I2 TECHNOLOGIES INC
Form 10-Q
May 10, 2004
Table of Contents

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 March 31, 2004

or

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

For the transition period from ______ to ______

Commission file number 0-28030

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**75-2294945** **(I.R.S. Employer** **Identification No.)**
One i2 Place **11701 Luna Road** **Dallas, Texas** **(Address of principal executive offices)**	**75234** **(Zip code)**

(469) 357-1000

(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 such filing requirements for the past 90 days. Yes x No ¨

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

As of April 30, 2004 the Registrant had 436,591,785 shares of $0.00025 par value Common Stock outstanding.

Table of Contents

i2 TECHNOLOGIES, INC.

QUARTERLY REPORT ON FORM 10-Q

March 31, 2004

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

i2 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	March 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 259,076	$ 288,822
Restricted cash	10,897	15,532
Short-term investments, at fair value	5,000	5,000
Accounts receivable, net of allowance for doubtful accounts	41,156	36,746
Deferred contract costs	6,889	6,995
Other current assets	24,762	27,529
Total current assets	347,780	380,624
Long-term investments, at fair value	14,719	
Premises and equipment, net	25,000	28,483
Intangible assets, net	4,099	4,647
Goodwill	16,620	16,620
Total assets	$ 408,218	$ 430,374
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 19,079	$ 20,853
Accrued liabilities	114,093	109,499
Accrued compensation and related expenses	26,994	27,380
Deferred tax liabilities	9	9
Deferred revenue	216,888	212,753
Total current liabilities	377,063	370,494
Other long-term liabilities	15	18
Long-term debt	356,800	356,800
Total liabilities	733,878	727,312
Commitments and contingencies		

Stockholders deficit:		
Preferred stock, $0.001 par value, 5,000 shares authorized, none issued		
Series A junior participating preferred stock, $0.001 par value, 2,000 shares authorized, none issued		
Common stock, $0.00025 par value, 2,000,000 shares authorized, 434,615 and 434,133 shares issued and outstanding	109	109
Additional paid-in capital	10,377,641	10,376,937
Accumulated other comprehensive income	762	217
Accumulated deficit	(10,704,172)	(10,674,201)
Net stockholders deficit	(325,660)	(296,938)
Total liabilities and stockholders deficit	$ 408,218	$ 430,374

See accompanying notes to condensed consolidated financial statements

3

Table of Contents

i2 TECHNOLOGIES, INC

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2004	**2003**
Revenues:		
Software licenses	$ 12,388	$ 19,149
Development services	6,617	9,289
Contract	5,970	56,593
Services	24,973	35,377
Reimbursable expenses	2,670	3,196
Maintenance	31,004	34,345
Total revenues	83,622	157,949
Costs and expenses:		
Cost of revenues:		
Software licenses	3,177	283
Development services	6,606	6,221
Contract	106	7,197
Services and maintenance	29,307	33,578
Reimbursable expenses	2,670	3,196
Amortization of acquired technology	145	145
Sales and marketing	19,921	23,649
Research and development	19,691	20,777
General and administrative	25,461	14,379
Amortization of intangibles	39	423
Restructuring charges and adjustments	575	253
Total costs and expenses	107,698	110,101
Operating income (loss)	(24,076)	47,848
Non-operating expense, net	(5,091)	(5,018)
Income (loss) before income taxes	(29,167)	42,830
Income tax expense	809	1,498
Net income (loss)	$ (29,976)	$ 41,332
Net income (loss) per common share:		
Basic	$ (0.07)	$ 0.10
Diluted	$ (0.07)	$ 0.09
Weighted-average common shares outstanding:		
Basic	434,439	432,850
Diluted	434,439	477,524

Comprehensive income (loss):		
Net income (loss)	$ (29,976)	$ 41,332
Other comprehensive income:		
Unrealized gain on available-for-sale securities arising during the period	14	121
Foreign currency translation adjustments	531	279
Tax effect of other comprehensive income loss		(44)
Total other comprehensive income	545	356
Total comprehensive income (loss)	$ (29,431)	$ 41,688

See accompanying notes to condensed consolidated financial statements

4

Table of Contents

i2 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2004	**2003**
Cash flows from operating activities:		
Net income (loss)	$ (29,976)	$ 41,332
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,036	7,394
Write-down of equipment	282	349
Provision (credit) for bad debts charged to costs and expenses	(784)	(594)
Amortization of deferred compensation	338	352
Deferred income taxes	(3)	30
Changes in operating assets and liabilities:		
Restricted cash	4,635	(34)
Accounts receivable, net	(3,680)	7,855
Deferred contract costs	106	1,941
Other assets	2,666	(2,051)
Accounts payable	(1,809)	(405)
Accrued liabilities	4,502	(20,679)
Accrued compensation and related expenses	(479)	(11,542)
Deferred revenue	3,995	(39,729)
Net cash used in operating activities	(16,171)	(15,781)
Cash flows from investing activities:		
Purchases of premises and equipment	(544)	(97)
Proceeds from sales of long-term investments		5,000
Purchases of long-term investments	(14,705)	
Net cash used in investing activities	(15,249)	4,903
Cash flows from financing activities:		
Net proceeds from option exercises and stock issued under employee stock purchase plans	365	1
Net cash provided by financing activities	365	1
Effect of exchange rates on cash	1,309	142
Net change in cash and cash equivalents	(29,746)	(10,735)
Cash and cash equivalents at beginning of period	288,822	402,177
Cash and cash equivalents at end of period	$ 259,076	$ 391,442

