would have to take a charge to income for that portion of goodwill or intangible assets that we believed was impaired. Any resulting impairment loss could have a material adverse impact on our financial position and results of operations. At December 31, 2004, our goodwill balance was \$32.5 million and our intangible assets with definite lives balance was \$8.3 million, net of accumulated amortization.

Income Taxes

We provide for the effect of income taxes on our financial position and results of operations in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Under this accounting pronouncement, income tax expense is recognized for the amount of income taxes payable or refundable for the current year and for the change in net deferred tax assets or liabilities resulting from events that are recorded for financial reporting purposes in a different reporting period than recorded in the tax return. Management must make significant assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against our net deferred tax asset. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws, allowable deductions, projected tax credits and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our financial position and results of operations. Our assumptions, judgments and estimates relative to the value of our net deferred tax asset take into account predictions of the amount and category of future taxable income. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate, thus materially impacting our financial position and results of operations.

Restatement of Financial Statements

In connection with the financial reporting close process for the year ended December 31, 2005, we became aware of certain tax accounting issues related to prior years and determined that a restatement of our previously issued Consolidated Financial Statements for the years ended December 31, 2000 through December 31, 2004 (the

Restatement Period) was necessary. As a result, we are filing this Form 10-K/A for the year ended December 31, 2004 to restate our Consolidated Financial Statements as of and for the years ended December 31, 2002, 2003, and 2004.

The restatements are primarily the result of certain errors made in connection with the calculation of our income tax credits and evaluation of sales tax expenses. The net income during the Restatement Period was overstated by a total of approximately \$7.4 million, resulting primarily from an error in the method of computing its research and development income tax credit following a small acquisition in 1998 and from not providing the appropriate liability for sales taxes in certain states.

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The following table summarizes the net impact of the restatement corrections for selected balance sheet line items as of December 31, 2003 and 2004 (in thousands):

	Total Current	Total Assets	Total Current Liabilities	Retained Earnings	Total Shareholders Equity	Total Liabilities & Shareholders Equity
December 31, 2003	Assets	Assets	Liabilities	Earnings	Equity	Equity
As previously reported	\$ 193,459	\$ 264,882	\$ 35,296	\$ 83,653	\$ 228,242	\$ 264,882
Adjustments	2,901	1,726	6,206	(6,932)	(4,084)	1,726
As restated	\$ 196,360	\$ 266,608	\$ 41,502	\$ 76,721	\$ 224,158	\$ 266,608

	Total Current	Total Assets	Total Current Liabilities	Retained Earnings	Total Shareholders Equity	Total Liabilities & Shareholders Equity
December 31, 2004	Assets	Assets	Liabilities	Earnings	Equity	Equity
As previously reported	\$ 183,563	\$ 290,501	\$ 44,803	\$ 105,762	\$ 244,627	\$ 290,501
Adjustments	682	(262)	5,814	(7,407)	(5,610)	(262)
As restated	\$ 184,245	\$ 290,239	\$ 50,617	\$ 98,355	\$ 239,017	\$ 290,239

The following table summarizes the net impact of the restatement corrections for selected income statement line items for the three years ended December 31, 2002, 2003, and 2004 (in thousands, except per share data):

	Net Income	Basic Earnings per Share	Diluted Earnings per Share
Year ended December 31, 2002			
As previously reported	\$ 25,196	\$ 0.88	\$ 0.83
Adjustments	(1,591)	(0.06)	(0.05)
As restated	\$ 23,605	\$ 0.82	\$ 0.78

	Net Income	Basic Earnings per Share	Diluted Earnings per Share
Year ended December 31, 2003			
As previously reported	\$ 21,845	\$ 0.74	\$ 0.71
Adjustments	(1,264)	(0.04)	(0.04)
As restated	\$ 20,581	\$ 0.70	\$ 0.67

Diluted

	Net	Basic	Earnings
Year ended December 31, 2004	Income	per Share	per Share
As previously reported	\$22,109	\$ 0.74	\$ 0.71
Adjustments	(475)	(0.02)	(0.01)
As restated	\$21,634	\$ 0.72	\$ 0.70

For further details on the restatement adjustments, see Note 2 to the restated Consolidated Financial Statements in Item 8.

Pursuant to the Public Company Accounting Oversight Board Standards and following a further review and examination of the Company's internal controls, the management has determined that a material weakness existed in the Company's internal controls with respect to processes surrounding the calculation of the income tax provision and the accrual for sales taxes. See Item 9A Controls and Procedures Management's Report on Internal Control over Financial Reporting for further information regarding our reassessment of material weaknesses in internal control over financial reporting.

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Over the past several years, our primary goal has been and continues to be to expand of our position as a leading provider of supply chain execution and optimization solutions by delivering integrated, modular solutions to our customers. With the addition and integration of new products resulting from the acquisitions completed during 2002, 2003 and 2004, as discussed above, along with the synchronized release of new versions of our product suite with enhanced functionality, we were able to accomplish continued revenue growth.

During 2004, we continued to experience the effects of a weak spending environment for information technology in the United States and Europe, in the form of delayed and cancelled buying decisions by customers for our software, services and hardware, deferrals by customers of service engagements previously scheduled and pressure by our customers and competitors to discount our offerings. We believe that a deterioration in the current business climates or continued delay in capital spending within the United States and/or other geographic regions in which we operate, principally the United Kingdom and continental Europe, could have a material adverse impact on our future operations.

