

ASPEN TECHNOLOGY INC /DE/
Form 10-Q
November 14, 2006

**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 quarterly period ended September 30, 2006

OR

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

For the transition period from _____ to _____

Commission File Number: 000-24786

Aspen Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

Ten Canal Park

Cambridge, Massachusetts

(Address of Principal Executive Offices)

04-2739697

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

02141

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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

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As of November 10, 2006, there were 53,519,072 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.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited and dollars in thousands)

| | September 30, 2006 | June 30, 2006 |
|--|-----------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 88,866 | \$ 86,272 |
| Accounts receivable, net | 50,576 | 55,654 |
| Unbilled services | 8,544 | 8,518 |
| Current portion of long-term installments receivable, net | 5,699 | 12,123 |
| Prepaid expenses and other current assets | 8,439 | 8,813 |
| Total current assets | 162,124 | 171,380 |
| Long-term installments receivable, net | 10,447 | 35,681 |
| Retained interest in sold receivables. | 28,067 | 19,010 |
| Property and leasehold improvements, at cost | 44,491 | 43,895 |
| Accumulated depreciation and amortization | (36,398) | (35,544) |
| Property and leaseholds, net. | 8,093 | 8,351 |
| Computer software development costs, net | 16,242 | 15,456 |
| Purchased intellectual property, net | 24 | 165 |
| Other intangible assets, net | 3,658 | 5,131 |
| Goodwill, net | 14,901 | 14,917 |
| Deferred tax asset | 1,595 | 1,595 |
| Other assets | 2,466 | 2,552 |
| | \$ 247,617 | \$ 274,238 |
| LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT) | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 249 | \$ 247 |
| Accounts payable and accrued expenses | 70,104 | 81,646 |
| Deferred revenue | 52,824 | 63,988 |
| Total current liabilities | 123,177 | 145,881 |
| Long-term debt and obligations, less current maturities | 97 | 149 |
| Deferred revenue, less current portion | 2,851 | 2,609 |
| Deferred tax liability | 1,309 | 1,309 |
| Other liabilities | 19,080 | 20,446 |
| Redeemable Preferred Stock: | | |
| Outstanding 333,364 shares as of September 30, 2006 and June 30, 2006 | 129,211 | 125,475 |
| Stockholders equity (deficit): | | |
| Common stock: | | |
| Outstanding 53,461,512 as of September 30, 2006 and 48,857,035 as of June 30, 2006 | 5,370 | 4,909 |
| Additional paid-in capital | 433,120 | 430,811 |
| Accumulated deficit | (466,032) | (456,508) |
| Accumulated other comprehensive income (loss) | (53) | (330) |
| Treasury stock, at cost | (513) | (513) |
| Total stockholders equity (deficit) | (28,108) | (21,631) |
| | \$ 247,617 | \$ 274,238 |

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

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

| | Three Months Ended | |
|---|---------------------------|--------------------------------------|
| | September 30, | |
| | 2006 | 2005 |
| | | (As restated see Note 12) |
| Software licenses | \$ 28,076 | \$ 24,037 |
| Service and other | 35,878 | 35,797 |
| Total revenues | 63,954 | 59,834 |
| Cost of software licenses | 3,149 | 3,875 |
| Cost of service and other | 17,481 | 17,343 |
| Amortization of technology related intangible assets | 1,472 | 1,782 |
| Total cost of revenues | 22,102 | 23,000 |
| Gross profit | 41,852 | 36,834 |
| Operating costs: | | |
| Selling and marketing | 21,210 | 18,758 |
| Research and development | 8,490 | 10,183 |
| General and administrative | 10,145 | 10,459 |
| Restructuring charges | 1,446 | 2,199 |
| Loss on sale of assets | 5,769 | 61 |
| Total operating costs | 47,060 | 41,660 |
| Income (loss) from operations | (5,208) | (4,826) |
| Other income (expense), net | (415) | (204) |
| Interest income, net | 767 | 816 |
| Income (loss) before provision for income taxes | (4,856) | (4,214) |
| Provision for income taxes | (932) | (650) |
| Net income (loss) | (5,788) | (4,864) |
| Accretion of preferred stock discount and dividend | (3,736) | (3,778) |
| Income (loss) applicable to common shareholders | \$ (9,524) | \$ (8,642) |
| Basic and diluted income (loss) per share applicable to common shareholders | \$ (0.18) | \$ (0.20) |
| Weighted average shares outstanding basic and diluted | 52,801 | 43,237 |

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

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

| | Three Months Ended | |
|--|---------------------------|--------------------------------------|
| | September 30, | |
| | 2006 | 2005 |
| | | (As restated see Note 12) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (5,788) | \$ (4,864) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 4,841 | 6,013 |
| Stock-based compensation | 1,741 | 1,808 |
| Loss on securitization of installments receivable | 5,672 | |
| Loss on sales and disposals of assets | 97 | 61 |
| Accretion of discount on retained interest in sold receivables | (766) | (757) |
| Changes in assets and liabilities: | | |
| Decrease in accounts receivable | 4,050 | 7,421 |
| Decrease (increase) in unbilled services | 10 | (1,479) |
| Decrease (increase) in installments receivable | 17,754 | (3,382) |
| Decrease (increase) in prepaid expenses and other current assets | 404 | (1,078) |
| Decrease in accounts payable and accrued expenses | (16,573) | (18,708) |
| Decrease in deferred revenue | (4,751) | (4,345) |
| Increase (decrease) in other liabilities | (1,366) | 24 |
| Net cash provided by (used in) operating activities | 5,325 | (19,286) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and leasehold improvements | (957) | (395) |
| Decrease in other long-term assets | 86 | 55 |
| Capitalized computer software development costs | (2,744) | (2,105) |
| Net cash used in investing activities | (3,615) | (2,445) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Issuance of common stock under employee stock purchase plans | 423 | 445 |
| Exercise of stock options | 551 | 1,194 |
| Payments of long-term debt | (50) | (311) |
| Net cash provided by financing activities | 924 | 1,328 |
| EFFECTS OF EXCHANGE RATE CHANGES ON CASH | (40) | (46) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 2,594 | (20,449) |
| CASH AND CASH EQUIVALENTS, beginning of period | 86,272 | 68,149 |
| CASH AND CASH EQUIVALENTS, end of period | \$ 88,866 | \$ 47,700 |

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

ASPEN TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Interim Condensed and Consolidated Financial Statements

In the opinion of management, the accompanying unaudited interim condensed consolidated 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 (the 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 condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2006, which are contained in the Annual Report on Form 10-K, as amended, 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 condensed consolidated balance sheet presented as of June 30, 2006 has been derived from the consolidated financial statements that have been audited by the Company's independent auditors. The results of operations for the three-month period ended September 30, 2006 are not necessarily indicative of the results to be expected for the full fiscal year.

