I2 TECHNOLOGIES INC
Form 10-Q
November 09, 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 September 30, 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 0-28030

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**75-2294945**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

One i2 Place

11701 Luna Road

Dallas, Texas	**75234**
(Address of principal executive offices)	**(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 ¨

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

As of October 31, 2005, the Registrant had 20,700,895 shares of $0.00025 par value Common Stock outstanding.

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i2 TECHNOLOGIES, INC.

QUARTERLY REPORT ON FORM 10-Q

September 30, 2005

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PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

i2 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value or stated value)

(Unaudited)

	September 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 254,954	$ 133,273
Restricted cash	5,081	7,717
Short-term investments, at fair value	11,983	144,532
Accounts receivable, net	23,121	37,439
Deferred contract costs	311	1,886
Other current assets	17,155	22,034
Total current assets	312,605	346,881
Long-term investments, at fair value	1,000	
Premises and equipment, net	14,787	18,987
Net deferred charges	1,420	2,473
Goodwill	16,321	16,620
Non-current deferred tax asset	5,485	5,712
Total assets	$ 351,618	$ 390,673
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 12,383	$ 13,988
Accrued liabilities	40,344	39,152
Accrued compensation and related expenses	17,210	27,227
Deferred revenue	130,218	165,362
Total current liabilities	200,155	245,729
Non-current deferred tax liability		1,177
Long-term debt	295,250	316,800
Total liabilities	495,405	563,706
Commitments and contingencies		
Stockholders deficit:		
Preferred Stock, $0.001 par value, 5,000 shares authorized, none issued and outstanding		
Series A junior participating preferred stock, $0.001 par value, 2,000 shares authorized, none issued and outstanding		

Series B 2.5% convertible preferred stock, $1,000 stated value, 150 shares authorized, 103 and 101 issued and outstanding at September 30, 2005 and December 31, 2004, respectively	98,653	97,045
Common stock, $0.00025 par value, 2,000,000 shares authorized, 20,626 and 18,608 shares issued and outstanding at September 30, 2005 and December 31, 2004, respectively	5	5
Additional paid-in capital	10,419,561	10,403,515
Accumulated other comprehensive income	399	3,675
Accumulated deficit	(10,662,405)	(10,677,273)
Net stockholders deficit	(143,787)	(173,033)
Total liabilities and stockholders deficit	$ 351,618	$ 390,673

See accompanying notes to condensed consolidated financial statements.

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i2 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues:				
Software licenses	$ 14,638	$ 17,441	$ 42,797	$ 41,856
Development services	7,194	7,510	44,087	23,319
Contract	899	29,130	19,298	67,070
Services	20,201	26,781	66,518	76,318
Reimbursable expenses	2,039	2,458	7,812	8,206
Maintenance	24,268	27,742	75,582	88,544
Total revenues	69,239	111,062	256,094	305,313
Costs and expenses:				
Cost of revenues:				
Software licenses	882	3,816	5,786	7,189
Development services	3,002	3,353	10,921	14,004
Contract		2,079	1,575	3,210
Amortization of acquired technology		90		369
Reimbursable expenses	2,039	2,458	7,812	8,206
Services and maintenance	21,726	25,915	68,793	82,413
Sales and marketing	8,176	19,326	42,374	60,838
Research and development	8,913	16,612	35,257	55,418
General and administrative	12,137	17,253	49,372	55,467
Amortization of intangibles				39
Gain on sale of assets	(2,176)		(2,176)	
Restructuring charges and adjustments	(256)	(670)	11,650	3,575
Total costs and expenses	54,443	90,232	231,364	290,728
Operating income	14,796	20,830	24,730	14,585
Gain on sale of securities			11,000	
Other expense, net	(2,969)	(1,788)	(12,763)	(11,257)
Income before income taxes	11,827	19,042	22,967	3,328
Income tax expense	2,436	1,176	5,843	3,281
Net income	$ 9,391	$ 17,866	$ 17,124	$ 47
Preferred stock dividend and accretion of discount	764	742	2,256	989