See accompanying notes to condensed consolidated financial statements

Table of Contents

i2 TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Table dollars in thousands, except per share data)

(Unaudited)

1. Summary of Significant Accounting Policies

Nature of Operations. We are a provider of enterprise supply chain management solutions, including various supply chain software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by managing variability, reducing complexity, improving operational visibility, increasing operating velocity and integrating planning and execution. Our offerings help customers maximize efficiency in relation to spend, production, revenue and profit, fulfillment and logistics performance. Our application software is often bundled with other offerings, including content and services we provide such as business optimization and technical consulting, training, solution maintenance, content management, software upgrades and development.

Basis of Presentation. Our unaudited condensed consolidated financial statements have been prepared by management and reflect all adjustments (all of which are normal and recurring in nature, with the exception of certain accruals discussed in Note 7, *Commitments and Contingencies*) 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 quarter or for the entire year ending December 31, 2004. Certain information and 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 under the Securities and Exchange Commission s rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, presented in our Annual Report on Form 10-K/A for the year ended December 31, 2003 filed on March 17, 2004 with the Securities and Exchange Commission (2003 Annual Report on Form 10-K).

Stock-Based Compensation Plans. Employee compensation expense under stock option plans is reported only if options are granted below market price at the grant date in accordance with the intrinsic value method of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees . Statement of Financial Accountings Standards (SFAS) No. 123, Accounting for Stock Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , requires pro forma disclosures of net income and earnings per share for companies not adopting its fair value accounting method for stock-based employee compensation.

Table of Contents

Fair values of options are estimated at the date of grant using Black-Scholes option pricing model with the following weighted-average assumptions for the three months ended March 31, 2004: risk-free interest rate of 2.59%; market price volatility factors of 1.21; a weighted-average expected life of the options of four years; and no dividend yields. For the three months ended March 31, 2003, these values were: risk-free interest rate of 2.49%; market price volatility factors of 1.24; a weighted-average expected life of the options of four years; and no dividend yields.

The following pro forma information presents net income/(loss) and income/(loss) per common share for the three months ended March 31, 2004 and 2003 had the fair value method under SFAS No. 123 been used to measure compensation cost for stock-based compensation plans. For purposes of these pro forma disclosures, the estimated fair value of the options and stock rights is amortized to expense over the related vesting periods and the estimated fair value of the employee stock purchase plans shares is amortized to expense over the purchase period. During the second quarter of 2002, we ceased recognizing tax benefits for net operating losses for financial reporting purposes. Accordingly, the pro forma adjustments in the table below have not been tax affected for the three months ended March 31, 2004 and 2003.

	Three Months Ended March 31,	
	2004	2003
Net income (loss), as reported	$ (29,976)	$ 41,332
Stock-based employee compensation expense included in reported net income (loss)	338	321
Total stock-based employee compensation expense determined under fair value based method for all awards	(19,910)	(46,260)
Pro forma net loss	$ (49,548)	$ (4,607)
Net income (loss) per common share Basic:		
As reported	$ (0.07)	$ 0.10
Pro forma	$ (0.11)	$ (0.01)
Net income (loss) per common share Diluted:		
As reported	$ (0.07)	$ 0.09
Pro forma	$ (0.11)	$ (0.01)

Reclassifications. Certain items in prior period financial statements have been reclassified to conform to the current period presentation.

Allowance For Doubtful Accounts. Our allowance for doubtful accounts was $2.5 million and $3.1 million at March 31, 2004 and December 31, 2003, respectively. The decrease in our allowance for doubtful accounts is a credit for bad debts charged to costs and expenses of $(0.8) million and write-offs, net of recoveries and other adjustments of $0.2 million. Our provision for doubtful accounts is included as a component of sales and marketing expense and services and maintenance expense in our statement of operations.

