

INTER TEL INC  
Form 10-K/A  
April 28, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K/A**

**Amendment No. 1**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF  
1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005**

**Commission file number 1-10211**

**INTER-TEL, INCORPORATED**

(Exact name of registrant as specified in its charter)

Arizona

(State or other jurisdiction of incorporation or  
organization)

86-0220994

(I.R.S. Employer Identification No.)

1615 S. 52<sup>nd</sup> Street

Tempe, Arizona

(Address of principal executive offices)

(Registrant's telephone number, including area code)

85281

(Zip Code)

(480) 449-8900

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, No Par Value

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 Section 15(d) of the Exchange Act. YES  NO

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, 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 or any amendment to this Form 10-K. 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.

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 Exchange Act). YES  NO

As of June 30, 2005, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$485.3 million based on the closing sale price as reported on the Nasdaq National Market System. Shares of Common Stock held by each executive officer and director as of June 30, 2005 have been excluded in that such persons may be deemed to be affiliates.

As of March 22, 2006, there were 26,386,651 shares of the registrant's common stock outstanding.

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**DOCUMENTS INCORPORATED BY REFERENCE**

None.

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Inter-Tel, Incorporated (the Company) is filing this Amendment No. 1 to Form 10-K for the sole purpose of timely providing certain information required by Parts II and III of Form 10-K. No other changes are being made to the Company's Annual Report on Form 10-K filed March 16, 2006.

**PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS****Equity Compensation Plan Information**

The following table summarizes our equity compensation plan information as of December 31, 2005. Information is included for both equity compensation plans approved by Inter-Tel shareholders and equity compensation plans not approved by Inter-Tel shareholders.

| <b>Plan Category</b>   | <b>Common shares<br/>to<br/>be issued upon<br/><br/>exercise of<br/>outstanding<br/>options,<br/>warrants<br/><br/>and rights<br/>(a)</b> | <b>Weighted-average<br/>exercise price<br/>of<br/>outstanding<br/>options,<br/>warrants<br/><br/>and rights<br/>(b)</b> | <b>Common shares<br/>available for future<br/>issuance under<br/>equity<br/>compensation plans<br/>(excluding<br/>securities<br/>reflected in column<br/>(a))<br/>(c)</b> |
|--|---|---|---|
| Equity compensation plans approved by Inter-Tel shareholders     | 3,580,508(1)  | \$ 16.18  | 1,211,807(2)  |
| Equity compensation plans not approved by Inter-Tel shareholders | 275,480(3)  | \$ 18.62  | 152,076   |
| Totals:  | 3,855,988   | \$ 16.36  | 1,363,883   |

(1) Includes options to purchase shares outstanding under the plans approved by Inter-Tel shareholders. Of these shares, options to purchase 100,800 shares were outstanding from the Inter-Tel 1994 Long-Term

Incentive Plan,  
options to  
purchase  
3,337,208 shares  
were outstanding  
from the  
Inter-Tel 1997  
Long-Term  
Incentive Plan  
and options to  
purchase  
142,500 shares  
were outstanding  
from the 1990  
Inter-Tel  
Director Option  
Plan.

- (2) Includes shares  
available for  
future issuance  
under the  
Inter-Tel 1994  
Long-Term  
Incentive Plan,  
the Inter-Tel  
1997 Long-Term  
Incentive Plan,  
the 1990  
Inter-Tel  
Director Option  
Plan and the  
Inter-Tel 1997  
Employee Stock  
Purchase Plan;  
excludes  
securities  
reflected in  
column (a). Of  
these shares,  
33,676 shares  
were available  
under the 1994  
Long-Term  
Incentive Plan,  
708,372 shares  
were available  
under the  
Inter-Tel 1997  
Long-Term  
Incentive Plan,

72,500 shares were available under the 1990 Inter-Tel Director Option Plan and 397,259 shares were available under the Inter-Tel 1997 Employee Stock Purchase Plan. Under the Inter-Tel 1997 Long-Term Incentive Plan, the amount of shares authorized for issuance increases annually by the lesser of (a) 2.5% of the outstanding shares on that date, (b) 750,000 shares (subject to appropriate adjustments for stock splits, dividends, subdivisions, combinations, recapitalizations and like transactions) or (c) a lesser amount as determined by the Inter-Tel Board of Directors.

