

AGILE SOFTWARE CORP
Form 10-Q
September 08, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2005

OR

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

For the transition period from _____ to _____

Commission file number 000-27071

AGILE SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

77-0397905
(I.R.S. Employer
Identification No.)

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

(Address of principal executive office)

(408) 284-4000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

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

The number of shares of Common Stock of Agile Software Corporation issued and outstanding as of July 31, 2005 was 53,595,262.

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AGILE SOFTWARE CORPORATION

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JULY 31, 2005

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

	July 31,	April 30,
	2005	2005 (1)
	<u> </u>	<u> </u>
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 77,356	\$ 81,760
Short-term investments	99,106	93,444
Accounts receivable, net of allowance for doubtful accounts of \$1,879 and \$1,892 as of July 31, 2005 and April 30, 2005, respectively	27,024	26,899
Other current assets	5,327	5,157
	<u> </u>	<u> </u>
Total current assets	208,813	207,260
Long-term investments	21,921	23,176
Property and equipment, net	10,087	10,067
Intangible assets, net	11,108	12,735
Other assets	1,056	1,127
Goodwill	66,769	66,658
	<u> </u>	<u> </u>
Total assets	\$ 319,754	\$ 321,023
	<u> </u>	<u> </u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable	\$ 7,661	8,409
Accrued expenses and other liabilities	17,208	16,275
Accrued restructuring, current	1,075	2,010
Deferred revenue	26,757	25,190
	<u> </u>	<u> </u>
Total current liabilities	52,701	51,884
Accrued restructuring, non-current	537	615
Other non-current liabilities	6,823	7,643
	<u> </u>	<u> </u>
Total liabilities	60,061	60,142
	<u> </u>	<u> </u>
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common Stock	54	54

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Additional paid-in capital	552,143	551,846
Notes receivable from stockholders	(77)	(77)
Unearned stock compensation		(526)
Accumulated other comprehensive loss	(82)	(1,391)
Accumulated deficit	(292,345)	(289,025)
	<u> </u>	<u> </u>
Total stockholders' equity	259,693	260,881
	<u> </u>	<u> </u>
Total liabilities and stockholders' equity	\$ 319,754	\$ 321,023
	<u> </u>	<u> </u>

(1) Amounts as of April 30, 2005 have been derived from audited financial statements as of that date.

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

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

	Three Months Ended July 31,	
	2005	2004
Revenues:		
License	\$ 13,401	\$ 10,314
Service	20,983	16,167
Total revenues	34,384	26,481
Cost of revenues:		
License	772	1,077
Service (1)	11,682	7,569
Amortization of intangible assets	725	178
Total cost of revenues	13,179	8,824
Gross margin	21,205	17,657
Operating expenses:		
Sales and marketing (1)	12,830	10,336
Research and development (1)	8,221	5,330
General and administrative (1)	3,446	2,733
Amortization of intangible assets	602	656
Restructuring charges		2,132
Total operating expenses	25,099	21,187
Loss from operations	(3,894)	(3,530)
Interest and other income, net	870	800
Loss before provision for income taxes	(3,024)	(2,730)
Provision for income taxes	296	273
Net loss	\$ (3,320)	\$ (3,003)
Net loss per share:		
Basic and diluted	\$ (0.06)	\$ (0.06)
Weighted average shares	53,591	52,442

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(1) Effective May 1, 2005, Agile adopted FAS 123(R), Share-Based Payments, and uses the modified prospective method to value its share-based payments. Accordingly, for the three months ended July 31, 2005, stock compensation was accounted under FAS 123(R) while for the three months ended July 31, 2004, stock compensation was accounted under APB 25, Accounting for Stock Issued to Employees. See Note 1 - Summary of Significant Accounting Policies. The amounts in the tables above includes stock compensation as follows:

Cost of service revenue	\$ 92	\$ 90
Sales and marketing	413	159
Research and development	61	15
General and administrative	198	72
	<hr/>	<hr/>
Total stock compensation	\$ 764	\$ 336
	<hr/>	<hr/>

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

Table of Contents**AGILE SOFTWARE CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Three Months Ended July 31,	
	2005	2004
Cash flows from operating activities:		
Net loss	\$ (3,320)	\$ (3,003)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for doubtful accounts	16	100
Depreciation and amortization	2,441	2,171
Stock compensation	764	336
Non-cash portion of restructuring charges		39
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(597)	(1,194)
Other assets, current and non-current	(207)	(315)
Accounts payable	(489)	1,270
Accrued expenses and other liabilities	28	(1,200)
Deferred revenue	1,797	(221)
Net cash provided by (used in) operating activities	433	(2,017)
Cash flows from investing activities:		
Purchases of investments	(15,436)	(47,085)
Proceeds from maturities of investments	12,097	57,225
Cash paid in business combinations, net of cash acquired	189	(266)
Acquisition of property and equipment	(1,227)	(812)
Net cash provided by (used in) investing activities	(4,377)	9,062
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of repurchases	57	632
Repayment of notes receivable from stockholders		4
Net cash provided by financing activities	57	636
Effect of exchange rate changes on cash	(517)	326
Net increase (decrease) in cash and cash equivalents	(4,404)	8,007
Cash and cash equivalents at beginning of period	81,760	45,337
Cash and cash equivalents at end of period	\$ 77,356	\$ 53,344
Supplementary disclosure of cash flows information		
Cash paid during the period for taxes	\$ 143	\$ 173

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

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AGILE SOFTWARE CORPORATION

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Summary of Significant Accounting Policies:

Basis of presentation

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

Reclassifications

Certain reclassifications have been made to the prior year consolidated statements of cash flows to conform to the current year presentation. These reclassifications have no impact on previously reported net loss or net cash activities.

As a result of changes in industry practice related to auction rate securities and in order to comply with the requirements of applicable accounting literature, we reclassified our auction rate securities previously classified as cash equivalents, as short-term investments beginning with the quarter ended January 31, 2005. The Company had historically classified these instruments as cash equivalents if the period between interest rate resets was 90 days or less, which was based on our ability to either liquidate our holdings or roll our investment over to the next reset period. As a result of this reclassification, cash and cash equivalents was reduced, and short term investments was increased, by \$66.6 million and \$67.7 million at July 31, 2004 and April 30, 2004, respectively, and corresponding changes were made in our unaudited condensed consolidated statements of cash flows. This reclassification has no impact on our net loss or net loss per share for any period presented.

These securities are classified as available-for-sale pursuant to Statement of Accounting Standards No. 115. Furthermore, we classified these securities as short-term because (i) we acquired and held these securities with the intent to liquidate them as the need for working capital arose in the ordinary course of business; (ii) we are able to either liquidate our holdings or roll our investment over to the next reset period at each interest rate reset interval, usually every 7, 28 or 35 days. In addition, as a result of the ability to sell the securities as part of the auction process at short, predetermined intervals, they are priced and traded in the financial markets as short-term instruments.

Concentrations of credit risk and significant customers

In the three months ended July 31, 2005, none of our customers accounted for more than 10% of our total revenue and one customer represented 10% of our net accounts receivable. In the three months ended July 31, 2004, none of our customers accounted for more than 10% of our total revenue or 10% of our net accounts receivable.

Stock compensation

We adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, effective May 1, 2005. SFAS 123R requires the recognition of the fair value of stock compensation in net income. We recognize the stock compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. All of our stock compensation are accounted for as an equity instrument. Prior to May 1, 2005, we followed Accounting Principles Board (APB) Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for our stock compensation.

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

Table of Contents**AGILE SOFTWARE CORPORATION****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Under the provisions of SFAS 123R, we recorded \$764,000 of stock compensation on our unaudited condensed consolidated statement of operations for the three months ended July 31, 2005. We utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted after the adoption of SFAS 123R. The weighted-average fair values of the options granted under the stock option plans and shares subject to purchase under the employee stock purchase plan for the period were \$4.49 and \$1.78, respectively, using the following assumptions:

	Three Months Ended July 31, 2005	
	Stock Option Plan	Purchase Plan
Dividend yield		
Expected volatility	67%	37%
Average risk-free interest rate	3.58%	3.24%
Expected life (in years)	4.5	.5

The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. Expected volatility is based on the combination of historical volatility of our common stock over the period commensurate with the expected life of the options and the mean historical implied volatility from traded options with a term greater than 240 days measured over one year. The risk-free interest rate is derived from the average U.S. Treasury Strips rate during the period, which approximate the rate in effect at the time of grant. The expected life calculation is based on the observed and expected time to post-vesting exercise and forfeitures of options by our employees.

