

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTER ENDED DECEMBER 31, 2005**
- or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 000-24786

**Aspen Technology, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-2739697**  
(I.R.S. Employer  
Identification No.)

**Ten Canal Park, Cambridge, Massachusetts 02141**  
(Address of principal executive office and zip code)

**(617) 949-1000**  
(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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  No

Indicate by check whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of February 7, 2006, there were 44,056,772 shares of the registrant's common stock (par value \$0.10 per share) outstanding.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**ASPEN TECHNOLOGY, INC.  
CONSOLIDATED CONDENSED BALANCE SHEETS**

(Unaudited and in thousands)

	December 31, 2005	June 30, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 57,458	\$ 68,149
Accounts receivable, net	44,615	52,254
Unbilled services	9,533	9,826
Current portion of long-term installments receivable, net	10,632	5,355
Deferred tax asset	702	692
Prepaid expenses and other current assets	9,115	11,483
Total current assets	<u>132,055</u>	<u>147,759</u>
Long-term installments receivable, net	28,746	19,425
Retained interest in sold receivables, net	17,145	16,667
Property and leasehold improvements, at cost	50,012	50,824
Accumulated depreciation and amortization	<u>(40,719)</u>	<u>(39,436)</u>
	9,293	11,388
Computer software development costs, net	15,919	17,411
Purchased intellectual property, net	447	730
Other intangible assets, net	8,538	12,123
Goodwill	14,713	14,729
Deferred tax asset	1,293	1,354
Other assets	2,536	2,656
	<u>\$ 230,685</u>	<u>\$ 244,242</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Current liabilities:		
Current portion of long-term debt	\$ 502	\$ 1,042
Accounts payable and accrued expenses	65,936	84,407
Unearned revenue	30,322	23,480
Deferred revenue	27,213	34,854
Total current liabilities	<u>123,973</u>	<u>143,783</u>
Long-term debt and obligations, less current maturities	234	338
Deferred revenue, less current portion	1,156	2,093
Deferred tax liability	2,780	2,760
Other liabilities	22,237	23,143
Redeemable Preferred Stock		
Outstanding—363,364 shares as of December 31, 2005 and June 30, 2005	128,831	121,210
Stockholders' equity (deficit):		
Common stock		
Outstanding—43,925,681 as of December 31, 2005 and 41,483,423 as of June 30, 2005	4,416	4,330
Additional paid-in capital	351,342	345,278
Accumulated deficit	(403,337)	(398,727)
Accumulated other comprehensive income (loss)	(434)	547
Treasury stock, at cost	(513)	(513)
Total stockholders' equity (deficit)	<u>(48,526)</u>	<u>(49,085)</u>
	<u>\$ 230,685</u>	<u>\$ 244,242</u>

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

**ASPEN TECHNOLOGY, INC.**  
**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**  
(Unaudited and in thousands, except for per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Software licenses	\$ 41,690	\$ 36,732	\$ 66,007	\$ 62,005
Service and other	34,701	34,893	70,437	72,890
Total revenues	<u>76,391</u>	<u>71,625</u>	<u>136,444</u>	<u>134,895</u>
Cost of software licenses	4,244	4,731	8,026	8,672
Cost of service and other	17,859	21,913	35,103	44,021
Amortization of technology related intangibles	1,773	1,778	3,555	3,552
Total Cost of Revenues	<u>23,876</u>	<u>28,422</u>	<u>46,684</u>	<u>56,245</u>
Gross Profit	52,515	43,203	89,760	78,650
Operating Costs:				
Selling and marketing	20,624	23,401	39,271	45,776
Research and development	11,771	11,574	21,905	23,757
General and administrative	9,884	12,694	20,069	23,121
Restructuring charges and FTC legal costs	995	219	3,194	21,727
Loss (gain) on sales and disposals of assets	316	5	377	(357)
Total Operating Costs	<u>43,590</u>	<u>47,893</u>	<u>84,816</u>	<u>114,024</u>

Income (loss) from operations	8,925	(4,690)	4,944	(35,374)
Other income (expense), net	1,055	351	392	(42)
Interest income, net	244	657	395	1,311
Income (loss) before income tax benefit (provision)	10,244	(3,682)	5,731	(34,105)
Income tax benefit (provision)	(2,080)	573	(2,720)	913
Net income (loss)	8,144	(3,109)	3,011	(33,192)
Accretion of preferred stock discount and dividend	(3,843)	(3,589)	(7,621)	(7,117)
Net income (loss) applicable to common shareholders	<u>\$ 4,301</u>	<u>\$ (6,698)</u>	<u>\$ (4,610)</u>	<u>\$ (40,309)</u>
Basic net income (loss) per share applicable to common shareholders	<u>\$ 0.10</u>	<u>\$ (0.16)</u>	<u>\$ (0.11)</u>	<u>\$ (0.96)</u>
Diluted net income (loss) per share applicable to common shareholders	<u>\$ 0.08</u>	<u>\$ (0.16)</u>	<u>\$ (0.11)</u>	<u>\$ (0.96)</u>
Weighted average shares outstanding—Basic	43,743	42,153	43,491	41,974
Weighted average shares outstanding—Diluted	<u>52,765</u>	<u>42,153</u>	<u>43,491</u>	<u>41,974</u>

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

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**ASPEN TECHNOLOGY, INC.**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
**(Unaudited and in thousands)**

	Six Months Ended December 31,	
	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 3,011	\$ (33,192)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	11,715	13,094
Stock-based compensation	3,372	—
Asset impairment charges, write-offs under restructuring charges, and (gains) losses on sales and disposals of assets	377	1,190
Accretion of discount on retained interest in sold receivables	(478)	—
Deferred income taxes	100	(176)
Decrease in accounts receivable	7,301	1,142
Decrease in unbilled services	168	5,128
Decrease (increase) in installments receivable	(14,598)	5,085
Decrease (increase) in prepaid expenses and other current assets	2,283	(20)
Decrease in accounts payable and accrued expenses	(18,940)	(13,519)
Increase in unearned revenue	6,788	2,752
Decrease in deferred revenue	(8,575)	(8,624)
Increase (decrease) in other liabilities	(906)	11,427
Net cash used in operating activities	<u>(8,382)</u>	<u>(15,713)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and leasehold improvements	(1,344)	(4,036)
Decrease in other long-term assets	119	180
Capitalization of computer software development costs	(3,040)	(3,872)
Net cash used in investing activities	<u>(4,265)</u>	<u>(7,728)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock under employee stock purchase plans	445	1,297
Exercise of stock options	2,276	1,932
Payments of long-term debt and capital lease obligations	(644)	(1,045)
Net cash provided by financing activities	<u>2,077</u>	<u>2,184</u>
EFFECTS OF EXCHANGE RATE CHANGES ON CASH	(121)	467
DECREASE IN CASH AND CASH EQUIVALENTS	<u>(10,691)</u>	<u>(20,790)</u>
CASH AND CASH EQUIVALENTS, beginning of period	68,149	107,677
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 57,458</u>	<u>\$ 86,887</u>

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

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## 1. Interim Condensed and Consolidated Financial Statements

In the opinion of management, the accompanying unaudited interim consolidated condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) for reporting on Form 10-Q. Accordingly, certain information and footnote disclosures required for complete financial statements are not included herein. It is suggested that these unaudited interim consolidated condensed financial statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2005, which are contained in the Annual Report on Form 10-K of Aspen Technology, Inc. (the Company), as previously filed with the SEC. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair presentation of the financial position, results of operations, and cash flows at the dates and for the periods presented have been included. The consolidated condensed balance sheet presented as of June 30, 2005 has been derived from the consolidated financial statements that have been audited by the Company's independent auditors. The results of operations for the six-month period ended December 31, 2005 are not necessarily indicative of the results to be expected for the full year.

## 2. Sale of Installments Receivable

Installments receivable represent the present value of future payments related to the financing of noncancelable term and perpetual license agreements that provide for payment in installments over a one to five-year period. A portion of each installment agreement is recognized as interest income in the accompanying consolidated condensed statements of operations. The interest rate utilized for the three and six months ended December 31, 2005 and 2004 was 8.0%

The Company has arrangements to sell certain of its installments receivable to three financial institutions. The Company sold, with limited recourse, certain of its installment contracts for aggregate proceeds of approximately \$25.5 million and \$35.2 million during the three and six months ended December 31, 2005, respectively, and \$25.6 million and \$51.2 million during the three and six months ended December 31, 2004, respectively. The financial institutions have certain recourse to the Company upon nonpayment by the customer under the installments receivable. The amount of recourse is determined pursuant to the provisions of the Company's contracts with the financial institutions. Collections of these receivables reduce the Company's recourse obligations, as defined. Generally, no gain or loss is recognized on the sale of the receivables due to the consistency of the discount rates used by the Company to record the installments receivable initially and the discount rate that the financial institutions are willing to use to purchase such receivables.

At December 31, 2005, there was approximately \$65 million of additional availability under the arrangements. The Company expects that there will be continued ability to sell installments receivable, as the collection of the sold receivables will reduce the outstanding balance and the availability under the arrangements can be increased. The Company's potential recourse obligation related to these contracts ranges from \$0.4 million to \$2.1 million. In addition, the Company is obligated to pay additional costs to the financial institutions in the event of default by the customer.

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## 3. Derivative Instruments and Hedging

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133, as amended by SFAS No. 138, requires that all derivatives, including foreign currency exchange contracts, be recognized on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings.

Forward foreign exchange contracts are used primarily by the Company to hedge certain balance sheet exposures resulting from changes in foreign currency exchange rates. Such exposures have historically resulted from portions of the Company's installments receivable that are denominated in currencies other than the U.S. dollar, primarily the Euro, Japanese Yen, Canadian Dollar and the British Pound Sterling. In addition, the Company incurred a potential exposure as part of the June 2005 securitization of installments receivable, in that the Company is obligated to cover the exposure in the installments receivable that were sold resulting from changes in foreign currency exchange rates.

The foreign exchange contracts are entered into to hedge installments receivable, which are either held or securitized, made in the normal course of business, and accordingly are not speculative in nature. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, the Company hedges the majority of its installments receivable denominated in foreign currencies.

The Company's obligation to cover the potential exposure in the securitized installments receivable represents an embedded derivative. The Company calculates the value of this obligation at each balance sheet date, and if the value of the embedded derivative represents an obligation, the fair value is recorded as a liability. To the extent that valuation of this obligation represents an asset to the Company, no entry is recorded because the embedded derivative does not contain upside potential. As of December 31, 2005, the value of this embedded derivative represented an obligation of the Company, and as such, a liability of \$0.4 million was recorded. As of June 30, 2005, the value of this embedded derivative represented an asset to the Company, and as such, no asset or liability was recorded.

At December 31, 2005, the Company had effectively hedged \$32.7 million of installments receivable and accounts receivable denominated in foreign currency. The Company does not hold or transact in financial instruments for purposes other than to hedge foreign currency risk. The gross value of the held and securitized long-term installments receivable that were denominated in foreign currency was \$36.6 million at December 31, 2005. The installments receivable held as of December 2005 mature at various times through December 2010. There have been no material gains or losses recorded relating to hedge contracts for the periods presented.

The Company records its foreign currency exchange contracts at fair value in its consolidated balance sheet and the related gains or losses on these hedge contracts are recognized in earnings. Gains and losses resulting from the changes in value of forward foreign exchange contracts are designated to offset certain accounts and installments receivable and are recognized as other income or expense in the period in which the fair market values change and offset the foreign currency losses and gains on the underlying exposures being hedged. During the three and six months ended December 31, 2005 the net gain or loss recognized in the consolidated statements of operations was a gain of \$0.6 million and a loss of \$0.2 million, respectively. During the three and six months ended December 31, 2004 the net gain or loss recognized in the consolidated statements of operations was not material. The ineffective portion of a derivative's change in fair value is recognized currently through earnings regardless of whether the instrument is designated as a

hedge. The gains and losses resulting from the impact of currency rate movements on forward currency exchange contracts are not material.

The following table provides information about the Company's foreign currency derivative financial instruments outstanding as of December 31, 2005. The information is provided in U.S. dollar amounts (in thousands), as presented in the Company's consolidated financial statements. The table presents the notional amount (at contract exchange rates) and the weighted average contractual foreign currency rates (in thousands, except average contract rate):

	Notional Amount	Estimated Fair Value*	Average Contract Rate
Euro	\$ 22,278	\$ 21,153	0.80
Japanese Yen	4,779	4,252	110.93
Canadian Dollar	2,520	2,692	1.21
British Pound Sterling	2,186	2,031	0.55
Swiss Franc	959	925	1.26
	<u>\$ 32,722</u>	<u>\$ 31,053</u>	

\* The estimated fair value is based on the estimated amount at which the contracts could be settled based on spot and forward rates as of December 31, 2005. The market risk associated with these instruments resulting from currency exchange rate movements is expected to offset the market risk of the underlying installments being hedged. The credit risk is that the Company's banking counterparties may be unable to meet the terms of the agreements. The Company minimizes such risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any loss as a result of default by other parties. However, there can be no assurances that the Company will be able to mitigate market and credit risks described above.

#### 4. Stock-Based Compensation

The Company issues stock options to its employees and outside directors and provides employees the right to purchase stock pursuant to stockholder approved stock option and employee stock purchase programs. Effective July 1, 2005, the Company adopted the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), using the Statement's modified prospective application method. Prior to July 1, 2005, the Company followed Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock compensation.

Under the provisions of SFAS No. 123R, the Company recognizes the fair value of stock compensation in net income, over the requisite service period of the individual grantees, which generally equals the vesting period. All of the Company's stock compensation is accounted for as an equity instrument and there have been no liability awards granted.