2. Investment Securities

Short-term time deposits and other liquid investments in debt securities with remaining maturities of less than three months when acquired by us are classified as available for sale and reported as cash and cash equivalents in the condensed consolidated balance sheets. The estimated fair value of these investments approximates their carrying value. Investment securities reported as cash equivalents were as follows:

	March 31, 2004	December 31, 2003
Short-term time deposits	$ 731	$ 19,956
Obligations of state and local municipalities	10,400	35,600
Corporate bonds and notes	78,025	146,399
Commercial paper	37,945	5,000
	$ 127,101	$ 206,955

Table of Contents

Investments in debt securities with remaining maturities in excess of three months but less than one year when acquired by us are classified as available for sale and reported as short-term investments in the condensed consolidated balance sheets. Short-term investments were as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
March 31, 2004				
Obligations of state and local municipalities	$ 5,000	$	$	$ 5,000
December 31, 2003				
Obligations of state and local municipalities	$ 5,000	$	$	$ 5,000

Investments in debt securities with remaining maturities in excess of one year when acquired by us and corporate equity securities are classified as available for sale and reported as long-term investments in the condensed consolidated balance sheets. All long-term debt securities outstanding at March 31, 2004 will contractually mature within 18 months. We had no long-term investments at December 31, 2003. Long-term investments were as follows at March 31, 2004:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
March 31, 2004				
U.S. government obligations	$ 14,705	$ 14	$	$ 14,719

3. Borrowings and Debt Issuance Costs

In December 1999, we issued $350.0 million of convertible subordinated notes. The notes mature on December 15, 2006 and bear interest at a rate of 5.25%, per annum, which is payable semi-annually. The notes are convertible at the option of the holder into shares of our common stock at a conversion price of $38.00 per share at any time prior to maturity. Since December 20, 2002, we have had the option to redeem, in cash, all or a portion of the notes that have not been previously converted. We may also, from time to time, seek to retire the notes through cash repurchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise**.** Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. As of March 31, 2004, none of the notes have been converted to common stock, redeemed, or otherwise retired. The principal balance of the notes totalled $350.0 million at March 31, 2004 and December 31, 2003.

In May 2003, we entered into a lease termination agreement with the owner of one of our headquarter buildings that we vacated in January 2003 as part of our restructuring plan. The lease, originally scheduled to expire in 2011, would have required us to pay approximately $43.4 million through the lease s original date of termination. In consideration for the early termination of the lease, we paid approximately $7.6 million in cash and issued a $6.8 million non-negotiable promissory note due and payable on December 15, 2006. The note bears interest at a rate of 5.25% per annum, payable semi-annually in arrears.

4. Restructuring Charges and Adjustments

2004 Restructuring Plan. In response to our recent operating losses, in March 2004, we initiated a global workforce reduction plan to further reduce our operating expenses and bring them in line with our current revenue levels. During March 2004, 11 employees were involuntarily terminated. The plan is expected to be finalized in the second quarter of 2004 and we currently estimate the involuntary termination of an additional 170 to 180 employees. These activities are being accounted for in accordance with SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities . During the first quarter of 2004, we recorded restructuring charges totalling approximately $575,000 related to the severance payments to be paid to the 11 employees involuntarily terminated during the first quarter. We currently estimate that the finalization of our plan will result in restructuring expense within the range of $5 million to $7 million to be recorded in the second quarter of 2004.

2002 Restructuring Plan. In July 2002, we initiated a global restructuring plan to further reduce our operating expenses and to bring them into alignment with our revenue levels. Overall expense reductions were necessary to lower

Table of Contents

our existing cost structure and to realign and reallocate our resources in a manner commensurate with our new operating plan. Declining revenues, gross margins, losses and other performance measures such as revenue per employee during 2002 precipitated the restructuring plan. The plan included the elimination of certain employee positions and the reduction of office space and related overhead expenses. The restructuring charges recorded in the third and fourth quarters of 2002 primarily consisted of severance and termination costs for the involuntarily terminated employees and office closure costs. The majority of the restructuring activity related to the 2002 restructuring charges occurred during 2002 and the remaining actions, such as additional office closures and consolidations and asset disposals, were completed during 2003. During 2002, we recorded restructuring charges totalling $111.9 million. Of this amount, $56.8 million related to employee severance and termination, $35.2 million related to office closure and consolidation and $19.9 million related to asset disposal losses.

2001 Restructuring Plan. During 2001, we implemented a global restructuring plan to reduce our operating expenses with a goal of improving our financial position. The restructuring plan was initiated in response to poor economic conditions during 2001, which led to increasing net losses, declining gross margins and other performance measures such as revenue per employee. The restructuring plan encompassed terminating employees and reducing office space and related overhead expenses. Charges related to the restructuring plan primarily consisted of severance and termination costs for the involuntarily terminated employees and office closure costs. The majority of the restructuring activity occurred during 2001, with the remaining actions, including closing and consolidating identified offices, completed in 2002. During 2001, we recorded restructuring charges totalling $113.3 million. Of this amount, $60.7 million related to employee severance and termination, $41.6 million related to office closure and consolidation and $11.0 million related to asset disposal losses.