In 2005, we plan to continue to enhance our solutions, expand globally and further develop our sales and marketing, including strategic alliances and indirect sales channels. Our success could be limited by several factors, including spending on information technology, the timely release of quality new products and releases, continued market acceptance of our solutions and the introduction of new products by existing or new competitors.

On December 31, 2002, we acquired certain assets of Logistics.com, Inc. for a cash payment of approximately \$21.3 million. The acquisition has been accounted for under the purchase method of accounting; thus the results of operations reflect the incremental effect beginning January 1, 2003. \$1.5 million of the purchase price was allocated to acquired in-process research and development. Values assigned to the acquired in-process research and development (IPRD) were determined using the income approach. To determine the value of the IPRD, we considered, among other factors, the state of development of each project, the time and costs required to complete each project, expected income and associated risks, which included the inherent difficulties and uncertainties in completing the project and achieving technological feasibility and risks related to the viability of and potential changes in future target markets. This analysis resulted in amounts assigned to IPRD for projects that had not yet reached technological feasibility and do not have alternative future uses.

Revenue

	Year Ended December 31, 2002	% Change 2002 to 2003	Year Ended December 31, 2003	% Change 2003 to 2004	Year Ended December 31, 2004
Software and hosting fees	\$ 40,233	7%	\$ 43,229	15%	\$ 49,886
Percentage of total revenues	23%		22%		23%
Services	110,516	17%	129,320	9%	141,492
Percentage of total revenues	63%		66%		66%
Hardware and other	22,675	3%	23,417	1%	23,541
Percentage of total revenues	13%		12%		11%
Recovery relating to bankrupt customer	2,297	*	848	*	
Total revenue	\$ 175,721	12%	\$ 196,814	9%	\$ 214,919

* Percentage is not meaningful

Our revenue consists of fees generated from the licensing and hosting of software; fees from professional services, customer support services and software enhancement subscriptions; and sales of complementary radio frequency and computer equipment, which are considered non-strategic. We believe our revenue growth in the last two years is attributable to several factors, including, among others, increased sales of our expanded product suite, geographic expansion, our market leadership positions as to breadth of product offerings and financial stability and a compelling return on investment proposition for our customers.

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Software and hosting fees. The increase in software and hosting fees from 2002 to 2003 was due to sales of newer products, hosting fees and funded development, relating primarily to the TMS products obtained through the acquisition of Logistics.com. Sales of our solution groups other than our warehouse management solution group increased by \$10.9 million, or 166%, from 2002 to 2003, while sales of our warehouse management solution group decreased by \$7.9 million, or 24%, from 2002 to 2003. The increase from 2003 to 2004 was attributable to an increase of \$2.8 million, or 11%, in sales of our warehouse management solution group and an increase of \$3.9 million, or 22%, for all other solution groups. Sales outside of North America also impacted the increase from 2003 to 2004 as sales increased from 18% of total software and hosting fees in 2003 to 28% in 2004.

Services revenue. The increases in services revenue from 2002 to 2003 and 2003 to 2004 were principally due to: (i) increases of 14% and 13% in 2003 and 2004, respectively, in the number of active engagements required to implement the increased amount of software sold and to upgrade existing customers to more current versions of our offerings; and (ii) renewals of customer support services and software enhancement subscription agreements on a growing installed base. Revenue from software enhancement subscription agreements increased by 30% and 20% during 2003 and 2004, respectively. During the economic downturn, we have experienced some pricing pressures with regard to our services. We believe that the pricing pressures are attributable to global macro-economic conditions and competitive pressures. Our services revenue growth has been and will likely continue to be affected by the mix of products sold. The individual engagements involving our newer products, including TMS, RFID and TPM, typically require less implementation services; however, the number of engagements continue to grow.

Hardware and other. Sales of hardware are non-strategic and largely dependent upon customer-specific desires. Sales of hardware decreased \$0.4 million, or 2%, from approximately \$17.3 million in 2002 to approximately \$16.9 million in 2003 and decreased an additional \$0.4 million, or 2%, to approximately \$16.5 million in 2004. The decreases in hardware sales from 2002 to 2003 and 2003 to 2004 are attributable to customers' desires in the current macro-economic environment to buy hardware from other suppliers offering greater discounts, combined with increased sales of our optimization and transportation products, which require less hardware than our core warehouse management products. As described in the Notes to Consolidated Financial Statements, reimbursements for out-of-pocket expenses are required to be classified as revenue and are included in hardware and other revenue. For 2002, 2003 and 2004, reimbursements by customers for out-of-pocket expenses were approximately \$5.4 million, \$6.5 million and \$7.0 million, respectively.

Recovery relating to bankrupt customer. On January 22, 2002, a significant customer for 2001 filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code. As a result of the filing, the uncertainties around the bankruptcy proceedings and the ultimate timing of payment, we recorded an allowance of \$4.3 million in 2001 to effectively defer revenues arising in the fourth quarter of 2001 from the significant customer, but unpaid at the time of the bankruptcy declaration. We recorded a recovery of approximately \$2.3 million of the receivable in the fourth quarter of 2002. Upon receiving the final cash settlement in June 2003, subsequent to the significant customer emerging from bankruptcy, we recovered an additional \$848,000 of the receivable during the second quarter of 2003. The recoveries were recorded as separate revenue line items in the Consolidated Statements of Income and reductions to the allowance for doubtful accounts in the Consolidated Balance Sheets during the respective quarters.