Net income (loss) applicable to common shareholders	$ 8,627	$ 17,124	$ 14,868	$ (942)
Net income (loss) per common share:				
Basic	$ 0.34	$ 0.75	$ 0.63	$ (0.05)
Diluted	$ 0.33	$ 0.75	$ 0.62	$ (0.05)
Weighted-average common shares outstanding:				
Basic	25,063	22,686	23,739	17,842
Diluted	25,958	22,764	24,038	17,842
Comprehensive income (loss):				
Net income (loss) applicable to common shareholders	$ 8,627	$ 17,124	$ 14,868	$ (942)
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities arising during the period	115	419	234	(109)
Foreign currency translation adjustments	193	139	(3,433)	(510)
Tax effect of other comprehensive income (loss)	(40)	(138)	(77)	
Total other comprehensive income (loss)	268	420	(3,276)	(619)
Total comprehensive income (loss)	$ 8,895	$ 17,544	$ 11,592	$ (1,561)

See accompanying notes to condensed consolidated financial statements

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i2 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2005	2004
		(as restated, see Note 11)
Cash flows from operating activities:		
Net income	$ 17,124	$ 47
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	5,791	10,053
Write-down of equipment	871	330
(Gain) loss on extinguishment of debt	86	(2,223)
Gain on sale of assets	(2,176)	
Gain on sale of securities	(11,000)	
Provision (credit) for bad debts charged to expense	(90)	(1,443)
Amortization of deferred compensation	706	991
Deferred income taxes	(581)	
Changes in assets and liabilities:		
Accounts receivable, net	14,327	(1,255)
Deferred contract costs	1,580	3,210
Other assets	4,780	7,392
Accounts payable	(1,791)	(5,180)
Accrued liabilities	413	(59,212)
Accrued compensation and related expenses	(9,901)	57
Deferred revenue	(35,565)	(58,944)
Net cash used in operating activities	(15,426)	(106,177)
Cash flows from investing activities:		
Purchase of premises and equipment	(2,184)	(1,642)
Proceeds from sale of assets	2,653	620
Restrictions released from cash	2,636	6,701
Purchase of short-term investments	(95,950)	(322,425)
Proceeds from sale of short-term investments	228,656	397,825
Proceeds from sale of securities	11,000	
Purchase of long-term investments	(1,000)	(26,708)
Net cash provided by investing activities	145,811	54,371
Cash flows from financing activities:		
Proceeds from sale of series B preferred stock, net of issuance costs		95,325
Proceeds from sale of common stock, net of issuance costs	14,950	19,733
Repurchase of convertible subordinated notes	(21,529)	(37,400)
Net proceeds from common stock issuance from options and employee stock purchase plans	391	2,399

Net cash provided by (used in) financing activities	(6,188)	80,057
Effect of exchange rates on cash	(2,516)	(681)
Net change in cash and cash equivalents	121,681	27,570
Cash and cash equivalents at beginning of period	133,273	106,822
Cash and cash equivalents at end of period	$ 254,954	$ 134,392
Supplemental cash flow information		
Interest paid	$ 8,646	$ 9,795
Income taxes paid (net of refunds received)	$ 5,479	$ 2,379
Schedule of non cash financing activities		
Preferred stock dividend and accretion of discount	$ 2,256	$ 989

See accompanying notes to condensed consolidated financial statements.

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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. We also offer master data management technology, which is designed to collect, synthesize and distribute critical reference data. Our offerings help customers improve efficiency in relation to sourcing, supply, demand, 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 5, *Restructuring Charges and Adjustments* and Note 8, *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, 2005. 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 (SEC) 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 for the year ended December 31, 2004 filed on March 16, 2005 with the SEC (2004 Annual Report on Form 10-K) and as amended on Form 10-K/A filed on August 9, 2005.

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.