The Company has 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. 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 previous filings. Under the provisions of SFAS 123R, the Company recorded \$1.9 million and \$3.4 million of stock-based compensation on its consolidated condensed statements of operations for the three and six months ended December 31, 2005, respectively, included in the following expense categories (in thousands):

	Three Months Ended December 31, 2005	Six Months Ended December 31, 2005
Cost of service and other	\$ 302	\$ 532
Selling and marketing	550	958
Research and development	274	436
General and administrative	805	1,446
	<u>\$ 1,931</u>	<u>\$ 3,372</u>

The Company 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 were \$4.38 and \$7.57 for the three months ended December 31, 2005 and \$3.92 and \$3.81 for the six months ended December 31, 2005, respectively, using the following assumptions:

	Three Months Ended December 31, 2005		Six Months Ended December 31, 2005	
	Stock Option Plans	Purchase Plan	Stock Option Plans	Purchase Plan
Average risk-free interest rate	4.37%	4.03%	4.20%	3.79%
Expected dividend yield	None	None	None	None
Expected life	6.0 Years	0.5 Years	6.0 Years	0.5 Years
Expected volatility	85%	42%	85%	42%

The dividend yield of zero is based on the fact that the Company has never paid cash dividends and has no present intention to pay cash dividends. Expected volatility is based on the historical volatility of the Company's common stock over the period commensurate with or longer than the expected life of the options. The risk-free interest rate is the U.S. Treasury Strips rate on the date of grant. The expected life was calculated using the method outlined in SEC Staff Accounting Bulletin Topic 14.D.2, "Expected Term," as the Company's historical experience does not provide a reasonable basis for the expected term of the option.

Based on the Company's historical voluntary turnover rates, an annualized estimated forfeiture rate of 18% has been used in calculating the cost. Under the true-up provisions of SFAS 123R, additional expense will be recorded if the actual forfeiture rate is lower than estimated, and a recovery of prior expense will be recorded if the actual forfeiture is higher than estimated.

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

	<u>Three Months Ended December 31, 2004</u>	<u>Six Months Ended December 31, 2004</u>
Net income (loss) attributable to common shareholders—		
As reported	\$ (6,698)	\$ (40,309)
Less: Stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	1,913	2,728
Add: Stock-based compensation expense included in reported net income	537	537
Pro forma	<u>\$ (8,074)</u>	<u>\$ (42,500)</u>
Net income (loss) attributable to common shareholders per share—Basic		
As reported	\$ (0.16)	\$ (0.96)
Pro forma	(0.19)	(1.01)

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 \$4.43 and \$2.13 for the three months ended December 31, 2004 and \$4.43 and \$2.22 for the six months ended December 31, 2004, respectively, using the following assumptions:

	<u>Three Months Ended December 31, 2004</u>		<u>Six Months Ended December 31, 2004</u>	
	<u>Stock Option Plans</u>	<u>Purchase Plan</u>	<u>Stock Option Plans</u>	<u>Purchase Plan</u>
Average risk free interest rates	3.49%	3.49%	3.49%	3.49%
Expected dividend yield	None	None	None	None
Expected life	5 Years	0.5 Years	5 Years	0.5 Years
Expected volatility	100%	100%	100%	100%

## 5. Net Income (Loss) Per Common Share

Basic earnings per share was determined by dividing net income (loss) attributable to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings per share was determined by dividing net income (loss) attributable to common shareholders by diluted weighted average shares outstanding. Diluted weighted average shares reflect the dilutive effect, if any, of potential common shares. To the extent their effect is dilutive, potential common shares include common stock options, restricted stock and warrants, based on the treasury stock method, convertible debentures and preferred stock, based on the if-converted method, and other commitments to be settled in common stock. The calculations of basic and diluted net income (loss) attributable to common shareholders per share and basic and diluted weighted average shares outstanding are as follows (in thousands, except per share data):

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net income (loss) applicable to common shareholders	\$ 4,301	\$ (6,698)	\$ (4,610)	\$ (40,309)
Basic weighted average common shares outstanding	43,743	42,153	43,491	41,974
Dilutive potential common shares	9,022	—	—	—
Diluted weighted average shares outstanding	52,765	42,153	43,491	41,974
Basic net income (loss) per share applicable to common shareholders	<u>\$ 0.10</u>	<u>\$ (0.16)</u>	<u>\$ (0.11)</u>	<u>\$ (0.96)</u>
Diluted net income (loss) per share applicable to common shareholders	<u>\$ 0.08</u>	<u>\$ (0.16)</u>	<u>\$ (0.11)</u>	<u>\$ (0.96)</u>

The following potential common shares were excluded from the calculation of diluted weighted average shares outstanding as their effect would be anti-dilutive (in thousands):

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Convertible preferred stock	36,336	36,336	36,336	36,336
Options and warrants	4,047	20,362	21,424	20,362
Convertible debt	—	1,071	—	1,071
Preferred stock dividend, to be settled in common stock	—	2,243	3,192	2,243
Total	<u>40,383</u>	<u>60,012</u>	<u>60,952</u>	<u>60,012</u>

## 6. Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The components of comprehensive income (loss) for the three and six months ended December 31, 2005 and 2004 are as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Net income (loss)	\$ 8,144	\$ (3,109)	\$ 3,011	\$ (33,192)
Foreign currency adjustment	(463)	9	(981)	(82)
Comprehensive income (loss)	<u>\$ 7,681</u>	<u>\$ (3,100)</u>	<u>\$ 2,030</u>	<u>\$ (33,274)</u>

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## 7. Restructuring Charges and FTC Legal Costs

Restructuring charges and FTC legal costs consist of the following (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Restructuring charges	\$ 995	\$ 219	\$ 3,194	\$ 21,886
FTC legal costs	—	—	—	(159)
	<u>\$ 995</u>	<u>\$ 219</u>	<u>\$ 3,194</u>	<u>\$ 21,727</u>

During the three months ended December 31, 2005, the Company recorded \$1.0 million in restructuring charges. Of this amount, \$0.2 million relates to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that did not qualify for accrual at June 30, 2005. The remaining \$0.8 million relates to revisions of estimates associated with lease exit costs and accretion of the discounted restructuring accruals under previous restructuring plans.

### (a) Restructuring charge originally arising in Q4 FY05, Q1 FY06 and Q2 FY06

In May 2005 the Company initiated a plan to consolidate several corporate functions and to reduce its operating expenses. The plan to reduce operating expenses primarily resulted in headcount reductions, and also included the termination of a contract and the consolidation of facilities. These actions resulted in an aggregate restructuring charge of \$3.8 million, recorded in the fourth quarter of fiscal 2005.

During the three and six months ended December 31, 2005, the Company recorded \$0.2 million and \$1.4 million, respectively, related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that did not qualify for accrual at June 30, 2005.

As of December 31, 2005, there was \$1.1 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities and Contract exit costs	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 84	\$ 2,460	\$ 2,544
Restructuring charge	306	859	1,165
Restructuring charge—Accretion	—	7	7
Payments	(65)	(1,919)	(1,984)
Accrued expenses, September 30, 2005	325	1,407	1,732
Restructuring charge	139	57	196
Restructuring charge—Accretion	—	14	14
Payments	(112)	(728)	(840)
Accrued expenses, December 31, 2005	<u>\$ 352</u>	<u>\$ 750</u>	<u>\$ 1,102</u>
Expected final payment date	May 2007	July 2006	

The components of the additional restructuring activities completed in fiscal 2006 are as follows:

*Closure/consolidation of facilities:* Approximately \$0.4 million of the additional restructuring charge related to the termination of a facility lease. The facility lease had a remaining term of two years. The amount accrued is an estimate of the remaining obligation under the lease, reduced by expected income from the sub-lease of the underlying properties.

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*Employee severance, benefits and related costs:* Approximately \$1.0 million of the additional restructuring charge related to relocation costs and the reduction in headcount. The relocation costs are associated with employees that relocated during the six months ended December 31, 2005, and consist of the costs of moving the employees and relocation bonuses. The costs associated with reductions in headcount relate to employees that were notified as of June 30, 2005, but continued to provide services to the Company during the six months ended December 31, 2005.

### (b) Restructuring charge originally arising in Q4 FY04 and Q1 FY05

In June 2004, the Company initiated a plan to reduce its operating expenses in order to better align its operating cost structure with the then-current economic environment and to improve its operating margins. The plan to reduce operating expenses resulted in the consolidation of facilities, headcount

reductions, and the termination of operating contracts. These actions resulted in an aggregate restructuring charge of \$23.5 million, recorded in the fourth quarter of fiscal 2004. During the year ended June 30, 2005, the Company recorded \$14.4 million related to headcount reductions and facility consolidations associated with the June 2004 restructuring plan that did not qualify for accrual at June 30, 2004. During the six months ended December 31, 2005, the Company recorded a \$0.5 million increase to the accrual due to a change in the estimate of future operating costs and sub-lease assumptions associated with the facilities.

As of December 31, 2005, there was \$7.8 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations, lease payments and disposition costs. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities and Contract exit costs	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 8,425	\$ 232	\$ 8,657
Change in estimate—Revised assumptions	242	—	242
Restructuring charge—Accretion	102	—	102
Payments	(894)	(50)	(944)
Accrued expenses, September 30, 2005	7,875	182	8,057
Change in estimate—Revised assumptions	243	3	246
Restructuring charge—Accretion	112	—	112
Payments	(608)	(6)	(614)
Accrued expenses, December 31, 2005	<u>\$ 7,622</u>	<u>\$ 179</u>	<u>\$ 7,801</u>
Expected final payment date	September 2012	December 2006	

**(c) Restructuring charge originally arising in Q2 FY03**

In October 2002, we initiated a plan to further reduce operating expenses in response to first quarter revenue results that were below expectations and to general economic uncertainties. In addition, we revised revenue expectations for the remainder of the fiscal year and beyond, primarily related to the manufacturing/supply chain product line, which had been affected the most by the economic conditions. The plan to reduce operating expenses resulted in headcount reductions, consolidation of facilities, and discontinuation of development and support for certain non-critical products. These actions resulted in an aggregate restructuring charge of \$28.1 million. During fiscal 2004, we recorded a \$4.9 million decrease to the accrual related to revised assumptions associated with lease exit costs, particularly the buyout of a remaining lease obligation, and severance obligations. During fiscal 2005, we recorded a \$6.9 million increase to the accrual primarily due to a change in the estimate of the facility vacancy term, extending to the term of the lease. During the six months ended December 31, 2005, the Company recorded a

\$1.0 million increase to the accrual due to a change in the estimate of future operating costs and sub-lease assumptions associated with the facilities.

As of December 31, 2005, there was \$11.3 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations, lease payments and disposition costs. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Impairment of Assets and Disposition Costs	Total
Accrued expenses, June 30, 2005	\$ 11,698	\$ 160	\$ 78	\$ 11,936
Change in estimate—Revised assumptions	648	—	—	648
Payments	(646)	(1)	(19)	(666)
Accrued expenses, September 30, 2005	11,700	159	59	11,918
Change in estimate—Revised assumptions	399	—	—	399
Payments	(957)	(23)	(31)	(1,011)
Accrued expenses, December 31, 2005	<u>\$ 11,142</u>	<u>\$ 136</u>	<u>\$ 28</u>	<u>\$ 11,306</u>
Expected final payment date	September 2012	June 2006	January 2006	

**(d) Restructuring charge originally arising in Q4 FY02**

In the fourth quarter of fiscal 2002, the Company initiated a plan to reduce operating expenses and to restructure operations around its two primary product lines, engineering software and manufacturing/supply chain software. The Company reduced worldwide headcount by approximately 10%, or 200 employees, closed and consolidated facilities, and disposed of certain assets, resulting in an aggregate restructuring charge of \$13.2 million. During fiscal 2004, the Company recorded a \$1.5 million decrease to the accrual related to revised assumptions associated with lease exit costs, particularly the buyout of a remaining lease obligation, and severance obligations. During fiscal 2005, the Company recorded a \$0.2 million increase to the accrual due to changes in estimates of sublease assumptions and severance settlements.

As of December 31, 2005, there was \$0.7 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations and lease payments. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 782	\$ 111	\$ 893
Change in estimate—Revised assumptions	36	—	36
Payments	(107)	(69)	(176)
Accrued expenses, September 30, 2005	711	42	753
Change in estimate—Revised assumptions	26	—	26
Payments	(119)	—	(119)
Accrued expenses, December 31, 2005	<u>\$ 618</u>	<u>\$ 42</u>	<u>\$ 660</u>



## 8. Commitments and Contingencies

### *U.S. Attorney's Office Investigation*

On October 29, 2004, the Company announced that it had received a subpoena from the U.S. Attorney's Office for the Southern District of New York requesting documents relating to transactions to which the Company was a party during the 2000 to 2002 time frame, associated documents dating from January 1, 1999, and additional materials. The Company has cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney's Office.

### *Class Action Suits*

In November 2004, two putative class action lawsuits were filed against the Company in the United States District Court District of Massachusetts, captioned, respectively, *Fener v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12375 (D. Mass.) (filed Nov. 9, 2004) and *Stockmaster v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12387 (D. Mass.) (filed Nov. 10, 2004) (the "Class Actions"). The Class Actions allege, among other things, that the Company violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in connection with various statements about its financial condition for fiscal years 2000 through 2004. On February 2, 2005, the Court consolidated the cases under the caption *Aspen Technology, Inc. Securities Litigation*, Civil Action No. 04-12375 (D. Mass.), and appointed The Operating Engineers and Construction Industry and Miscellaneous Pension Fund (Local 66) and City of Roseville Employees' Retirement System as lead plaintiff, purporting to represent a putative class of persons who purchased Aspen Technology, Inc. common stock between January 25, 2000 and October 29, 2004. On August 26, 2005, the plaintiffs filed a consolidated amended complaint containing allegations materially similar to the prior complaints and expanding the class action period.

Following mediation, on November 16, 2005, the Company and the plaintiffs on behalf of putative class members entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action (the "Stipulation") which was filed with the Court on the same date. On December 12, 2005, the Court granted preliminary approval of the settlement provided for in the Stipulation and set a hearing date of March 6, 2006 to consider final approval of the settlement. The terms of the proposed settlement, including the terms of the distribution of settlement funds, are disclosed in the notice that was sent by the court-appointed Claims Administrator, Gilardi & Co., LLC, to members of the class, defined to include all persons who purchased Aspen Technology, Inc. common stock between October 29, 1999 and March 15, 2005, inclusive (the "Class").

Pursuant to the terms of the settlement, a total of \$5.6 million has been paid into a settlement fund by the Company and its insurance carrier. All costs of preparing and distributing notices to members of the Class and administration of the settlement, together with all fees and expenses awarded to plaintiffs' counsel and certain other expenses, will be paid out of the settlement fund, which will be maintained by an escrow agent under the court's supervision. However, the settlement remains subject to the satisfaction of various conditions, including final approval by the court. If final approval is not obtained, or if Class members opt out of the settlement, and the Company is required to litigate the dispute or elects to settle the dispute on different terms, the ultimate outcome could have a material adverse effect on the Company's financial position or results of operations.