Table of Contents**Costs and Expenses**

	Year Ended December 31, 2002	% Change 2002 to 2003	Year Ended December 31, 2003	% Change 2003 to 2004	Year Ended December 31, 2004
Cost of software and hosting fees	\$ 1,927	132%	\$ 4,470	(9%)	\$ 4,085
Percentage of software and hosting fees	5%		10%		8%
Amortization of acquired developed technology	1,500	33%	1,999	4%	2,079
Percentage of software and hosting fees	4%		5%		4%
Cost of services	46,611	16%	54,218	21%	65,853
Percentage of services revenues	42%		42%		47%
Cost of hardware and other	19,027	6%	20,123	0%	20,071
Percentage of hardware and other revenues	84%		86%		85%
Research and development	20,780	30%	26,982	7%	28,822
Percentage of total revenues	12%		14%		13%
Sales and marketing	26,413	18%	31,200	9%	34,049
Percentage of total revenues	15%		16%		16%
General and administrative (restated)	22,136	9%	24,117	11%	26,855
Percentage of total revenues	13%		12%		12%
Amortization of acquisition-related intangibles	272	427%	1,433	4%	1,496
Percentage of total revenues	0%		1%		1%
In-process research and development and acquisition-related charges	1,470	*	885	*	
Restructuring charge		*	893	*	

* Percentage is not meaningful

Cost of Software and Hosting Fees. Cost of software and hosting fees consists of the costs associated with software reproduction; hosting services; funded development; media, packaging and delivery, documentation and other related costs; royalties on third-party software sold with or as part of our products; and the amortization of capitalized research and development costs. The increase in cost of software fees, as a percent of software and hosting fees and in absolute dollars, in 2003 is principally attributable to the costs associated with hosting certain of our software solutions, which was approximately \$1.7 million in 2003. As discussed above, we did not offer hosting services

during 2002. In addition, sales of our open systems products as a percentage of total revenue from all products sold, increased from approximately 50% in 2002 to approximately 80% in 2003 which resulted in higher royalties paid to third parties during 2003. The decrease in cost of software fees, as a percentage of software and hosting fees and in absolute dollars, in 2004 is attributable to lower telecommunication costs associated with hosting certain of our software solutions and lower amortization expense. There was approximately \$300,000 of amortization expense in 2003 associated with capitalized development costs, which were fully amortized by the end of 2003.

Amortization of Acquired Developed Technology. Amortization of acquired developed technology increased from \$1.5 million in 2002 to \$2.0 million in 2003 to \$2.1 million in 2004. The increases were the result of the acquisitions of Logistics.com in December 2002, ReturnCentral in June 2003, Streamsoft in October 2003 and Avere in January 2004.

Cost of Services. Cost of services consists primarily of salaries and other personnel-related expenses of employees dedicated to professional and technical services and customer support services. The increases in cost of services from 2002 to 2003 and 2003 to 2004 were principally due to increases in salary-related costs resulting from: (i) increases of 11% and 19%, respectively, in the number of personnel dedicated to the delivery of professional and technical services; and (ii) annual compensation increases. The decrease in the services gross margin from 58% in 2002 and 2003 to 53.5% during 2004 was attributable to the shift in product mix to open systems, fixed price contracts, including unusually high costs associated with the implementation for one particularly challenging customer, and increased costs due to international expansion and training. The implementation of our warehouse management open systems products is more costly than the implementation of our legacy warehouse management product, the iSeries or AS400, due to the lower maturity level of the product and limited experience of the services

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personnel and integration requirements with multiple third party hardware and software products. Due to the shift towards open systems sales and less implementation services on our other products outside of warehouse management, we do not anticipate our services gross margin to return to the 2002 and 2003 levels, although some improvement is anticipated.

Cost of Hardware and other. Cost of hardware decreased from approximately \$13.6 million in 2002 and 2003 to approximately \$13.1 million in 2004 as a direct result of lower sales of hardware. Cost of hardware and other includes out-of-pocket expenses to be reimbursed by customers of approximately \$5.4 million, \$6.5 million and \$7.0 million for 2002, 2003 and 2004, respectively. The increase in reimbursed out-of-pocket expenses is due to increased travel related to the increase in services projects.

Research and Development. Research and development expenses primarily consist of salaries and other personnel-related costs for personnel involved in our research and development activities. The increases in research and development expenses from 2002 to 2003 and 2003 to 2004 are principally attributable to: (i) increases in the number of full-time and contracted personnel dedicated to our ongoing research and development activities; (ii) the expansion of our offshore development center in India, which was formed in 2002; and (iii) annual compensation increases. Domestic research and development personnel increased by approximately 11% from the end of 2002 to the end of 2003 and 4% from the end of 2003 to the end of 2004. The number of personnel related to our offshore development center increased from 32 at December 31, 2002 to 164 at December 31, 2003 to 279 at December 31, 2004. Our principal research and development activities in 2004 focused on the expansion and integration of new products and the synchronized product release, which included expanded product functionality, interoperability and testing.

Computer software development costs are charged to research and development expense until technological feasibility is established, after which remaining software production costs are capitalized. We have defined technological feasibility as the point in time at which we have a detailed program design or a working model of the related product, depending upon the type of development effort. For the years ended December 31, 2002, 2003 and 2004, we capitalized no research and development costs because the costs between the attainment of technological feasibility for the related software product through the date of general release were insignificant.