2. Sale of Installments Receivable

(a) Traditional Activities

Installments receivable represent the present value of future payments related to the financing by the Company of noncancelable term and perpetual license agreements with its customers which 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 months ended September 30, 2006 and 2005 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 \$9.0 million and \$8.5 million during the three months ended September 30, 2006 and 2005, 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 and the financial institutions.

At September 30, 2006, there was approximately \$72 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 is within the range of \$0.1 million to \$1.2 million. In addition, the Company is obligated to pay additional costs to the financial institutions in the event of default by the customer.

(b) Securitization of Installments Receivable

On September 29, 2006, the Company entered into a \$75.0 million three year revolving securitization facility and securitized certain outstanding installment software license receivables (which receivables were not sold in the traditional sales described above) with a net carrying value of \$32.1 million. The structure of the facility was such that the securitization qualified as a sale. The Company received \$19.4 million of cash and retained an interest in the sold receivables valued at \$8.3 million. It also retained certain limited recourse obligations relative to the receivables valued at approximately \$0.5 million. Overall, the transaction resulted in a loss of \$5.7 million in the quarter ended September 30, 2006 and was recorded as a loss on sales and disposals of assets in the accompanying consolidated statement of operations.

The amount of the loss was based on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer, as well as transaction costs.

As noted above, the retained interest in the sold receivables was recorded at its fair value of \$8.3 million at the time of the transaction and is classified as a long-term asset on the Company's consolidated balance sheet. The Company estimates fair value based on the present value of future expected cash flows based on using management's best estimates of key assumptions, principally credit losses, and discount rates commensurate with the risks involved.

The Company retained the servicing rights relative to the receivables and receives annual servicing fees of \$0.3 million per year. The benefits of the servicing rights approximate the costs estimated to be incurred by the Company, and thus no servicing asset or liability has been recorded.

In connection with the above transaction, the Company incurred an obligation to guarantee that the proceeds from all installments receivable denominated in currencies other than the U.S. dollar included in the securitized pool will be equal to the U.S. dollar value on the initial contract date. The Company has entered into forward foreign exchange contracts intended to mitigate the financial exposure due to changes in currency exchange rates which are further described below. The fair value of this obligation was not material and has thus been accorded no value.

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. The ineffective portion of a derivative's change in fair value is to be immediately 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 primarily result from portions of the Company's installment receivables that are denominated in currencies other than the U.S. dollar, primarily the Euro, the Japanese Yen, Canadian dollar and the British Pound Sterling. In addition, the Company incurred exposures as part of the June 2005 and September 2006 securitizations of installments receivable, in that the Company is obligated, in the form of a guarantee, to cover the exposure in the installments receivable that were transferred to its subsidiaries, resulting from changes in foreign currency exchange rates.

The foreign exchange contracts are entered into to hedge recorded installments receivable, both held and 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 guarantee to cover the exposure in the securitized installments receivable represents an embedded derivative. The Company calculates the value of this guarantee at each balance sheet date, and if the value of the guarantee represents an obligation, the fair value is recorded as a liability. As of September 30, 2006, the value of this embedded derivative represented an asset to the Company, and as such, no entry was recorded.

At September 30, 2006, the Company had effectively hedged \$29.3 million of installments receivable, either held or securitized, 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 installments receivable that were denominated in foreign currency was \$33.3 million and \$40.3 million at September 30, 2006 and June 30, 2006, respectively. The installments receivable held as of September 30, 2006 mature at various times through September 2011. 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. During the three months ended September 30, 2006 and 2005 the net gain recognized in the consolidated statements of operations was not material.

The following table provides information about the Company's foreign currency derivative financial instruments outstanding as of September 30, 2006. 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:

| | Notional Amount | Estimated Fair Value(1) | Average Contract Rate |
|------------------------|----------------------------|------------------------------------|----------------------------------|
| Euro | \$ 19,329 | \$ 19,676 | 1.26 |
| British Pound Sterling | 4,987 | 5,118 | 1.83 |
| Canadian Dollar | 2,434 | 2,483 | 1.14 |
| Japanese Yen | 2,154 | 2,004 | 112.38 |
| Swiss Franc | 394 | 388 | 1.21 |
| | \$ 29,298 | \$ 29,669 | |

(1) The estimated fair value is based on the estimated amount at which the contracts could be settled based on the spot rates as of September 30, 2006. 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 Plans

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. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of the grant; those options generally vest over four years and have 7 and 10-year contractual terms.

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 Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its stock-based compensation. Under the provisions of SFAS No. 123R, the Company recognizes the fair value of stock-based 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-based compensation is accounted for as equity instruments and there have been no liability awards granted.

The Company elected the modified prospective transition method for adopting SFAS 123R, and consequently prior periods have not been modified. 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*, (SFAS 123) as disclosed in previous filings. Under the provisions of SFAS 123R, the Company recorded \$1.8 million of stock-based compensation for the three months ended September 30, 2006 and 2005, included in the following categories (in thousands):

| | Three Months Ended September 30, | |
|---|---|-------------|
| | 2006 | 2005 |
| Recorded as expense: | | |
| Cost of service and other | \$ 310 | \$ 299 |
| Selling and marketing | 621 | 509 |
| Research and development | 199 | 208 |
| General and administrative | 611 | 792 |
| | 1,741 | 1,808 |
| Capitalized computer software development costs | 55 | 39 |
| Total stock-based compensation. | \$ 1,796 | \$ 1,847 |

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 were \$8.91 and \$3.88 and of the shares subject to purchase under the employee stock purchase plan were \$2.60 and \$1.99 for the three months ended September 30, 2006 and 2005, respectively, using the following assumptions:

| | Three Months Ended September 30, 2006 | | | | Three Months Ended September 30, 2005 | | | |
|---------------------------------|--|---|----------------------|---|--|---|----------------------|---|
| | Stock Option Plans | | Purchase Plan | | Stock Option Plans | | Purchase Plan | |
| Average risk-free interest rate | 4.84 | % | 5.10 | % | 4.06 | % | 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 | % | 53 | % | 85 | % | 42 | % |

The dividend yield of zero is based on the Company's history of not having paid cash dividends and on its present intention not 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.