Consolidated Restructuring Accrual

The following table summarizes the 2004 restructuring related payments and accruals, and the components of the remaining restructuring accruals, included in accrued liabilities, at March 31, 2004 and December 31, 2003:

	Employee Severance and Termination	Office Closure and Consolidation	Total
Remaining accrual balance at December 31, 2003	$ 3,417	$ 11,590	$ 15,007
2004 restructuring plan expense	575		575
Payments in 2004 related to the 2001 and 2002 plans	(2,766)	(1,916)	(4,682)
Remaining accrual balance at March 31, 2004	1,226	9,674	10,900

In May 2003, we entered into a lease termination agreement with the owner of one of our headquarter buildings that we vacated in January 2003 as part of our restructuring plan. This lease, originally scheduled to expire in 2011, would have required us to pay approximately $43.4 million through the lease s original date of termination. In consideration for the early termination of the lease, we paid approximately $7.6 million in cash and issued a $6.8 million non-negotiable promissory note due and payable on December 15, 2006. The note bears interest at a rate of 5.25% per annum, payable semi-annually in arrears. Upon executing this agreement in the second quarter of 2003, the remaining restructuring accrual of $12.4 million was utilized and an additional charge of $2.0 million was recorded as a general and administrative expense.

The accrual for office closure and consolidation of $9.7 million at March 31, 2004 represents future payments to be made for facilities that we have exited as part of our 2001 and 2002 restructuring plans. This accrual is net of estimated sublease income of $10.9 million.

Table of Contents

5. Net Income (Loss) Per Common Share

Net Income (Loss) Per Common Share. Basic net income (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted net income (loss) per common share includes the dilutive effect of stock options, share rights awards, and warrants granted and, using the treasury stock method, the effect of contingently issuable shares earned during the period and shares issuable under the conversion feature of our convertible notes using the if-converted method. A loss causes all outstanding stock options to be anti-dilutive due to an increase of the weighted average shares from the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. Therefore, for the period ended March 31, 2004, the basic and dilutive loss per common share are the same. There were outstanding common stock equivalents of 104.4 million common shares related to outstanding options and share rights awards and debt convertible into 9.2 million common shares for the three months ended March 31, 2004 which were all anti-dilutive due to our net loss for the period. The anti-dilutive common stock equivalents for the same period in 2003 were 92.4 million common shares related to outstanding options and share rights awards and debt convertible into 9.2 million common shares. The following is a reconciliation of the number of shares used in the calculation of basic and diluted earnings per share for the three months ended March 31, 2004 and 2003 (in thousands):

	2004	**2003**
Basic earnings per share of common stock weighted average common shares outstanding	434,439	432,850
Effect of dilutive securities:		
Outstanding stock option and share rights awards		5,674
Convertible debt		39,000
Diluted earnings per share weighted average common and common equivalent shares outstanding	434,439	477,524

6. Segment Information, International Operations and Customer Concentrations

We operate our business in one segment, supply chain management solutions designed to help enterprises optimize business processes both internally and among trading partners. Statement of Financial Accounting Standards (SFAS No. 131), Disclosures About Segments of an Enterprise and Related Information, establishes standards for the reporting of information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, who is our Chief Executive Officer, in deciding how to allocate resources and in assessing performance.

We market our software and services primarily through our worldwide sales organization augmented by other service providers, including both domestic and international systems consulting and integration firms and other industry-related partners. Our chief operating decision maker evaluates resource allocation decisions and our performance based on financial information, presented on a consolidated basis, accompanied by disaggregated information by geographic regions. Sales to our customers generally include products from some or all of our product suites. We have not consistently allocated revenues from such sales to individual products for internal or general-purpose financial statements.

Revenues are attributable to regions based on the locations of the customers operations. Total revenues by geographic region, as reported to our chief operating decision maker, were as follows:

	Three Months Ended March 31,	
	2004	2003
United States	$ 51,140	109,909
Non-US Americas	1,167	2,737
EMEA	17,861	26,604
Japan	9,092	9,913
APAC	4,362	8,786
	$ 83,622	$ 157,949

Table of Contents

Revenues from international operations totalled $32.5 million and $48.0 million during the three months ended March 31, 2004 and 2003, respectively. During the periods presented, no individual customer accounted for more than 10% of total revenues.

Long-lived assets by geographic region, as reported to our chief operating decision maker, were as follows:

	March 31, 2004	December 31, 2003
United States	$ 34,544	$ 23,315
Non-US Americas	519	781
EMEA	21,821	21,871
Japan	654	769
APAC	2,900	3,014
	$ 60,438	$ 49,750

7. Commitments and Contingencies

We are subject to various claims and legal proceedings that arise in the ordinary course of our business, including claims and legal proceedings which have been asserted against us by former employees and certain customers, and have been in negotiations to settle certain of those contingencies. In addition, a formal investigation is being conducted by the Securities and Exchange Commission (SEC), class action securities and shareholder derivative litigation has been commenced against us and one additional private securities action has been commenced against certain of our current and former officers with respect to whom we may have indemnification obligations, all in connection with matters relating to the restatement of our consolidated financial statements for certain periods prior to 2003, which was completed in 2003. As discussed below, we are also attempting to settle or otherwise resolve those proceedings.