- (3) As of December 31, 2005, individual options to purchase a total of 275,480 shares had been

assumed or  
issued in  
connection with  
acquisition  
transactions by  
Inter-Tel, at a  
weighted  
average exercise  
price of \$18.62  
per share. These  
options were  
issued under the  
Inter-Tel  
Acquisition  
Stock Option  
Plan, which has  
not been  
approved by  
Inter-Tel  
shareholders.



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(a) Executive Officers See the Section entitled Directors and Executive Officers of the Registrant in Part III, Item 10 of the Company's Annual Report on Form 10-K filed on March 16, 2006.

(b) Directors The names of each of the directors and certain information about each of them are set forth below.

| <b>Name of Nominee</b> | <b>Age</b> | <b>Current Position</b>              | <b>Director Since</b> |
|------------------------|------------|--------------------------------------|-----------------------|
| Norman Stout           | 48         | Director and Chief Executive Officer | 2006                  |
| Alexander Cappello     | 50         | Chairman of the Board                | 2005                  |
| J. Robert Anderson     | 69         | Director                             | 1997                  |
| Jerry W. Chapman       | 65         | Director                             | 1999                  |
| Gary D. Edens          | 64         | Director                             | 1994                  |
| Steven E. Karol        | 51         | Director                             | 2006                  |
| Robert Rodin           | 52         | Director                             | 2006                  |
| Agnieszka Winkler      | 60         | Director                             | 2005                  |

**MR. STOUT** was appointed Chief Executive Officer and a member of Inter-Tel's Board of Directors on February 22, 2006. He began his tenure at Inter-Tel in 1994 as a director. Four years later, he resigned from the board and joined Inter-Tel as executive vice president, chief administrative officer and president of Inter-Tel Software and Services. Prior to joining Inter-Tel, Mr. Stout was Chief Operating Officer of Oldcastle Architectural Products and since 1996, Mr. Stout also had served as President of Oldcastle Architectural West. Mr. Stout held previous positions as President of Superlite Block; Chief Financial Officer and Chief Executive Officer (successively) of Boorhem-Fields, Inc. of Dallas, Texas; and as a Certified Public Accountant with Coopers & Lybrand. He currently serves on the board of directors of Hypercom Corporation, a public company headquartered in Phoenix, Arizona. Mr. Stout holds a Bachelor of Business Administration degree in Accounting from Texas A&M and an MBA from the University of Texas.

**MR. CAPPELLO** was elected as one of our directors in the April, 2005 annual meeting of shareholders, and to Chairman at the July, 2005 Board meeting. Since March 1996, Mr. Cappello has served as the Chairman and Chief Executive Officer of the Cappello Group, Inc., a global boutique merchant bank, which includes Cappello Capital Corp. (member SIPC-NASD). He has over thirty years experience in corporate management & finance, investment banking, merchant banking both in the U.S. and overseas. He is currently or has been a member of the board of directors of several companies and institutions including: University of Southern California (USC) Board of Trustees/President-Elect of the Board of Governors & Alumni Association, RAND Corporation-Center for Middle East Public Policy, Genius Products, Inc. (NASDAQ:GNPI), CytRx Pharmaceuticals, Inc. (NASDAQ:CYTR), and Swiss American Financial & Euro American Financial (Chairman). Mr. Cappello is a member of the Young Presidents Organization (YPO), where he has served as Chairman of the International Board from 2003-2005. He received a Bachelor of Science degree from the Marshall School of Business at USC in 1977 with honors. He has been a guest lecturer at the USC, UCLA, and Harvard Business Schools and is a contributing author of *The New Investor Relations*, being published by Bloomberg PRESS.

**MR. ANDERSON** has served as one of our directors since February 1997 and currently serves as the Chairman of our Compensation Committee. Mr. Anderson held various positions at Ford Motor Company from 1963 to 1983, serving as President of the Ford Motor Land Development Corporation from 1978 to 1983. He served as Senior Vice President, Chief Financial Officer and as a member of the board of directors of The Firestone Tire and Rubber Company from 1983 to 1989, and as Vice

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Chairman of Bridgestone/Firestone, Inc. from 1989 through 1991. He most recently served as Vice Chairman, Chief Financial Officer and as a member of the board of directors of the Grumman Corporation from 1991 to 1994. He currently serves on the boards of GenCorp, Inc. and B-G Corp. Mr. Anderson is currently semi-retired, and he is an active leader in various business, civic and philanthropic organizations.