5. Net Income (Loss) Per Common Share

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

| | Three Months Ended September 30, | |
|---|-------------------------------------|-------------|
| | 2006 | 2005 |
| Income (loss) applicable to common shareholders | \$ (9,524) | \$ (8,642) |
| Basic weighted average common shares outstanding | 52,801 | 43,237 |
| Weighted average potential common shares | | |
| Diluted weighted average shares outstanding | 52,801 | 43,237 |
| Basic and diluted income (loss) per share applicable to common shareholders | \$ (0.18) | \$ (0.20) |

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):

| | Three Months Ended September 30, | |
|---|-------------------------------------|--------|
| | 2006 | 2005 |
| Convertible preferred stock | 33,336 | 36,336 |
| Preferred stock dividend, to be settled in common stock | 2,864 | 3,554 |
| Options and warrants | 12,213 | 21,911 |
| Total | 48,413 | 61,801 |

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 months ended September 30, 2006 and 2005 are as follows (in thousands):

| | Three Months Ended September 30, | |
|-----------------------------|-------------------------------------|-------------|
| | 2006 | 2005 |
| Net income (loss) | \$ (5,788) | \$ (4,864) |
| Foreign currency adjustment | 277 | (518) |
| Comprehensive income (loss) | \$ (5,511) | \$ (5,382) |

7. Restructuring Charges

During the three months ended September 30, 2006, the Company recorded \$1.4 million in restructuring charges primarily related to severance and relocation expenses under the May 2005 restructuring plan which are recognized in the period in which the affected employees were notified or the relocation expenses were incurred.

(a) *Restructuring charges originally arising in Q4 FY05.*

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 year ended June 30, 2006, the Company recorded an additional \$1.8 million related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that are recognized in the period in which the affected employees were notified, the relocation expenses were incurred, or the Company ceased use of the affected facilities. During the quarter ended September 30, 2006, the Company recorded an additional \$1.4 million in severance and relocation expenses for employees that were notified or relocation expenses that were incurred during the period.

As of September 30, 2006, there was \$1.3 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the three months ended September 30, 2006, the following activity was recorded (in thousands):

| Fiscal 2005 Restructuring Plan | Closure/ Consolidation of Facilities | Employee Severance, Benefits, and Related Costs | Total |
|--------------------------------------|--|--|----------|
| Accrued expenses, June 30, 2006 | \$ 99 | \$ 513 | \$ 612 |
| Restructuring charge | 26 | 1,369 | 1,395 |
| Restructuring charge Accretion | 1 | | 1 |
| Payments | (64) | (680) | (744) |
| Accrued expenses, September 30, 2006 | \$ 62 | \$ 1,202 | \$ 1,264 |
| Expected final payment date | May 2007 | March 2007 | |

(b) *Restructuring charges originally arising in Q4 FY04*

During fiscal 2004, the Company recorded \$15.2 million in net restructuring charges. Of this amount, \$23.5 million is associated with a June 2004 restructuring plan, which is offset by \$8.3 million in adjustments to prior restructuring accruals and deferred rent balances.

In June 2004, the Company initiated a plan to reduce its operating expenses in order to better align its operating cost structure with the current economic environment and to improve 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 are recognized in the period in which the affected employees were notified or the Company ceased use of the affected facilities. In addition, the Company recorded \$0.4 million in restructuring charges related to the accretion of the discounted restructuring accrual and a \$0.8 million decrease to the accrual related to changes in estimates of severance benefits and sublease terms. During the year ended June 30, 2006 the Company recorded a \$0.7 million increase to the accrual

primarily due to a change in the estimate of future operating costs and sublease assumptions associated with the facilities.

As of September 30, 2006, there was \$6.5 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the three months ended September 30, 2006, the following activity was recorded (in thousands):

| | Closure/ Consolidation of Facilities and Contract exit costs | Employee Severance, Benefits, and Related Costs | Total |
|--|---|--|--------------|
| Fiscal 2004 Restructuring Plan | | | |
| Accrued expenses, June 30, 2006 | \$ 6,855 | \$ 192 | \$ 7,047 |
| Change in estimate Revised assumptions | 21 | | 21 |
| Restructuring charge Accretion | 65 | | 65 |
| Payments | (583 |) (79 |) (662) |
| Accrued expenses, September 30, 2006 | \$ 6,358 | \$ 113 | \$ 6,471 |
| Expected final payment date | September 2012 | December 2006 | |

(c) Restructuring charges originally arising in Q2 FY03

In October 2002, management initiated a plan to further reduce operating expenses in response to first quarter revenue results that were below expectations and to general economic uncertainties. 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 \$28.7 million. During fiscal 2004, the Company 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 benefit obligations. During fiscal 2005 and fiscal 2006, the Company recorded \$7.0 million and \$1.0 million increases, respectively to the accrual primarily due to a change in the estimate of the facility vacancy term, extending to the term of the lease.

As of September 30, 2006, there was \$9.5 million remaining in accrued expenses relating to the remaining lease payments. The components of the restructuring plan are as follows (in thousands):

| | Closure/ Consolidation of Facilities |
|---|---|
| Fiscal 2003 Restructuring Plan | |
| Accrued expenses, June 30, 2006 | \$ 9,966 |
| Change in estimate Revised assumptions. | (38) |
| Payments. | (387) |
| Accrued expenses, September 30, 2006 | \$ 9,541 |
| Expected final payment date | September 2012 |

8. Commitments and Contingencies

U.S. Attorney s Office Investigation and Wells Notice

In October 2004, the audit committee of the Company s board of directors commenced a detailed investigation of the accounting for certain software license and service agreement transactions entered into with certain alliance partners and other customers during fiscal years 2000 through 2002 (and later, fiscal 2000 to 2004), which investigation concluded in March 2005. In October 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.

In June 2006, the Company received a Wells Notice letter from the SEC of possible civil enforcement action regarding the Company's originally filed financial statements for fiscal years 2000 through 2004, which the Company restated in March 2005 following the conclusion of the audit committee's review. In addition, the Company has been advised that Lawrence Evans, its former Chairman of the Board and Chief Executive Officer, David McQuillin, its former Chief Executive Officer, and Lisa Zappala, its former Chief Financial Officer, received separate Wells Notice letters in July 2006 regarding the same matter. Lawrence Evans is a current employee of the Company pursuant to an employment agreement entered into in June 2003, although he is no longer an executive officer.

The Company has cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney's Office and the SEC. The investigation by the U.S. Attorney's Office is ongoing in coordination with the SEC, to which the audit committee had initially reported the initiation of the audit committee's investigation. The Company is currently unable to determine whether resolution of these matters 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 these matters. However, the ultimate outcome could have a material adverse effect on the Company's financial position and results of operations.

Class Action and Opt Out Suits

In November 2004, two putative class action lawsuits were filed against the Company in the United States District Court for the 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, defined to include all persons who purchased our common stock between October 29, 1999 and March 15, 2005, inclusive, (the "Class"), entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action, which (the "Stipulation"). The Stipulation was filed with the Court on the same date and provided, among other things, for settlement and release of all direct and indirect claims of the Class concerning matters covered by the Stipulation. On December 12, 2005, the Court granted preliminary approval of the settlement provided for in the Stipulation. After notice to the Class and after the hearing, on March 6, 2006, the Court granted final approval of the settlement, and the class action lawsuit was dismissed with prejudice. 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.