Sales and Marketing. Sales and marketing expenses include salaries, commissions, travel and other personnel-related costs of sales and marketing personnel and the costs of our marketing and alliance programs and related activities. The increases in sales and marketing expenses from 2002 to 2003 and 2003 to 2004 are principally attributable to: (i) an increase in salary-related costs resulting from a 9% increase in the average number of international and domestic sales and marketing personnel in 2003 compared to 2002 and no increase in 2004 compared to 2003; (ii) greater incentive compensation paid on 7% and 15% higher license and hosting fees in 2003 over 2002 and 2004 over 2003, respectively; and (iii) continued global expansion of our sales and marketing programs.

General and Administrative. General and administrative expenses consist primarily of salaries and other personnel-related costs of executive, financial, human resources, information technology and administrative personnel, as well as facilities, depreciation, legal, insurance, accounting and other administrative expenses. The increases in general and administrative expenses from 2002 to 2003 and 2003 to 2004 were principally attributable to increases in salary-related costs from increases of approximately 16% each year in the average number of general and administrative personnel, primarily from our international expansion, and increased audit and outside consulting costs associated with Sarbanes-Oxley compliance. The increases in general and administrative expenses from 2002 to 2003 and 2003 to 2004 were partially offset by decreases in the amount of expense recorded to provide for sales taxes on consulting and maintenance services performed in those years by our employees for our customers where the collectibility of those taxes from our customers is uncertain. During 2002 and 2003, we recorded sales tax expense of approximately \$1.2 million and \$30,000, respectively, and in 2004, we recorded a reduction in sales tax expense of approximately \$191,000. The sales tax expense decreased as a result of the expiration of certain state sales tax statutes, which resulted in the reversal of previously recorded sales tax liabilities. Depreciation expense is included in general and administrative expenses and was \$6.3 million, \$7.6 million and \$7.2 million during 2002, 2003 and 2004, respectively.

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Amortization of Acquisition-Related Intangibles. We have recorded goodwill and other acquisition-related intangible assets as part of the purchase accounting associated with various acquisitions, including the acquisitions of Logistics.com in December 2002, ReturnCentral in June 2003, Streamsoft in October 2003, Avere in January 2004, and eebiznet in July 2004. The increase in the amortization of acquisition-related intangibles is the result of amortization of intangible assets with finite lives that were purchased as part of the various acquisitions. Effective January 1, 2002, we adopted SFAS No. 142, which requires that goodwill and certain intangible assets no longer be amortized to earnings, but instead be tested for impairment at least annually.

In-Process Research and Development and Acquisition-Related Charges. On December 31, 2002, we acquired certain assets of Logistics.com, Inc. from Internet Capital Group for a cash payment of approximately \$21.3 million. The acquisition was accounted for under the purchase method of accounting. The purchase price was allocated to net assets acquired of \$1.2 million, acquired in-process research and development of \$1.5 million, acquired developed technology of \$1.5 million, and other intangible assets of \$17.1 million.

During the third quarter of 2003, we recorded expenses of \$885,000 relating to fees incurred in connection with two potential acquisitions that we decided not to consummate. The acquisition-related charges are presented as a separate line item in the Consolidated Statements of Income and consist primarily of legal, accounting and travel expenses associated with the two transactions.

Restructuring Charge. During the second quarter of 2003, we recorded a restructuring charge of \$893,000 relating to an internal reorganization. The reorganization more closely aligned our implementation teams and customer support organization with our technical teams. The charge consisted primarily of severance payments. Approximately \$857,000 was paid prior to December 31, 2003 and the remaining \$36,000 was and paid out in January 2004.

	Year Ended December 31, 2002	% Change 2002 to 2003	Year Ended December 31, 2003	% Change 2003 to 2004	Year Ended December 31, 2004
Income from operations (restated)	\$ 35,585	(14%)	\$ 30,494	4%	\$ 31,609
Percentage of total revenues	20%		15%		15%
Other income, net	2,801	(2%)	2,746	19%	3,257
Percentage of total revenues	2%		1%		2%
Income tax provision (restated)	14,781	(14%)	12,659	5%	13,232
Percentage of income before income taxes	39%		38%		38%

Income from Operations. The decrease in operating income from 2002 to 2003 was attributable to a lower margin on our software fees resulting from our hosting services, a \$1.5 million decrease in the amount recovered relating to the bankrupt customer and an overall increase in operating expenses from the continued investment in global expansion initiatives and the further development of our product suite. Operating income for 2002 reflects a recovery relating to the bankrupt customer totaling \$2.3 million; a charge for in-process research and development totaling \$1.5 million associated with the acquisition of Logistics.com, \$1.2 million of sales tax expense on consulting and maintenance services performed for customers and non-cash, acquisition-related intangible asset amortization totaling \$1.8 million. Operating income for 2003 reflects a recovery relating to the bankrupt customer totaling \$0.8 million; acquisition-related expenses of \$0.9 million; a restructuring charge of \$0.9 million; and non-cash, acquisition-related intangible asset amortization totaling \$3.4 million. The increase in operating income from 2003 to 2004 resulted from the growth in higher margin software fees. Operating income for 2004 reflects acquisition-related intangible asset amortization totaling \$3.6 million.