As part of the settlement, the Plaintiffs have agreed to dismiss the class action lawsuit with prejudice effective upon entry of final judgment after court approval. The Company entered into the Stipulation to resolve the matter and without acknowledging any fault, liability or wrongdoing of any kind. There has been no adverse determination by the court against the Company or any of the other defendants in the case.

### *Demand Letter*

On April 12, 2005, the Company received a letter dated March 22, 2005 alleging that the officers and directors of AspenTech failed to disclose and misrepresented that the Company inappropriately recognized revenues in the 2000-2002 fiscal years, and that the Company should commence suit for relief equivalent to that sought in the derivative action previously brought against certain present and former executives and directors of the Company that was dismissed with prejudice on August 18, 2005, including requiring certain present and former officers of the Company to return remuneration paid to them while in breach of their fiduciary duties to the Company. The Company is currently unable to determine whether resolution of this matter will have a material adverse impact on its financial position or results of operations, or reasonably estimate the amount of the loss, if any, that may result from resolution of this matter. However, the ultimate outcome could have a material adverse effect on the Company's financial position or results of operations.

## 9. Preferred Stock Financing

In August 2003, the Company issued and sold Series D-1 and D-2 convertible preferred stock in a private placement to several investment partnerships managed by Advent International Corporation and to former Series B convertible preferred stockholders.

Each share of Series D Preferred initially is convertible into 100 shares of common stock, and in the aggregate, the Series D Preferred are convertible into 36,336,400 shares of common stock. The preferred stock was recorded at a discount and accrues a dividend.

In the accompanying consolidated condensed statements of operations, the accretion of the preferred stock discount and dividend consist of the following (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Accrual of dividend on Series D preferred stock	\$ (2,864)	\$ (2,646)	\$ (5,672)	\$ (5,240)
Accretion of discount on Series D preferred stock	(979)	(943)	(1,949)	(1,877)
Total	<u>\$ (3,843)</u>	<u>\$ (3,589)</u>	<u>\$ (7,621)</u>	<u>\$ (7,117)</u>

## 10. Segment Information

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," establishes standards for reporting information about operating segments in companies' financial statements. 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, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Chief Executive Officer of the Company.

The Company is organized geographically and by line of business. The Company has three major lines of business operating segments: license, consulting services and maintenance and training. The Company also evaluates certain subsets of business segments by vertical industries as well as by product categories. While the Executive Management Committee evaluates results in a number of different ways, the line of business management structure is the primary basis by which the committee assesses financial performance and allocates resources.

The accounting policies of the line of business operating segments are the same as those described in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2005. The Company does not track assets or capital expenditures by operating segments. Consequently, it is not practical to show

assets, capital expenditures, depreciation or amortization by operating segments. The following table presents a summary of operating segments (in thousands):

	<u>License</u>	<u>Consulting Services</u>	<u>Maintenance and Training</u>	<u>Total</u>
<b>Three Months Ended December 31, 2005—</b>				
Revenues from external customers	\$ 41,690	\$ 15,595	\$ 19,106	\$ 76,391
Controllable expenses	16,503	11,534	3,623	31,660
Controllable margin(1)	<u>\$ 25,187</u>	<u>\$ 4,061</u>	<u>\$ 15,483</u>	<u>\$ 44,731</u>
<b>Three Months Ended December 31, 2004—</b>				
Revenues from external customers	\$ 36,732	\$ 15,636	\$ 19,257	\$ 71,625
Controllable expenses	16,024	14,439	4,106	34,569
Controllable margin(1)	<u>\$ 20,708</u>	<u>\$ 1,197</u>	<u>\$ 15,151</u>	<u>\$ 37,056</u>
<b>Six Months Ended December 31, 2005—</b>				
Revenues from external customers	\$ 66,007	\$ 32,480	\$ 37,957	\$ 136,444
Controllable expenses	30,964	22,708	7,064	60,736
Controllable margin(1)	<u>\$ 35,043</u>	<u>\$ 9,772</u>	<u>\$ 30,893</u>	<u>\$ 75,708</u>
<b>Six Months Ended December 31, 2004—</b>				
Revenues from external customers	\$ 62,005	\$ 34,754	\$ 38,136	\$ 134,895
Controllable expenses	31,491	29,549	7,795	68,835
Controllable margin(1)	<u>\$ 30,514</u>	<u>\$ 5,205</u>	<u>\$ 30,341</u>	<u>\$ 66,060</u>

(1) The controllable margins reported reflect only the expenses of the line of business and do not represent the actual margins for each operating segment since they do not contain an allocation for selling and marketing, general and administrative, development and other corporate expenses incurred in support of the line of business.

**Profit Reconciliation (in thousands):**

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	2005	2004	2005	2004
Total controllable margin for reportable segments	\$ 44,731	\$ 37,056	\$ 75,708	\$ 66,060
Selling and marketing	(17,056)	(19,813)	(32,280)	(38,674)
General and administrative and overhead	(17,439)	(21,709)	(34,913)	(41,390)
Restructuring and Other charges	(995)	(219)	(3,194)	(21,727)
Interest and other income and expense, net	983	1,003	410	1,626
Income (loss) before income tax benefit (provision)	<u>\$ 10,224</u>	<u>\$ (3,682)</u>	<u>\$ 5,731</u>	<u>\$ (34,105)</u>

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

THE FOLLOWING DISCUSSION AND ANALYSIS OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES APPEARING ELSEWHERE IN THIS QUARTERLY REPORT ON FORM 10-Q AND IN OUR ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED JUNE 30, 2005. THIS DISCUSSION AND ANALYSIS CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS, UNCERTAINTIES AND ASSUMPTIONS. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF A NUMBER OF FACTORS, INCLUDING THOSE SET FORTH UNDER "FACTORS THAT MAY AFFECT OUR OPERATING RESULTS AND STOCK PRICE" AND ELSEWHERE IN THIS QUARTERLY REPORT.

**Overview**

Since our founding in 1981, we have developed and marketed software and services to companies in the process industries. In addition to internally generated growth, we have acquired a number of businesses, including Hyprotech on May 31, 2002.

**Significant Events—Three Months Ended December 31, 2005**

On November 16, 2005, we and the plaintiffs on behalf of members of the Class entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action, which we refer to as the stipulation, which was filed with the court on the same date. On December 12, 2005, the court granted preliminary approval of the settlement provided for in the stipulation and set a hearing date of March 6, 2006 to consider final approval of the settlement. Pursuant to the terms of the settlement, a total of \$5.6 million has been paid into a settlement fund by us and our insurance carrier. All costs of preparing and distributing notices to members of the Class and administration of the settlement, together with all fees and expenses awarded to plaintiffs' counsel and certain other expenses, will be paid out of the settlement fund, which will be maintained by an escrow agent under the court's supervision. However, the settlement remains subject to the satisfaction of various conditions, including final approval by the court.

During the three months ended December 31, 2005, we recorded \$1.0 million in restructuring charges. Of this amount, \$0.2 million relates to headcount reductions, relocation costs and facility consolidations associated with the May 2005 restructuring plan that did not qualify for accrual at June 30, 2005. The remaining \$0.8 million relates to revisions of estimates associated with lease exit costs and accretion of the discounted restructuring accruals under previous restructuring plans.

#### Significant Events—Three Months Ended September 30, 2005

During the three months ended September 30, 2005, we recorded \$2.2 million in restructuring charges. Of this amount, \$1.2 million relates to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that did not qualify for accrual at June 30, 2005. The remaining \$1.0 million relates to revisions of estimates associated with lease exit costs and accretion of the discounted restructuring accruals under previous restructuring plans.

#### Summary of Restructuring Accruals

##### Restructuring charge originally arising in Q4 FY05, Q1 FY06 and Q2 FY06

In May 2005, we initiated a plan to consolidate several corporate functions and to reduce our operating expenses. The plan to reduce operating expenses primarily resulted in headcount reductions, and also included the termination of a contract and the consolidation of facilities. These actions resulted in an aggregate restructuring charge of \$3.8 million, recorded in the fourth quarter of fiscal 2005.

During the three and six months ended December 31, 2005, we recorded \$0.2 million and \$1.4 million, respectively, related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that did not qualify for accrual at June 30, 2005.

As of December 31, 2005, there was \$1.1 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities and Contract exit costs	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 84	\$ 2,460	\$ 2,544
Restructuring charge	306	859	1,165
Restructuring charge—Accretion	—	7	7
Payments	(65)	(1,919)	(1,984)
Accrued expenses, September 30, 2005	325	1,407	1,732
Restructuring charge	139	57	196
Restructuring charge—Accretion	—	14	14
Payments	(112)	(728)	(840)
Accrued expenses, December 31, 2005	\$ 352	\$ 750	\$ 1,102
Expected final payment date	May 2007	July 2006	

##### Restructuring charge originally arising in Q4 FY04 and Q1 FY05

In June 2004, we initiated a plan to reduce our operating expenses in order to better align our operating cost structure with the then-current economic environment and to improve our operating margins. The plan to reduce operating expenses resulted in the consolidation of facilities, headcount reductions, and the termination of operating contracts. These actions resulted in an aggregate restructuring charge of \$23.5 million, recorded in the fourth quarter of fiscal 2004. During the year ended June 30, 2005, we recorded \$14.4 million related to headcount reductions and facility consolidations associated with the June 2004 restructuring plan that did not qualify for accrual at June 30, 2004. During the six months ended December 31, 2005, we recorded a \$0.5 million increase to the accrual due to a change in the estimate of future operating costs and sub-lease assumptions associated with the facilities.

As of December 31, 2005, there was \$7.8 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations, lease payments and disposition costs. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities and Contract exit costs	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 8,425	\$ 232	\$ 8,657
Change in estimate—Revised assumptions	242	—	242
Restructuring charge—Accretion	102	—	102
Payments	(894)	(50)	(944)
Accrued expenses, September 30, 2005	7,875	182	8,057
Change in estimate—Revised assumptions	243	3	246
Restructuring charge—Accretion	112	—	112
Payments	(608)	(6)	(614)
Accrued expenses, December 31, 2005	\$ 7,622	\$ 179	\$ 7,801
Expected final payment date	September 2012	December 2006	

### Restructuring charge originally arising in Q2 FY03

In October 2002, we initiated a plan to further reduce operating expenses in response to first quarter revenue results that were below expectations and to general economic uncertainties. In addition, we revised revenue expectations for the remainder of the fiscal year and beyond, primarily related to the manufacturing/supply chain product line, which had been affected the most by the economic conditions. The plan to reduce operating expenses resulted in headcount reductions, consolidation of facilities, and discontinuation of development and support for certain non-critical products. These actions resulted in an aggregate restructuring charge of \$28.1 million. During fiscal 2004, we recorded a \$4.9 million decrease to the accrual related to revised assumptions associated with lease exit costs, particularly the buyout of a remaining lease obligation, and severance obligations. During fiscal 2005, we recorded a \$6.9 million increase to the accrual primarily due to a change in the estimate of the facility vacancy term, extending to the term of the lease. During the six months ended December 31, 2005, we recorded a \$1.0 million increase to the accrual due to a change in the estimate of future operating costs and sub-lease assumptions associated with the facilities.

As of December 31, 2005, there was \$11.3 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations, lease payments and disposition costs. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Impairment of Assets and Disposition Costs	Total
Accrued expenses, June 30, 2005	\$ 11,698	\$ 160	\$ 78	\$ 11,936
Change in estimate—Revised assumptions	648	—	—	648
Payments	(646)	(1)	(19)	(666)
Accrued expenses, September 30, 2005	11,700	159	59	11,918
Change in estimate—Revised assumptions	399	—	—	399
Payments	(957)	(23)	(31)	(1,011)
Accrued expenses, December 31, 2005	\$ 11,142	\$ 136	\$ 28	\$ 11,306
Expected final payment date	September 2012	June 2006	January 2006	

### Restructuring charge originally arising in Q4 FY02

In the fourth quarter of fiscal 2002, we initiated a plan to reduce operating expenses and to restructure operations around our two primary product lines, engineering software and manufacturing/supply chain software. We reduced worldwide headcount by approximately 10%, or 200 employees, closed and consolidated facilities, and disposed of certain assets, resulting in an aggregate restructuring charge of \$13.2 million. During fiscal 2004, we recorded a \$1.5 million decrease to the accrual related to revised assumptions associated with lease exit costs, particularly the buyout of a remaining lease obligation and severance obligations. During fiscal 2005, we recorded a \$0.2 million increase to the accrual due to changes in estimates of sublease assumptions and severance settlements.

As of December 31, 2005, there was \$0.7 million remaining in accrued expenses and other liabilities relating to the remaining severance obligations and lease payments. During the six months ended December 31, 2005, the following activity was recorded (in thousands):

	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2005	\$ 782	\$ 111	\$ 893
Change in estimate—Revised assumptions	36	—	36
Payments	(107)	(69)	(176)
Accrued expenses, September 30, 2005	711	42	753
Change in estimate—Revised assumptions	26	—	26
Payments	(119)	—	(119)
Accrued expenses, December 31, 2005	\$ 618	\$ 42	\$ 660
Expected final payment date	September 2012	June 2006	

### Critical Accounting Estimates and Judgments

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue recognition for both software licenses and fixed-fee consulting services,
- Impairment of long-lived assets, goodwill and intangible assets,
- Accrual of legal fees associated with outstanding litigation,
- Accounting for taxes,
- Allowance for doubtful accounts, and
- Accounting for securitization of installments receivable.

### **Revenue Recognition—Software Licenses**

We recognize software license revenue in accordance with Statement of Position, or SOP, No. 97-2, “Software Revenue Recognition,” as amended by SOP No. 98-4 “Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition,” and SOP No. 98-9, “Software Revenue Recognition with Respect to Certain Transactions,” as well as the various interpretations and clarifications of those statements. These statements require that four basic criteria must be satisfied before software license revenue can be recognized:

- persuasive evidence of an arrangement between ourselves and a third party exists;
- delivery of our product has occurred;
- the sales price for the product is fixed or determinable; and

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- collection of the sales price is probable.