Fair values of stock options and employee stock purchase plan (ESPP) shares are estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Stock Options Three Months Ended September 30,	ESPP Shares Three Months Ended September 30,	Stock Options Nine Months Ended September 30,	ESPP Shares Nine Months Ended September 30,

	2005	2004	2005	2004	2005	2004	2005	2004
Risk-free interest rate	3.98%	3.28%	3.89%	3.28%	3.84%	2.99%	3.83%	3.10%
Expected term (years)	4	4	0.5	0.5	4	4	0.5	0.5
Volatility	1.02	1.13	0.91	0.79	1.05	1.19	0.84	0.86
Dividend yield	0%	0%	0%	0%	0%	0%	0%	0%

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i2 TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Table dollars in thousands, except per share data)

(Unaudited)

The following pro forma information presents net income (loss) applicable to common stockholders and net income (loss) per common share for the three and nine months ended September 30, 2005 and 2004 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. In 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 and nine months ended September 30, 2005 and 2004.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss) applicable to common stockholders, as reported	$ 8,627	$ 17,124	$ 14,868	$ (942)
Add: Stock-based employee compensation expense included in reported net income (loss)	249	349	706	1,135
Less: Total stock-based employee compensation expense determined under fair value based method for all awards	(5,805)	(7,994)	(25,130)	(39,776)
Pro forma net income (loss)	$ 3,071	$ 9,479	$ (9,556)	$ (39,583)
Net income (loss) per common share-Basic:				
As reported	$ 0.34	$ 0.75	$ 0.63	$ (0.05)
Pro forma	$ 0.12	$ 0.42	$ (0.40)	$ (2.22)
Net income (loss) per common share-Diluted:				
As reported	$ 0.33	$ 0.75	$ 0.62	$ (0.05)
Pro forma	$ 0.12	$ 0.42	$ (0.40)	$ (2.22)

Allowance For Doubtful Accounts. Our allowance for doubtful accounts was $1.0 million at each of September 30, 2005 and December 31, 2004.

Recent Accounting Pronouncements.

EITF 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share

In November 2004, the Emerging Issues Task Force (EITF) issued EITF 04-8, *Effect of Contingently Convertible Instruments on Diluted Earnings per Share,* which addresses the earnings per share impact of when the conversion feature of contingently convertible shares is based on a market price trigger. This statement requires the inclusion of the effect of such contingently convertible securities in the calculation of diluted earnings per share regardless of whether the market price trigger has been met.

We were required to apply the guidance in this issue for periods ending after December 15, 2004, with comparative periods presented restated to conform to this guidance. Earnings per share for the three and nine months ended September 30, 2004 has been restated to give effect to the new guidance.

SFAS No. 123(R), Share-Based Payment

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which establishes accounting standards for all transactions in which an entity exchanges its equity instruments for goods and

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Table dollars in thousands, except per share data)

(Unaudited)

services. SFAS No. 123(R) focuses primarily on accounting for transactions with employees, and carries forward without change prior guidance for share-based payments for transactions with non-employees. SFAS No. 123(R) eliminates the intrinsic value measurement objective in APB Opinion 25 and generally requires us to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of the grant.

We are required to apply SFAS No. 123(R) to all awards granted, modified or settled in our first reporting period under U.S. GAAP after June 15, 2005. However, on April 14, 2005, the Securities and Exchange Commission issued a press release (2005-57) that extended the compliance of SFAS 123(R). The SEC s new rule allows companies to implement Statement No. 123(R) at the beginning of their next fiscal year, instead of the next reporting period after June 15, 2005, which for calendar year end companies would be the first reporting period of 2006.

We have commenced our analysis of the impact of SFAS 123(R), but have not yet decided: (1) whether we will elect to adopt early, (2) if we elect to adopt early, then at what date we would do so, or (3) whether we will use the modified prospective method or elect to use the modified retrospective method. Additionally, we cannot predict with reasonable certainty the number of options that will be unvested and outstanding in 2006.