Other Income, Net. Other income, net includes interest income and interest expense and foreign currency gains and losses. Interest income decreased from \$2.1 million in 2002 to \$1.5 million in 2003 due to an overall decline in market

interest rates, and increased to \$2.4 million in 2004 due to an overall increase in market interest rates along with an increase in the cash available to invest. The weighted-average interest rate on investment securities at December 31, 2002 was approximately 1.4%, as compared to 1.1% at December 31, 2003 and 2.2% at December 31, 2004. Interest expense was \$147,000 in 2002, \$13,000 in 2003, and \$26,000 in 2004. We recorded net foreign currency gains of \$0.8 million in 2002, \$1.3 million in 2003, and \$0.9 million in 2004. The foreign

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currency gains resulted from gains on intercompany transactions denominated in U.S. dollars with subsidiaries due to the weakening of the U.S. dollar relative to other foreign currencies, primarily the British Pound and Euro.

Income Tax Provision. The fluctuation in the income tax provision during 2003 and 2004 is directly attributable to the decrease during 2003 and increase during 2004 of income before income taxes. Our effective income tax rates were 38.5%, 38.1% and 38.0% in 2002, 2003 and 2004, respectively. Our effective income tax rate takes into account the source of taxable income, domestically by state and internationally by country, and available income tax credits. The decrease in the tax rates in 2003 was attributable to an increase in income generated in countries with lower tax rates. The impact of the restatement on the 2002, 2003 and 2004 income tax rates was an increase of approximately 2.2%, 3.9% and 1.6% from the previously reported income tax rates. The provisions for income taxes for 2002, 2003 and 2004 do not include the \$14.0 million, \$14.2 million and \$9.7 million of tax benefits realized from stock options exercised during the years, respectively. These tax benefits reduce our income tax liabilities and are included in additional paid-in capital.

Liquidity and Capital Resources

During 2003 and 2004, we funded our operations primarily through cash generated from operations. As of December 31, 2003, we had \$155.4 million in cash, cash equivalents and investments compared to \$172.7 million at December 31, 2004.

Our operating activities provided cash of \$45.5 million in 2002, \$37.0 million in 2003 and \$44.5 million in 2004. Cash from operating activities for 2002 arose principally from a substantial increase in operating income, the income tax benefits arising from exercises of stock options by employees, partially off-set by the increase in accounts receivable. Cash from operating activities for 2003 arose principally from operating income, the income tax benefits arising from exercises of stock options by employees, the increase in deferred revenue and rent, partially off-set by the increase in accounts receivable and decreases in accounts payable and accrued liabilities. Days sales outstanding increased from 65 days at December 31, 2002 to 76 days at December 31, 2003, as a result of slower collections associated with international revenues. Cash from operating activities for 2004 arose principally from operating income, the income tax benefits arising from exercises of stock options by employees, increases in deferred revenue, accounts payable and accrued liabilities, partially off-set by the increase in accounts receivable. Days sales outstanding was 76 days at December 31, 2004, consistent with the prior year.

Our investing activities used approximately \$65.7 million, \$77.8 million, and \$20.9 million of cash during the years ended December 31, 2002, 2003 and 2004, respectively. During 2002, our principal uses of cash were \$21.2 million for the acquisition of Logistics.com, \$6.0 million for purchases of capital equipment to support our business and infrastructure and net purchases of \$38.6 million in investments. During 2003, our principal uses of cash were for net purchases of \$65.3 million in investments, purchases of capital equipment of \$7.7 million to support our business and infrastructure, \$2.6 million for the acquisitions of ReturnCentral and Streamsoft, and the \$2.0 million investment in Alien Technology. During 2004, our principal uses of cash were \$7.6 million for purchases of capital equipment to support our business and infrastructure, \$1.7 million for acquisitions and net purchases of \$11.6 million in investments.

Our financing activities used cash of approximately \$0.9 million in 2002 and \$17.9 million in 2004 and provided approximately \$9.0 million of cash in 2003. The principal uses of cash for financing activities in 2002 was for the repurchase of 260,000 shares of our common stock for approximately \$4.1 million and the repayment of \$5.3 million relating to the note payable issued in conjunction with the acquisition of Intrepa, L.L.C. in October 2000. The principal source of cash provided by financing activities in 2003 was \$9.3 million in proceeds from the issuance of common stock pursuant to the exercise of stock options. The principal uses of cash for financing activities in 2004 was for repurchase of 885,400 shares of our common stock for approximately \$21.8 million, partially off-set by the proceeds from the issuance of common stock pursuant to the exercise of stock options of approximately \$4.0 million. The stock purchases in 2002 and 2004 were through open market transactions as part of a publicly-announced repurchase program.

We believe there are opportunities to grow our business through the acquisition of complementary and synergistic companies, products and technologies. Any material acquisition could result in a decrease to our working capital depending on the amount, timing and nature of the consideration to be paid. Our Board of Directors has approved a

stock repurchase program covering up to \$20 million of our common stock over a period ending no
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later than July 21, 2005, of which \$4.2 million in approved but unspent stock repurchases remains at December 31, 2004. In February 2005, our Board of Directors authorized us to purchase up to \$20 million of our common stock, including the amount that had previously been approved but not yet spent, over a period ending no later than February 3, 2006. We expect to fund purchases under the program through existing cash, cash equivalents and investments.

We believe that our existing liquidity and expected cash flows from operations will satisfy our capital requirements for normal operations for the foreseeable future. We believe that existing balances of cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs at least for the next twelve months, although there can be no assurance that this will be the case.

New Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board (FASB) approved the consensus reached on the EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting provisions of EITF 03-1 were effective for all reporting periods beginning after June 15, 2004, while the disclosure requirements were effective only for annual periods ending after June 15, 2004. The adoption of EITF 03-1 did not have a material effect on the Consolidated Statements of Income, financial position or liquidity.

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004), *Share-Based Payment*, which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Statement 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Statement 123(R) must be adopted no later than July 1, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.

2. A modified retrospective method, which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We will adopt Statement 123(R) beginning on July 1, 2005 and are currently in the process of evaluating which method we will adopt.

As permitted by Statement 123, we currently account for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method will have a significant impact on our results of operations. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income and earnings per share in Note 1. Pro forma net loss for 2002, 2003 and 2004 was \$1.4 million, \$7.7 million and \$9.0 million, respectively, compared to reported net income of \$23.6 million, \$20.6 million and \$21.6 million in 2002, 2003 and 2004, respectively. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This

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requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While we cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions were \$14.0 million, \$14.2 million, and \$9.7 million in 2002, 2003 and 2004, respectively.

In December 2004, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (the Act) that provides tax relief to U.S. domestic manufacturers. The FSP states that the manufacturers' deduction provided for under the Act should be accounted for as a special deduction in accordance with Statement 109 rather than as a tax rate reduction. Also in December 2004, the FASB issued FSP FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004, addressing accounting and disclosure guidance relating to a company's repatriation program. The additional disclosures required under this FSP are included in Note 3, Income Taxes. Both FSPs were effective upon issuance.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Our principal commitments as of December 31, 2004, consist of obligations under operating leases. We expect to fulfill all of the following commitments from our working capital.

Lease Commitments

We lease certain of our facilities and some of our equipment under noncancelable operating lease arrangements that expire at various dates through 2008. Rent expense for these leases aggregated \$4.0 million, \$5.0 million and \$5.9 million during fiscal 2002, 2003 and 2004, respectively.

The following table summarizes our contractual commitments as of December 31, 2004 (in thousands):

	Total	2005	2006	2007	2008	2009	After 2009
Non-cancelable operating leases	\$22,233	\$5,554	\$6,373	\$6,007	\$2,715	\$1,298	\$ 286
Capital leases	\$ 304	\$ 152	\$ 152	\$	\$	\$	\$

Indemnifications

Our sales agreements with customers generally contain infringement indemnity provisions. Under these agreements, we agree to indemnify, defend and hold harmless the customer in connection with patent, copyright or trade secret infringement claims made by third parties with respect to the customer's authorized use of our products and services. The indemnity provisions generally provide for our control of defense and settlement and cover costs and damages finally awarded against the customer, as well as our modification of the product so it is no longer infringing or, if it cannot be corrected, return of the product for a refund. Our sales agreements with customers sometimes also contain indemnity provisions for death, personal injury or property damage caused by our personnel or contractors in the course of performing services to customers. Under these agreements, we agree to indemnify, defend and hold harmless the customer in connection with death, personal injury and property damage claims made by third parties with respect to actions of our personnel or contractors. The indemnity provisions generally provide for our control of defense and settlement and cover costs and damages finally awarded against the customer. The indemnity obligations contained in sales agreements generally have no specified expiration date and no specified monetary limitation on the amount of award covered. We have not previously incurred costs to settle claims or pay awards under these indemnification obligations. We account for these indemnity obligations in accordance with SFAS No. 5, *Accounting for Contingencies*, and record a liability for these obligations when a loss is probable and reasonably estimable. We have not recorded any liabilities for these agreements as of December 31, 2004.

We warrant to our customers that our software products will perform in all material respects in accordance with our standard published specifications in effect at the time of delivery of the licensed products to the customer for 90 days after first use of the licensed products, but no more than 24 months after execution of the license agreement. Additionally, we warrant to our customers that our services will be performed consistent with generally accepted industry standards or specific service levels through completion of the agreed upon services. If necessary, we would

provide for the estimated cost of product and service warranties based on specific warranty claims and claim history. However, we have not incurred significant recurring expense under our product or service warranties. As a result,

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we believe the estimated fair value of these agreements is nominal. Accordingly, we have no liabilities recorded for these agreements as of December 31, 2004.

Item 8. Financial Statements and Supplementary Data*Financial Statements*

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING (AS REVISED)

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rules 13a-15(f) under the Securities Exchange Act of 1934. The company's internal control over financial reporting is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, including our Chief Financial Officer and Principal Accounting Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2004 based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our management concluded that our internal control over financial reporting was not effective as of December 31, 2004 due to material weaknesses.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of December 31, 2004, management has determined that:

- § The Company's controls over monitoring vendor-specific objective evidence of fair value for undelivered elements related to sales contracts with multiple revenue elements were insufficient. Although no material misstatements related to revenue recognition were discovered, until this deficiency is remediated, there is a more than remote likelihood that a material misstatement of the annual or interim consolidated financial statements could occur and not be prevented or detected by the Company's controls in a timely manner.

- § The Company's controls over monitoring the completeness and accuracy of the determination and reporting of sales tax payable were insufficient. Specifically, the Company did not have personnel with sufficient skills and experience to enable the Company to properly determine whether certain consulting and maintenance services were considered taxable transactions in certain states. As a result, the Company concluded that its previously reported general and administrative expenses and accrued liabilities had been understated. These control deficiencies resulted in the restatement of the annual consolidated financial statements for 2002, 2003 and 2004 and for each of the quarters in the years ended December 31, 2003 and 2004.