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

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

	Three Months Ended July 31, 2004	
Net loss as reported	\$	(3,003)
Add: employee stock compensation included in reported net loss		340

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Less: employee stock compensation under SFAS No. 123	(4,703)
Pro forma net loss	\$ (7,366)
Net loss per basic and diluted share as reported	\$ (0.06)
Pro forma net loss per basic and diluted share	\$ (0.14)

During the three months ended July 31, 2004, the weighted-average fair values of the options granted under the stock option plans and shares subject to purchase under the employee stock purchase plan were \$4.14 and \$2.72, respectively, using the following assumptions:

	Three Months Ended July 31, 2004	
	Stock Option Plan	Purchase Plan
Dividend yield		
Expected volatility	47%	47%
Average risk-free interest rate	3.83%	1.64%
Expected life (in years)	5	.5

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AGILE SOFTWARE CORPORATION

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The amortization of stock compensation under SFAS 123R for the period after its adoption, and under APB 25 or SFAS 123 (pro forma disclosure) for the period prior to the adoption of SFAS 123R was done in accordance with Financial Accounting Standard Board (FASB) Interpretation (FIN) No. 28 (i.e. accelerated method). Total compensation cost of options granted but not yet vested as of July 31, 2005 was \$5.2 million, which is expected to be recognized over the weighted average period of 2 years.

Stock Option Acceleration

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

The primary purpose of the accelerated vesting was to reduce future compensation expense associated with the accelerated stock options upon the planned adoption of SFAS 123R. We estimate that the acceleration eliminated \$24.7 million in future compensation charges we would otherwise have taken with respect to the accelerated options. The Company's Board of Directors believes, based on its consideration of the expense savings and the current intrinsic and perceived value of the accelerated stock options, that the acceleration is in the best interests of the Company and its shareholders. The Board of Directors further believes that the acceleration is consistent with anticipated changes in the Company's overall equity compensation approach, which are expected to include a reduced use of stock options.

Option Exchange

On July 11, 2005, Agile extended an offer to exchange outstanding options with an exercise price of \$6.76 per share or greater for new options with an exercise price of \$0.001. The exchange ratio in the offer was one new option share for each three old option shares tendered for exchange. The new options vest over a period of approximately two years. Participation in the offer was voluntary, and was limited to then-current employees. Non-employee members of the board of directors were not eligible to participate. At the time the offer was made, there were options to purchase 19.1 million shares outstanding, of which options to purchase approximately 14 million shares were eligible for exchange in the exchange offer.

On August 19, 2005, the exchange offer expired. Of the approximately 14 million options eligible to participate in exchange offer, 11.4 million options were surrendered and exchanged into approximately 3.8 million new options. As a result of the exchange, our total number of options outstanding (overhang) decreased by 7.6 million to approximately 11.5 million. For financial accounting purposes, we will record a compensation expense of \$1 million to \$2 million in connection with the exchange, which will be recognized over the approximately two year vesting term of the new options.

Unearned stock compensation

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

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During the three months ended July 31, 2004, we terminated the employment of individuals for whom we had recorded unearned stock compensation and had recognized related expense on an accelerated basis. Upon termination, we recorded as a recovery within the statements of operations the difference between the actual expense recorded using the accelerated method and the expense that would have been recorded under the straight-line method. Additionally, during the three months ended July 31, 2004, the termination of these individuals reduced unearned stock compensation, which would have been amortized to future expense, by \$33,000.

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

	Three Months Ended July 31, 2004
Amortization - employees	\$ 342
Amortization - non-employees	(4)
Recovery - employees	(2)
Total stock compensation	\$ 336

Note 2 Net Loss Per Share:

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

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

	Three Months Ended July 31,	
	2005	2004
Numerator:		
Net loss	\$ (3,320)	\$ (3,003)

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Denominator:		
Weighted average shares	53,591	52,466
Weighted average unvested shares of restricted common stock subject to repurchase		(24)
Denominator for basic and diluted calculation	53,591	52,442
Net loss per share:		
Basic and diluted	\$ (0.06)	\$ (0.06)

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

	Three Months Ended July 31,	
	2005	2004
Unvested common stock subject to repurchase		23
Options to purchase common stock	19,158	19,769
Total shares excluded	19,158	19,792

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

	Three Months Ended	
	July 31,	
	2005	2004
Net loss	\$ (3,320)	\$ (3,003)
Other comprehensive gain (loss):		
Unrealized gain (loss) on investments	1,068	(344)
Foreign currency translation adjustment	242	(219)
Other comprehensive gain (loss)	\$ 1,310	\$ (563)
Total comprehensive loss	\$ (2,010)	\$ (3,566)

Note 4 Business Combinations - Cimmetry:

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

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

The aggregate purchase price for the Cimmetry acquisition has been allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition see table below. The net tangible assets acquired and liabilities

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assumed in the acquisition, as discussed further below, were recorded at the fair value, which approximated the carrying amounts at the acquisition date. We determined the valuation of the identifiable intangible assets using future revenue assumptions and a valuation analysis from an independent appraiser. The amounts allocated to the identifiable intangible assets were determined through established valuation techniques accepted in the technology and software industries. In calculating the value of the acquired in-process research and development (IPR&D), we gave consideration to relevant market size and growth factors, expected industry trends, the anticipated nature and timing of new product introductions by us and our competitors, individual product sales cycles, and the estimated lives of each of the products derived from the underlying technology. The value of the acquired IPR&D reflects the relative value and contribution of the acquired research and development. Consideration was given to the stage of completion, the complexity of the work completed to date, the difficulty of completing the remaining development, costs already incurred, and the expected cost to complete the project in determining the value assigned to the acquired IPR&D. The amounts allocated to the acquired IPR&D were immediately expensed in the period the acquisition was completed because the projects associated with the IPR&D efforts had not yet reached technological feasibility and no future alternative uses existed for the technology. The income approach, which includes an analysis of the cash flows and risks associated with

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achieving such cash flows, was the primary technique utilized in valuing the other identifiable intangible assets. Key assumptions included discount factors ranging from 20% to 23%, estimates of revenue growth, maintenance renewal rates, cost of sales, operating expenses and taxes. The purchase price in excess of the identified tangible and intangible assets was allocated to goodwill.

The aggregate purchase price for the Cimmetry acquisition has been allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition as follows (in thousands):

	<u>Cimmetry</u>
Tangible assets acquired:	
Cash and cash equivalents	\$
Accounts receivable	3,472
Property and equipment	135
Other assets	140
Liabilities assumed:	
Accounts payable	(353)
Accrued expenses and other liabilities	(1,087)
Deferred revenue	(1,524)
Identifiable intangible assets acquired:	
In-process research and development	1,700
Other identifiable intangible assets:	
Developed technology	6,600
Customer relationships	2,400
Trademark	1,200
Non-compete agreements	80
Goodwill	31,284
	<u> </u>
Total	\$ 44,047
	<u> </u>

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

Balance as of April 30, 2005	\$ 66,658
Cimmetry purchase price allocation adjustments	111
	<u> </u>

Balance as of July 31, 2005	\$ 66,769
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Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is no longer subject to amortization. Rather, we evaluate goodwill for impairment at least annually or more frequently if events and changes in circumstances suggest that the carrying amount may not be recoverable.

As at July 31, 2005, \$31.2 million of goodwill is deductible for that purpose.