**MR. CHAPMAN** was elected as one of our directors in December 1999 and previously served as one of our directors from 1989 to 1992. He currently serves as the Chairman of our Audit Committee. As a Certified Public Accountant, he served with a local accounting firm from 1963 through 1969, at which time he joined Ernst & Ernst, a predecessor entity of Ernst & Young LLP. He became a partner of Ernst & Young in 1977 and, until retiring from the firm in 1989, served as engagement partner on a wide variety of audit, assurance and consulting engagements. Additionally, he managed Ernst & Young's practices in Arizona as well as various offices in the adjoining southwest states from 1980 through 1989. He then operated his own consulting firm through 1992 and joined Arthur Andersen in 1993 as a partner specializing in providing business consulting services. He retired from Arthur Andersen in 1999.

Mr. Chapman currently serves on the board of CoBiz Inc., a public company headquartered in Denver, Colorado. Additionally, he provides services for a small number of clients requiring strategic and market-driven services.

**MR. EDENS** has served as one of our directors since October 1994 and currently serves as the Chairman of our Corporate Governance and Nominating Committee. He was an executive with Southern Broadcasting Company 1968-1982, Harte-Hanks Radio, Inc, chief executive officer, 1982-1984, and Edens Broadcasting, Inc., chairman and chief executive officer 1984-1994. Mr. Edens has served on a number of corporate boards, such as Great Western Bank and Citibank (Arizona), as well as holding leadership positions on the Radio Advertising Board, National Radio Broadcasters Association and Young Presidents' Organization. In 1998 he was chairman of the annual international financial seminar for Chief Executives Organization and World Presidents' Organization. Since 1994, he has been president of The Hanover Companies, Inc., a private investment firm. He holds a B.S. Degree in Business Administration from the University of North Carolina at Chapel Hill. In 2005 he participated in continuing education for directors at Harvard Business School.

**MR. KAROL** was elected as one of our directors in February 2006. Mr. Karol is founder, Managing Partner, and Chairman of HMK Enterprises, Inc. and Watermill Group, which consists of Watermill Ventures and Watermill Advisors. He has been an investor, operator, and advisor for almost thirty years. Through HMK and Watermill, he has owned and operated close to 50 companies and has built both into enterprises with over \$1 billion in revenue on several occasions. Mr. Karol serves on several corporate boards including: Mooney Aircraft Company (OTC:MNYG.OB) (Chairman), StockerYale (NASDAQ: STKR), and J. Walter Company. He is also on several not-for-profit boards, including the Tufts University Board of Overseers for the School of Engineering (Chairman), the Vermont Academy Board of Trustees (Chairman), and The Brain Tumor Society (Chairman of Strategic Planning). He is a former International President of the Young Presidents' Organization where he held many positions throughout his twenty-six year relationship with the organization. He is a former trustee of the Boston Ballet and a former overseer of the Boston Symphony Orchestra. Mr. Karol received his Bachelor of Science degree from Tufts University in 1976. He completed the President's Program of Leadership at the Graduate School of Business Administration at Harvard University in 1997.

**MR. RODIN** who was elected as one of our directors in February 2006, is currently the Chairman and CEO of RDN Group; strategic advisors focused on corporate transitions, customer interface, sales and marketing, and supply chain management. Previously, Mr. Rodin was Chairman and CEO of eConnections, a provider of extended supply chain intelligence solutions, which he founded in 1999. From 1991 to 1999, he served as the CEO of Marshall Industries (NYSE:MI), a \$1.8 billion industrial electronics distributor and supply chain management company. Marshall Industries was recognized as the World's Number One Business to Business Website, by Advertising Age Magazine and Information Week Magazine highlighted Marshall Industries as the World's Number One Company in the Use of Technology, Additionally, CIO Magazine recognized Mr. Rodin as one of the Top 100 Leaders for the New Millennium. Following the sale of Marshall to Avnet (NYSE:AVT) in 1999, Mr. Rodin served as president of global supply chain management and electronic commerce solutions and as a member of the Avnet Global Managing Board. Mr. Rodin currently serves as director of Napster (NASDAQ: NAPS), director and Vice Chairman of CommerceNet and director of SM&A (NASDAQ: WINS). Mr. Rodin's best selling book, Free, Perfect and Now: Connecting to the



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Customer Demands , chronicles the radical transformation of Marshall Industries. The changes he led have been taught as case studies at Harvard Business School, Columbia, USC, MIT, and Stanford University.