- § The Company's review and approval controls over the accounting for income taxes, including the determination and reporting of income taxes payable, deferred income tax assets and liabilities and the related income tax provision were insufficient. Specifically, the Company did not have personnel with sufficient skills and experience to enable the Company to properly consider and apply generally accepted accounting principles for taxes, and ensure that the rationale for certain tax positions was adequately documented and appropriately communicated. Additionally, the Company did not maintain effective controls to review and monitor the accuracy of the components of the income tax provision calculations and the related deferred income taxes and income taxes payable. As a result, the Company concluded that its previously reported income tax provision, current and noncurrent deferred income taxes, and income taxes payable had been misstated. These control deficiencies resulted in the restatement of the annual consolidated financial statements for 2002, 2003 and 2004 and for each of the quarters in the years ended December 31, 2003 and 2004.

Because of these material weaknesses, we have concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2004 based on the criteria in the *Internal Control - Integrated Framework*. We previously had concluded that the Company did not maintain effective internal control over financial reporting because of the material weakness related to insufficient controls over monitoring vendor-specific objective

evidence of fair value for undelivered elements related to sales contracts with multiple revenue elements as described above. In connection with the restatement of the Company's consolidated financial statements as discussed in Note 2 to the consolidated financial statements, we have determined that the additional material weaknesses described above also existed at December 31, 2004. Accordingly, we have revised our annual report on internal control over financial reporting.

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Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004 has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Ernst & Young's attestation report on management's assessment of the Company's internal controls over financial reporting appears beginning on page 19 hereof.

/s/ Steven R. Norton

Steven R. Norton
Senior Vice President and Chief
Financial Officer

/s/ Peter F. Sinisgalli

Peter F. Sinisgalli
President and Chief Executive
Officer

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Shareholders

Manhattan Associates, Inc.

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Manhattan Associates, Inc. did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weaknesses identified in management's assessment and described below, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Manhattan Associates, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment:

The Company's controls over monitoring vendor-specific objective evidence of fair value for undelivered elements related to sales contracts with multiple revenue elements were insufficient. Although no material misstatements related to revenue recognition were discovered, until this deficiency is remediated, there is a more than remote likelihood that a material misstatement to the annual or interim consolidated financial statements could occur and not be prevented or detected by the Company's controls in a timely manner.

The Company's controls over monitoring the completeness and accuracy of the determination and reporting of sales tax payable were insufficient. Specifically, the Company did not have personnel with sufficient skills and experience to enable the Company to properly determine whether certain consulting and maintenance services were considered taxable transactions in certain states. As a result, the Company concluded that its previously reported general and administrative expenses and accrued liabilities had been understated. These control

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deficiencies resulted in the restatement of the annual consolidated financial statements for 2002, 2003 and 2004 and for each of the quarters in the years ended December 31, 2003 and 2004.

The Company's review and approval controls over the accounting for income taxes, including the determination and reporting of income taxes payable, deferred income tax assets and liabilities and the related income tax provision were insufficient. Specifically, the Company did not have personnel with sufficient skills and experience to enable the Company to properly consider and apply generally accepted accounting principles for taxes, and ensure that the rationale for certain tax positions was adequately documented and appropriately communicated. Additionally, the Company did not maintain effective controls to review and monitor the accuracy of the components of the income tax provision calculations and the related deferred income taxes and income taxes payable. As a result, the Company concluded that its previously reported income tax provision, current and noncurrent deferred income taxes, and income taxes payable had been misstated. These control deficiencies resulted in the restatement of the annual consolidated financial statements for 2002, 2003 and 2004 and for each of the quarters in the years ended December 31, 2003 and 2004.

Management previously had concluded that the Company did not maintain effective internal control over financial reporting because of the material weakness related to insufficient controls over monitoring vendor-specific objective evidence of fair value for undelivered elements related to sales contracts with multiple revenue elements as described above. In connection with the restatement of the Company's consolidated financial statements as discussed in Note 2 to the consolidated financial statements, management has determined that the additional material weaknesses described above also existed at December 31, 2004. As a result, management has revised its assessment to include these additional material weaknesses in their conclusion that the Company's internal control over financial reporting was not effective as of December 31, 2004. Accordingly, we have revised our annual report on internal control over financial reporting to include a description of these additional material weaknesses.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements (as restated), and this report does not affect our report dated March 16, 2005, except for Note 2 as to which the date is February 28, 2006, on those consolidated financial statements (as restated).

In our opinion, management's assessment that Manhattan Associates, Inc. did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Manhattan Associates, Inc. has not maintained effective internal control over financial reporting as of December 31, 2004, based on the COSO control criteria.

/s/ ERNST & YOUNG LLP

Atlanta, Georgia

March 16, 2005, except for the effect of the material weaknesses described in the seventh, eighth, and ninth paragraphs above, as to which the date is February 28, 2006

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON THE CONSOLIDATED FINANCIAL STATEMENTS**

The Board of Directors and Shareholders

Manhattan Associates, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Manhattan Associates, Inc. and subsidiaries (the Company) as of December 31, 2003 and 2004 (as restated), and the related consolidated statements of income, shareholders' equity, comprehensive income and cash flows for each of the three years in the period ended December 31, 2004 (as restated). Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2003 and 2004 (as restated), and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 (as restated), in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The consolidated financial statements as of December 31, 2003 and 2004 and for each of the three years in the period ended December 31, 2004 have been restated as discussed in Note 2.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2005, except for the effect of the material weaknesses described in the seventh, eighth, and ninth paragraphs in that report, as to which the date is February 28, 2006, expressed an unqualified opinion on management's assessment and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ ERNST & YOUNG LLP