Table of Contents**AGILE SOFTWARE CORPORATION****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Intangible Assets**

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

	July 31, 2005			April 30, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible Assets:						
Developed technologies	\$ 9,200	\$ (2,690)	\$ 6,510	\$ 9,200	\$ (1,965)	\$ 7,235
Customer relationships	6,882	(3,424)	3,458	7,182	(2,892)	4,290
Trademark	1,200	(120)	1,080	1,200	(60)	1,140
Non-compete agreements	1,280	(1,220)	60	1,280	(1,210)	70
	<u>\$ 18,562</u>	<u>\$ (7,454)</u>	<u>\$ 11,108</u>	<u>\$ 18,862</u>	<u>\$ (6,127)</u>	<u>\$ 12,735</u>

All of our acquired identifiable intangible assets are subject to amortization and have approximate original estimated weighted-average useful lives as follows: Developed technologies three to five years; Customer relationships three years; Trademark five years; Non-compete agreements two year. No significant residual value is estimated for the intangible assets.

As of July 31, 2005, the estimated future amortization expense of acquired identifiable intangible assets is as follows (in thousands):

Fiscal Years:	
2006 (remaining nine months)	\$ 4,056
2007	4,037
2008	2,595
2009	240
2010	180
Total	<u>\$ 11,108</u>

Note 6 Restructuring Charges:

From time to time, management has initiated various restructurings of our operations and facilities. These restructurings have been taken primarily in response to redundant or excess capacity brought about by acquisitions and/or significant changes in economic conditions and market demand. During the second quarter of fiscal 2003, we recorded a restructuring charge of \$5.2 million (the 2003 Restructuring). The 2003 Restructuring consisted primarily of the consolidation of excess facilities and abandonment of certain assets in connection with the consolidation of excess facilities. As of July 31, 2005, \$647,000 of the 2003 Restructuring obligations remained, which represents costs related to excess facilities.

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

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

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

As of July 31, 2005, \$545,000 of the 2004 Restructuring obligations remained, which represents costs related to excess facilities.

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

Table of Contents**AGILE SOFTWARE CORPORATION****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

We review the assumptions used in estimating our restructuring charges, principally sublease income expectations for excess facilities and employee termination expenses, quarterly. Based upon this review, we did not make any adjustments to our prior restructuring estimates and assumptions during the quarter ended July 31, 2005. Furthermore, we currently do not expect our existing restructuring estimates and assumptions to change materially.

Summary of Restructuring Obligations

The significant activity within and components of the restructuring charges during the three months ended July 31, 2005 are as follows (in thousands):

	Employee Termination Costs	Facility- Related Costs	Total
Restructuring obligations at April 30, 2005 (1)	\$ 420	\$ 2,205	\$ 2,625
Cash payments		(1,013)	(1,013)
Restructuring obligations at July 31, 2005 (2)	\$ 420	\$ 1,192	\$ 1,612
Accrued restructuring, current			\$ 1,075
Accrued restructuring, non-current			537
			\$ 1,612

- (1) The 2005 Restructuring charges and related obligations were recorded at fair value, after giving effect to the fair value of the related obligations, in accordance with SFAS No. 146.
- (2) The remaining employee termination obligations are expected to be paid through the quarter ending January 31, 2006. The remaining facility-related obligations are expected to be paid through the quarter ending January 31, 2008, with the majority expected to be fully paid by August 2005.

Note 7 Commitments and Contingencies:**Indemnification obligations**

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

Litigation

On or around October 25, 2001, a class action lawsuit was filed on behalf of holders of Agile securities in the Southern District of New York against Agile Software Corporation, Bryan D. Stolle and Thomas P. Shanahan (collectively the Agile Defendants) and others including underwriters Morgan Stanley and Deutsche Bank Securities. The case is now captioned *In re Agile Software, Inc. Initial Public Offering Securities Litigation*, 01 CIV 9413 (SAS), related to *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS).

On or about April 19, 2002, plaintiffs electronically served an amended complaint. The amended complaint is brought purportedly on behalf of all persons who purchased the Company's common stock from August 19, 1999 through December 6, 2000. It names as defendants the Agile Defendants; and several investment banking firms that served as underwriters of the

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AGILE SOFTWARE CORPORATION

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Company's initial public offering and secondary offering. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The amended complaint also alleges that false analyst reports were issued. No specific damages are claimed.

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

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

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

We are also subject to various other claims and legal actions arising in the ordinary course of business. In our opinion, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on our business, financial condition or results of operations.

Note 8 Segment and Geographic Information:

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

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The following geographic information is presented for the three-months ended July 31, 2005 and 2004 (in thousands, except percentages):

	As percentage of total revenue			
	Three Months Ended		Three Months Ended	
	July 31,		July 31,	
	2005	2004	2005	2004
Revenues:				
North America	\$ 24,686	\$ 17,298	72%	65%
Europe	8,860	6,981	26	26
Asia-Pacific	838	2,202	2	9
	\$ 34,384	\$ 26,481	100%	100%

No single customer has accounted for 10% or more of total revenues for the three-months ended July 31, 2005 and 2004.

Table of Contents**AGILE SOFTWARE CORPORATION****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

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

	July 31, 2005	April 30, 2005
	<u> </u>	<u> </u>
Long-lived assets:		
North America	\$ 8,444	\$ 8,335
Europe	1,214	1,401
Asia-Pacific	429	331
	<u> </u>	<u> </u>
	\$ 10,087	\$ 10,067
	<u> </u>	<u> </u>

Note 9 Subsequent Event

On August 19, 2005, our offer to employees to exchange every three outstanding options with an exercise price of \$6.76 per share or greater for one new option with an exercise price of \$0.001 expired. Of the approximately 14 million options eligible to participate in exchange offer, 11.4 million options were surrendered and exchanged into approximately 3.8 million new options. As a result of the exchange, our total number of options outstanding (overhang) decreased by 7.6 million to approximately 11.5 million. For financial accounting purposes, we will record a compensation expense of \$1 million to \$2 million in connection with the exchange, which will be recognized over the approximately two year vesting term of the new options.

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Item 2. Management's Discussion & Analysis of Financial Condition and Results of Operations

The information in this discussion contains forward-looking statements (within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended). Such statements are based upon current expectations that involve risks and uncertainties, and we undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this report. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, anticipates, plans, expects, intends, and similar words are used to identify forward-looking statements. Our actual results and the timing of certain events may differ materially from those reflected in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the Risk Factors section included below in this Quarterly Report on Form 10-Q as well as in the Risk Factors section included in our Annual Report of Form 10-K, filed on July 14, 2005. The following discussion should be read in conjunction with the Unaudited Condensed Consolidated Financial Statements and notes thereto appearing elsewhere in this report. Our fiscal year ends on April 30 of each year.

Business Overview

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

We believe that understanding the following key developments is helpful to an understanding of our operating results for fiscal 2006.

Increased Product Breadth

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

Expanded Industry Focus

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

Electronics and high technology;

Industrial products;

Life sciences; and

Others.

Acquisitions

Our strategy has been, and continues to be, to expand our business both organically and through acquisitions of complementary products, technologies and companies. We have made the following acquisitions since December 2002:

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

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

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

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

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

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Through the acquisition of Eigner we acquired what is now our Product Catalog, Requirements Management, Configuration Management, Engineering Collaboration and Maintenance, Repair and Overhaul products. Eigner also provided us with a stronger presence in the automotive supply chain, industrial equipment, aerospace and defense industries, as well as in certain geographic markets such as the Central European region. Through the acquisition of TRADEC we acquired additional functionality to our existing products as well as new customers. Through the acquisition of Cimmetry we acquired visual collaboration software that has become an increasingly important element of PLM solutions. The results of all of these acquisitions are included in our statements of operations beginning as of the respective acquisition date.

Restructurings

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

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

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

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

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

Overview of Our Results

We derive revenues from the license of software products under software license agreements and from the delivery of associated professional and maintenance services. Our license revenue is comprised of fees charged for the use of our products licensed under perpetual arrangements. Our service revenue is comprised of fees charged for implementation services and fees charged for post-contract customer support (i.e., technical support and product updates). Our implementation services are typically provided over a period of three to six months subsequent to the signing of a software license arrangement. Post-contract customer support is generally purchased at the time of initial license purchase, and renewed annually thereafter. Post-contract customer support revenue is recognized ratably over the support period, generally 12 months.