**MS. WINKLER** was elected as one of our directors in the April 2005 annual meeting of shareholders. Ms. Winkler was the founder, Chairman and CEO of two companies, Winkler Advertising, founded in 1984, and TeamToolz, Inc., founded in 1999, both of which were acquired. She is currently founder and Chairman of The Winkler Group, a management consultancy specializing in marketing efficiency and effectiveness for Fortune 1000 companies. She has served on the board of directors of two NASDAQ companies, SuperCuts and RenoAir, and currently serves on the board of directors of IP Locks, Inc. and the Board of Trustees of Santa Clara University. In addition, she has served on the boards of numerous professional and civic institutions throughout her career and currently sits on the boards of the Committee of 200 Foundation and the Western Folklife Center. Winkler has a BA and an MA and received an MBA from Santa Clara University in 1981. A frequent keynote speaker on the subjects of marketing and branding at industry meetings globally, she is also the author of Warp Speed Branding: The Impact of Technology on Marketing, published by Wiley in the US, China and Turkey.

**Audit Committee**

The Audit Committee of the Board of Directors consists of directors Chapman, Anderson, Cappello and Edens and, until July 22, 2005 when he resigned from the Audit Committee, Dr. Roland Haden was also a member of the Audit Committee. Each of the current members of the Committee is independent within the meaning of the Nasdaq director independence standards, as currently in effect, and Dr Haden was independent by such standards during his tenure as well. The Board of Directors has determined that director Chapman is an Audit Committee financial expert as defined in SEC rules. Mr. Chapman serves as Chairman of the Audit Committee.

Pursuant to the Audit Committee Charter, the Audit Committee reviews, acts and reports to the Board of Directors of the Company on various auditing and accounting matters, including the appointment of the Company's independent auditors, the scope of the Company's annual audits, fees to be paid to the Company's independent auditors, the performance of the Company's independent auditors, the sufficiency of the Company's internal controls and the Company's accounting and financial management practices.

The Audit Committee met four (4) times during the last fiscal year. The Audit Committee also meets with our independent auditors in an executive session, without the presence of our management, on a quarterly basis, following completion of their quarterly reviews and annual audit and prior to our earnings announcements, to review the results of their work.

**Compliance With Section 16(a) of the Exchange Act**

Section 16(a) of the Securities and Exchange Act of 1934 requires the Company's directors and executive officers, and persons who own more than ten percent of a registered class of the Company's equity securities, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of the Company. Officers, directors and greater than ten percent shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based on review of the copies of such reports furnished to the Company and written representations that no other reports were required, during the year ended December 31, 2005, all Section 16(a) filing requirements applicable to its officers, directors and ten percent shareholders were complied with, except as follows: On May 3, 2005, stock options were granted pursuant to the terms of the Director Stock Option Plan to each of the independent directors. The stock options for Agnieszka Winkler were not reported on Form 4 within two business days because Company representatives were unable to obtain a power of attorney to complete the filings because Ms. Winkler was out of the country. For the same reason, the Company was also unable to file Ms. Winkler's Form 3 on a timely basis.

**Table of Contents****Code of Business Conduct**

Inter-Tel has a Code of Business Conduct ( Code ) that applies to all of our employees, including our principal executive officer and principal financial and accounting officer. This code is posted on our Internet web site. The Internet address for our web site is <http://www.inter-tel.com>, and the code may be found as follows:

1. From our main web page at <http://www.inter-tel.com>, first click on Company.
2. Then click on About Inter-Tel .
3. Next, click on Code of Business Conduct.

We will provide a copy of the Code upon request made by email to [financialinfo@inter-tel.com](mailto:financialinfo@inter-tel.com) or by writing to us at Inter-Tel, Incorporated, Attention: Investor Relations, 1615 S. 52<sup>nd</sup> Street, Tempe, Arizona 85281. We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding an amendment to, or waiver from, a provision of this Code by posting such information on our web site, at the address and location specified above, and to the extent required, by filing a Current Report on Form 8-K with the SEC disclosing such information.

**ITEM 11. EXECUTIVE COMPENSATION**

The following Summary Compensation Table sets forth the compensation earned for services rendered to the Company during the fiscal years 2005, 2004 and 2003 by the Chief Executive Officer and the four other most highly compensated executive officers of the Company who were serving as executive officers of the Company at the end of 2005 and whose aggregate salary and bonus in fiscal 2005 exceeded \$100,000 (the *Named Executive Officers* ).