Securities and Exchange Commission Investigation

On or about March 26, 2003, we were advised that the SEC had issued a formal order of investigation to determine whether there have been violations of the federal securities laws by the company and/or others involved with the company in connection with matters relating to the 2003 restatement of our consolidated financial statements. Our Board of Directors had previously directed our Audit Committee to conduct an internal investigation of certain allegations made during the fall of 2001 by a former officer relating to revenue recognition and financial reporting, among other things. In November 2002, we reported to the SEC and publicly disclosed the results of that investigation, as well as certain related allegations made during the fall of 2002 by the former officer and another former officer. Thereafter, the staff of the SEC opened an informal inquiry into these allegations and other matters relating to our financial reporting, and the SEC issued its formal order of investigation. We intend to continue to fully cooperate with the SEC and discussions with the SEC staff regarding a possible resolution of the SEC investigation are continuing. However, we may face sanctions in connection with any resolution of the SEC investigation, including but not limited to significant monetary penalties and injunctive relief.

Class Action Litigation

Beginning in March 2001, a number of purported class action complaints were filed in the United States District Court for the Northern District of Texas (Dallas Division) against the company and certain of our officers and directors. The cases were consolidated, and in August 2001 plaintiffs filed a consolidated amended complaint. The consolidated amended complaint alleges that we and certain of our officers and directors violated the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, by making purportedly false and misleading statements concerning the characteristics and implementation of certain of our software products. The consolidated amended complaint seeks unspecified damages on behalf of a purported class of purchasers of our common stock during the period from May 4, 2000 to February 26, 2001. By stipulation, in December 2002, the court certified the plaintiff class.

Table of Contents

Beginning in April 2003, additional purported class action complaints were filed in the United States District Court for the Northern District of Texas (Dallas Division) against the company and certain of our current and former officers and directors. The complaints brought claims under the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, relating to the 2003 restatement of our consolidated financial statements. Specifically, these actions allege that we issued a series of false or misleading statements to the market during the class period that failed to disclose that (i) we had materially overstated our revenue by improperly recognizing revenue on certain customer contracts, (ii) we lacked adequate internal controls and were therefore unable to ascertain our true financial condition, and (iii) as a result of the foregoing, our financial statements issued during the class period were materially false and misleading. Plaintiffs contend that such statements caused our stock price to be artificially inflated. The complaints seek unspecified damages on behalf of a purported class of purchasers of our common stock during the period from April 18, 2000 to January 24, 2003.

In July 2003, all of these class action complaints were consolidated for purposes of pre-trial matters only. Although we have vigorously defended against these lawsuits, as discussed below we have recently entered into a definitive agreement to settle the actions.

Derivative Litigation

In April 2001, a purported shareholder derivative lawsuit was filed in Dallas County, Texas, against certain of our officers and directors, naming the company as a nominal defendant. The complaint alleged that certain of our officers and directors breached their fiduciary duties to the company and our stockholders by (i) selling shares of our common stock while in possession of material adverse non-public information regarding our business and prospects, and (ii) disseminating inaccurate information regarding our business and prospects to the market and/or failing to correct such inaccurate information. This lawsuit was removed to the United States District Court for the Northern District of Texas (Dallas Division). A motion to dismiss the action was filed, and on October 8, 2002, the motion was granted. Plaintiffs filed an appeal of that decision on October 15, 2002 and, following oral arguments, plaintiffs moved for voluntary dismissal of their appeal. On January 5, 2004, the appellate court granted plaintiffs voluntary dismissal motion and judgment against the plaintiffs became final.

In April and May 2003, two additional purported shareholder derivative lawsuits were filed in the United States District Court for the Northern District of Texas (Dallas Division) against certain of our officers and directors, naming the company as a nominal defendant. The complaints alleged that certain of our officers and directors breached their fiduciary duties to the company and our stockholders by (i) causing us to improperly recognize revenue in violation of generally accepted accounting principles to artificially inflate our stock price in order to complete acquisitions in which our stock was used as consideration, (ii) selling shares of our common stock while in possession of material adverse non-public information regarding our financial statements and (iii) securing personal loans using our allegedly artificially inflated stock price. In July 2003, these lawsuits were consolidated for all purposes. Plaintiffs amended their consolidated complaint to add a claim that our Chief Executive Officer and our former Chief Financial Officer violated Section 304 of the Sarbanes-Oxley Act of 2002, seeking recovery from them of bonuses, equity-based compensation and profits realized from sales of securities of the company. A motion to dismiss the actions was filed, and on January 26, 2004, the motion was granted and judgment was entered against the plaintiffs. An appeal of that decision was filed on February 24, 2004.