Our year over year revenues increased as a result of stronger sales from the North American region. While we believe that demand for our products in North America is strengthening, we have not yet seen the same strengthening in the market outside North America, and in Japan, we have generally experienced declining license revenue over the past several quarters. We will continue to seek to increase revenues from customers in North America as well as internationally. In fiscal 2005 we began to reorganize our international sales organization, a process that is still underway. In connection with these changes, we have recently hired new country managers for Taiwan and Japan.

We were able to achieve the following results in the first quarter of fiscal 2006:

We recorded record fiscal quarter total revenues of 34.4 million, a 30% increase from total revenues of \$26.5 million in the prior-year period.

Our license revenue reached \$13.4 million, a 30% increase from license revenue of \$10.3 million in the prior-year period.

Our cash flows provided by operations were \$433,000. In addition, we maintained a cash and investments balance as of July 31, 2005 of \$198.4 million.

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Due to the amortization of the intangibles as a result of the Cimmetry acquisition and the adoption of SFAS No. 123R effective in our first quarter of fiscal 2006, we will likely not be profitable on a GAAP basis for the foreseeable future. Achieving and sustaining profitable results, even on a non-GAAP basis, will depend upon a combination of careful expense management coupled with higher revenue levels. Many of our expenses are relatively fixed in the short term and there can be no assurance that we will be able to maintain expenses at target levels. There can also be no assurance that our revenues will increase. As a result, there can be no assurance that we will achieve or maintain profitable operations in the future.

Critical Accounting Policies

We have prepared our condensed consolidated financial statements in accordance with accounting principals generally accepted in the United States of America. In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our reported revenues, loss from operations, and net loss, as well as on the value of certain assets and liabilities on our balance sheet. These estimates, assumptions and judgments about future events and their effects on our results cannot be determined with certainty, and are made based upon our historical experience and on other assumptions that are believed to be reasonable under the circumstances. These estimates may change as new events occur or additional information is obtained, and we may periodically be faced with uncertainties, the outcomes of which are not within our control and may not be known for a prolonged period of time. The discussion and analysis of our financial condition and results of operations are based upon these statements. While there are a number of accounting policies, methods and estimates affecting our financial statements, areas that are particularly significant include revenue recognition, allowance for doubtful accounts and sales returns, investments, prepaid software license fees, restructuring reserves, sales commission, stock options, and business combinations and acquired intangible assets, which are described below. In addition, please refer to Note 1 of our unaudited condensed consolidated financial statements for further discussion of our significant accounting policies.

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

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

Results of Operations

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

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	Three Months Ended July 31,	
	2005	2004
Revenues:		
License	39%	39%
Service	61	61
Total revenues	100	100
Cost of revenues:		
License	2	4
Service	34	28
Amortization of intangible assets	2	1
Total cost of revenues	38	33
Gross margin	62	67
Operating expenses:		
Sales and marketing:	37	39
Research and development:	24	20
General and administrative:	10	10
Amortization of intangible assets	2	3
Restructuring and other charges		8
Total operating expenses	73	80
Loss from operations	(11)	(13)
Interest and other income, net	2	3
Loss before provision for income taxes	(9)	(10)
Provision for income taxes	1	1
Net loss	(10)%	(11)%

(1) Effective May 1, 2005, Agile adopted FAS 123(R), Share-Based Payments, and uses the modified prospective method to value its share-based payments. Accordingly, for the three months ended July 31, 2005, stock compensation was accounted under FAS 123(R) while for the three months ended July 31, 2004, stock compensation was accounted under APB 25, Accounting for Stock Issued to Employees. See Note 1 Summary of Significant Accounting Policies. The amounts in the tables above includes stock compensation as follows:

Cost of service revenue		
Sales and marketing	1%	1%
Research and development		
General and administrative	1	
Total stock compensation	2%	1%

Comparison of the Three Months Ended July 31, 2005 and 2004

Revenues

Total revenues for the three months ended July 31, 2005 increased by \$7.9 million, or 30% from the prior-year period. This increase was as the result of increases in our license and service revenues in North America, and to a lesser extent, in Europe, partially offset by the decreased revenues in Asia-Pacific region, particularly Japan.

In the three months ended July 31, 2005, none of our customers accounted for more than 10% of our total revenue and one customer represented 10% of our net accounts receivable. In the three months ended July 31, 2004, none of our customers accounted for more than 10% of our total revenue or 10% of our net accounts receivable.

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Our revenues by geographic region for the three months ended July 31, 2005 and 2004 are as follows (in thousands, except percentages):

	Three Months Ended		As percentage of total revenue	
	July 31,		Three Months Ended	
	2005	2004	2005	2004
Revenues:				
North America	\$ 24,686	\$ 17,298	72%	65%
Europe	8,860	6,981	26	26
Asia-Pacific	838	2,202	2	9
	\$ 34,384	\$ 26,481	100%	100%

During the three months ended July 31, 2005 and 2004, revenues from customers located outside of North America were approximately 28% and 35% of total revenues, respectively. Revenues from customers located outside of North America during those periods were derived primarily from sales to customers in Europe and, to a lesser extent, the Asia-Pacific region. The decrease in sales to customers located outside of North America during the three months ended July 31, 2005 compared to the prior-year period resulted from declining revenue from Asia-Pacific, primarily Japan. We have recently hired a new country manager for Japan, but we do not expect a material improvement in sales in Japan until later in our fiscal year.

License Revenue

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	(in thousands, except percentages)			
License revenue	\$ 13,401	\$ 3,087	30%	\$ 10,314
As a percentage of total revenues	39%			39%

The increase in license revenue in absolute dollars during the three months ended July 31, 2005 when compared to the prior-year period was primarily due to increase in our North American region of \$2.7 million, and to a lesser extent in our European region. For the three months ended July 31, 2005, license revenue includes the contribution from Cimmetry, which we acquired early in the fourth quarter of fiscal 2005. A majority of Cimmetry's revenue is derived from customers located in North America.

Service Revenue

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	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
(in thousands, except percentages)				
Professional service	\$ 8,467	\$ 2,718	47%	\$ 5,749
Maintenance	12,516	2,098	20%	10,418
Total service revenue	\$ 20,983	\$ 4,816	30%	\$ 16,167
As a percentage of total revenues	61%			61%

Service revenue includes fees earned, and to a lesser extent reimbursable expenses incurred, in connection with consulting, software implementation and training services we provide to our customers as well as fees from software maintenance agreements we offer. Service revenue inherently lags behind the related license revenue as the service engagements and maintenance (and the related revenue) commence after the initial license sale. As a result, the positive impact of increasing license revenue on service revenue tends to be delayed by one to two quarters. Additionally, as our maintenance revenue in any given period is derived from a larger customer base than our license revenue in that period, the percentage of increase in maintenance revenue is generally smaller than the percentage of increase in license revenue.

The increase in service revenue in absolute dollars during the three months ended July 31, 2005 compared to the prior-year period was primarily derived from a \$3.1 million increase in professional services delivered to customers located in North America. Our North American maintenance revenue also increased by \$1.7 million, to a large extent due to our acquisition of Cimmetry. We expect that service revenue will increase or decrease somewhat in relation to our license revenue.

Table of Contents**Cost of Revenues***Cost of License Revenue*

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	_____	_____	_____	_____
	(in thousands, except percentages)			
Cost of license revenue	\$ 772	\$ (305)	(28)%	\$ 1,077
As a percentage of license revenue	6%			10%

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

The decrease in cost of license revenue in absolute dollars and as a percentage of license revenue during the three months ended July 31, 2005 when compared to the prior-year period was primarily due to our purchase of Cimmetry, which lowers the cost of embedded third-party software as we had formerly licensed Cimmetry software to include in our products.

In the future, we expect cost of license revenue in absolute dollars to track our overall license revenue. We expect cost of license revenue as a percentage of license revenue to remain comparable to the results for the three months ended July 31, 2005. Actual results may fluctuate somewhat depending upon the amount of non-embedded third-party software sold in any particular period.