**SUMMARY COMPENSATION TABLE**

| <i>Name and Position</i><br>(a)   | Year<br>(b) | Salary<br>(\$)<br>(c) | Bonus<br>(\$)<br>(2)<br>(d) | Long-Term<br>Compensation<br>Awards;<br>Securities<br>Underlying<br>Options<br>(#)<br>(g) | All<br>Other<br>Compensation<br>(\$)<br>(3)<br>(i) |
|---|-------------|-----------------------|-----------------------------|---|--|
| Steven G. Mihaylo (1)(4)(5)<br>Chief Executive Officer  | 2005        | 350,000               |                             |   | 6,000  |
|   | 2004        | 315,000               |                             |   | 6,000  |
|   | 2003        | 315,000               | 46,707                      |   | 6,032  |
| Norman Stout (1)(4)(5)<br>Exec. Vice President, Chief<br>Administrative Officer<br>and Chief Strategy Officer | 2005        | 335,000               |                             | 70,000  | 16,247   |
|   | 2004        | 315,000               |                             |   | 18,729   |
|   | 2003        | 315,000               | 46,707                      | 100,000   | 15,998   |
| Craig W. Rauchle (4)(5)<br>President and<br>Chief Operating Officer   | 2005        | 335,000               |                             | 70,000  | 47,201   |
|   | 2004        | 315,000               |                             |   | 16,574   |
|   | 2003        | 315,000               | 46,707                      | 100,000   | 50,610   |
| Jeffrey T. Ford (4)(5)<br>Sr. Vice President and<br>Chief Technology Officer                                  | 2005        | 281,000               | 14,261                      | 15,000  | 6,291  |
|   | 2004        | 263,000               | 107,659                     |   | 11,905   |
|   | 2003        | 263,000               | 88,894                      | 10,000  | 5,030  |
| Kurt R. Kneip (5)<br>Sr. Vice President and<br>Chief Financial Officer  | 2005        | 201,000               |                             |   | 6,029  |
|   | 2004        | 188,000               |                             |   | 5,857  |
|   | 2003        | 188,000               | 14,726                      | 7,500   | 5,030  |

(1)

Mr. Mihaylo resigned as Chief Executive Officer on February 22, 2006 and resigned from the Company's Board of Directors on March 6, 2006. Norman Stout was named as Chief Executive Officer and as a member of the Board of Directors on February 22, 2006.

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(2) The Compensation Committee set earnings per share performance levels for the consolidated Company, upon which incentives were placed for each of the Named Executive Officers. Cash bonus awards, based upon meeting or exceeding such performance levels and limited to a percentage of base salary, were set for each executive officer. The maximum bonuses ranged from 60 percent to 125 percent as a percentage of base salary, as noted in the table below. For each of the officers except for Jeff Ford, the bonus to be earned was dependent entirely on meeting established earnings per share goals. Mr. Ford's 2005 bonus was determined

one-third on meeting the earnings per share goal and two-thirds on meeting divisional targets. The bonuses are earned on a sliding scale, with minimum targets that must be met to earn any bonus and maximum targets that must be achieved to earn the highest potential bonus. The bonus payout increases ratably for achievements between the minimum and maximum targets. For 2005, bonus goals based on earnings per share calculations excluded the impact of in-process research and development charges incurred in connection with acquisitions. In addition, although the Committee was authorized to use its discretion to revise the calculated bonus amounts



upwards or downwards based on any information the Committee deems appropriate, no adjustments were made for 2005. The specific earnings per share and divisional targets have not been included in this description in order to maintain the confidentiality of the Company's confidential or commercial business information. Column (d) above reflects net bonuses achieved for these performance targets.

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| Name              | 2005<br>Salary (\$) | 2005 Maximum<br>Bonus<br>Opportunity (%) | 2005 Maximum<br>Bonus<br>Opportunity (\$) | 2005<br>Bonus<br>Achieved |
|-------------------|---------------------|--|---|---------------------------|
| Steven G. Mihaylo | 350,000             | 125%                                     | 437,500                                   |                           |
| Norman Stout      | 335,000             | 100%                                     | 335,000                                   |                           |
| Craig W. Rauchle  | 335,000             | 100%                                     | 335,000                                   |                           |
| Jeffrey T. Ford   | 281,000             | 100%                                     | 281,000                                   | 14,261                    |
| Kurt R. Kneip     | 201,000             | 60%                                      | 120,600                                   |                           |