In May 2003, another purported shareholder derivative lawsuit was filed in the United States District Court for the Northern District of Texas (Dallas Division) against our Chief Executive Officer, our former Chief Financial Officer and our directors, naming the company as a nominal defendant. The complaint alleges that our Chief Executive Officer and our former Chief Financial Officer violated Section 304 of the Sarbanes-Oxley Act of 2002, and seeks recovery from them of bonuses, equity-based compensation and profits realized from sales of securities of the company. The lawsuit also names our directors for failing to seek recovery of the aforementioned bonuses, equity-based compensation and trading profits. A motion to dismiss was filed, and on February 26, 2004, the motion was granted and judgment was entered against the plaintiffs. Plaintiffs did not appeal that decision, and the judgment against them is final.

As stated, these lawsuits are or were derivative in nature; they do not and did not seek relief from the company. However, we have entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors, and have advanced payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. In addition, we may be obligated to continue to advance payment of legal fees and costs incurred by the individual defendants in the remaining lawsuits throughout the pendency of those actions. Although we have vigorously defended against these lawsuits, as discussed below we have recently entered into a definitive agreement to settle these actions.

Settlement of Class Action Litigation and Derivative Litigation

On May 7, 2004, we reached a definitive agreement to settle the class action and derivative litigation referred to above. Under the agreement, the total settlement amount is $85 million, which includes $43 million that will be covered by our insurance policies and $42 million that will be paid by the company. To fund a portion of the $42 million payable by the company in connection with this settlement, the company has entered into definitive agreements providing for the issuance and sale by the company, after the satisfaction of certain conditions, of $20.0 million of common stock to Sanjiv Sidhu, our Chairman, Chief Executive Officer and President, and $2.0 million of common stock to Gregory Brady, our former Chief Executive Officer and President, both of whom were individual defendants in the actions.

The settlement, which does not reflect any admission of wrongdoing by the company or its directors and officers, is subject to certain conditions including approval by the U.S. District Court for the Northern District of Texas following notice to class members of an opportunity to object or exclude themselves from the settlement. The settlement does not cover the private securities action discussed below.

Private Securities Action

On February 13, 2004, a complaint was filed in the United States District Court for the Northern District of Texas (Dallas Division) against certain of our current and former officers and directors with respect to whom we may have indemnification obligations, entitled *Baldridge v. Sidhu*, No. 3:04CV-319-D. Our company is not named as a defendant in this action. The complaint asserts claims under the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, relating to the 2003 restatement of our consolidated financial statements. Plaintiffs contend that such consolidated financial statements caused our stock price to be artificially inflated. The complaints seek unspecified damages on behalf of four purported purchasers of a total of 610,250 shares of our common stock from March 2001 through August 2002.

Patent Infringement Suit

On April 12, 2004, a complaint was filed in the United States District Court in Marshall, Texas against the company by Sky Technologies. The complaint alleges that we have infringed upon certain of the patents of Sky Technologies and further alleges that we misappropriated certain of the plaintiff s trade secrets. The plaintiff claims an unspecified amount of damages at this time. We have yet to file an appearance in the lawsuit. As this action is at an early stage, we are currently not able to assess an impact, if any, to our condensed consolidated financial statements.

Certain Accruals

We have accrued for estimated losses in the accompanying condensed consolidated financial statements for those matters where we believe the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

Based on the status of our discussions with the SEC staff, we have recorded an accrual of $10.0 million in the accompanying condensed consolidated financial statements for the first quarter of 2004 for costs associated with a possible resolution of the SEC investigation. The accrual represents our estimate of the costs, in addition to legal expenses, that will be required to be paid by us if a resolution of the SEC investigation is achieved.

In addition, we recorded an accrual of $42.0 million in the fourth quarter of 2003 for estimated losses relating to a possible settlement of the class action and derivative litigation. The accrual represented our estimate at such time of the amount, in excess of expected payments from our insurance carriers, that would be required to be paid by us if a settlement of the lawsuits was achieved.

Discussions with the SEC staff regarding a possible resolution of the SEC investigation are continuing. In addition, as described above, we have reached a definitive agreement to settle the class action and derivative litigation, subject to court approval. Any resolution of the SEC investigation and the class action and derivative litigation will involve significant cash payments by the company. Such cash payments could be more than the amounts currently estimated and accrued for in our condensed consolidated financial statements for the quarter ended March 31, 2004.

The adverse resolution of any one or more of the matters described in this Note 7 over and above the amount, if any, that has been estimated and accrued in the accompanying condensed consolidated financial statements could have a material adverse effect on our business, financial condition or results of operations.

Table of Contents

Indemnification Agreements

We have entered into indemnification agreements with certain of our officers, directors and employees that may require us, among other things, to indemnify such officers, directors and employees against certain liabilities that may arise by reason of their status or service as directors, officers or employees and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified. Pursuant to these agreements, we plan to advance or indemnify certain current and former directors, officers and employees for fees and expenses incurred by them in connection with the class action and derivative litigation resulting from the 2003 restatement of our consolidated financial statements, the related SEC investigation and other matters.