Members of the Class who opted out of the settlement (representing 1,457,969 shares of common stock, or less than 1% of the shares putatively purchased during the Class Action period) may bring their own individual actions, ("Opt Out Claims"). To date, state law Opt Out Claims, including claims of fraud, statutory treble damages, deceptive practices, and/or rescissory damages liability, based on the restated results of one or more fiscal periods included in the restated financial statements referenced in the Class Action, have been filed in Massachusetts Superior Court. The Company has responded by motion to

dismiss on the grounds that the claims fail properly to state a claim. If not dismissed or settled on terms acceptable to us, the Company plans to defend the Opt Out Claims vigorously.

Pursuant to the terms of the Class Action settlement, the Company paid \$1.9 million and its insurance carrier paid \$3.7 million into a settlement fund for a total of \$5.6 million. The Company's \$1.9 million payment was recorded in general and administrative expenses in the quarter ended September 30, 2005. 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.

On September 6, 2006, the Company also announced that, in connection with the preparation of financial statements for the fiscal year ended June 30, 2006, a subcommittee of independent directors was appointed to review the Company's accounting treatment for stock option grants for prior years. Following that announcement, the Company and certain of its officers and directors were named defendants in a purported federal securities class action lawsuits filed in Massachusetts federal district court, alleging violations of the Exchange Act and claiming material misstatements concerning its financial condition and results. In response to the Company's motion to dismiss the complaint, the parties stipulated to voluntary dismissal of the plaintiff's claims with prejudice on September 26, 2006 without any payment by the Company.

Derivative Suits

On December 1, 2004, a putative derivative action lawsuit was filed as a related action to the first filed of the Class Actions (described above) in the United States District Court for the District of Massachusetts, captioned Caviness v. Evans, et al., Civil Action No. 04-12524 (D. Mass.), (the Derivative Action). The complaint, as subsequently amended, alleged, among other things, that the former and current director and officer defendants caused the Company to issue false and misleading financial statements, and brought derivative claims for the following: breach of fiduciary duty for insider trading; breach of fiduciary duty; abuse of control; gross mismanagement; waste of corporate assets; and unjust enrichment.

On August 18, 2005, the Court granted defendants' motion to dismiss the Derivative Action for failure of the plaintiff to make a pre-suit demand on the Company's board of directors to take the actions referenced in the Derivative Action complaint.

On April 12, 2005, the Company received a letter on behalf of another shareholder, demanding that the board of directors of the Company take actions substantially similar to those referenced in the Derivative Action. On February 28, 2006, the Company received a letter on behalf of Mr. Caviness, demanding that the Company take actions referenced in the Derivative Action complaint. The board of directors responded to both of the foregoing letters that the board has taken the letters under advisement pending further regulatory investigation developments, which the board continues to monitor and with which the Company continues to cooperate. In its responses, the board also requested confirmation of each person's status as a stockholder of Aspen Technology, Inc., and, with respect to the most recent letter, also referred the purported stockholder to the March 6, 2006 final approval of the settlement of direct and indirect claims of the Class in the Class Actions.

On September 27, 2006, a purported derivative action was filed in Massachusetts state court against the Company and certain present and former officers and directors captioned Rapine v. AspenTech (Civ. No. 06-3455). The complaint alleged that the Company breached its fiduciary duty in connection with the Company's restatement of financial statements stemming from its review of past stock option grants. On October 16, 2006, the Company removed the case to federal court and moved to dismiss it on the grounds that the plaintiff had failed to make the requisite pre-suit demand on the Company's board of directors,

and because the Company was advised that the claims are largely also barred by the March 6, 2006 Class Action settlement. The court has not ruled on the motion to dismiss. The Company cannot estimate the ultimate outcome of the case at this preliminary stage.

Other

From time to time, the Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. The outcome of these matters is currently not determinable, and there can be no assurance that such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

9. Preferred Stock Financing

In August 2003, the Company issued and sold 300,300 shares of Series D-1 convertible preferred stock (Series D-1 Preferred), along with warrants to purchase up to 6,006,006 shares of common stock at a price of \$3.33 per share, in a private placement to several investment partnerships managed by Advent International Corporation for an aggregate purchase price of \$100.0 million and incurred issuance costs of \$10.7 million. Concurrently, the Company paid cash of \$30.0 million and issued 63,064 shares of Series D-2 convertible preferred stock (Series D-2 Preferred), along with warrants to purchase up to 1,261,280 shares of common stock at a price of \$3.33 per share, to repurchase all of the outstanding Series B-I and B-II convertible preferred stock. In addition the Company exchanged existing warrants to purchase 791,044 shares of common stock at an exercise price ranging from \$20.64 to \$23.99 held by the Series B Preferred holders, for new warrants to purchase 791,044 shares of common stock at an exercise price of \$4.08.

In May 2006, holders of the Series D-1 Preferred converted 30,000 shares into 3,000,000 shares of common stock so that as of September 30, 2006 the Series D Preferred is convertible into 33,336,400 shares of common stock. In July 2006, 6,006,006 warrants were exercised in a cashless exercise, resulting in the issuance of 4,369,336 shares of the Company's common stock.

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

| | Three Months Ended | |
|---|---------------------------|--------------------|
| | September 30, | |
| | 2006 | 2005 |
| Accrual of dividend on Series D preferred stock | \$ (2,812) | \$ (2,808) |
| Accretion of discount on Series D preferred stock | (924) | (970) |
| Total | \$ (3,736) | \$ (3,778) |

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 for which it assesses financial performance and allocates resources.

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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, as amended, for the fiscal year ended June 30, 2006. 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):

| | License | Consulting Services | Maintenance and Training | Total |
|--|-----------|---------------------|--------------------------|-----------|
| Three Months Ended September 30, 2006 | | | | |
| Revenues from external customers | \$ 28,076 | \$ 16,544 | \$ 19,334 | \$ 63,954 |
| Controllable expenses | 12,268 | 10,767 | 3,784 | 26,819 |
| Controllable margin(1) | \$ 15,808 | \$ 5,777 | \$ 15,550 | \$ 37,135 |
| Three Months Ended September 30, 2005 | | | | |
| Revenues from external customers | \$ 24,037 | \$ 16,946 | \$ 18,851 | \$ 59,834 |
| Controllable expenses | 14,603 | 11,273 | 3,441 | 29,317 |
| Controllable margin(1) | \$ 9,434 | \$ 5,673 | \$ 15,410 | \$ 30,517 |