Our management uses its judgment concerning the satisfaction of these criteria, particularly the criteria relating to the determination of whether the fee is fixed and determinable and the criteria relating to the collectibility of the receivables, particularly the installments receivable, relating to such sales. In addition, our management uses its judgment in applying these two criteria to reseller transactions where, specifically, revenue is only recognized upon delivery to the end user, since the determination of whether the fee is fixed or determinable and whether collection if probable is more difficult. Should changes and conditions cause management to determine that these criteria are not met for certain future transactions, all or substantially all of the software license revenue recognized for such transactions could be deferred.

### **Revenue Recognition—Fixed-Fee Consulting Services**

We recognize revenue associated with fixed-fee service contracts in accordance with the proportional performance method, measured by the percentage of costs (primarily labor) incurred to date as compared to the estimated total costs (primarily labor) for each contract. When a loss is anticipated on a contract, the full amount of the anticipated loss is provided currently. Our management uses its judgment concerning the estimation of the total costs to complete the contract, considering a number of factors including the experience of the personnel that are performing the services and the overall complexity of the project. We have a significant amount of experience in the estimation of the total costs to complete a contract and have not typically recorded material losses related to these estimates. We do not expect the accuracy of our estimates to change significantly in the future. Should changes and conditions cause actual results to differ significantly from management’s estimates, revenue recognized in future periods could be adversely affected.

### **Impairment of Long-lived Assets, Goodwill and Intangible Assets**

In accordance with Statement of Financial Accounting Standards, or SFAS, No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” we review the carrying value of long-lived assets when circumstances dictate that they should be reevaluated, based upon the expected future operating cash flows of our business. These future cash flow estimates are based on historical results, adjusted to reflect our best estimate of future markets and operating conditions, and are continuously reviewed based on actual operating trends. Historically, actual results have occasionally differed from our estimated future cash flow estimates. In the future, actual results may differ materially from these estimates, and accordingly cause a full impairment of our long-lived assets.

In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” we conduct at least an annual assessment on January 1st of the carrying value of our goodwill assets. We obtain a third-party valuation of the reporting units associated with the goodwill assets, which is based on either estimates of future income from the reporting units or estimates of the market value of the units, based on comparable recent transactions. These estimates of future income are based upon historical results, adjusted to reflect our best estimate of future markets and operating conditions, and are continuously reviewed based on actual operating trends. Historically, actual results have occasionally differed from our estimated future cash flow estimates. In the future, actual results may differ materially from these estimates. In addition, the relevancy of recent transactions used to establish market value for our reporting units is based on management’s judgment.

In prior years we recorded charges related to the impairment of certain long-lived assets and technology related intangible and computer software development assets. The timing and size of future impairment charges involves the application of management’s judgment and estimates and could result in the impairment of all or substantially all of our long-lived assets, intangible assets and goodwill, which totaled \$51.4 million as of December 31, 2005.

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### **Accrual of Legal Fees Associated with Outstanding Litigation**

We accrue estimated future legal fees associated with outstanding litigation for which management has determined that it is probable that a loss contingency exists. This requires management to estimate the amount of legal fees that will be incurred in the defense of the litigation. These estimates are based heavily on our expectations of the scope, length to complete and complexity of the claims. Historically, as these factors have changed after our original estimates, we have adjusted our estimates accordingly. In the future, additional adjustments may be recorded as the scope, length or complexity of outstanding litigation changes.

### **Accounting for Taxes**

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax liabilities together with the assessment of temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. Tax assets also result from net operating losses, research and development tax credits and foreign tax credits. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, the impact will be included in the tax provision in our statement of operations.

Significant management judgment is required in determining our deferred tax assets and liabilities and any valuation allowance recorded against these amounts. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods we may need to establish an additional valuation allowance which could result in a tax provision equal to the carrying value of our deferred tax assets.

### **Allowance for Doubtful Accounts**

We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables for which collection is doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. In determining these provisions, we analyze our historical collection experience and current economic trends. If the historical data we use to calculate the allowance provided for doubtful accounts do not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be required for all or substantially all of certain receivable balances.

### **Accounting for Securitization of Installments Receivable**

We made judgments with respect to several variables associated with our June 2005 securitization transaction that had a significant impact on the valuation of our retained interest in the sold receivables, as well as the calculation of the loss on the transaction. These judgments include the discount rate used to value the retained interest in the sold receivables and estimates of rates of default. In determining these factors, we looked at comparable transactions with respect to fair market discount rates, and analyzed our historical collection experience to default rates and collection timing. If the historical collection data do not reflect the future ability to collect outstanding receivables, an impairment of a substantial portion of our retained interest may result.

## **Results of Operations**

The following table sets forth the percentages of total revenues represented by certain consolidated condensed statement of operations data for the periods indicated:

	<b>Three Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Revenues:</b>				
Software licenses	54.6%	51.3%	48.4%	46.0%
Service and other	45.4	48.7	51.6	54.0
Total revenues	100.0	100.0	100.0	100.0
<b>Cost of revenues:</b>				
Cost of software licenses	5.6	6.6	5.9	6.4
Cost of service and other	23.4	30.6	25.7	32.6
Amortization of technology related intangible assets	2.3	2.5	2.6	2.6
Total cost of revenues	31.3	39.7	34.2	41.7
Gross profit	68.7	60.3	65.8	58.3
<b>Operating costs:</b>				
Selling and marketing	27.0	32.7	28.8	33.9
Research and development	15.4	16.2	16.1	17.6
General and administrative	12.9	17.7	14.7	17.1
Restructuring charges and FTC legal costs	1.3	0.3	2.3	16.1
Gain on sales and disposals of assets	0.4	0.0	0.3	(0.3)
Total operating costs	57.0	66.9	62.2	84.5
Income (loss) from operations	11.7	(6.5)	3.6	(26.2)
Interest income, net	0.3	1.0	0.3	1.0
Other income (expense), net	1.4	0.5	0.3	0.0
Income (loss) before (provision for) benefit from income taxes	13.4%	(5.1)%	4.2%	(25.3)%

### **Comparison of the Three and Six Months Ended December 31, 2005 and 2004**

#### **New Stock-Based Compensation Accounting Pronouncement**

Effective July 1, 2005, we adopted the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment," or SFAS 123R, using the Statement's modified prospective application method. Prior to July 1, 2005, we followed Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock compensation.

Under the provisions of SFAS 123R, we now recognize the fair value of stock compensation in net income, over the requisite service period of the individual grantees, which generally equals the vesting period of four years.

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. The unrecognized expense of awards not yet vested at the date of adoption will 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 previous filings.

Under the provisions of SFAS 123R, we recorded \$1.9 million and \$3.4 million of stock-based compensation on our consolidated condensed statements of operations for the three and six months ended December 31, 2005, respectively, included in the following expense categories (in thousands):

	<u>Three Months Ended December 31, 2005</u>	<u>Six Months Ended December 31, 2005</u>
Cost of service and other	\$ 302	\$ 532
Selling and marketing	550	958
Research and development	274	436
General and administrative	805	1,446
	<u>\$ 1,931</u>	<u>\$ 3,372</u>

### **Total Revenues**

Revenues are derived from software licenses, consulting services and maintenance and training. Total revenues for the three months ended December 31, 2005 increased 6.7% to \$76.4 million from \$71.6 million in the three months ended December 31, 2004. Total revenues for the six months ended December 31, 2005 increased 1.0% to \$136.4 million from \$134.9 million in the six months ended December 31, 2004. Total revenues from customers outside the United States were \$42.7 million and \$78.3 million, or 55.9% and 57.4% of total revenues for the three and six months ended December 31, 2005, respectively, as compared to \$41.2 million and \$81.5 million, or 57.6% and 60.7% of total revenues for the three and six months ended December 31, 2004. The geographical mix of revenues can vary from period to period.

### **Software License Revenues**

Software license revenues are attributable to software license renewals covering existing users, the expansion of existing customer relationships through licenses covering additional users, licenses of additional software products, and, to a lesser extent, to the addition of new customers. Software license revenues represented 54.6% of total revenues for the three months ended December 31, 2005 compared to 51.3% for the three months ended December 31, 2004. Revenues from software licenses in the three months ended December 31, 2005 increased 13.5% to \$41.7 million from \$36.7 million in the three months ended December 31, 2004.

Software license revenues represented 48.4% of total revenues for the six months ended December 31, 2005 compared to 46.0% for the six months ended December 31, 2004. Revenues from software licenses in the six months ended December 31, 2005 increased 6.5% to \$66.0 million from \$62.0 million in the six months ended December 31, 2004.

The increases in the three and six month periods principally reflected the increased efforts and time that our management were able to dedicate to software license activities, and the increased willingness of customers to make investments in our products, following the resolution of the Federal Trade Commission, or FTC, proceedings and the audit committee investigation pending during the earlier periods.

### **Service and Other Revenues**

Revenues from service and other consist of consulting services, post-contract support on software licenses, training and sales of documentation. Revenues from service and other for the three months ended December 31, 2005 decreased 0.6% to \$34.7 million from \$34.9 million for the three months ended December 31, 2004. Revenues from service and other for the six months ended December 31, 2005 decreased 3.4% to \$70.4 million from \$72.9 million for the six months ended December 31, 2004.

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These decreases in the three and six month periods were attributable primarily to the consulting services business. Consulting services decreased due to the December 2004 sale of a portion of our consulting business to Honeywell, as part of our settlement with the FTC.

### **Cost of Software Licenses**

Cost of software licenses consists of royalties, amortization of previously capitalized software costs, costs related to delivery of software, including disk duplication and third-party software costs, printing of manuals and packaging. Cost of software licenses for the three months ended December 31, 2005 decreased 10.3% to \$4.2 million from \$4.7 million for the three months ended December 31, 2004. Cost of software licenses for the six months ended December 31, 2005 decreased 7.4% to \$8.0 million from \$8.7 million for the six months ended December 31, 2004. Cost of software licenses as a percentage of revenues from software licenses was 10.2% and 12.2% for the three and six months ended December 31, 2005, respectively, as compared to 12.9% and 14.0% for the three and six months ended December 31, 2004, respectively.

The cost decreases in the three and six month periods were primarily due to decreases in third-party royalty costs. This is due to both mix of products sold as well as the termination of several non-essential royalty agreements.

### **Cost of Service and Other**

Cost of service and other consists of the cost of execution of application consulting services, technical support expenses and the cost of training services. Cost of service and other for the three months ended December 31, 2005 decreased 18.5% to \$17.9 million from \$21.9 million in the three months ended December 31, 2004. Cost of service and other for the six months ended December 31, 2005 decreased 20.3% to \$35.1 million from \$44.0 million in the six months ended December 31, 2004. Cost of service and other as a percentage of service and other revenues was 51.5% and 49.8% in the three and six months ended December 31, 2005, respectively, as compared to 62.8% and 60.4% in the three and six months ended December 31, 2004, respectively.

The cost decrease in the three month periods was primarily due to decreased payroll and related costs of \$3.9 million and decreased rent and facility costs of \$1.1 million related to reductions in headcount and facility consolidations, offset in part by stock-based compensation costs of \$0.3 million. The decrease in cost for the six month periods was attributable to decreased payroll and related costs of \$7.0 million and decreased rent and facility costs of \$2.1 million related to reductions in headcount and facility consolidations, and decreased third-party consultant costs of \$0.4 million, offset in part by stock-based compensation costs of \$0.5 million.

### **Amortization of Technology Related Intangibles**

Amortization of technology related intangibles for the three months ended December 31, 2005 and 2004 was \$1.8 million, and for the six months ended December 31, 2005 and 2004 was \$3.6 million. As a percentage of total revenues, amortization of technology related intangibles was 2.3% and 2.6% for the three and six months ended December 31, 2005, respectively, as compared to 2.5% and 2.6% for the three and six months ended December 31, 2004.

### **Selling and Marketing Expenses**

Selling and marketing expenses for the three months ended December 31, 2005 decreased 11.9% to \$20.6 million from \$23.4 million in the three months ended December 31, 2004. Selling and marketing expenses for the six months ended December 31, 2005 decreased 14.2% to \$39.3 million from \$45.8 million in the six months ended December 31, 2004. As a percentage of total revenues, selling and marketing

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expenses were 27.0% and 28.8% for the three and six months ended December 31, 2005, respectively, as compared to 32.7% and 33.9% for the three and six months ended December 31, 2004, respectively.

The decrease in cost for the three month periods was attributable to decreased payroll and related costs of \$2.0 million and decreased rent and facilities costs of \$0.9 million related to reductions in headcount and facility consolidations, and decreased marketing costs of \$1.6 million, offset in part by \$0.6 million in stock based compensation costs and increases in commission and bonus costs of \$0.9 million. The decrease in cost for the six month periods was attributable to decreased payroll and related costs of \$3.5 million and decreased rent and facilities costs of \$2.1 million related to reductions in headcount and facility consolidations, and decreased marketing costs of \$2.9 million, offset in part by \$1.0 million in stock-based compensation costs and increases in commission and bonus costs of \$1.1 million.

### ***Research and Development Expenses***

Research and development expenses consist of personnel and outside consultancy costs required to conduct our product development efforts. Research and development expenses during the three months ended December 31, 2005 increased 1.7% to \$11.8 million from \$11.6 million in the three months ended December 31, 2004. Research and development expenses during the six months ended December 31, 2005 decreased 7.8% to \$21.9 million from \$23.8 million in the six months ended December 31, 2004. As a percentage of revenues, research and development costs were 15.4% and 16.1% for the three and six months ended December 31, 2005, respectively, as compared to 16.2% and 17.6% for the three and six months ended December 31, 2004, respectively.

The increase in costs for the three month periods was due to a decrease in software development costs eligible for capitalization of \$0.9 million and \$0.3 million in stock-based compensation costs, both offset in part by decreased payroll and related costs of \$0.6 million and third-party consultant costs of \$0.3 million. The decrease in costs for the six month periods was attributable to decreased salary and related costs of \$1.2 million, decreased third-party consultant costs of \$0.9 million, and decreased fixed asset depreciation costs of \$0.4 million, all offset in part by a decrease in software development costs eligible for capitalization of \$0.7 million and stock-based compensation costs of \$0.4 million.