We have also entered into agreements regarding the advancement of costs with certain officers and employees. Pursuant to these agreements, we have paid fees and expenses incurred by certain officers and employees in connection with the class action and derivative litigation resulting from the 2003 restatement of our consolidated financial statements, the related SEC investigation and other matters.

The maximum potential amount of future payments we could be required to make under these indemnification agreements and the agreements for the advancement of costs is unlimited. Additionally, our corporate by-laws allow us to choose to indemnify any employee for certain events or occurrences while the employee is, or was serving, at our request in such capacity. During the first quarter of 2004, we incurred approximately $1.0 million of expense for legal fees and expenses incurred by current and former employees.

8. Subsequent Event

On April 27, 2004, we entered into an agreement with R^2 Investments, LDC, an affiliate of Q Investments, a private investment firm and an affiliate of an existing stockholder, under which R^2 Investments, LDC agreed to purchase, subject to certain conditions, 100,000 shares of 2.5% Series B Convertible Preferred Stock at a purchase price of $1,000 per share, for a total purchase price of $100 million. Under the terms of the agreement, R^2 Investments, LDC will also have preemptive rights upon the issuance of certain of our securities during the three year period following the closing of the transaction. Dividends on the 2.5% Series B Preferred Stock, which may be paid in cash or kind at our discretion, will be payable semi-annually at the rate of 2.5% per year. The 2.5% Series B Preferred Stock will automatically convert into shares of our common stock on the tenth anniversary of issuance and can be converted into shares of our common stock at the option of the holder at any time prior to such tenth anniversary. If our common stock is trading over $2.50 per share at any time after the second anniversary of the closing of the investment, we can require that the 2.5% Series B Preferred Stock be converted into common stock. The initial conversion price, which is subject to certain adjustments, will be $.926 per share. After four years, we can force redemption by buying out the preferred stock for cash at 104% of the liquidation value of the security. The closing of the transaction is expected to occur in the second quarter of 2004, subject to the satisfaction of closing conditions including the receipt of applicable regulatory approvals.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical or current facts, including, without limitation, statements about our business strategy, plans, objectives and future prospects, are forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from these expectations, which could have a material adverse effect on our business and thereby cause our stock price to decline. Such risks and uncertainties include, without limitation, the following:

We are currently experiencing substantial negative cash flows and we may not achieve a return to positive cash flow. Our continued inability to stabilize or grow revenues, control expenses and achieve positive cash flows could impair our ability to support our operations, adversely affect our liquidity, and, eventually, threaten our solvency and our ability to repay debts when they come due.

Table of Contents

We may not benefit from increased demand in the market for information technology and the improving macroeconomic environment if we are unable to capture a share of an enlarged market, which would negatively impact our revenues and stock price.

We face risks related to the SEC investigation and the class action and derivative litigation that have had and could continue to have a material adverse effect on our customer relationships and our business, financial condition and results of operations. We have recorded an accrual of $10 million for estimated costs relating to a possible resolution of the SEC investigation. We have also recorded an accrual of $42 million with respect to a possible settlement of the class action and derivative litigation, and we recently entered into a definitive agreement to settle that litigation for a net amount (in excess of payments from our insurance carriers) of $42 million. The settlement of the class action and derivative litigation is subject to court approval following notice to class members of an opportunity to object or exclude themselves from the settlement. Any resolution of the SEC investigation or settlement of the class action and derivative litigation will involve significant cash payments from the company, which could further impair our liquidity. In addition, we may face additional litigation in the future that could also harm our business and impair our liquidity, including one private securities action that is not covered by the settlement to which we have agreed.

R^2 Investments, LDC, an affiliate of Q Investments, a private investment firm and an existing investor in i2, has agreed to make a $100 million preferred stock investment in our company. The closing of the transaction is expected to occur in the second quarter of 2004, subject to the satisfaction of closing conditions including the receipt of applicable regulatory approvals. We also anticipate that we will receive $22.0 million from the sale of common stock to certain individual defendants in the class action and derivative litigation, the aggregate proceeds of which would help fund the settlement of the class action and derivative litigation. The consummation of these transactions will have a dilutive effect on the holdings of our existing stockholders. In the future, we may seek additional private or public debt or equity financing, which could also have a dilutive effect on our stockholders. While we recently secured the financings described above, any future financings may not be available on advantageous terms.

Our financial results have varied and may continue to vary significantly from quarter to quarter and we may again fail to meet expectations, which might negatively impact the price of our stock.

We have been and continue to be subject to certain claims pertaining to the quality of our products and services, and questions regarding our financial viability. These claims and perceptions, if unresolved or not addressed, could seriously harm our business and our stock price.

Additional restructuring initiatives have been executed, and such activities could pose significant risks to our business.

We may not be competitive.