(3) All Other Compensation included in column (i) above for 2005 includes the following:

| Name              | Auto<br>Allowance | 401K<br>Match | Club Dues | Other (see<br>below) | Total  |
|-------------------|-------------------|---------------|-----------|----------------------|--------|
| <b>2005</b>       |                   |               |           |                      |        |
| Steven G. Mihaylo | 6,000             |               |           |                      | 6,000  |
| Norman Stout      | 6,000             | 6,291         | 3,956     |                      | 16,247 |
| Craig W. Rauchle  | 6,000             | 5,263         | 28,000    | 7,938                | 47,201 |
| Jeffrey T. Ford   |                   | 6,291         |           |                      | 6,291  |
| Kurt R. Kneip     |                   | 6,029         |           |                      | 6,029  |

**2004**

|                   |       |       |       |  |        |
|-------------------|-------|-------|-------|--|--------|
| Steven G. Mihaylo | 6,000 |       |       |  | 6,000  |
| Norman Stout      | 6,000 | 5,905 | 6,824 |  | 18,729 |
| Craig W. Rauchle  | 6,000 | 5,465 | 5,109 |  | 16,574 |
| Jeffrey T. Ford   |       | 5,905 |       |  | 5,905  |
| Kurt R. Kneip     |       | 5,857 |       |  | 5,857  |

**2003**

|                   |       |       |       |        |        |
|-------------------|-------|-------|-------|--------|--------|
| Steven G. Mihaylo | 6,032 |       |       |        | 6,032  |
| Norman Stout      | 6,000 | 5,030 | 4,968 |        | 15,998 |
| Craig W. Rauchle  | 6,000 | 5,030 | 4,195 | 35,385 | 50,610 |
| Jeffrey T. Ford   |       | 5,030 |       |        | 5,030  |
| Kurt R. Kneip     |       | 5,030 |       |        | 5,030  |

Other: During 2005, \$7,938 was included in Mr. Rauchle's income in connection with travel costs incurred by him and his guest for attendance at company-sponsored business trips. In addition, during 2003, Mr. Rauchle received \$35,385 in other compensation related to reimbursement of health and welfare benefits for a family member. No compensation is present under omitted columns (e), (f) and (h).

- (4) Fringe benefits include use of IP telephones or complete Inter-Tel telephone systems in the home. No amounts have been included in the above tables for such use.
- (5) Messrs. Mihaylo, Rauchle, Stout, Ford and Kneip had access to the company aircraft principally for business use. No amounts have been included in the above tables for such use based on the de minimis incremental costs to the Company.

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The following table below sets forth information concerning stock options held or acquired by each of the Named Executive Officers during the year ended December 31, 2005:

**AGGREGATED OPTION EXERCISES IN 2005 AND DECEMBER 31, 2005 OPTION VALUES**

| Name<br>(a)       | Shares                                |   | Number of<br>Unexercised<br>Options at<br>December 31, 2005 | Value of in-the-money<br>options at December 31,         |
|-------------------|---------------------------------------|---|---|--|
|                   | Acquired on<br>Exercise<br>(#)<br>(b) | Value<br>Realized<br>(\$)<br>(1)<br>(c) | (#)<br>Exercisable/<br>Unexercisable<br>(d)                 | 2005 (\$)<br>(2)<br>Exercisable/<br>Unexercisable<br>(i) |
| Steven G. Mihaylo |                                       |   | /   | /  |
| Norman Stout      | 200,000                               | 3,354,465                               | 262,600/134,400   | 1,219,766/1,079,367                                      |
| Craig W. Rauchle  | 225,000                               | 4,283,000                               | 317,600/134,400   | 3,000,568/1,079,367                                      |
| Jeffrey T. Ford   |                                       |   | 119,000/14,000  | 1,027,785/116,875  |
| Kurt R. Kneip     | 20,000                                | 366,685                                 | 36,000/8,500  | 359,685/69,155   |

(1) Based upon the market price of the purchased shares on the exercise date less the option exercise price paid for such shares.

(2) Based upon the market price of \$19.57 per share, which was the closing selling price per share of Common Stock on the Nasdaq National Market on the last day of the Company's 2005 fiscal year, less the option exercise price payable per share.