We capitalized software development costs that amounted to 7.9% and 13.8% of our total research and development costs during the three and six months ended December 31, 2005, respectively, as compared to 13.9% and 16.9% during the three and six months ended December 31, 2004, respectively.

### ***General and Administrative Expenses***

General and administrative expenses consist primarily of salaries of administrative, executive, financial and legal personnel, outside professional fees, and amortization of other intangible assets. General and administrative expenses for the three months ended December 31, 2005 decreased 22.1% to \$9.9 million from \$12.7 million for the three months ended December 31, 2004. General and administrative expenses for the six months ended December 31, 2005 decreased 13.2% to \$20.1 million from \$23.1 million for the six months ended December 31, 2004.

The decrease in costs for the three month periods can be attributed to decreased legal costs of \$3.1 million related to the audit committee investigation in the prior year, the existence of a contract termination charge in the prior year of \$1.1 million, and decreased payroll and related costs of \$0.7 million, all offset in part by stock-based compensation costs of \$0.8 million, increased third-party consultant costs of \$0.2 million, and increased recruiting costs of \$0.2 million. The decrease in costs for the six month periods can be attributed to decreased legal costs of \$5.0 million related to the audit committee investigation and other litigation in the prior year, the existence of a contract termination charge in the prior year of \$1.1 million, and decreased payroll and related costs of \$1.2 million, all offset in part by stock-

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based compensation costs of \$1.4 million, increased third-party consultant costs of \$0.7 million, and increased recruiting costs of \$0.3 million.

### ***Restructuring Charges and FTC Legal Costs***

During the three months ended December 31, 2005, we recorded \$1.0 million in restructuring charges. Of this amount, \$0.2 million relates to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that did not qualify for accrual at June 30, 2005. The remaining \$0.8 million relates to revisions of estimates associated with lease exit costs and accretion of the discounted restructuring accruals under previous restructuring plans.

### ***Interest Income***

Interest income is generated from investment of excess cash in short-term and long-term investments and from the license of software pursuant to installment contracts. Under these installment contracts, we offer a customer the option to make annual payments for its term licenses instead of a single license fee payment at the beginning of the license term. Historically, a substantial majority of our asset optimization customers have elected to license these products through installment contracts. Included in the annual payments is an implicit interest rate established by us at the time of the license. As we sell more perpetual licenses for value chain solutions, these sales are being paid for in forms that are generally not installment contracts. If the mix of sales moves away from installment contracts, interest income in future periods will be reduced.

We sell a portion of our installment contracts to unrelated financial institutions. The interest earned by us on the installment contract portfolio in any one year is the result of the implicit interest rate established by us on installment contracts and the size of the contract portfolio. Interest income was \$0.5 million and \$0.9 million for the three and six months ended December 31, 2005, respectively, as compared to \$1.5 million and \$3.3 million for the three and six months ended December 31, 2004, respectively. This decrease is due to the securitization of approximately \$71.2 million of our installments receivable in June 2005.



## Interest Expense

Interest expense is generated from interest charged on our convertible debentures, notes payable and capital lease obligations. Interest expense was \$0.2 million and \$0.4 million for the three and six months ended December 31, 2005, as compared to \$0.9 million and \$2.0 million for the three and six months ended December 31, 2004, respectively. This decrease in interest expense resulted from the retirement of our convertible debentures in June 2005.

## Tax Rate

The tax provision recorded during the three and six months ended December 31, 2005 primarily relates to state and foreign taxes. We did not record a domestic income tax benefit for the six months ended December 31, 2005 and 2004, as we provided a full valuation against the domestic tax net operating loss carryforwards that were generated during the periods. The tax benefit recorded during the three and six months ended December 31, 2004 related to losses incurred in foreign locations.

## Liquidity and Capital Resources

During the six months ended December 31, 2005, operating activities used \$8.4 million of cash primarily due to cash payments related to restructuring, legal and financing accruals, offset by the collection of accounts receivable. Investing activities used \$4.3 million of cash as a result of the purchase of property and equipment and the capitalization of computer software development costs. Financing

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activities provided \$2.1 million of cash primarily due to the exercise of stock options and the issuance of shares under our employee stock purchase plan.

Historically, we have financed our operations principally through cash generated from public offerings of our convertible debentures and common stock, private offerings of our preferred stock and common stock, operating activities, and the sale of installment contracts to third parties.

On June 15, 2005, we paid \$58.2 million to retire all of the outstanding principal amount of our convertible debentures, together with interest accrued thereon. We funded this payment with (a) \$8.6 million of our existing cash, (b) \$5.8 million obtained from our sales of installments receivable under our existing receivables programs with Silicon Valley Bank and GE Capital Corporation, and (c) \$43.8 million through the sale of additional installments receivable under the arrangement described below.

On June 15, 2005, we securitized outstanding installment software license receivables totaling \$71.2 million. Such securitization was structured in manner so that the securitization qualified as a sale. We received \$43.8 million of cash and retained an interest in the sold receivables initially valued at \$16.6 million. We also retained certain limited recourse obligations relative to the receivables valued at approximately \$1.0 million. Overall, the transaction (including \$2.1 million in aggregate fees and expenses, including fees of the lenders' agent and fees of our outside legal counsel and financial advisors) resulted in a loss of \$13.9 million in the quarter ended June 30, 2005 and was recorded as a loss on sales and disposals of assets. We expect that we would have received approximately \$23.1 million, \$17.2 million and \$14.0 million of cash flows from these installments receivable during fiscal years 2006, 2007 and 2008, if not for the securitization of the receivables.

In August 2003, we issued and sold 300,300 shares of Series D-1 convertible preferred stock, or Series D-1 preferred, along with warrants to purchase up to 6,006,006 shares of common stock, which we refer to as the WD warrants, for an aggregate purchase price of \$100.0 million. Concurrently, we paid \$30.0 million and issued 63,064 shares of Series D-2 convertible preferred stock, or Series D-2 preferred, along with warrants to purchase 791,044 shares of common stock, which we refer to as the WB warrants, and WD warrants to purchase up to 1,261,280 shares of common stock, to repurchase all of the outstanding Series B-I and Series B-II convertible preferred stock, which we refer to as the Series B preferred. The Series D-1 preferred and Series D-2 preferred, which we refer to collectively as the Series D preferred, earns cumulative dividends at an annual rate of 8% that are payable when and if declared by the board, in cash or, subject to certain conditions, common stock. Each share of Series D preferred currently is convertible into 100 shares of common stock, subject to anti-dilution and other adjustments. As a result, the shares of Series D preferred currently are convertible into an aggregate of 36,336,400 shares of common stock. The Series D preferred is subject to redemption at the option of the holders as follows: 50% on or after August 14, 2009 and 50% on or after August 14, 2010.

We have had arrangements to sell installments receivable to three financial institutions, General Electric Capital Corporation, Bank of America and Silicon Valley Bank. We sold certain installment contracts for aggregate proceeds of approximately \$25.5 million and \$35.2 million during the three and six months ended December 31, 2005, respectively, and \$25.6 million and \$51.2 million during the three and six months ended December 31, 2004, respectively. As of December 31, 2005, there was approximately \$65 million in additional availability under the arrangements. We expect to continue to have the ability to sell receivables, as the collection of the sold receivables will reduce the outstanding balance, and the availability under the arrangements can be increased. At December 31, 2005, we had a partial recourse obligation that was within the range of \$0.4 million to \$2.1 million.

In January 2003, we executed a loan arrangement with Silicon Valley Bank. This arrangement provides a line of credit of up to the lesser of (1) \$15.0 million or (2) 70% of eligible domestic receivables, and a line of credit of up to the lesser of (1) \$10.0 million or (2) 80% of eligible foreign receivables. The

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lines of credit bear interest at the bank's prime rate (7.25% at December 31, 2005) plus 0.5%. We are required to maintain a \$4.0 million compensating cash balance with the bank, or be subject to an unused line fee and collateral handling fees. The lines of credit initially are collateralized by nearly all of our assets, but upon achieving certain net income targets, the collateral will be reduced to a lien on our accounts receivable. We are required to meet certain financial covenants, including minimum tangible net worth, minimum cash balances and an adjusted quick ratio. As of December 31, 2005, there was \$8.5 million in letters of credit outstanding under the line of credit, and there was \$5.8 million available for future borrowing. The loan arrangement expires in July 2006.

As of December 31, 2005, we had cash and cash-equivalents totaling \$57.5 million. Our commitments as of December 31, 2005 consisted of debt obligations and leases for our headquarters and other facilities. Other than these, there were no other commitments for capital or other expenditures. Our obligations related to these items at December 31, 2005 were as follows (in thousands):

	2006	2007	2008	2009	2010	Thereafter	Total
Operating leases	\$ 5,455	\$ 9,467	\$ 7,777	\$ 7,589	\$ 7,123	\$ 21,262	\$ 58,673

Debt obligations	388	172	115	—	—	—	675
Total commitments	\$ 5,843	\$ 9,639	\$ 7,892	\$ 7,589	\$ 7,123	\$ 21,262	\$ 59,348

We believe our current cash balances, together with availability of sales of our installment contracts and cash flows from our operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. However, we may need to obtain additional financing thereafter or earlier, if our current plans and projections prove to be inaccurate or our expected cash flows prove to be insufficient to fund our operations because of lower-than-expected revenues, unanticipated expenses or other unforeseen difficulties. In addition, we may seek to take advantage of favorable market conditions by raising additional funds from time to time through public or private security offerings, debt financings, strategic alliances or other financing sources. Our ability to obtain additional financing will depend on a number of factors, including market conditions, our operating performance and investor interest. These factors may make the timing, amount, terms and conditions of any financing unattractive. They may also result in our incurring additional indebtedness or accepting stockholder dilution. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, reduce or defer our development activities, or delay our introduction of new products and services. Any of these actions may seriously harm our business and operating results.

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### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information relating to quantitative and qualitative disclosure about market risk is set forth in note 3 under the caption “Notes to Consolidated Condensed Financial Statements,” and below under the caption “Derivative Instruments and Hedging.”

#### Investment Portfolio

We do not use derivative financial instruments in our investment portfolio. We place our investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines; the policy also limits the amount of credit exposure to any one issuer and the types of instruments approved for investment. We do not expect any material loss with respect to our investment portfolio. The following table provides information about our investment portfolio. For investment securities, the table presents principal cash flows and related weighted average interest rates by expected maturity dates.

Principal (Notional) Amounts by Expected Maturity in U.S. Dollars (\$ in thousands)

	Fair Value at December 31, 2005	Maturing in FY2006
Cash Equivalents	\$ 57,458	\$ 57,458
Weighted Average Interest Rate	4.28%	4.28%
Investments	\$ —	\$ —
Weighted Average Interest Rate	—%	—%
Total Portfolio	\$ 57,458	\$ 57,458
Weighted Average Interest Rate	4.28%	4.28%

#### Impact of Foreign Currency Rate Changes

During the first six months of fiscal 2006, the U.S. dollar generally strengthened as compared to the European and Asia/Pacific currencies, and weakened as compared to the Canadian currency. The translation of our intercompany receivables and foreign entities assets and liabilities did not have a material impact on our consolidated results. Foreign exchange forward contracts are only purchased to hedge certain customer accounts and installment receivable amounts denominated in a foreign currency.

#### Foreign Exchange Hedging

We enter into foreign exchange forward contracts to reduce our exposure to currency fluctuations on customer accounts receivables denominated in foreign currency. The objective of these contracts is to neutralize the impact of foreign currency exchange rate movements on our operating results. We do not use derivative financial instruments for speculative or trading purposes. We had \$32.7 million of foreign exchange forward contracts denominated in British, Japanese, Swiss, Euro and Canadian currencies, which represented underlying customer accounts receivable transactions at December 31, 2005. The underlying customer installments receivable transactions consist of assets carried on our balance sheet and assets that were transferred to our subsidiary as part of the securitization of installments receivable, for which we have assumed the exposure associated with changes in foreign exchange rates. At each balance sheet date, the foreign exchange forward contracts and the related installments receivable denominated in foreign currencies are revalued based on the current market exchange rates. Resulting gains and losses are included in earnings or deferred as a component of other comprehensive income. These deferred gains and losses are recognized in income in the period in which the underlying anticipated transaction occurs. Gains and losses related to these instruments during the three months ended December 2005 were not material to our financial position. We do not anticipate any material adverse effect on our consolidated financial position, operating results or cash flows resulting from the use of these instruments. There can be

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no assurance, however, that these strategies will be effective or that transaction losses can be limited or forecasted accurately.

The following table provides information about our forward contracts, as of December 31, 2005, to sell foreign currencies for U.S. dollars. All of these contracts relate to customer accounts and installments receivable. The table presents the value of the contracts in U.S. dollars at the contract exchange rate as of the contract maturity date. The average contract rate approximates the weighted average contractual foreign currency exchange rate and the forward position in U.S. dollars approximates the fair value on the contract as of December 31, 2005.

#### Forward Contracts to Sell Foreign Currencies for U.S. Dollars Related to Customer Installments Receivable:

Currency	Average Contract	Forward Amount in	Contract Origination Date	Contract Maturity Date
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	Rate	U.S. Dollars (in thousands)		
Euro	0.80	\$22,278	Various: Feb 05—Dec 05	Various: Jan 06—Dec 06
Japanese Yen	110.93	4,779	Various: Feb 05—Dec 05	Various: Jan 06—Dec 06
Canadian Dollar	1.21	2,520	Various: Feb 05—Dec 05	Various: Jan 06—Apr 07
British Pound Sterling	0.55	2,186	Various: Feb 05—Dec 05	Various: Jan 06—Oct 06
Swiss Franc	1.26	959	Various: Jul 05—Nov 05	Various: Jan 06—Jul 06
Total		<u>\$32,722</u>		

#### Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2005. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We previously reported six material weaknesses in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act), which were described in Item 9A and Management’s Report on Internal Control Over Financial Reporting in our Annual Report on Form 10-K for the fiscal year ended June 30, 2005, which we filed on September 13, 2005. A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

During the fiscal quarter ended December 31, 2005, we implemented a number of remedial measures designed to address these material weaknesses. However, we have not tested all of the changes related to internal controls over financial reporting initiated in the current fiscal year. Therefore, our chief executive officer and chief financial officer do not have sufficient assurance that these changes are adequate to

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prevent or detect material misstatement of our financial position or results of operations and have concluded that our disclosure controls and procedures were not effective as of December 31, 2005.