(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):

| | Three Months Ended September 30, | |
|--|-------------------------------------|-------------|
| | 2006 | 2005 |
| Total controllable margin for reportable segments | \$ 37,135 | \$ 30,517 |
| Selling and marketing | (17,629) | (15,335) |
| General and administrative and overhead | (17,499) | (17,748) |
| Restructuring charges | (1,446) | (2,199) |
| Loss on sales and disposals of assets | (5,769) | (61) |
| Interest and other income and expense, net | 352 | 612 |
| Income (loss) before provision for from income taxes | \$ (4,856) | \$ (4,214) |

11. Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertain Tax Positions, an Interpretation of FAS 109 (FIN 48), which clarifies the criteria for recognition and measurement of benefits from uncertain tax positions. Under FIN 48, an entity should recognize a tax benefit when it is more-likely-than-not, based on the technical merits, that the position would be sustained upon examination by a taxing authority. The amount to be recognized should be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Furthermore, any change in the recognition, derecognition or measurement of a tax position should be recognized in the interim period in which the change occurs. The Company expects to adopt FIN 48 as of July 1, 2007, and any change in net assets as a result of applying the Interpretation will be recognized as an adjustment to retained earnings on that date. The Company is in the process of evaluating its uncertain tax positions in accordance with FIN 48.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides guidance on the consideration of the

effects of prior year misstatements in quantifying current year misstatements for the purpose of materiality. SAB 108 is effective for fiscal years beginning after November 15, 2006. The Company believes that the initial adoption of SAB 108 will not have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Standard No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company has not yet determined the effect, if any, that the application of SFAS No. 157 will have on its consolidated financial statements.

12. Restatement of Condensed Consolidated Financial Statements

In connection with the preparation of the consolidated financial statements for the fiscal year ended June 30, 2006, a subcommittee of independent members of the board of directors reviewed the Company's accounting treatment for all stock options granted since the Company completed its initial public offering in fiscal 1995. Based upon the subcommittee's review, the Audit Committee and Company management determined that certain option grants during fiscal years 1995 through 2004 were accounted for improperly, and concluded that stock-based compensation associated with certain grants was misstated in fiscal years 1995 through 2005, and in the nine months ended March 31, 2006. The subcommittee identified errors related to the determination of the measurement dates for grants of options allocated among a pool of employees when the specific number of options to be awarded to specific employees had not been finalized, and other measurement date errors. As a result of the errors in determining measurement dates, the Company also recorded payroll withholding tax-related adjustments for certain options formerly classified as Incentive Stock Option (ISO) grants under Internal Revenue Service regulations. These options were determined to have been granted with an exercise price below the fair market value of the Company's stock on the actual grant date, so do not qualify for ISO tax treatment. The disqualification of ISO classification and the resulting conversion to non-qualified status results in additional withholding taxes on exercise of those options. The Company recorded estimated payroll withholding tax charges of \$0.5 million, \$0.2 million, and \$1.2 million for the years ended June 30, 2004, 2005, and 2006, respectively, in connection with the disqualification of such ISO tax treatment. The stock-based compensation charges, including the aforementioned withholding tax adjustments, increased the net loss by \$0.2 million for the three months ended September 30, 2005 relative to amounts previously reported for that quarter.

In addition, as a result of the errors in determining measurement dates, certain options were determined to have been granted with an exercise price below the fair market value of the Company's stock on the actual grant date. These discounted options vesting subsequent to December 2004 result in nonqualified deferred compensation for purposes of Section 409A of the Internal Revenue Code, and holders are subject to an excise tax on the value of the options in the year in which they vest. Management has concluded that it is probable the Company will either implement a plan to assist the affected employees for the amount of this tax, or adjust the terms of the original option grant which would also have financial statement ramifications. As such, the Company recorded an estimated liability of approximately \$1.0 million in June 2006 in connection with this contingency.

In the course of preparing the condensed consolidated financial statements for the three months ended September 30, 2006, the Company identified errors in the accounting for stock-based compensation and certain revenue transactions in the fiscal year ended June 30, 2006. The stock-based compensation error was due to a calculation error associated with forfeiture rates upon the adoption of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123R), as of July 1, 2005. The effect of correcting this error increased the net loss by \$0.3 million during the three months ended September 30, 2005 relative to amounts previously reported for that quarter.

The restatement of the condensed consolidated financial statements for the quarter ended September 30, 2005 also included adjustments for other errors identified after that quarter had originally been reported. These errors primarily related to the timing of revenue recognition, interest income, and the calculation of foreign currency gains and losses.

As a result of the foregoing, the Company has restated its condensed consolidated financial statements for the three months ended September 30, 2005.

Impact of the Financial Statement Adjustments on the Condensed Consolidated Statement of Operations

The following table presents the impact of the financial statement adjustments on the Company's previously reported condensed consolidated statement of operations for the three months ended September 30, 2005 (in thousands, except per share data).

Condensed Consolidated Statement of Operations

| | As Previously Reported | Adjustments | As Restated |
|---|-----------------------------------|--------------------|--------------------|
| Software licenses | \$ 24,317 | \$ (280) | \$ 24,037 |
| Service and other | 35,736 | 61 | 35,797 |
| Total revenues | 60,053 | (219) | 59,834 |
| Cost of software licenses | 3,782 | 93 | 3,875 |
| Cost of service and other | 17,244 | 99 | 17,343 |
| Amortization of technology related intangibles | 1,782 | | 1,782 |
| Total cost of revenues | 22,808 | 192 | 23,000 |
| Gross profit | 37,245 | (411) | 36,834 |
| Operating costs: | | | |
| Selling and marketing | 18,647 | 111 | 18,758 |
| Research and development | 10,134 | 49 | 10,183 |
| General and administrative | 10,185 | 274 | 10,459 |
| Restructuring charges | 2,199 | | 2,199 |
| Loss on sales and disposals of assets | 61 | | 61 |
| Total operating costs | 41,226 | 434 | 41,660 |
| Income (loss) from operations | (3,981) | (845) | (4,826) |
| Other income (expense), net | (663) | 459 | (204) |
| Interest income, net | 151 | 665 | 816 |
| Income before provision for income taxes | (4,493) | 279 | (4,214) |
| Provision for income taxes | (640) | (10) | (650) |
| Net income (loss) | (5,133) | 269 | (4,864) |
| Accretion of preferred stock discount and dividend | (3,778) | | (3,778) |
| Income applicable to common shareholders | \$ (8,911) | \$ 269 | \$ (8,642) |
| Basic and diluted income (loss) per share applicable to common shareholders | \$ (0.21) | \$ 0.01 | \$ (0.20) |
| Weighted average shares outstanding - basic and diluted | 43,237 | | 43,237 |

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

The following discussion 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 Form 10-Q and in our annual report on Form 10-K, as amended, for the fiscal year ended June 30, 2006. This discussion 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 in Item 1A. Risk Factors in Part II of this Form 10-Q.