Cost of Service Revenue

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	_____	_____	_____	_____
	(in thousands, except percentages)			
Cost of service revenue, excluding stock compensation	\$ 11,590	\$ 4,111	55%	\$ 7,479
Stock compensation	92	2	2%	90
Total cost of service revenue	\$ 11,682	\$ 4,113	54%	\$ 7,569
As a percentage of service revenue (excluding stock compensation)	55%			46%

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Our cost of service revenue includes salaries and related expenses for the implementation, training services, and customer support organizations, costs of third parties contracted to provide implementation and maintenance renewal services to customers and an allocation of overhead expenses, including rent, information technology and other overhead expenses. In addition, cost of service revenue includes support and upgrade fees paid to third parties with respect to the third-party software integrated into or sold with our products for which our customers have purchased support from us.

The increase in cost of service revenue in absolute dollars during the three months ended July 31, 2005 when compared to the prior-year period was primarily related to: (a) \$2.7 million in increased personnel-related costs (including compensation and benefits, travel expenditures, and direct facilities and depreciation expense) resulting from an increase in service organization headcount, primarily in North America; and (b) \$1.1 million in incremental costs associated with third-party service providers we relied on to meet increased demand, particularly in regions where we have limited services resources.

As a percentage of service revenue, cost of service revenue increased by 9% in the three months ended July 31, 2005 compared to the prior-year period. Approximately half of the increase was due to the recent hiring of additional service employees who take time to become fully productive. The other half of the increase was a result of higher proportion of professional service revenue in the current-year period, which carries a lower margin than our maintenance revenue.

For the three months ending October 31, 2005, we expect cost of service revenue in absolute dollars to track or slightly increase with our service revenue and, as a percentage of service revenue, to be slightly better than the results achieved in the three months ended July 31, 2005 as our recently-hired personnel become more fully productive.

Table of Contents**Operating Expenses**

We classify all charges to operating expense categories based on the nature of the expenditures. Although each category includes expenses that are unique to the category type, there are common recurring expenditures that are typically included in all operating expense categories, such as salaries, employee benefits, incentive compensation, bonuses, travel costs, communication, rent and other allocated facilities costs, information technology, and professional fees. Also included in our operating expenses is the amortization of stock compensation, that is included in each of the sales and marketing, research and development, and general and administrative categories.

Sales and Marketing

The following table sets forth a summary of our sales and marketing expenses in absolute dollars and expressed as a percentage of total revenues for the three months ended July 31, 2005 and 2004.

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	(in thousands, except percentages)			
Sales and marketing, excluding stock compensation	\$ 12,417	\$ 2,240	22%	\$ 10,177
Stock compensation	413	254	160%	159
Total sales and marketing	\$ 12,830	\$ 2,494	24%	\$ 10,336
As a percentage of total revenues (excluding stock compensation)	36%			38%

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

The increase in sales and marketing expenses, excluding stock compensation, in absolute dollars during the three months ended July 31, 2005 when compared to the prior-year period was primarily related to \$1.7 million in increased personnel-related costs associated with higher revenue, and \$347,000 in increased marketing expenses primarily due to the addition of Cimmetry's marketing activities.

For the three months ending October 31, 2005, we expect sales and marketing expenses, excluding stock compensation, in absolute dollars to be consistent with the result achieved in the first quarter of fiscal 2006.

Research and Development

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The following table sets forth a summary of our research and development expenses in absolute dollars and expressed as a percentage of total revenues for the three months ended July 31, 2005 and 2004.

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	(in thousands, except percentages)			
Research and development, excluding stock compensation	\$ 8,160	\$ 2,845	54%	\$ 5,315
Stock compensation	61	46	307%	15
Total research and development	\$ 8,221	\$ 2,891	54%	\$ 5,330
As a percentage of total revenues (excluding stock compensation)	24%			20%

In addition to the common recurring expenditures mentioned above, our research and development expenses consist of costs associated with the development of new products, enhancements of existing products, and quality assurance procedures. These costs consist primarily of consulting costs and the cost of software development tools and equipment. To date, all software development costs in research and development have been expensed as incurred. Stock compensation is explained separately under [Stock Compensation](#) below.

The increase in research and development expenses, excluding stock compensation, in absolute dollars during the three months ended July 31, 2005 when compared to the prior-year period was primarily related to (i) \$1.7 million in increased

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compensation and benefits resulting from the additions of the Cimmetry workforce and to a lesser extent from increased spending on our existing products and (ii) \$966,000 in increased outside consulting fees related to work being performed on the next releases of our products, primarily Agile 9.

For the three months ending October 31, 2005, we expect research and development expenses, excluding stock compensation, in absolute dollars to increase slightly as we continue to invest in our products.

General and Administrative

The following table sets forth a summary of our general and administrative expenses in absolute dollars and expressed as a percentage of total revenues for the three months ended July 31, 2005 and 2004.

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
		(in thousands, except percentages)		
General and administrative, excluding stock compensation	\$ 3,248	\$ 587	22%	\$ 2,661
Stock compensation	198	126	175%	72
Total general and administrative (excluding stock compensation)	\$ 3,446	\$ 713	26%	\$ 2,733
As a percentage of total revenues (excluding stock compensation)	9%			10%

In addition to the common recurring expenditures mentioned above, our general and administrative expenses consist primarily of compensation and benefits costs, including stock compensation, for executive, finance, human resources, legal and administrative personnel, bad debt expense, and other costs associated with being a publicly held company, including SEC and Sarbanes-Oxley compliance and director compensation.

The increase in general and administrative expenses, excluding stock compensation, in absolute dollars during the three months ended July 31, 2005 when compared to the prior-year period was primarily related to \$346,000 in increased compensation and benefits and \$214,000 in increased outside consulting fees.

For the three months ending October 31, 2005, we expect general and administrative expenses, excluding stock compensation, to remain essentially flat or decrease in absolute dollars when compared with our results for the three months ended July 31, 2005.

Stock Compensation

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	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
(in thousands, except percentages)				
Stock compensation included in:				
Cost of revenues	\$ 92	\$ 2	2%	\$ 90
Sales and marketing	413	254	160%	159
Research and development	61	46	307%	15
General and administrative	198	126	175%	72
Total stock compensation	\$ 764	\$ 428	127%	\$ 336
As a percentage of total revenues		2%		1%

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

We use the modified prospective method to value our share-based payments under SFAS 123R. Accordingly, for the three months ended July 31, 2005, we accounted for stock compensation under SFAS 123R while for the three months ended July 31, 2004, we accounted for stock compensation under APB 25. Under APB 25, we were generally required to record compensation expense only if there were positive differences between the market value of our common stock and the exercise

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price of the options granted to employees as of the date of the grant. Under SFAS 123R, however, we record compensation expense for all share-based payments made to employees based on the fair value at the date of the grant. Therefore, stock compensation for the three months ended July 31, 2005 is not comparable to the prior-year period.

For the three months ending October 31, 2005, we expect our stock compensation expense to increase when compared with our results for the three months ended July 31, 2005 due to the grant of new options and the exchange offering as discussed in Note 1 Summary of Significant Accounting Policies.

Amortization of Intangible Assets

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
(in thousands, except percentages)				
Amortization of goodwill and other intangible assets	\$ 1,327	\$ 493	59%	\$ 834
As a percentage of total revenues	4%			4%

During fiscal 2005 and 2004 we made selective acquisitions of assets and businesses, including certain intangible assets. Intangible assets consist of developed technologies, customer relationships, trademarks and non-compete agreements acquired as part of our acquisitions described above. Intangible assets are subject to amortization and have original estimated weighted-average useful lives ranging from one to five years. No significant residual value is estimated for the intangible assets.