Management’s Report on Internal Control Over Financial Reporting in our Annual Report on Form 10-K for the fiscal year ended June 30, 2005 describes the initiatives we implemented prior to June 30, 2005 to address the previously reported material weaknesses. During the quarter ended September 30, 2005, we conducted additional assessments and further developed our remediation plan designed to address the material weaknesses. During that fiscal quarter, we also accomplished a limited number of the measures initially identified in our remediation plan.

During the quarter ended December 31, 2005, we made the following changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to address our previously reported material weaknesses. These changes in our internal control over financial reporting have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting and:

- We have taken steps to address the inadequate staffing of our accounting and finance organization, including hiring additional general accountants, a manager of revenue operations, a credit and collections manager, a sales tax analyst and additional accounts payable and payroll specialists;
- We have taken steps to improve our procedures relating to approving and recording foreign agent commissions, including redefining the identification, approval, recording and monitoring processes for agents and increasing coordination amongst our internal functional organizations;
- We have completed an inventory of software currently held by our resellers;
- We have implemented a policy requiring each customer to provide written confirmation of acceptance of ongoing maintenance;
- We have enhanced our documentation regarding our pricing policies relating to consulting services and software maintenance services;
- We have enhanced our policies and procedures relating to determining the creditworthiness of new and existing customers;
- We have engaged external collections agencies in North America and in Asia to assist with the collection of outstanding accounts receivable in those regions;
- We have enhanced our bad debt policies to clarify when reserves and write-offs are required and have implemented procedures designed to assess the proper valuation of our accounts receivable reserves;
- We have implemented policies and procedures to identify and add accounts, including bank accounts, to our general ledger chart of accounts on a timely basis;
- We have enhanced our existing policies and procedures relating to general ledger account reconciliations, including establishment of a formal escalation method to notify senior financial management of accounts that have unreconciled variances;
- We have enhanced our existing monthly closing meetings to improve our financial review process;
- We have implemented policies and procedures for the determination, review and documentation of income tax and sales tax liabilities and deferred income tax assets and liabilities as well as for preparing income tax provision calculations; and
- We have identified and have taken steps to close or consolidate certain of our bank accounts and update bank signatory authorizations as appropriate;

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- We have enhanced our existing policies and procedures related to the maintenance of bank accounts to include a periodic evaluation of our existing accounts to determine if there are accounts that can be closed or consolidated and if bank signatory authorizations have been updated appropriately;
- We have held several training sessions on revenue recognition accounting for accounting, finance and operations personnel;
- We have held periodic meetings of cross-functional teams to improve communication and provide additional training;
- We have consolidated our North American accounting operations into a single shared service center at our Cambridge, Massachusetts headquarters;
- We have implemented formal policies and procedures to ensure that our accounting and analysis of intangible assets, reserves and accruals are adequately supported and documented; and
- We have implemented procedures for the timely preparation of memoranda to support all non-routine transactions.

In addition, we are also implementing the following initiatives, all of which we expect to complete by June 30, 2006:

- We recently hired a corporate controller in January 2006 and are actively recruiting additional accounting and finance personnel, including a manager of financial reporting and additional experienced personnel and specialists;
- We will continue to increase the number of internal personnel and external agencies engaged in the collections process and pursue all appropriate legal measures, in order to collect outstanding accounts receivable in a more timely manner;
- We will continue to increase the frequency and scope of training on revenue recognition accounting for accounting, finance and operations personnel;
- We will continue to schedule and hold periodic meetings of cross-functional teams to improve communication and provide additional training;
- We intend to implement formal policies and procedures to ensure that accurate invoices are submitted to customers and that all invoices paid by customers are recorded accurately and timely in our records; and

We have designed these various initiatives to address all of our previously reported material weaknesses. However, certain of these remedial measures will require some time to be fully implemented or to take full effect. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues including instances of fraud, if any, have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected and could be material and require a restatement of our financial statements. Over time, the controls and procedures we have implemented may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. The actual efficacy of these initiatives and of our controls and procedures is subject to continuing review by our management, supported by confirmation and testing by our management and internal and external auditors.

If the remedial measures described above are insufficient to address any of the six identified material weaknesses, our financial statements may contain material misstatements. Among other things, any unremediated material weakness could result in material post-closing adjustments in future financial

statements. Furthermore, any such unremediated material weakness could have the effects described in “Item 2.—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Factors that may affect our operating results and stock price—We have identified six material weaknesses in our internal control over financial reporting as of December 31, 2005 that, if not remedied effectively, could result in material misstatements in our financial statements for future periods.”

The certifications of our principal executive officer and principal financial officer required in accordance with Section 302 of the Sarbanes-Oxley Act are attached as exhibits to this Form 10-Q. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in internal control over financial reporting, referred to in paragraph 4 of the certifications. This Item 4 should be read in conjunction with the officer certifications for a more complete understanding of the topics presented.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

#### *U.S. Attorney’s Office Investigation*

On October 29, 2004, we announced that we had received a subpoena from the U.S. Attorney’s Office for the Southern District of New York requesting documents relating to transactions to which we were a party during the 2000 to 2002 time frame, associated documents dating from January 1, 1999, and additional materials. We have cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney’s Office.

#### *Class Action Suits*

In November 2004, two putative class action lawsuits were filed against us in the United States District Court District of Massachusetts, captioned, respectively, *Fener v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12375 (D. Mass.) (filed Nov. 9, 2004) and *Stockmaster v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12387 (D. Mass.) (filed Nov. 10, 2004), which we refer to as the class actions. The class actions allege, among other things, that we violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in connection with various statements about our financial condition for fiscal years 2000 through 2004. On February 2, 2005, the court consolidated the cases under the caption *Aspen Technology, Inc. Securities Litigation*, Civil Action No. 04-12375 (D. Mass.), and appointed *The Operating Engineers and Construction Industry and Miscellaneous Pension Fund (Local 66) and City of Roseville Employees’ Retirement System* as lead plaintiff, purporting to represent a putative class of persons who purchased our common stock between January 25, 2000 and October 29, 2004. On August 26, 2005, the plaintiffs filed a consolidated amended complaint containing allegations materially similar to the prior complaints and expanding the class action period.

Following mediation, on November 16, 2005, we and the plaintiffs on behalf of putative class members entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action which was filed with the court on the same date. On December 12, 2005, the court granted preliminary approval of the settlement provided for in the stipulation and set a hearing date of March 6, 2006 to consider final approval of the settlement. The terms of the proposed settlement, including the terms of the distribution of settlement funds, are disclosed in the notice that was sent by the court-appointed claims administrator, Gilardi & Co., LLC, to members of the class, defined to include all persons who purchased our common stock between October 29, 1999 and March 15, 2005, inclusive, which we refer to as the class.

Pursuant to the terms of the settlement, a total of \$5.6 million has been paid into a settlement fund by us and our insurance carrier. All costs of preparing and distributing notices to members of the class and administration of the settlement, together with all fees and expenses awarded to plaintiffs' counsel and certain other expenses, will be paid out of the settlement fund, which will be maintained by an escrow agent under the court's supervision. However, the settlement remains subject to the satisfaction of various conditions, including final approval by the court. If final approval is not obtained, or if class members opt out of the settlement, and we are required to litigate the dispute or elect to settle the dispute on different terms, the ultimate outcome could have a material adverse effect on our financial position or results of operations.

As part of the settlement, the plaintiffs have agreed to dismiss the class action lawsuit with prejudice effective upon entry of final judgment after court approval. We entered into the stipulation to resolve the matter and without acknowledging any fault, liability or wrongdoing of any kind. There has been no adverse determination by the court against us or any of the other defendants in the case.

### ***Demand Letter***

On April 12, 2005, we received a letter dated March 22, 2005 alleging that our officers and directors failed to disclose and misrepresented that we inappropriately recognized revenues in the 2000-2002 fiscal years, and that we should commence suit for relief equivalent to that sought in the derivative action previously brought against certain of our present and former executives and directors that was dismissed with prejudice on August 18, 2005, including requiring certain of our present and former officers to return remuneration paid to them while in breach of their fiduciary duties. We are currently unable to determine whether resolution of this matter will have a material adverse impact on our financial position or results of operations, or reasonably estimate the amount of the loss, if any, that may result from resolution of this matter. However, the ultimate outcome could have a material adverse effect on our financial position or results of operations.

### **Item 1A. Risk Factors**

**INVESTING IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD CAREFULLY CONSIDER THE RISKS AND UNCERTAINTIES DESCRIBED BELOW BEFORE PURCHASING OUR COMMON STOCK. THE RISKS AND UNCERTAINTIES DESCRIBED BELOW ARE NOT THE ONLY ONES FACING OUR COMPANY. ADDITIONAL RISKS AND UNCERTAINTIES MAY ALSO IMPAIR OUR BUSINESS OPERATIONS. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCUR, OUR BUSINESS, FINANCIAL CONDITION OR RESULTS OF OPERATIONS WOULD LIKELY SUFFER. IN THAT CASE, THE TRADING PRICE OF OUR COMMON STOCK COULD FALL, AND YOU MAY LOSE ALL OR PART OF THE MONEY YOU PAID TO BUY OUR COMMON STOCK.**

#### **Risks Related to our Business**

***Fluctuations in our quarterly revenues, operating results and cash flow may cause the market price of our common stock to fall.***

Our revenues, operating results and cash flow have fluctuated in the past and may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control, including:

- demand for our products and services;
- our customers' purchasing patterns;
- the length of our sales cycle;
- changes in the mix of our license revenues and service revenues;
- the timing of introductions of new solutions and enhancements by us and our competitors;
- seasonal weakness in the first quarter of each fiscal year (which for us is the quarter ended September 30), primarily caused by a slowdown in business in some of our international markets;
- the timing of our investments in new product development;
- the mix of domestic and international sales;
- changes in our operating expenses; and
- fluctuating economic conditions, particularly as they affect companies in the oil and gas, chemicals, petrochemicals and petroleum industries.

We ship software products within a short period after receipt of an order and typically do not have a material backlog of unfilled orders for software products. Consequently, revenues from software licenses in any quarter are substantially dependent on orders booked and shipped in that quarter. Historically, a majority of each quarter's revenues from software licenses has come from license agreements that have been entered into in the final weeks of the quarter. Therefore, even a short delay in the consummation of an agreement may cause our revenues to fall below expectations of public market analysts and investors for that quarter.

Since our expense levels are based in part on anticipated revenues, we may be unable to adjust our spending quickly enough to compensate for any revenue shortfall and any revenue shortfall would likely have a disproportionately adverse effect on our operating results. We expect that the factors listed

above will continue to affect our operating results for the foreseeable future. Because of the factors listed above, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and should not be relied upon as indications of future performance.

Term license renewal negotiations may be difficult and more time consuming than negotiations for new licenses. Moreover, customers may choose not to renew term licenses, resulting in reduced revenue to us. In addition, customers may wish to negotiate renewals of term licenses on terms and conditions that require us to change the way we recognize revenue under our existing revenue recognition practices at the time of such renewal with such customers. Any such changes could result in a material adverse effect on our results.

If, due to one or more of the foregoing factors or an unanticipated cause, our operating results fail to meet the expectations of public market analysts and investors in a future quarter, the market price of our common stock would likely decline.

***Our lengthy sales cycle makes it difficult to predict quarterly revenue levels and operating results.***

Because license and implementation fees for our software products are substantial and the decision to purchase our products typically involves members of our customers' senior management, the sales process for our solutions is lengthy and can exceed one year. Accordingly, the timing of our license revenues is difficult to predict, and the delay of an order could cause our quarterly revenues to fall substantially below our expectations and those of public market analysts and investors. Moreover, to the extent that we succeed in shifting customer purchases away from individual software products and toward more costly integrated suites of software and services, our sales cycle may lengthen, which could increase the likelihood of delays and cause the effect of a delay to become more pronounced. Delays in sales could cause significant shortfalls in our revenues and operating results for any particular period.

***We derive a majority of our total revenues from customers in the oil and gas, chemicals, petrochemicals and petroleum industries, which are highly cyclical, and our operating results may suffer if these industries experience an economic downturn.***

We derive a majority of our total revenues from companies in the oil and gas, chemicals, petrochemicals and petroleum industries. Accordingly, our future success depends upon the continued demand for manufacturing optimization software and services by companies in these process manufacturing industries. The oil and gas, chemicals, petrochemicals and petroleum industries are highly cyclical and highly reactive to the price of oil, as well as general economic conditions. In the past, worldwide economic downturns and pricing pressures experienced by oil and gas, chemical, petrochemical and petroleum companies have led to consolidations and reorganizations. These downturns, pricing pressures and restructurings have caused delays and reductions in capital and operating expenditures by many of these companies. These delays and reductions have reduced demand for products and services like ours. A recurrence of these industry patterns, as well as general domestic and foreign economic conditions

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and other factors that reduce spending by companies in these industries, could harm our operating results in the future.

***We have identified six material weaknesses in our internal control over financial reporting that, if not remedied effectively, could result in material misstatements in our financial statements for future periods.***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for our company, as defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2005 and identified six material weaknesses, which weaknesses were previously reported and described in our Annual Report on Form 10-K for our fiscal year ended June 30, 2005. A material weakness is defined by the Public Company Accounting Oversight Board (United States) as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

The material weaknesses identified by management as of June 30, 2005 and again as of December 31, 2005 consisted of:

- inadequate staffing and ineffective training and communication within our accounting and finance organization;
- ineffective revenue recognition controls;
- inadequate financial statement preparation and review procedures;
- ineffective and inadequate controls over the accounts receivable function;
- inadequate controls over the accounting for taxes; and
- inadequate controls over bank accounts.

Because of these material weaknesses, our management concluded, as of December 31, 2005 that our internal control over financial reporting was not effective based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework.