The following discussion gives effect to the restatement discussed in Note 12 to the consolidated financial statements included in this Form 10-Q. Our fiscal year ends on June 30, and references in this Form 10-Q to a specific fiscal year are the twelve months ended June 30 of such year (for example, fiscal 2006 refers to the year ended June 30, 2006).

Overview

We are a leading supplier of integrated software and services to the process industries, which consist of oil and gas, petroleum, chemicals, pharmaceuticals and other industries that manufacture and produce products from a chemical process. We provide a comprehensive, integrated suite of software applications that utilize proprietary empirical models of chemical manufacturing processes to improve plant and process design, economic evaluation, production, production planning and scheduling, and operational performance, and an array of services designed to optimize the utilization of these products by our customers.

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 income taxes;
- allowance for doubtful accounts;
- accounting for securitization of installments receivable and subsequent valuation;
- restructuring accruals; and
- accounting for stock-based compensation.

Revenue Recognition Software Licenses

We recognize software license revenue in accordance with SOP No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-4 and SOP No. 98-9, as well as the various interpretations and

clarifications of those statements. When we provide professional services considered essential to the functionality of the software, we recognize revenue from the fees for such revenue and any related software licenses in accordance with SOP 81-1, Accounting for Performance of Construction Type and Certain Performance Type Contracts . 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
- collection of the sales price is reasonably assured.

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. These two criteria are particularly relevant 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 is 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 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, 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.

The timing and size of any 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 \$34.8 million as of September 30, 2006.

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 Income Taxes

We 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. Deferred tax assets also result from unused operating loss carryforwards, research and development tax credit carryforwards and foreign tax credit carryforwards. 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 any valuation allowance recorded against these deferred tax assets and liabilities. 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. We have provided a full valuation allowance for all U.S. domiciled net 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 and September 2006 securitization transactions 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 transactions. 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 consulted third parties 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, the value of our retained interest may fluctuate.

Accounting for Restructuring Accruals

We follow SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities. In accounting for these obligations, we are required to make assumptions related to the amounts of employee severance, benefits, and related costs and to the time period over which facilities will remain vacant, sublease terms, sublease rates and discount rates. We base our estimates and assumptions on the best information available at the time the obligation has arisen. These estimates are reviewed and revised as facts and circumstances dictate; changes in these estimates could have a material effect on the amount accrued on the balance sheet.

Accounting for Stock-Based Compensation

We adopted SFAS No. 123(R), Share-Based Payment, effective July 1, 2005. Under the fair value provisions of this statement, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. SFAS 123(R) requires significant judgment and the use of estimates, particularly for assumptions such as stock price volatility and expected option lives to value stock-based compensation in net income. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could fluctuate significantly.

Results of Operations

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

| | Three Months Ended | |
|--|--------------------|---------|
| | September 30, | |
| | 2006 | 2005 |
| Software licenses | 43.9 % | 40.2 % |
| Service and other | 56.1 | 59.8 |
| Total revenues | 100.0 | 100.0 |
| Cost of software licenses | 4.9 | 6.5 |
| Cost of service and other | 27.4 | 29.0 |
| Amortization of technology related intangible assets | 2.3 | 3.0 |
| Total Cost of Revenues | 34.6 | 38.5 |
| Gross Profit | 65.4 | 61.5 |
| Operating costs: | | |
| Selling and marketing | 33.1 | 31.4 |
| Research and development | 13.3 | 17.0 |
| General and administrative | 15.9 | 17.4 |
| Restructuring charges | 2.2 | 3.7 |
| Loss on sale of assets | 9.0 | 0.1 |
| Total operating costs | 73.5 | 69.6 |
| Income from operations | (8.1) | (8.1) |
| Other income (expense), net | (0.7) | (0.3) |
| Interest income, net | 1.2 | 1.4 |
| Income before provision for income taxes | (7.6)% | (7.0)% |

Comparison of the Three Months Ended September 30, 2006 and 2005

Total Revenues

Revenues are derived from software licenses, consulting services and maintenance and training. Total revenues for the three months ended September 30, 2006 increased 6.9% to \$64.0 million from \$59.8 million in the three months ended September 30, 2005. Total revenues from customers outside the United States were \$35.8 million or 55.9% of total revenues for the three months ended September 30, 2006 as compared to \$35.6 million or 59.5% of total revenues for the three months ended September 30, 2005. The geographical mix of revenues can vary from period to period.

Software License Revenues

Software license revenues represented 43.9% of total revenues for the three months ended September 30, 2006 compared to 40.2% for the three months ended September 30, 2005. Revenues from software licenses in the three months ended September 30, 2006 increased 16.8% to \$28.1 million from \$24.0 million in the three months ended September 30, 2005. 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. The increase primarily reflected strength in our energy end-market, along with continued strength in our chemicals and engineering and construction end-markets.

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 September 30, 2006 were relatively unchanged at \$35.9 million compared to \$35.8 million for the three months ended September 30, 2005.

Cost of Software Licenses

Cost of software licenses consists primarily of royalties and amortization of previously capitalized software costs. Cost of software licenses for the three months ended September 30, 2006 declined 18.7% to \$3.1 million from \$3.9 million for the three months ended September 30, 2005. Cost of software licenses as a percentage of revenues from software licenses decreased to 11.2% for the three months ended September 30, 2006 from 16.1% for the three months ended September 30, 2005. The cost decrease is primarily due to a \$0.5 million decrease in royalty expense associated with the termination of a long-term fixed royalty contract.

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 September 30, 2006 increased 0.8% to \$17.5 million from \$17.3 million for the three months ended September 30, 2005. Cost of service and other, as a percentage of revenues from service and other for the three months ended September 30, 2006 increased to 48.7% from 48.4% for the three months ended September 30, 2005.

Amortization of Technology Related Intangibles

Amortization of technology related intangibles for the three months ended September 30, 2006 was \$1.5 million and \$1.8 million for the three months ended September 30, 2005. As a percentage of total

revenues, amortization of technology related intangibles was 2.3% for the three months ended September 30, 2006, as compared to 3.0% for the three months ended September 30, 2005.

Selling and Marketing Expenses

Selling and marketing expenses for the three months ended September 30, 2006 increased 13.1% to \$21.2 million from \$18.8 million for the three months ended September 30, 2005, while increasing as a percentage of total revenues to 33.1% from 31.4%. The increase in dollars is primarily due to a \$0.6 million increase in payroll and stock-based compensation costs, \$1.2 million of sales conference expenses, and a \$0.3 million increase in external sales commission expense.