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

	July 31, 2005			April 30, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible Assets:						
Developed technologies	\$ 9,200	\$ (2,690)	\$ 6,510	\$ 9,200	\$ (1,965)	\$ 7,235
Customer relationships	6,882	(3,424)	3,458	7,182	(2,892)	4,290
Trademark	1,200	(120)	1,080	1,200	(60)	1,140
Non-compete agreements	1,280	(1,220)	60	1,280	(1,210)	70
	<u>\$ 18,562</u>	<u>\$ (7,454)</u>	<u>\$ 11,108</u>	<u>\$ 18,862</u>	<u>\$ (6,127)</u>	<u>\$ 12,735</u>

As of July 31, 2005, the estimated future amortization expense of acquired intangible assets is as follows (in thousands):

Fiscal Years:

2006 (remaining nine months)	\$ 4,056
2007	4,037
2008	2,595
2009	240
2010	180
Total	\$ 11,108

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

Table of Contents**Restructuring Charges**

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	(in thousands, except percentages)			
Restructuring charges	\$	\$ (2,132)	(100)%	\$ 2,132
As a percentage of total revenues				8%

From time to time, management has initiated various restructurings of our operations and facilities. These restructurings have been taken primarily in response to redundant or excess capacity brought about by acquisitions and/or significant changes in economic conditions and market demand. During the second quarter of fiscal 2003, we recorded a restructuring charge of \$5.2 million (the 2003 Restructuring). The 2003 Restructuring consisted primarily of the consolidation of excess facilities and abandonment of certain assets in connection with the consolidation of excess facilities. As of July 31, 2005, \$647,000 of the 2003 Restructuring obligations remained, which represents costs related to excess facilities.

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

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

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

As of July 31, 2005, \$545,000 of the 2004 Restructuring obligations remained, which represents costs related to excess facilities.

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

We review the assumptions used in estimating our restructuring charges, principally sublease income expectations for excess facilities and employee termination expenses, quarterly. Based upon this review, we did not make any adjustments to our prior restructuring estimates and assumptions during the quarter ended July 31, 2005. Furthermore, we currently do not expect our existing restructuring estimates and

assumptions to change materially.

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Summary of Restructuring Obligations

The significant activity within and components of the restructuring charges during the three months ended July 31, 2005 are as follows (in thousands):

	<u>Employee Termination Costs</u>	<u>Facility- Related Costs</u>	<u>Total</u>
Restructuring obligations at April 30, 2005 (1)	\$ 420	\$ 2,205	\$ 2,625
Cash payments		(1,013)	(1,013)
Restructuring obligations at July 31, 2005 (2)	<u>\$ 420</u>	<u>\$ 1,192</u>	<u>\$ 1,612</u>
Accrued restructuring, current			\$ 1,075
Accrued restructuring, non-current			537
			<u>\$ 1,612</u>

- (1) The 2005 Restructuring charges and related obligations were recorded at fair value, after giving effect to the fair value of the related obligations, in accordance with SFAS No. 146.
- (2) The remaining employee termination obligations are expected to be paid through the quarter ending January 31, 2006. The remaining facility-related obligations are expected to be paid through the quarter ending January 31, 2008, with the majority expected to be fully paid by August 2005.

Interest and Other Income (Expense), Net

	<u>Three Months Ended</u>		<u>Change</u>	<u>Three Months Ended</u>	
	<u>July 31, 2005</u>		<u>\$</u>	<u>%</u>	<u>July 31, 2004</u>
	<i>(in thousands, except percentages)</i>				
Interest and other income, net	\$ 870	\$ 70	9%		\$ 800
As a percentage of total revenues	2%				3%

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

The increase in interest and other income, net during the three months ended July 31, 2005 compared to the prior-year period was due principally to higher interest rates, offset by lower average cash and investment balances principally due to the acquisition of Cimmetry. Additionally, as a result of the US Dollar strengthening against the Euro during the three months ended July 31, 2005, we recorded an unrealized

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loss from foreign currency translation of \$250,000, which was included in interest and other income, net. See also Liquidity and Capital Resources below.

For the three months ending October 31, 2005, we expect interest and other income, net to increase as the interest income tracks the prevailing interest rates but we do not expect to incur significant unrealized losses from foreign currency translation.

Provision for Income Taxes

	Three Months Ended	Change		Three Months Ended
	July 31, 2005	\$	%	July 31, 2004
	(in thousands, except percentages)			
Provision for income taxes	\$ 296	\$ 23	8%	\$ 273
Effective income tax rates	10%			10%

Our provision for income taxes primarily reflects actual taxes associated with our international operations, since we incurred net losses in both periods presented. As a result, even though our effective tax rate for both periods presented above have been consistent, it may not continue in the future. Other than the provision for foreign taxes, and to a lesser extent, provision for state income taxes and US deferred tax liabilities, no provision for income taxes has been recorded since our inception because we have incurred net losses in all periods. We have recorded a valuation allowance for the full amount of our net deferred tax assets, including our net operating loss carryforwards and tax credits, as sufficient uncertainty exists regarding our ability to realize the deferred tax asset balance.

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

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

	<u>As of July 31,</u>	
	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 77,356	\$ 81,760
Short-term and long-term investments	121,027	116,620
	<u>\$ 198,383</u>	<u>\$ 198,380</u>

Our cash, cash equivalents, and investments are generally placed with high credit quality financial institutions, commercial companies and government agencies in order to limit the amount of credit exposure. As of July 31, 2005, our working capital was \$156.1 million and our days sales outstanding was 72 days.

Cash Flows

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

	<u>Three Months Ended July 31,</u>	
	<u>2005</u>	<u>2004</u>
Net cash provided by (used in) operating activities	\$ 433	\$ (2,017)
Net cash provided by (used in) investing activities	(4,377)	9,062
Net cash provided by financing activities	57	636

Cash provided by operating activities during the three months ended July 31, 2005 consists of our net loss for the period of \$3.3 million, offset by non-cash items of \$3.2 million (primarily depreciation and amortization) and a net increase of approximately \$532,000 in other operating assets and liabilities. Cash used in operating activities during the three months ended July 31, 2004 was primarily due to our net loss for the period of \$3.0 million and a net decrease of approximately \$1.7 million in working capital, offset by non-cash items of \$2.6 million.

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Cash used in investing activities during the three months ended July 31, 2005 resulted from \$3.3 million of net purchases of short-term and long-term investments and \$1.2 million of purchases of property and equipment. Cash provided by investing activities during the three months ended July 31, 2004 resulted from \$10.1 million of net maturities of short-term and long-term investments, partially offset by \$812,000 purchases of property and equipment.

Cash provided by financing activities during the three months ended July 31, 2005 and 2004 was primarily due to the issuance of Common Stock associated with the exercise of stock options totaling \$57,000 and \$632,000, respectively. During the three months ended July 31, 2005, our stock prices were relatively lower compared to prior periods, and as such we experienced lower exercises of our employee stock options. Furthermore, we expect cash provided by financing activities to decrease in future periods as we grant fewer stock options to our employees.

As discussed in Note 1 Summary of Significant Accounting Policies, beginning with the quarter ended January 31, 2005 we reclassified our auction rate securities previously classified as cash equivalents as short-term investments. The Company had historically classified these instruments as cash equivalents if the period between interest rate resets was 90 days or less, which was based on our ability to either liquidate our holdings or roll our investment over to the next reset period. As a result of this reclassification, cash and cash equivalents was reduced, and short term investments was increased, by \$66.6 million and \$67.7 million at July 31, 2004 and April 30, 2004, respectively, and corresponding changes were made in our unaudited condensed consolidated statements of cash flows.

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We anticipate that our operating expenses, particularly in sales and marketing and research and development will constitute a material use of our cash resources over the next quarter, partially offset by anticipated collections of accounts receivable. Additionally, for the three months ending October 31, 2005 we expect negative cash flows from operating activities of \$2 to \$3 million due to seasonally low maintenance renewals.

We may utilize cash resources to fund acquisitions of investments in complementary businesses, technologies or product lines. We believe that our existing cash, cash equivalents and investments, together with our anticipated cash flows from operations will be sufficient to meet our working capital and operating resource expenditure requirements for at least the next twelve months.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. SFAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This standard is effective for fiscal periods beginning after June 15, 2005. We believe that the adoption of SFAS No. 153 will not have a material impact on our consolidated statement of income or financial condition.