**OPTION GRANTS IN LAST FISCAL YEAR**

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| Name             | Number of Securities Underlying Options Granted | Percent of Total Options Granted To Employees In Fiscal Year (1) | Exercise Price (\$/Sh) | Expiration Date (2) | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Terms (3) |             |
|------------------|---|--|------------------------|---------------------|---|-------------|
|                  |   |  |                        |                     | 5%(\$)  | 10%(\$)     |
| Norman Stout     | 70,000  | 9.9%   | \$ 19.13               | 5/3/2015            | \$842,153   | \$2,134,181 |
| Craig W. Rauchle | 70,000  | 9.9%   | \$ 19.13               | 5/3/2015            | \$842,153   | \$2,134,181 |
| Jeffrey T. Ford  | 15,000  | 2.1%   | \$ 19.13               | 5/3/2015            | \$ 180,461  | \$ 457,324  |

Increase in market value of the Company's Common Stock for all shareholders at assumed annual rates of stock price appreciation (as used in the table above) from \$19.57 per share, over the ten-year period, based on 26.3 million shares outstanding on December 31, 2005.

|  | 5% (to          | 10% (to         |
|--|-----------------|-----------------|
|  | \$31.88/sh)     | \$50.76/sh)     |
|  | \$323.2 million | \$819.2 million |

(1) The Company granted options to purchase 707,300 shares of Common Stock to employees and directors in fiscal 2005 pursuant to the Company's 1997 Long Term Incentive Plan and Director Stock Option Plan, in each case as amended. The above listed executive officer option grants vest 1/3 per annum on the anniversary of the grant date over 3 years. All Director Stock Option Plan grants vest six months from the date of grant. The exercise

price for each option to purchase Common Stock equals the fair market value of the Common Stock on the date of such grant.

- (2) The term of each option is ten years. Options may terminate before their expiration upon the termination of the optionee's status as an employee or consultant, or upon the death of the optionee.
- (3) Potential realizable value assumes that the stock price increases from the date of grant until the end of the option term (10 years) at the annual rate specified (5% and 10%). Annual compounding results in total appreciation of 62.9% (at 5% per year) and 159.4% (at 10% per year). The assumed annual rates of appreciation are mandated by the rules of the

Securities and Exchange Commission and do not represent the Company's estimate or projection of future stock price growth. Actual gains, if any, on stock option exercises are dependent upon the Company's future financial performance, overall market conditions and the option holders continued employment or consultancy through the vesting period.

**Table of Contents****ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table and footnotes thereto set forth the beneficial ownership of Common Stock of the Company as of the Record Date, by (a) each director and nominee for director of the Company who owned shares as of such date, (b) each of the Named Executive Officers (defined below), (c) all directors and executive officers of the Company as a group and (d) each person known by the Company to be the beneficial owner of more than 5% of the outstanding shares of Common Stock:

**Shares of Common Stock Beneficially Owned**

| <b>Name</b>  | <b>Owned Excluding Stock Options</b> | <b>Right to Acquire (2)</b> | <b>Total Number of Shares (1)</b> | <b>Percent of Total (3)</b> |
|--|--------------------------------------|-----------------------------|-----------------------------------|-----------------------------|
| J. Robert Anderson   | 20,000                               | 35,000                      | 55,000                            | *                           |
| Alexander Cappello   |                                      | 7,500                       | 7,500                             | *                           |
| Jerry W. Chapman   | 4,069                                | 35,000                      | 39,069(4)                         | *                           |
| Gary D. Edens  | 19,792                               | 35,000                      | 54,792                            | *                           |
| Agnieszka Winkler  |                                      | 7,500                       | 7,500                             | *                           |
| Norman Stout   | 18,861                               | 380,333                     | 399,194(5)                        | 1.5                         |
| Craig W. Rauchle   | 5,898                                | 355,190                     | 361,088                           | 1.3                         |
| Jeffrey T. Ford  | 63,672                               | 134,000                     | 197,672(6)                        | *                           |
| Kurt R. Kneip  | 25,078                               | 41,500                      | 66,578(7)                         | *                           |
| All directors and executive officers as a group (9 persons)  | 157,370                              | 1,031,024                   | 1,188,394                         | 4.3                         |
| <i>Other Beneficial Owners:</i>  |                                      |                             |                                   |                             |
| Steven G. Mihaylo<br>P.O Box 19790, Reno, NV 89511   | 5,179,498                            |                             | 5,179,498                         | 18.9                        |
| <i>Entities Affiliated with Barclays (8) 45<br/>Fremont Street, San Francisco, CA 94105</i>                | 2,340,549                            |                             | 2,340,549(8)                      | 8.5                         |
| <i>Dalton, Greiner, Hartmen, Maher &amp; Co<br/>LLC 565 Fifth Ave., Suite 2101, New York,<br/>NY 10017</i> | 1,356,607                            |                             | 1,356,607                         | 4.9                         |

\* Less than 1%.