We are continuing to implement remedial measures designed to address the material weaknesses identified as of December 31, 2005. We expect to complete implementation of these remedial initiatives during fiscal 2006. If these remedial initiatives are insufficient to address the six identified material weaknesses, or if additional material weaknesses or significant deficiencies in our internal control are discovered in the future, we may fail to meet our future reporting obligations on a timely basis, our financial statements may contain material misstatements, our operating results may be harmed, we may be subject to class action litigation, and our common stock may be delisted from the Nasdaq National Market. For example, material weaknesses that remain unremediated could result in material post-closing adjustments in future financial statements. Any failure to address the identified material weaknesses or any additional material weaknesses or significant deficiencies in our internal control could also adversely affect the results of the periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our "internal control over financial reporting" that are required to be included in our Annual Reports on Form 10-K. Internal control deficiencies could also cause investors to lose confidence in our reported financial information. We can give no assurance that the measures we have taken to date

or any future measures will remediate the material weaknesses identified or that any additional material weaknesses will not arise in the future due to a failure to implement and maintain adequate internal control over financial reporting or circumvention of these controls. In addition, even if we are successful in strengthening our controls and procedures, those controls and procedures may not be adequate to prevent or identify irregularities or facilitate the fair presentation of our financial statements or SEC reports.

***We face risks related to securities litigation and investigations that could have a material adverse effect on our business, financial condition and results of operations.***

Following the announcement in October 2004 of an investigation by the audit committee of our board of directors into the accounting treatment of certain software license transactions in prior fiscal years, we and certain of our current and former officers and directors were named as defendants in a securities class action lawsuit filed in Massachusetts federal district court, alleging violations of the Exchange Act and claiming material misstatements concerning our financial condition and results. On December 12, 2005, the court granted preliminary approval of a \$5.6 million settlement of this class action lawsuit. However, the settlement remains subject to final court approval. If this settlement does not receive final court approval, we may be required to litigate this matter or to settle on terms less favorable to us. Defending against existing or new litigation relating to the restatement of our consolidated financial statements will likely require significant attention and resources of management. Regardless of the outcome, such litigation and investigation have resulted in and may continue to result in significant legal expenses and may cause our customers, employees and investors to lose confidence in our company.

On October 29, 2004, we announced that we had received a subpoena from the U.S. Attorney's Office for the Southern District of New York requesting documents relating to transactions to which the Company was a party during the 2000 to 2002 time frame, associated documents dating from January 1, 1999, and additional materials. We have cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney's Office. However, we may in the future become the subject of investigation by other regulatory agencies such as the SEC.

We may be required to indemnify certain of our current or former directors and officers who are named as defendants in some of these lawsuits, and such indemnification commitments may be costly. Our director and officer liability insurance policies provide only limited liability protection relating to the securities class action lawsuit against us and certain of our officers and directors and may not cover director and officer indemnification. If these policies do not adequately cover expenses and certain liabilities relating to this lawsuit, or if we are unable to achieve a favorable settlement of this lawsuit, our financial condition could be materially harmed. Increased premiums could materially harm our financial results in future periods. The inability to obtain this coverage due to prohibitively expensive premiums would make it more difficult to retain and attract officers and directors and expose us to potentially self-funding any potential future liabilities ordinarily mitigated by director and officer liability insurance.

***New accounting standards or interpretations of existing accounting standards could adversely affect our operating results.***

Generally accepted accounting principles, or GAAP, in the United States are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

For example, we recognize software license revenue in accordance with SOP 97-2, as amended by SOP 98-4 and SOP 98-9. The accounting profession continues to discuss certain provisions of relevant accounting literature with the objective of providing additional guidance on potential interpretations

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related to software revenue recognition and "multiple element arrangements" in which a single contract includes a software license, a maintenance services agreement and/or other "elements" that are bundled together in a total offering to the customer. These discussions and the issuance of interpretations, once finalized, could lead to unanticipated changes in our current revenue accounting practices, which could change the timing of revenue recognition.

Certain factors have in the past and may in the future cause us to defer recognition for license fees beyond delivery, such as the inclusion of material non-standard terms in our licensing agreements. Because of these factors and other specific requirements under US GAAP for software revenue recognition, we must have very precise terms in our software arrangements in order to recognize revenue when we initially deliver software or perform services. Negotiation of mutually acceptable terms and conditions can extend our sales cycle, and we may accept terms and conditions that do not permit revenue recognition at the time of delivery.

***We face increased competition as a result of the sale of our operator training business and Hyprotech intellectual property to Honeywell and the settlement of proceedings with KBC Advanced Technologies, in addition to competition we have faced in the past, and if we do not compete successfully, we may lose market share.***

As a result of the consent decree we entered into with the FTC, and the related transactions with Honeywell and Bentley Systems, we transferred our AXSYS product line, our operator training business, and rights to the intellectual property of the Hyprotech product line. The ability of Honeywell to compete against our Hyprotech engineering product, the loss of our operator training business, the ability of Bentley Systems to compete against our Zyqad product line, and the increased costs of our support obligations to Honeywell under the two year support agreement may have a material adverse effect on our operations. The Hyprotech engineering products are material to our current business and strategy, and any decrease in our revenues from these products may have a material adverse impact on our results of operations. Because Honeywell may license the Hyprotech engineering products on more favorable terms than we may offer, sell the Hyprotech engineering products to companies that are customers of both Honeywell and us, and bundle the Hyprotech engineering products with its other products for the process industries, Honeywell may harm our ability to compete in the marketplace, including our ability to negotiate license renewals with our current customers.

In addition, as part of our settlement with KBC Advanced Technologies, we agreed to recognize KBC's right to develop, market and license HYSYS.Refinery, KBC's refinery-wide simulation product which competes with our refinery-wide simulation product, Aspen RefSYS. As a result of this settlement, we may encounter increased competition from KBC, which could decrease our market share and our revenues.

In addition, our markets in general are highly competitive. Our engineering software competes with products of other businesses such as ABB, Aveva Group (formerly Cadcentre), Bentley Systems, Chemstations, MDC Technology, Process Systems Enterprise, Simulation Sciences (a division of Invensys) and WinSim (formerly ChemShare). Our plant operations software competes with products of companies such as ABB, Honeywell, Invensys, OSISOft, Rockwell, components of SAP's offering and Siemens. Our supply chain management software competes with products of companies such as Honeywell, i2 Technologies, Manugistics and components of SAP's supply chain offering. As we expand our engineering solutions into other markets we may face competition from companies that we have not typically competed against in the past or competition from companies in areas where we have not competed in

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Many of our competitors have greater financial, marketing and other resources than we have. In addition, many of our competitors have established, and may in the future continue to establish, cooperative relationships with third parties to improve their product offerings and to increase the availability of their products to the marketplace. In addition, competitors may make strategic acquisitions to increase their ability to gain market share or improve the quality or marketability of their products. These cooperative relationships and strategic acquisitions could reduce our market share, require us to lower our prices, or both. Increased competition may result in price reductions, reduced profitability and loss of market share. We cannot assure you that we will be able to compete successfully against existing or future competitors.

***If economic conditions and the markets for our products do not continue to improve, sales of our product lines, particularly our manufacturing/supply chain product suites, will be adversely affected.***

Adverse changes in the economy and global economic and political uncertainty have previously caused delays and reductions in information technology spending by our customers and a consequent deterioration of the markets for our products and services, particularly our manufacturing/supply chain product suites. If adverse economic conditions worsen or do not continue to improve, we will experience further reductions, delays, and postponements of customer purchases that will negatively impact our revenue and operating results. If economic and political conditions and the market for our products do not continue to improve and our revenues decline, our business could be harmed, and we may not be able to further reduce our costs to align them with these decreased revenues.

***If we do not continue to make the technological advances required by the marketplace, our business could be seriously harmed.***

Enterprises are requiring their application software vendors to provide greater levels of functionality and broader product offerings. Moreover, competitors continue to make rapid technological advances in computer hardware and software technology and frequently introduce new products, services and enhancements. We must continue to enhance our current product line and develop and introduce new products and services that keep pace with increasingly sophisticated customer requirements and the technological developments of our competitors. Our business and operating results could suffer if we cannot successfully respond to the technological advances of others or if our new products or product enhancements and services do not achieve market acceptance.

Under our business plan, we are investing significantly in the development of new business process products that are intended to anticipate and meet the emerging needs of our target markets. We have initiated implementation of a product strategy that would unify our software solutions under the aspenONE brand with differentiated aspenONE vertical solutions targeted at specific process industries. We cannot assure you that our new product development will result in products that will meet market needs and achieve significant market acceptance.

***If we are unable to successfully market our products to senior executives of potential customers, our revenue growth may be limited.***

With the development of our integrated aspenONE solutions, we frequently must focus on selling the strategic value of our technology to the highest executive levels of customer organizations, typically the chief executive officer, chief financial officer or chief information officer. If we are not successful at selling and marketing to senior executives, our revenue growth and operating results could be materially and adversely affected.

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***If we are unable to develop or maintain strategic alliance relationships, our revenue growth may be harmed.***

An element of our growth strategy is to establish strategic alliances with a selected third-party systems integrators that market and integrate our products. If our current systems integrators terminate their existing relationships with us, or if we do not adequately train a sufficient number of other systems integrators, or if potential systems integrators focus their efforts on integrating or co-selling competing products to the process industries, our future revenue growth could be limited and our operating results could be materially and adversely affected. If our systems integrators fail to implement our solutions for our customers properly, the reputations of our products and services and our company could be harmed and we might be subject to claims by our customers. We intend to continue to establish business relationships with technology companies to accelerate the development and marketing of our products and services. To the extent that we are unsuccessful in maintaining our existing relationships and developing new relationships, our revenue growth may be materially and adversely affected.

***We may suffer losses on fixed-price engagements.***

We derive a substantial portion of our total revenues from service engagements and a significant percentage of these engagements have been undertaken on a fixed-price basis. Under these fixed-price engagements, we bear the risk of cost overruns and inflation, and as a result, any of these engagements may be unprofitable. In the past, we have had cost overruns on fixed-price service engagements. In addition, to the extent that we are successful in shifting customer purchases to our integrated suites of software and services and we price those engagements on a fixed-price basis, the size of our fixed-price engagements may increase, which could cause the impact of an unprofitable fixed-price engagement to have a more pronounced impact on our operating results.

***Our business may suffer if we fail to address the challenges associated with international operations.***

We derived approximately 50% of our total revenues from customers outside the United States in the three and six months ended December 31, 2005 and 2004. We anticipate that revenues from customers outside the United States will continue to account for a significant portion of our total revenues for the foreseeable future. Our operations outside the United States are subject to additional risks, including:

- unexpected changes in regulatory requirements, exchange rates, tariffs and other barriers;
- political and economic instability;
- less effective protection of intellectual property;



- difficulties in managing distributors and representatives;
- difficulties in staffing and managing foreign subsidiary operations;
- difficulties and delays in translating products and product documentation into foreign languages;
- difficulties and delays in negotiating software licenses compliant with accounting revenue recognition requirements in the United States;
- difficulties in collecting trade accounts receivable in other countries; and
- potentially adverse tax consequences.

The impact of future exchange rate fluctuations on our operating results cannot be accurately predicted. In recent years, we have increased the extent to which we denominate arrangements with international customers in the currencies of the countries in which the software or services are provided. From time to time we have engaged in, and may continue to engage in, hedges of a significant portion of installment contracts denominated in foreign currencies. Any hedging policies implemented by us may not

be successful, and the cost of these hedging techniques may have a significant negative impact on our operating results.

***We may not be able to protect our intellectual property rights, which could make us less competitive and cause us to lose market share.***

We regard our software as proprietary and rely on a combination of copyright, patent, trademark and trade secret laws, license and confidentiality agreements, and software security measures to protect our proprietary rights. We have registered or have applied to register several of our significant trademarks in the United States and in certain other countries. We generally enter into non-disclosure agreements with our employees and customers, and historically have restricted access to our software products' source codes, which we regard as proprietary information. In a few cases, we have provided copies of the source code for some of our products to customers solely for the purpose of special product customization and have deposited copies of the source code for some of our products in third-party escrow accounts as security for ongoing service and license obligations. In these cases, we rely on non-disclosure and other contractual provisions to protect our proprietary rights.

The steps we have taken to protect our proprietary rights may not be adequate to deter misappropriation of our technology or independent development by others of technologies that are substantially equivalent or superior to our technology. Any misappropriation of our technology or development of competitive technologies could harm our business, and could force us to incur substantial costs in protecting and enforcing our intellectual property rights. The laws of some countries in which our products are licensed do not protect our products and intellectual property rights to the same extent as the laws of the United States.

***Third-party claims that we infringe upon the intellectual property rights of others may be costly to defend or settle and could damage our business.***

We cannot be certain that our software and services do not infringe issued patents, copyrights, trademarks or other intellectual property rights of third parties. Litigation regarding intellectual property rights is common in the software industry, and we may be subject to legal proceedings and claims from time to time, including claims of alleged infringement of intellectual property rights of third parties by us or our licensees concerning their use of our software products and integration technologies and services. Although we believe that our intellectual property rights are sufficient to allow us to market our software without incurring liability to third parties, third parties may bring claims of infringement against us. Because our software is integrated with our customers' networks and business processes, as well as other software applications, third parties may bring claims of infringement against us, as well as our customers and other software suppliers, if the cause of the alleged infringement cannot easily be determined. Such claims may be with or without merit. Claims of alleged infringement may have a material adverse effect on our business and may discourage potential customers from doing business with us on acceptable terms, if at all. Defending against claims of infringement may be time-consuming and may result in substantial costs and diversion of resources, including our management's attention to our business. Furthermore, a party making an infringement claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our software or require that we re-engineer some or all of our products. Claims of intellectual property infringement also might require us to enter costly royalty or license agreements. We may be unable, however, to obtain royalty or license agreements on terms acceptable to us or at all. Our business, operating results and financial condition could be harmed significantly if any of these events occurred, and the price of our common stock could be adversely affected. Furthermore, former employers of our current and future employees may assert that our employees have improperly disclosed confidential or proprietary information to us. In addition, we have agreed, and may agree in the future, to indemnify certain of our

customers against claims that our software infringes upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we, as well as our customers, may be required to obtain one or more licenses from third parties, which may not be available on acceptable terms, if at all. Defense of any lawsuit or failure to obtain any such required licenses could harm our business, operating results and financial condition and the price of our common stock. In addition, although we carry general liability insurance, our current insurance coverage may not apply to, and likely would not protect us from, all liability that may be imposed under these types of claims.