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

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RISK FACTORS

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

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

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

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

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

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

Our products are generally integrated with many disparate systems operated by our customers. Through our professional services organization, we provide implementation services for our software on a fee-for-service basis. Implementations generally involve migrating data from existing systems, and configuring the Agile products to operate with the customers' existing computer systems and software. Agile 9, first released in January 2004, and the soon-to-be released Agile e6, each provide new product modules, extensive new features and capabilities and are designed to address a broader set of business objectives than were our prior products. Agile 9 and Agile e6 implementations may involve multiple products being deployed across multiple departments within the customer organizations and configuring the Agile software to operate with a broader range of existing systems and software. As a result, implementations of Agile 9 and Agile e6 will often take longer than was the case

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with our earlier products, where only one product was deployed across a typically narrower user base, and may lead to delays in, or the failure to place, orders for additional licenses or products. This is particularly true where delays in implementation cause delays in the deployment and initial production use of our products.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Diversion of management's attention from other business concerns;

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

Inability to retain key employees of acquired companies; and

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

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

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

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

Effective in the first quarter of fiscal 2006, we adopted SFAS 123R, which will result in a significant difference in the way in which we account for equity-based compensation. SFAS 123R is relatively new and, while it is expected to become mandatory in the future, to date has not yet been adopted by many companies. As a result, it may be difficult for analysts and others reviewing our financial statements to compare our financial statements to our prior period statements and to those of other companies that have not adopted SFAS 123R. Our stock price could be adversely affected if, as a result of adoption SFAS 123R, our financial performance compares unfavorably to other similarly situated companies.

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

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

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Finally, in connection with the adoption of SFAS 123R, we are reviewing our overall equity compensation strategy, and anticipate issuing fewer stock options to our employees than we have in the past. These changes in approaches to employee compensation could adversely affect our ability to attract and retain the highly qualified personnel we need to succeed.

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

Since inception, we have funded our business primarily through selling our stock, not from cash generated from our business. We have incurred annual losses in each of the years since we were formed. We incurred losses of \$3.3 million and \$3.0 million for the three months ended July 31, 2005 and 2004, respectively. As of July 31, 2005, we had an accumulated deficit of approximately \$292.3 million.

Due to the amortization of the intangibles as a result of the Cimmetry acquisition and the adoption of FAS 123R effective in our first quarter of fiscal 2006, we will likely not be profitable on a GAAP basis for the foreseeable future. Achieving and sustaining profitable results, even on a non-GAAP basis, will depend upon a combination of careful expense management coupled with higher revenue levels. Many of our expenses are relatively fixed in the short term and there can be no assurance that we will be able to maintain expenses at target levels. There can also be no assurance that our revenues will increase. As a result, there can be no assurance that we will achieve or maintain profitable operations in the future.

Our Success Depends Upon Attracting and Retaining Qualified Employees

Our success as a company is dependent upon our ability to attract and retain qualified employees. We are currently seeking to hire technically qualified individuals to augment the resources in our services delivery, product development and product support. If we are unable to attract the qualified people we seek, or if we are unable to retain our existing employees, our customer satisfaction and therefore our business could suffer. In addition, it generally takes six to 12 months for a sales executive to become fully productive. Turnover of sales executives tends to be higher in the first quarter of each fiscal year. If we are unable to retain our key sales executives, our revenue could be materially and adversely affected.

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

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

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

If we are unable to offer new and enhanced products as the market and technology evolve, if our products are not sufficiently scalable, or if we encounter development difficulties with new products we release, we may find it difficult to sell products to existing and prospective customers. Moreover, customers may delay purchasing decisions if they are aware that new or enhanced products are soon to be released. If we experience difficulties or delays in releasing new and enhanced products that customers are expecting, we may experience lost or delayed sales. Delays in releasing new and enhanced products could have a material negative impact on our results of operations, particularly in the periods when the new or enhanced products were expected to become available.

We Have Many New Sales Representatives, Particularly in Our International Sales Force, Who Could Take Time to Reach Productivity which could Result in Lost or Delayed Sales

We sell our products primarily through our direct sales force. Late in fiscal 2003 and continuing through fiscal 2004, we reorganized our North American sales organization. In fiscal 2005 we began to reorganize our international sales organization,

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a process that is still underway. In connection with these changes, we have recently hired new country managers for Taiwan and Japan. As a result of these changes, many of our account executives, particularly our international sales executives, are relatively new to Agile. It generally takes six to twelve months for a new account executive to become fully productive. Changes in account executives can also result in the need to reestablish relationships with existing customers. This can result in dissatisfaction, and lost or delayed sales as customers become accustomed to their new account executives.

In addition, a significant number of Eigner sales personnel joined Agile as a result of the Eigner acquisition, and we expect to add further sales personnel as a result of our acquisition of Cimmetry. Training these individuals on the Agile products and the Agile sales personnel on the products acquired with Eigner and with Cimmetry is and will be a substantial undertaking and is still ongoing. The ability of our entire sales force to effectively sell our full suite of products will be important to our growth. If the new members of our sales team are unable to quickly become fully productive, or if we cannot successfully cross-train our expanded sales force in our full suite of products, it may be difficult for us to sell our products, we may lose sales opportunities and market share, take longer to close anticipated sales, and experience a shortfall in revenues.

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

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

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

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

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

attractive terms to purchasers than we can.

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

We Have Significantly Expanded Our International Operations Which Has Increased Our Exposure to Risks Inherent in Conducting Business Activities in Geographies Outside of the United States

In May 2002, we began establishing research and development operations in India and China and in August 2003, through our acquisition of Eigner, we began significant operations in Germany. Additionally, in February 2005 we began

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significant operations in Canada through our acquisition of Cimmetry. We also have sales offices located in many additional locations. In addition to the increase in our international operations, we derive a significant portion of our revenues from customers located outside of the United States. For example, during fiscal 2005, revenues from customers located outside of North America were approximately 31% of total revenues. We expect both our operations and revenues from outside of North America to represent a significant portion of our overall operations and revenues, respectively.

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

Difficulties in managing geographically disparate operations;

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

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

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

The need to develop our software in multiple foreign languages;

Difficulties in enforcing agreements through non-U.S. legal systems;

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

Political and economic instability, civil unrest or war;

Terrorist activities that impact international commerce;

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

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

Nationalization of foreign owned assets, including intellectual property.

In addition, prior to the acquisition of Eigner, most of our revenues have been denominated in United States dollars. In both Europe and Japan, an increasing portion of our revenue is denominated in local currencies (Euro, Swiss Francs or British Pounds in Europe, and Yen in Japan). As

a result, we are exposed to greater risks in currency fluctuations. We currently do not engage in foreign exchange hedging activities, and therefore our international revenues and expenses are currently subject to the risks of foreign currency fluctuations. For example, we assumed a Euro-denominated obligation in connection with our acquisition of Eigner. As a result of the Euro strengthening against the US Dollar during fiscal 2004, we recorded an unrealized loss from foreign currency translation of \$639,000 related to this obligation. As a result of the US Dollar strengthening against the Euro during the three months ended July 31, 2005, we recorded an unrealized loss from foreign currency translation of \$250,000. While we are evaluation hedging strategies, we may continue to experience losses resulted from foreign currency fluctuations in the future.

We believe that continued expansion of our international operations will be necessary for our future success, and a key aspect to our business strategy has been and is to expand our sales and support organizations internationally. Therefore, we believe that we will need to commit additional significant resources to expand our international operations. If we are unable to successfully expand further in international markets on a timely basis, or if this expansion is more difficult than expected, we may not be able to achieve desired levels of revenue growth. In addition, due to the time delay between hiring sales executives and such executives becoming fully productive, expansion of our international operations could have the near term effect of increasing our cost structure without an immediate corresponding increase in revenues thus adversely affecting our profitability.