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 for the three months ended September 30, 2006 decreased 16.6% to \$8.5 million from \$10.2 million for the three months ended September 30, 2005, and decreased as a percentage of total revenues to 13.3% from 17.0%. The decrease is primarily attributable to a \$0.7 million increase in capitalized software development costs and a \$0.5 million reduction in consulting expenses.

We capitalized software development costs that amounted to 24.4% of our total engineering costs during the three months ended September 30, 2006, as compared to 17.1% during the three months ended September 30, 2005. These percentages will vary from quarter to quarter and year to year, depending upon the stage of development for the various projects in a given period.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries of administrative, executive, financial and legal personnel, and outside professional fees. General and administrative expenses for the three months ended September 30, 2006, were relatively unchanged, as they decreased 3.0% to \$10.1 million from \$10.5 million for the three months ended September 30, 2005, and declined as a percentage of total revenues to 15.9% from 17.4%.

Restructuring Charges

During the three months ended September 30, 2006, we recorded \$1.4 million in restructuring charges for severance and relocation expenses as part of the 2005 restructuring plan in the period in which the employees were notified or the relocation occurred.

Loss on sale of assets

Loss on the sale of assets during the three months ended September 30, 2006 was \$5.8 million as compared to \$0.1 million during the three months ended September 30, 2005. This increase is primarily due to the loss of \$5.7 million on the securitization of installments receivable in September 2006.

Interest Income

Interest income is generated from investment of excess cash in short-term and long-term investments, from the license of software pursuant to installment contracts and from the accretion to fair value of our retained interest in sold receivables. 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 the 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 the 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 for the three months ended September 30, 2006 increased 19.1% to \$1.2 million from \$1.0 million for the three months ended September 30, 2005. This increase primarily is due to higher interest rates received and higher average balances in our money market funds.

Interest Expense

Interest expense is generated from notes payable and through the course of our accounts and installments receivable financing transactions. Interest expense was \$0.5 million for the three months ended September 30, 2006 and \$0.2 million for the three months ended September 30, 2005.

Tax Provision

The tax provision recorded during the three months ended September 30, 2006 primarily relates to income taxes incurred in foreign jurisdictions for which an offsetting benefit in the United States is currently unavailable. The inability to realize a benefit from those foreign taxes is caused principally by our excess United States net operating loss carryforward position. Our ability to realize a benefit from these net operating loss carryforwards is dependent upon our future profitability in the United States. We did not record a domestic income tax benefit for the three months ended September 30, 2006 and 2005 as we provided a full valuation allowance against the domestic tax net operating loss carryforwards that were generated during the period.

Liquidity and Capital Resources

Resources

Historically, we have financed our operations principally through cash generated from operating activities, public and private offerings of securities, sales of installment contracts and borrowings under bank credit facilities. As of September 30, 2006, we had cash and cash equivalents totaling \$88.9 million. We believe our current cash and cash equivalents, cash available from sales of installment contracts, cash flow from operations and cash available under bank credit arrangements will be sufficient to meet our anticipated cash needs for at least the next twelve 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.

Operating Cash Flow

During the three months ended September 30, 2006, operating activities provided \$5.3 million of cash primarily due to the securitization of installments receivable, offset by cash payments of accrued expenses and accounts payable.

Financing Activities

During the three months ended September 30, 2006, financing activities provided \$0.9 million of cash primarily due to the exercise of stock options and to the issuance of shares under our employee stock purchase plan.

In August 2003, we issued and sold 300,300 shares of Series D-1 preferred, along with WD warrants to purchase up to 6,006,006 shares of common stock, for an aggregate purchase price of \$100.0 million. Concurrently, we paid \$30.0 million and issued 63,064 shares of Series D-2 preferred, along with WB and WD warrants to purchase up to 1,261,280 shares of common stock, to repurchase all of the outstanding Series B preferred. 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. The shares of Series D preferred currently are convertible into an aggregate of 33,336,400 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.

Sales of Installment Contracts

We historically have maintained arrangements to sell installments receivable to financial institutions, most recently General Electric Capital Corporation, Bank of America and Silicon Valley Bank. During the three months ended September 30, 2006 and 2005, we sold \$9.0 million and \$8.5 million of installments receivable under these arrangements, respectively. As of September 30, 2006, there was approximately \$72 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 September 30, 2006, we had a partial recourse obligation that was within the range of \$0.1 million to \$1.2 million.

In September 2006, we entered into a \$75.0 million three year revolving securitization facility and securitized certain outstanding installment software license receivables (which receivables were not sold in the traditional sales described below) with a net carrying value of \$32.1 million. The structure of the facility was such that the securitization qualified as a sale. We received \$19.4 million of cash and retained an interest in the sold receivables valued at \$8.3 million. We also retained certain limited recourse obligations relative to the receivables valued at approximately \$0.5 million. Overall, the transaction resulted in a loss of \$5.7 million in the quarter ended September 30, 2006 and was recorded as a loss on sales and disposals of assets in the accompanying consolidated statement of operations. We expect that we would have received approximately \$5.4 million, \$8.6 million and \$9.0 million of cash flows from these installments receivable during fiscal years 2007, 2008 and 2009, if not for the securitization of the receivables.

Credit Facility

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 (i) \$15.0 million or (ii) 70% of eligible domestic receivables, and a line of credit of up to the lesser of (i) \$10.0 million or (ii) 80% of eligible foreign receivables. The lines of credit bear interest at the bank's prime rate (8.25% at September 30, 2006). 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 will initially be collateralized by nearly all of our assets, and 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 September 30, 2006, there were \$8.5 million in letters of credit outstanding under the line of credit, and there was \$7.8 million available for future borrowing. As of September 30, 2006, we were in compliance with the tangible net worth covenant and adjusted quick ratio covenants. The loan agreement expires in January 2007. We are currently in negotiations to either: (1) extend this line of credit with our current lender and amend the terms of the facility; or (ii) obtain a facility from another lender.

Requirements*Capital Expenditures*

During the three months ended September 30, 2006, investing activities used \$3.6 million of cash as a result of the purchase of \$0.9 million of property and equipment and the capitalization of \$2.7 million of computer software development costs. We expect to spend an additional \$7 million in capital expenditures in the last nine months of fiscal 2007, primarily for additional purchases of software and computer equipment. We are not currently party to any purchase contracts related to future capital expenditures.