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 at September 30, 2005 and December 31, 2004 were as follows:

	September 30, 2005	December 31, 2004
Short-term time deposits	$ 15,083	$ 28,649
Commercial paper	94,115	23,792
	$ 109,198	$ 52,441

Investments in debt securities with remaining maturities in excess of three months when acquired by us that are held for purposes of funding our current operations are classified as available for sale and reported as short-term investments in the condensed consolidated balance sheets. Short-term investments at September 30, 2005 and December 31, 2004 were as follows:

	Amortized Cost	Unrealized Loss	Estimated Fair Value
September 30, 2005			
U.S. governmental obligations	12,000	(17)	11,983
	$ 12,000	$ (17)	$ 11,983
December 31, 2004			
Auction rate securities	$ 118,000	$	$ 118,000
U.S. governmental obligations	26,706	(174)	26,532
	$ 144,706	$ (174)	$ 144,532

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Table dollars in thousands, except per share data)

(Unaudited)

In addition to our short-term investments, the company holds minority equity investments in several privately-held companies, many of which can still be considered in the start-up or development stages or may no longer be viable or operational. As a result of significant declines in the expected realizable amounts of these investments, in previous periods we wrote off the book value of all these investments as the decline in fair value was considered other than temporary.

3. Leases

We lease our office facilities and certain office equipment under operating leases that expire at various dates through 2011. We have renewal options for most of our operating leases. Future minimum lease payments under our non-cancellable operating leases, including lease payments for restructured facilities without consideration of offsetting estimated sublease income of $1.9 million from the restructured facilities (See Note 5, *Restructuring Charges and Adjustments* for more details) as of September 30, 2005 are as follows:

2005	$ 4,900
2006	14,672
2007	9,827
2008	7,656
2009	7,122
Thereafter	3,668
Total	$ 47,845

4. Borrowings and Debt Issuance Costs

We have two long-term debt obligations outstanding as of September 30, 2005, which we have recorded as long-term liabilities. The costs incurred for the issuance of these debts are capitalized and amortized over the term of the debt obligation in accordance with SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. The following table summarizes the long-term debt and related debt issuance cost recorded on our condensed consolidated balance sheet at September 30, 2005 and December 31, 2004.

	September 30, 2005	December 31, 2004

Convertible subordinated notes, 5.25% annual rate payable semi-annually, due December 15, 2006	$ 288,450	$ 310,000
Non-negotiable promissory note, 5.25% annual rate payable semi-annually, due December 15, 2006	6,800	6,800
	$ 295,250	$ 316,800
Capitalized bond issuance costs, net	$ 1,420	$ 2,473

We retired $21.5 million of our convertible subordinated notes due December 15, 2006 during the last week of September 2005. The discount on retirement combined with the write-off of associated capitalized bond issuance costs resulted in a net loss on debt extinguishment of $0.1 million for the three months ended September 30, 2005. See Note 13, *Subsequent Events*, for discussion of retirement of an additional $28.5 million of such notes, which occurred after September 30, 2005.

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i2 TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Table dollars in thousands, except per share data)

(Unaudited)

5. Restructuring Charges and Adjustments

2005 Restructuring Plan. On March 30, 2005, we implemented a restructuring plan to resize our infrastructure and reduce our overhead to improve efficiencies and reduce operating expense. The restructuring included the involuntary termination of 184 employees and closing or partially vacating four office locations. 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 2005, we recorded a restructuring charge of $10.4 million for the involuntary terminations and $2.1 million for office closures.

2001 and 2002 Restructuring Plans. We initiated global restructuring plans in 2001 and 2002 to reduce our operating expenses and to bring them into alignment with our expected revenue levels. The plans included the elimination of certain employee positions and the reduction of office space and related overhead expenses. As of September 30, 2005, $1.2 million related to office closure and consolidation, net of estimated sublease income, remains in our restructuring accrual related to the 2001 and 2002 restructuring plans.

Consolidated Restructuring Accrual

The following table summarizes the 2005 restructuring related payments and accruals, and the components of the remaining restructuring accruals, included in accrued liabilities, at September 30, 2005 and December 31, 2004:

	Employee Severance and Termination