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

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

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

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

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

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

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

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

Many customers and prospective customers have already invested substantial resources in other methods of sharing product information during the manufacturing and supply process, most notably internally developed applications. These customers and prospective customers may be

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reluctant to adopt a new approach that may replace, limit or compete with their existing systems or methods. Moreover, customers and prospective customers have many competing demands placed on their available information technology budgets. There can be no assurance that PLM in general or Agile in particular will compete favorably against other potential uses of information technology spending.

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

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

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

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

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

We may, from time to time, be subject to claims of infringement of other parties' proprietary rights or claims that our own intellectual property rights are invalid. There has been a substantial amount of litigation in the software industry regarding intellectual property rights. It is possible that, in the future, third parties may claim that our current or potential future products infringe their intellectual property. We expect that software product developers and providers of electronic commerce solutions will increasingly be subject to infringement claims as the number of products and competitors in our industry grows and the functionality of PLM products begins to overlap with other software applications. Any infringement claims made against us, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or negative publicity. In addition, if our products were found to infringe a third party's proprietary rights, we could be required to enter into royalty or licensing agreements in order to continue to be able to sell our products. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or acceptable at all.

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

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

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

The market price for our common stock has been, and is likely to continue to be, highly volatile. During fiscal 2005, the high and low closing sales prices of our common stock were \$9.21 and \$6.55, respectively. Our stock price is subject to wide fluctuations in response to factors, some of which will be beyond our control.

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

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

In order to comply with the Sarbanes-Oxley Act of 2002, as well as recent changes to listing standards by NASDAQ, and

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Risk

We develop and market our products in North America, Europe, and the Asia-Pacific region. As a result of our non-North American business activities, our financial results could be affected by factors such as changes in foreign currency exchange rates or economic conditions in foreign markets, and there is no assurance that exchange rate fluctuations will not harm our business in the future. In second half of fiscal 2004, we started to sell our products through some of our foreign subsidiaries, including those in Europe, Japan and Taiwan, in their functional currencies. This provides some natural hedging because most of the subsidiaries' operating expenses are denominated in their functional currencies. Regardless of this natural hedging, our results of operations may be adversely impacted by the exchange rate fluctuation. Although we will continue to monitor our exposure to currency fluctuations, and, where appropriate, may use financial hedging techniques in the future to minimize the effect of these fluctuations, we are not currently engaged in any financial hedging transactions.

Interest Rate Risk

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since all of our investments are in instruments with maturities of less than two years. The primary objective of our investment activities is to preserve principal while at the same time

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maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our entire portfolio of cash in money market funds and investments classified as available-for-sale. In general, money market funds and investments with maturities of less than two years are not subject to significant market risk because the interest paid on such funds fluctuates with the prevailing interest rate. Because our mortgage arrangement is based on variable rates of interest, our interest expense is sensitive to changes in interest rates. Since these obligations represent a small percentage of our total capitalization, we believe that there is not a material risk exposure.

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

	Maturing within 12 months	Maturing between 1 and 2 years	Total
Cash equivalents	\$ 49,073	\$	\$ 49,073
<i>Weighted average interest rate</i>	<i>3.30%</i>	<i>%</i>	<i>3.30%</i>
Investments	\$ 86,757	\$ 21,921	\$ 108,678
<i>Weighted average interest rate</i>	<i>2.29%</i>	<i>3.59%</i>	<i>2.55%</i>
Total investment securities	\$ 135,830	\$ 21,921	\$ 157,751
<i>Weighted average interest rate</i>	<i>2.65%</i>	<i>3.59%</i>	<i>2.78%</i>

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

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

There have been no changes in our internal controls over financial reporting identified in connection with the evaluation described above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

CEO and CFO Certifications

Attached, as Exhibits 31 and 32, are two separate forms of certifications of the CEO and the CFO. The certifications attached as Exhibits 31.1 and 31.2 are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certification). The information contained in this Item 4 relates to the Controls Evaluation referred to in the Section 302 Certifications, and should be read with the Section 302 Certifications for a more complete understanding of the topics presented.

Disclosure Controls and Internal Controls

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

Limitations on the Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based

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in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Notwithstanding these limitations, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Our CEO and CFO have concluded that our controls and procedures are, in fact, effective at the reasonable assurance level.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

On or around October 25, 2001, a class action lawsuit was filed on behalf of holders of Agile securities in the Southern District of New York against Agile Software Corporation, Bryan D. Stolle and Thomas P. Shanahan (collectively the Agile Defendants) and others including underwriters Morgan Stanley and Deutsche Bank Securities. The case is now captioned *In re Agile Software, Inc. Initial Public Offering Securities Litigation*, 01 CIV 9413 (SAS), related to *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS).

On or about April 19, 2002, plaintiffs electronically served an amended complaint. The amended complaint is brought purportedly on behalf of all persons who purchased the Company's common stock from August 19, 1999 through December 6, 2000. It names as defendants the Agile Defendants; and several investment banking firms that served as underwriters of the Company's initial public offering and secondary offering. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The amended complaint also alleges that false analyst reports were issued. No specific damages are claimed.

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

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

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

We are also subject to various other claims and legal actions arising in the ordinary course of business. In our opinion, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on our business, financial condition or results of operations.

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

Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

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

Not Applicable

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Item 5. Other Information

On September 6, 2005, we entered into a letter agreement with Jay Fulcher, our President and Chief Operating Officer. Mr. Fulcher holds an option which he must exercise as to 50,000 shares on or before December 31, 2005 or the option will expire as to those shares. We have agreed with Mr. Fulcher that he will exercise the option during the open trading window that will occur in December 2005 and, should he be precluded from selling shares at that time for any reason, we will withhold shares from the exercise and remit on his behalf any withholding taxes due as a result of the option exercise. A copy of the letter agreement is attached as an exhibit to this report.

Item 6. Exhibits And Reports On Form 8-K

(a) Exhibits

- 3.1 Certificate of Incorporation of Agile Software Corporation, as amended to date. (1)
- 3.2 Certificate of Elimination and Certificate of Amendment. (1)
- 3.3 Amended and Restated Bylaws of Agile Software Corporation. (2)
- 4.1 Specimen Common Stock Certificate. (1)
- 4.2 Form of Rights Agreement between Agile Software Corporation and Fleet National Bank, as Rights Agent (including as Exhibit A the form of Certificate of Designation, Preferences and Rights of the Terms of the Series A Preferred Stock, as Exhibit B the form of Right Certificate, and as Exhibit C the Summary of Terms of Rights Agreement). (2)
- 10.1* Amended and Restated 1995 Stock Option Plan(1)
- 10.2* 1999 Employee Stock Purchase Plan(1)
- 10.3* 2000 Nonstatutory Stock Option Plan(3)
- 10.4* Form of Option Agreement and Related Restricted Stock Agreement(4)
- 10.5* Form of Indemnity Agreement between Agile Software Corporation and its directors and officers(1)
- 10.6* Executive Retention and Severance Plan adopted by the Company on October 17, 2002 and entered into with its executive officers and certain key employees, together with forms of Participation Agreement and Release of Claims Agreement(5)
- 10.7 Sublease dated May 9, 2003 made by and between Nortel Networks Inc. (as successor in interest to Alteon Web Systems), as sub landlord, and Agile Software Corporation as subtenant(6)
- 10.8* Letter agreement re: tax withholding
- 31.1 Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to Agile's Registration Statement on Form S-1 (Reg. No. 333-81387), declared effective on August 19, 1999.

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- (2) Incorporated by reference to Agile's Current Report on Form 8-K (file No. 000-27071), filed on April 26, 2001.
- (3) Incorporated by reference to Agile's Registration Statement on Form S-8 (Reg. No. 333-35416), filed on April 21, 2000.
- (4) Incorporated by reference to Agile's Amendment No. 1 to Schedule TO filed on August 24, 2005.
- (5) Incorporated by reference to Agile's Quarterly Report on Form 10-Q (file No. 000-27071), filed on December 13, 2002.
- (6) Incorporated by reference to Agile's Annual Report on Form 10-K (file No. 000-27071), filed on July 28, 2003.
- * Management contract or compensatory plan

Available Information

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