(1) Determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, as amended. Under this rule, a person is



deemed to be the beneficial owner of securities that can be acquired by such person within 60 days from the Record Date upon the exercise of options. Each beneficial owner's percentage ownership is determined by assuming that all options held by such person (but not those held by any other person) that are exercisable within 60 days from the Record Date have been exercised. All persons named in the table have sole voting and investment power with respect to all shares issuable pursuant to stock options. Unless otherwise noted in subsequent footnotes to this table, the Company believes that all persons named in the table have sole voting and investment power with respect to all shares of

Common Stock  
beneficially  
owned by them.

- (2) Shares that can be acquired through stock options vested through March 22, 2006, or within 60 days of that date.
- (3) Determined by dividing total number of shares by the sum of the total consolidated outstanding shares on the Record Date of 26,386,651 plus 1,031,024 shares that can be acquired through stock options as identified in item (2) above.
- (4) With respect to 4,069 of these shares, Mr. Chapman shares voting and investment power with his spouse.
- (5) With respect to 18,861 of these shares, Mr. Stout shares voting and investment power with his spouse.

(6)

With respect to 62,417 of these shares, Mr. Ford shares voting and investment power with his spouse.

(7) With respect to 20,000 of these shares, Mr. Kneip shares voting and investment power with his spouse.

(8) Based solely upon information contained in a Schedule 13G filed January 31, 2006. Of the total 2,340,549 shares owned, 1,821,669 shares were reported by Barclays Global Investors, NA and 518,880 shares were reported by Barclays Global Fund Advisors. Of these shares, the number of shares to which Barclays has sole power to vote or direct the vote totaled 2,084,456 shares,

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and sole power to dispose or to direct the disposition of totaled 2,340,549 shares.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

In February 2004, our Board of Directors approved two forms of Key Employee Change of Control Severance Agreements ( *Change of Control Agreements* ), entered into between the Company and each of our executive officers and one other key employee, as set forth in the table below. We entered into Change of Control Agreements with the following executive officers and key employee in March 2004:

**Change of Control Severance Agreements**

|                   |                 |
|-------------------|-----------------|
| Tier 1 (a)        | Tier 2 (b)      |
| Steven G. Mihaylo | Jeffrey T. Ford |
| Norman Stout      | John L. Gardner |
| Craig W. Rauchle  | Kurt R. Kneip   |

(a) Refer to Exhibit 10.63 to our Annual Report on Form 10-K filed March 12, 2004 for a copy of the sample Tier 1 Agreement.

(b) Refer to Exhibit 10.64 to our Annual Report on Form 10-K filed March 12, 2004 for a copy of the sample Tier 2 Agreement.

As noted, Steven G. Mihaylo resigned as Chief Executive Officer of the Company on February 22, 2006. Accordingly, the Key Employee Change of Control Severance Agreement between Mr. Mihaylo and the Company terminated as of such date, with Mr. Mihaylo receiving no benefits pursuant to the terms of the agreement. Inter-Tel Integrated Systems, Inc., a wholly-owned subsidiary of the Company, employs Carter Chapman as one of its Directors of Channel Sales. Carter Chapman is the son of Jerry Chapman, one of the Company's directors. In fiscal 2005, Carter Chapman's base salary and incentive-based sales commissions paid by the Company totaled \$95,899, and he was granted a stock option to acquire 1,250 shares of Inter-Tel Common Stock at the fair market value on the date of grant in May 2005.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The Audit Committee has established a policy of pre-approving audit and non-audit services provided by the auditors of Inter-Tel. Each of the fees for services listed below for 2005 were pre-approved by Inter-Tel's Audit Committee. The Audit Committee's review included matters to be considered under the rules of the SEC, including the nature and extent of non-audit services, to ensure that the auditors' independence would not be impaired. The Audit Committee expressed its satisfaction with Ernst & Young LLP in all of these respects. The Audit Committee of our board of directors has determined that the provision of services by Ernst & Young LLP other than for audit related services is compatible with maintaining the independence of Ernst & Young LLP as our independent auditors.

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The following table sets forth the approximate aggregate fees billed by Ernst & Young LLP to Inter-Tel during fiscal 2005 and 2004:

|  | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|
| Audit Fees (1)                             |             |             |
| Audit of consolidated financial statements | \$283,000   | \$231,000   |