Atlanta, Georgia

March 16, 2005, except for

Note 2, as to which the date is February 28, 2006

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MANHATTAN ASSOCIATES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (RESTATED)
(In thousands, except share and per share data)

	December 31,	
ASSETS	2003	2004
Current assets:		
Cash and cash equivalents	\$ 31,407	\$ 37,429
Short-term investments	114,549	88,794
Accounts receivable, net of a \$3,181 and \$4,171 allowance for doubtful accounts in 2003 and 2004, respectively	40,790	45,996
Deferred income taxes	4,987	4,939
Refundable income taxes		776
Prepaid expenses and other current assets	4,627	6,311
Total current assets	196,360	184,245
Property and equipment, net	13,015	13,598
Long-term investments	9,447	46,433
Acquisition-related intangible assets, net	10,942	8,320
Goodwill, net	31,688	32,469
Deferred income taxes	2,935	2,639
Other assets	2,221	2,535
Total assets	\$ 266,608	\$ 290,239

LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities:		
Accounts payable	\$ 5,235	\$ 6,800
Accrued compensation and benefits	6,702	6,639
Accrued liabilities	10,376	12,647
Current portion of capital lease obligations	132	139
Income taxes payable	917	1,479
Deferred rent	203	203
Deferred revenue	17,937	22,710
Total current liabilities	41,502	50,617
Long-term portion of capital lease obligations	288	148
Deferred rent	660	457
Commitments and contingencies (see footnote 6)		

Shareholders equity:

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Preferred stock, no par value; 20,000,000 shares authorized, no shares issued or outstanding in 2003 or 2004		
Common stock, \$.01 par value; 100,000,000 shares authorized, 30,086,164 shares issued and outstanding in 2003 and 29,580,724 shares issued and outstanding in 2004	301	296
Additional paid-in-capital	146,614	139,871
Retained earnings	76,721	98,355
Accumulated other comprehensive income	720	882
Deferred compensation	(198)	(387)
 Total shareholders' equity	 224,158	 239,017
 Total liabilities and shareholders' equity	 \$ 266,608	 \$ 290,239

The accompanying notes are an integral part of these Consolidated Balance Sheets.

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MANHATTAN ASSOCIATES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (RESTATED)
(In thousands, except per share data)

	Year Ended December 31,		
	2002	2003	2004
Revenue:			
Software and hosting fees	\$ 40,233	\$ 43,229	\$ 49,886
Services	110,516	129,320	141,492
Hardware and other	22,675	23,417	23,541
Recovery relating to bankrupt customer	2,297	848	
 Total revenue	 175,721	 196,814	 214,919
 Costs and expenses:			
Cost of software and hosting fees	1,927	4,470	4,085
Amortization of acquired developed technology	1,500	1,999	2,079
Cost of services	46,611	54,218	65,853
Cost of hardware and other	19,027	20,123	20,071
Research and development	20,780	26,982	28,822
Sales and marketing	26,413	31,200	34,049
General and administrative	22,136	24,117	26,855
In-process research and development and other acquisition-related charges	1,470	885	
Restructuring charge		893	
Amortization of acquisition-related intangibles	272	1,433	1,496
 Total operating expenses	 140,136	 166,320	 183,310
 Income from operations	 35,585	 30,494	 31,609
 Interest income	 2,098	 1,503	 2,383
Interest expense	(147)	(13)	(26)
Other income, net	850	1,256	900
 Income before income taxes	 38,386	 33,240	 34,866
Income tax provision	14,781	12,659	13,232
 Net income	 \$ 23,605	 \$ 20,581	 \$ 21,634
 Basic net income per share	 \$ 0.82	 \$ 0.70	 \$ 0.72
 Diluted net income per share	 \$ 0.78	 \$ 0.67	 \$ 0.70

Weighted average shares:

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Basic	28,653	29,532	30,056
Diluted	30,451	30,882	31,067

The accompanying notes are an integral part of these Consolidated Statements of Income.

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MANHATTAN ASSOCIATES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (RESTATED)
(In thousands, except share data)

	Common Stock		Additional	Retained	Accumulated Other Comprehensive	Deferred	Total
	Shares	Amount	Paid-In Capital	Earnings	Income (Loss)	Compensation	Shareholders Equity
Balance, December 31, 2001	27,719,753	\$ 277	\$ 104,445	\$ 32,535	\$ (25)	\$ (105)	\$ 137,127
Cancellation of common stock options			(5)			5	
Exercise of common stock options	1,571,354	16	8,620				8,636
Buyback of Manhattan common stock	(260,000)	(3)	(4,107)				(4,110)
Tax benefit from stock options exercised			14,024				14,024
Amortization of deferred compensation						58	58
Foreign currency translation adjustment					306		306
Unrealized loss on investments					(28)		(28)
Net income				23,605			23,605
Balance, December 31, 2002	29,031,107	290	122,977	56,140	253	(42)	179,618
Cancellation of common stock options			(24)			24	
Exercise of common stock options	1,046,948	11	9,259				9,270
Issuance of restricted Stock	8,109		232			(232)	
Tax benefit from stock options exercised			14,170				14,170
Amortization of deferred compensation						52	52

Foreign currency translation adjustment	482	482
Unrealized loss on investments	(15)	