Further loss of key employees, including customer-facing employees, may negatively affect our operating results and revenues.

Other risks indicated below under the section captioned Factors that May Affect Future Results and in our other filings with the SEC.

Many of these risks and uncertainties are beyond our control and, in many cases, we cannot accurately predict the risks and uncertainties that could cause our actual results to differ materially from those indicated by the forward-looking statements. When used in this document, the words believes, plans, expects, anticipates, intends, continue, may, will, should or the negative of such terms and similar express relate to us, our customers or our management are intended to identify forward-looking statements.

Table of Contents

References in this report to the terms optimal and optimization and words to that effect are not intended to connote the mathematically optimal solution, but may connote near-optimal solutions, which reflect practical considerations such as customer requirements as to response time, precision of the results and other commercial factors.

Overview

We are a provider of enterprise supply chain management solutions, including various supply chain software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by managing variability, reducing complexity, improving operational visibility, increasing operating velocity and integrating planning and execution. Our offerings help customers maximize efficiency in relation to sourcing, supply, demand, fulfillment and logistics performance. Our application software is often licensed in conjunction with other offerings including content and services we provide such as business optimization and technical consulting, training, solution maintenance, content management, software upgrades and development.

Application of Critical Accounting Policies and Accounting Estimates

There have been no changes during the first quarter of 2004 to our critical accounting policies as we described in our 2003 Annual Report on Form 10-K/A on March 17, 2004.

Table of Contents

Revenues

The following table sets forth revenues and the percentages of total revenues of selected items reflected in our Condensed Consolidated Statements of Operations. The quarter-to-quarter comparisons of financial results are not necessarily indicative of future results.

(in thousands)	Three Months Ended March 31, 2004	Percent of Total Revenue	Three Months Ended March 31, 2003	Percent of Total Revenue
Revenues				
Software products	$ 3,499	4%	$ 9,368	6%
Content subscriptions and other recurring revenue	8,889	11%	9,781	6%
Software licenses	$ 12,388	15%	$ 19,149	12%
Development services	6,617	8%	9,289	6%
Contract	5,970	7%	56,593	36%
Services	24,973	30%	35,377	22%
Reimbursable expenses	2,670	3%	3,196	2%
Maintenance	31,004	37%	34,345	22%
Total revenues	$ 83,622	100%	$ 157,949	100%

Total revenues decreased $74.3 million, or 47%, for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003. Details of our revenues are presented below.

Software Licenses. Software license revenue includes amounts related to software product sales, content subscriptions and other revenues classified as license revenue. Software license revenue totalled $12.4 million, or 15% of total revenues, for the three months ended March 31, 2004, decreasing $6.8 million, or 35%, from the same period in 2003.

Revenue from software product sales totalled $3.5 million, or 28% of our total software license revenue for the three months ended March 31, 2004. Software product sale revenue decreased $5.9 million, or 63%, for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003. The decrease in revenue from software products sales in the 2004 period as compared to the comparable period in 2003 was related to a decline in sales arising from deal execution problems, reduction in sales and marketing capacity, increased competition and related pricing pressures and an increasing number of transactions sold with development services that will be recognized as development services revenue in future periods. Our recent financial performance, negative cash flow, the 2003 restatement of our consolidated financial statements, the related SEC investigation and securities class action lawsuits and the de-listing of our common stock from The NASDAQ National Market have led our customers and prospects to voice concerns about our continued financial viability, which has also contributed to our revenue decline. Despite our efforts to generate demand and develop growth, our success has been limited, and there can be no assurance that our business will stabilize or that we will be able to develop revenue growth from software product sales.

Revenue from content subscriptions and other revenue classified as software license revenue decreased $0.9 million, or 9%, for the three months ended March 31, 2004 versus the comparable period in 2003. The decline in revenue is primarily attributable to a decline in the market for content and content services and increased competition, which has resulted in downward price pressure and a decline in content subscription renewals.

Our account teams, led by sales representatives and consulting managers, are responsible for generating most of our software license and development services revenue. Although we believe direct sales will continue to account for most of our software license and development services revenue for the foreseeable future, we plan to continue developing indirect sales through, or in conjunction with, sales alliances, distributors, resellers and other indirect channels. There can be no assurance that our efforts to further expand indirect sales of our software products and content subscriptions will be successful or will continue in the future.

Development Services. Development services revenue includes our license of software products and our agreement with customers to provide services to customize or enhance the software in accordance with specific customer requirements and/or other services associated with implementations that we have determined are essential to the functionality of the software as defined in SOP 97-2, *Software Revenue Recognition*. Under these circumstances, our services are essential to provide the required functionality, and we therefore recognize revenue in accordance with SOP 81-1 using either the percentage-of-completion method or the completed contract method. Revenue from development services projects decreased $2.7 million, or 29%, during the three months ended March 31, 2004 over the comparable period in 2003. During the three months ended March 31, 2003, one co