***Because some of our software products incorporate technology licensed from, or provided by, third parties, the loss of our right to use that technology or defects in that third party technology could harm our business.***

Some of our software products contain technology that is licensed from, or provided by, third parties. Any significant interruption in the supply or support of any such third-party software could adversely affect our sales, unless and until we can replace the functionality provided by the third-party software. Because some of our software incorporates software developed and maintained by third parties, we depend on these third parties to deliver and support reliable products, enhance our current software, develop new software on a timely and cost-effective basis and respond to emerging industry standards and other technological changes. In other instances we provide third-party software with our current software, and we depend on these third parties

to deliver reliable products, provide underlying product support and respond to emerging industry standards and other technological changes. The failure of these third parties to meet these criteria could harm our business.

***Our software is complex and may contain undetected errors.***

Like many other complex software products, our software has on occasion contained undetected errors or “bugs.” Because new releases of our software products are initially installed only by a selected group of customers, any errors or “bugs” in those new releases may not be detected for a number of months after the delivery of the software. These errors could result in loss of customers, harm to our reputation, adverse publicity, loss of revenues, delay in market acceptance, diversion of development resources, increased insurance costs or claims against us by customers.

***We may be subject to significant expenses and damages because of liability claims.***

The sale and implementation of certain of our software products and services, particularly in the areas of advanced process control and optimization, may entail the risk of product liability claims. Our software products and services are often integrated with our customers’ networks and software applications and are used in the design, operation and management of manufacturing processes at large facilities, often for mission critical applications. Any errors, defects, performance problems or other failure of our software could result in significant claims against us for damages or for violations of environmental, safety and other laws and regulations. In addition, the failure of our software to perform to customer expectations could give rise to warranty claims. Our agreements with our customers generally contain provisions designed to limit our exposure to potential product liability claims. It is possible, however, that the limitation of liability provisions in our agreements may not be effective as a result of federal, state or local laws or ordinances or unfavorable judicial decisions. A substantial product liability claim against us could materially and adversely harm our operating results and financial condition. Even if our software is not at fault, a product liability claim brought against us could be time consuming, costly to defend and harmful to our operations. In addition, although we carry general liability insurance, our current insurance coverage may be insufficient to protect us from all liability that may be imposed under these types of claims.

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***Implementation of our products can be difficult and time-consuming, and customers may be unable to implement our products successfully or otherwise achieve the benefits attributable to our products.***

Our products are intended to work with complex business processes. Some of our software, such as customized scheduling applications and integrated supply chain products, must integrate with the existing computer systems and software programs of our customers. This can be complex, time-consuming and expensive. As a result, some customers may have difficulty in implementing or be unable to implement these products successfully or otherwise achieve the benefits attributable to these products. Customers may also make claims against us relating to the functionality, performance or implementation of this software. Delayed or ineffective implementation of the software products or related services may limit our ability to expand our revenues and may result in customer dissatisfaction, harm to our reputation and may result in customer unwillingness to pay the fees associated with these products.

***If we are not successful in attracting and retaining management team members and other highly qualified individuals in our industry, we may not be able to successfully implement our business strategy.***

Our ability to establish and maintain a position of technology leadership in the highly competitive software market depends in large part upon our ability to attract and retain highly qualified managerial, sales and technical personnel. We have recently had a number of changes in our senior management. In addition, several of our executive officers have not entered into employment agreements with us. In the future, we may experience the departure of senior executives due to competition for talent from start-ups and other companies.

Our future success depends on a continued, successful management transition and will also depend on our continuing to attract, retain and motivate highly skilled employees. Competition for employees in our industry is intense. We may be unable to retain our key employees or attract, assimilate or retain other highly qualified employees in the future. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications.

***Recently enacted and proposed changes in securities laws and regulations will increase our costs.***

The Sarbanes-Oxley Act, which became law in July 2002, and new rules subsequently implemented by the SEC and the Nasdaq National Market have imposed various new requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will need to continue to devote a substantial amount of time to these new compliance initiatives. Moreover, these rules and regulations have increased our annual legal and financial compliance costs, have made some activities more time-consuming and costly, and could expose us to additional liability. We incurred approximately \$1.4 million in Sarbanes-Oxley related expenses in our fiscal year ended June 30, 2005, and we expect to continue to incur significant Sarbanes-Oxley related expenses for the foreseeable future. In addition, these rules and regulations may make retention and recruitment of qualified persons to serve on our board of directors or executive management more difficult. We continue to evaluate and monitor regulatory and legislative developments and cannot reliably estimate the timing or magnitude of all costs we may incur as a result of the Sarbanes-Oxley Act or other related legislation or regulation.

**Risks Related to our Common Stock**

***Our common stock may experience substantial price and volume fluctuations.***

The equity markets have from time to time experienced extreme price and volume fluctuations, particularly in the high technology sector, and those fluctuations have often been unrelated to the operating performance of particular companies. In addition, factors such as our financial performance, announcements of technological innovations or new products by us or our competitors, as well as market

In the past, following periods of volatility in the market price of a public company's securities, securities class action litigation has often been instituted against companies. We currently have a putative class action lawsuit pending against us in U.S. District Court, District of Massachusetts, as described above under "We face risks related to securities litigation and investigations that could have a material adverse effect on our business, financial condition and results of operations." This type of litigation could result in substantial costs and a diversion of management's attention and resources.

***Our common stockholders may experience further dilution as a result of provisions contained in our outstanding Series D preferred and warrants.***

The terms of our outstanding securities may result in substantial dilution to existing common stockholders. In August 2003, we issued 300,300 shares of Series D-1 preferred and delivered cash and 63,064 shares of Series D-2 preferred in consideration for the surrender of all of our outstanding Series B preferred. Each share of our Series D preferred is currently convertible, at the holder's option, into 100 shares of our common stock and may be converted into additional shares of our common stock upon certain events as a result of antidilution provisions in our charter. In addition, we issued the WD warrants and exchanged existing warrants to purchase 791,044 shares of common stock for the WB warrants. The WD warrants and WB warrants are currently exercisable for an aggregate of 8,058,330 shares of our common stock and may be converted into additional shares upon certain events as a result of antidilution provisions in the warrants. The Series D preferred, together with the WD warrants and WB warrants, were issued to several investment partnerships managed by Advent International Corporation and to holders of our Series B preferred.

In addition to the Series D preferred and the WD and WB warrants, we currently have additional warrants outstanding that are exercisable to purchase 1,023,474 shares of common stock at an exercise price of \$9.76 per share and 9,720 shares of common stock at an exercise price of \$120.98. Our common stockholders would be subject to substantial dilution if the Series D preferred is converted into common stock or if our outstanding warrants are exercised for common stock.

Each share of Series D preferred is entitled to a cumulative dividend of 8.0% of the stated value per share of such Series D preferred per year, payable at the discretion of the board of directors or upon conversion of the Series D preferred to common stock or redemption of the Series D preferred. Accumulated dividends, when and if declared by our board, could be paid in cash or, subject to specified conditions, common stock. If we elect to pay dividends in shares of common stock, we will issue a number of shares of common stock equal to the quotient obtained by dividing the dividend payment by the volume weighted average of the sale prices of the common stock on the Nasdaq National Market for 20 consecutive trading days, ending on the fourth trading day prior to the required dividend payment date.

***We are obligated to register for public sale shares of common stock issuable pursuant to our outstanding Series D preferred and warrants, and sales of those shares may result in a decrease in the price of our common stock.***

We have granted rights to require that we register under the Securities Act the shares of common stock issuable upon the conversion of, or as dividends on, the Series D preferred and upon the exercise of either the WB warrants or WD warrants:

- *Series D-1 preferred.* The holders of the Series D-1 preferred have the right to demand that we file on their behalf up to four registration statements covering shares of common stock issuable upon (a) conversion of the Series D-1 preferred and (b) exercise of the WD warrants issued to the holders of the Series D-1 preferred.

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- *Series D-2 preferred.* We previously filed a registration statement that covers all of the shares of common stock issuable upon (a) conversion of the Series D-2 preferred and (b) exercise of the WB and WD warrants issued to the initial holders of the Series D-2 preferred.

In addition, to the extent we elect to pay dividends on the Series D preferred in shares of our common stock, we are required to register such shares. Any sale of common stock into the public market by the holders of the Series D preferred pursuant to a registration statement could cause a decline in the trading price of our common stock.

***We may need to raise capital in the future and may not be able to secure adequate funds on terms acceptable to us or at all.***

We expect that our current cash balances, cash-equivalents, short-term investments, proceeds from the anticipated increased sale of installment contracts, funds available under our bank line of credit, and cash flows from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months. We may need to obtain additional financing thereafter or earlier, however, if our current plans and projections prove to be inaccurate or our expected cash flows prove to be insufficient to fund our operations because of lower-than-expected revenues, fewer sales of installment contracts, unanticipated expenses, including those related to the class action lawsuits or their outcome or settlement, or other unforeseen difficulties.

Our sales of receivables are an important part of our cash management program. We currently have arrangements to sell long-term contracts to three financial institutions, General Electric Capital Corporation, Bank of America and Silicon Valley Bank. These contracts represent amounts due over the life of existing term licenses. Under the three arrangements, we sold installments receivable of \$25.5 million and \$35.2 million during the three and six months ended December 31, 2005, respectively. During the six months ended December 31, 2005, our installments receivable balance increased to \$39.4 million at December 31, 2005 from \$24.8 million at June 30, 2005. Our ability to continue these arrangements or replace them with similar arrangements is important to maintain adequate funding. If there is insufficient interest from third parties in purchasing our installments receivable contracts, our ability to generate cash required to meet our financial obligations may be impaired. If we cannot generate sufficient cash to meet these obligations through the sales of our installments receivable contracts, we may be required to incur additional indebtedness or raise additional capital.

Our ability to obtain additional financing will depend on a number of factors, including market conditions, our operating performance and investor interest. These factors may make the timing, amount, terms and conditions of any financing unattractive. In addition, the uncertain outcome of the class action lawsuit impairs our ability to obtain additional financing. Until this lawsuit is resolved, or if any resolution is materially adverse to us, we expect our ability to obtain additional financing will be substantially impaired. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, reduce or defer our development activities, or delay our introduction of new products and services. Any of these actions may seriously harm our business and operating results.

***The holders of our Series D preferred and WB and WD warrants own a substantial portion of our capital stock that may afford them significant influence over our affairs.***

As of December 31, 2005, the Series D preferred (as converted to common stock) represented 41.1% of our outstanding common stock and the WB and WD warrants were exercisable for a number of shares representing 9.1% of our outstanding common stock (ignoring certain limitations on the ability to

company that may be favored by other stockholders and otherwise exercise significant influence over all corporate actions requiring stockholder approval, irrespective of how our other stockholders may vote, including:

- any amendment of our certificate of incorporation or bylaws;
- the approval of some mergers and other significant corporate transactions, including a sale of substantially all of our assets; or
- the defeat of any non-negotiated takeover attempt that might otherwise benefit the public stockholders.

In addition, the holders of the Series D-1 preferred have elected three of our non-employee board members. Accordingly, the holders of our Series D-1 preferred may be able to exert substantial influence over matters submitted for board approval.

***Our corporate documents and provisions of Delaware law may prevent a change in control or management that stockholders may consider desirable.***

Section 203 of the Delaware General Corporation Law and our charter and by-laws contain provisions that might enable our management to resist a takeover of our company. These provisions could have the effect of delaying, deferring, or preventing a change in control of our company or a change in our management that stockholders may consider favorable or beneficial. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. These provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock.

**Item 4. Submission of Matters to a Vote of Security Holders**

We held our 2005 annual meeting of stockholders on December 1, 2005 to elect Joan C. McArdle as a Class III director to hold office until our 2008 annual meeting of stockholders. Holders of our common stock and Series D-2 preferred voted together on Proposal One, the election of one Class III director, at the annual meeting. Holders of our Series D-1 preferred are entitled to elect their own designees to our board of directors and are not entitled to vote with the holders of our common stock and Series D-2 preferred in the general election of directors at the annual meeting.

Proxies for the meeting were solicited in accordance with Section 14(a) of the Exchange Act pursuant to a proxy statement dated October 28, 2005. There was no solicitation in opposition to Ms. McArdle's nomination by the board of directors, and Ms. McArdle was re-elected to our board. The votes cast by proxy or in person with respect to the election of Ms. McArdle, as determined by the final report of the inspector of elections, are set forth below. There were no abstentions or broker non-votes with respect to the election of directors.

<u>Nominee</u>	<u>Votes for Nominee</u>	<u>Votes Withheld</u>
Joan C. McArdle	34,291,867	2,655,204

Mr. Douglas A. Kingsley, the designee of the Series D-1 holders who was serving as a Class III director on the date of the 2005 annual meeting of stockholders, was re-elected by the Series D-1 holders to hold office until our 2008 annual meeting of stockholders. On January 20, 2006, Mr. Kingsley resigned from our board of directors, and the Series D-1 holders appointed Christopher Pike as a Class III director to fill the vacancy left by the resignation of Mr. Kingsley. The following directors of our company continued in office after the annual meeting: Donald P. Casey, Mark E. Fusco, Gary E. Haroian, Stephen M. Jennings, and Michael Pehl.

**Item 6. Exhibits**

<u>Exhibit Number</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 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 Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: February 9, 2006

By: /s/ MARK FUSCO  
Mark Fusco  
*President and Chief Executive Officer*

Date: February 9, 2006

By: /s/ CHARLES F. KANE  
Charles F. Kane  
*Senior Vice President and Chief Financial Officer*

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**EXHIBIT INDEX**

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**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR RULE 15d-14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark Fusco, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aspen Technology, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: February 9, 2006

/s/ MARK FUSCO

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Mark Fusco  
President and Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR RULE 15d-14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Charles F. Kane, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aspen Technology, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting

Date: February 9, 2006

/s/ CHARLES F. KANE

Charles F. Kane

Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Aspen Technology, Inc. (the "Company") for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Mark Fusco, President and Chief Executive Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 9, 2006

/s/ MARK FUSCO

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Mark Fusco  
President and Chief Executive Officer

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**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Aspen Technology, Inc. (the "Company") for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Charles F. Kane, Senior Vice President and Chief Financial Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 9, 2006

/s/ CHARLES F. KANE

Charles F. Kane

Senior Vice President and Chief Financial Officer

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