Contractual Obligations and Requirements

Our commitments as of September 30, 2006 consisted of debt and lease obligations 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 September 30, 2006 were as follows (in thousands):

| | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total |
|-------------------|----------|----------|----------|----------|----------|------------|-----------|
| Operating leases | \$ 7,260 | \$ 7,437 | \$ 7,570 | \$ 7,406 | \$ 6,460 | \$ 14,834 | \$ 50,967 |
| Debt obligations | 249 | 97 | | | | | 346 |
| Total commitments | \$ 7,509 | \$ 7,534 | \$ 7,570 | \$ 7,406 | \$ 6,460 | \$ 14,834 | \$51,313 |

Dividends

Each share of Series D preferred is entitled to a cumulative annual dividend of 8.0% of the stated value per share of such share, payable upon declaration by the board of directors, in its discretion, or upon conversion or redemption of the Series D preferred. As of September 30, 2006, there was \$31.3 million in accumulated but undeclared dividends on the Series D preferred. Accumulated dividends, when and if declared by our board, must be paid in cash, unless we elect to pay the dividends in common stock and we are able to satisfy specified conditions.

Summary of Restructuring Accruals

During the three months ended September 30, 2006, we recorded \$1.4 million in restructuring charges primarily related to severance and relocation expenses related to office consolidations under the May 2005 restructuring plan, which are recognized in the period in which the affected employees were notified or the relocation expenses were incurred.

Restructuring charges originally arising in Q4 FY05.

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, a termination of a contract and facilities consolidations. These actions resulted in an aggregate restructuring charge of \$3.8 million recorded in the fourth quarter of fiscal 2005. During the year ended June 30, 2006, we recorded an additional \$1.8 million related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that are recognized in the period in which the affected employees were notified, the relocation expenses were incurred, or we ceased use of the affected facilities. During the quarter ended September 30, 2006, we recorded an additional \$1.4 million in severance and relocation expenses for employees that were notified or relocation expenses that were incurred during the period.

As of September 30, 2006, there was \$1.3 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. The activity for the three months ended September 30, 2006 was (in thousands):

| | Closure/ Consolidation of Facilities | Employee Severance, Benefits, and Related Costs | Total |
|---------------------------------------|--|--|----------|
| Fiscal 2005 Restructuring Plan | | | |
| Accrued expenses, June 30, 2006 | \$ 99 | \$ 513 | \$ 612 |
| Restructuring charge | 26 | 1,369 | 1,395 |
| Restructuring charge Accretion | 1 | | 1 |
| Payments | (64) | (680) | (744) |
| Accrued expenses, September 30, 2006 | \$ 62 | \$ 1,202 | \$ 1,264 |
| Expected final payment date | May 2007 | March 2007 | |

Restructuring charges originally arising in Q4 FY04

As of September 30, 2006, there was \$6.5 million remaining in accrued expenses relating to the remaining severance obligations and lease payments for charges recorded in fiscal 2004. The activity for the three months ended September 30, 2006 was (in thousands):

| | Closure/ Consolidation of Facilities and Contract exit costs | Employee Severance, Benefits, and Related Costs | Total |
|--|---|--|----------|
| Fiscal 2004 Restructuring Plan | | | |
| Accrued expenses, June 30, 2006 | \$ 6,855 | \$ 192 | \$ 7,047 |
| Change in estimate Revised assumptions | 21 | | 21 |
| Restructuring charge Accretion | 65 | | 65 |
| Payments | (583) | (79) | (662) |
| Accrued expenses, September 30, 2006 | \$ 6,358 | \$ 113 | \$ 6,471 |
| Expected final payment date | September 2012 | December 2006 | |

Restructuring charges originally arising in Q2 FY03

As of September 30, 2006, there was \$9.5 million remaining in accrued expenses relating to the remaining lease payments for charges recorded in fiscal 2003. The activity for the three months ended September 30, 2006 was (in thousands):

| Fiscal 2003 Restructuring Plan | Closure/ Consolidation of Facilities |
|--|---|
| Accrued expenses, June 30, 2006 | \$ 9,966 |
| Change in estimate Revised assumptions | (38) |
| Payments | (387) |
| Accrued expenses, September 30, 2006 | \$ 9,541 |
| Expected final payment date | September 2012 |

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Additional information relating to quantitative and qualitative disclosure about market risk is set forth in Note 3 to the consolidated financial statements included in this Form 10-Q.

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 September 30, 2006 | | Maturing in Fiscal 2007 | |
|--------------------------------|---|--------|------------------------------------|--------|
| Cash Equivalents | \$ | 88,866 | \$ | 88,866 |
| Weighted Average Interest Rate | | 2.33 % | | 2.33 % |
| Investments | \$ | | \$ | |
| Weighted Average Interest Rate | | % | | % |
| Total Portfolio | \$ | 88,866 | \$ | 88,866 |
| Weighted Average Interest Rate | | 2.33 % | | 2.33 % |

Impact of Foreign Currency Rate Changes

During the first three months of fiscal 2007 the U.S. dollar strengthened against the Euro and Japanese Yen, and weakened against the British pound and Canadian dollar. 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 installments receivables denominated in foreign currencies. 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 \$29.3 million of foreign

exchange forward contracts denominated in British, Japanese, Swiss, Euro and Canadian currencies, which represented underlying customer installments receivable transactions at September 30, 2006. The underlying customer installments receivable transactions consist of assets carried on our balance sheet and assets that were transferred to our subsidiaries as part of the securitizations 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. Gains and losses related to these instruments for the three months ended September 30, 2006 and 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 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 at September 30, 2006, 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 of the contract at September 30, 2006.

| Currency | Average Contract Rate | Forward Amount in U.S. Dollars (in thousands) | Contract Origination Date | Contract Maturity Date |
|------------------------|-----------------------|---|---------------------------|------------------------|
| Euro | 1.26 | \$ 19,329 | Various: Oct 05 Sep 06 | Various: Oct 06 Jul 07 |
| British Pound Sterling | 1.83 | 4,987 | Various: Oct 05 Sep 06 | Various: Oct 06 Oct 07 |
| Canadian Dollar | 1.14 | 2,434 | Various: Oct 05 Sep 06 | Various: Oct 06 Oct 07 |
| Japanese Yen | 112.38 | 2,154 | Various: Oct 05 Sep 06 | Various: Oct 06 Jul 07 |
| Swiss Franc. | 0.57 | 394 | Various: May 06 Sep 06 | Various: Oct 06 May 07 |
| Total | | \$ 29,298 | | |

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 September 30, 2006. 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 a 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 four material weaknesses in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) as of June 30, 2006, 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, 2006.

In November 2006, our current management, including our chief executive officer and chief financial officer, identified a new material weakness in internal control over the calculation and review of forfeiture rates affecting stock-based compensation expense as of June 30, 2006. Specifically, we did not have effective operational and review controls in place to provide reasonable assurance that the calculation of stock-based compensation expense reflected accurate forfeiture rates under the provisions of SFAS No. 123R, which were adopted on July 1, 2005. This control deficiency resulted in the restatement of the consolidated financial statements for the year ended June 30, 2006 as described in Note 17 to the consolidated financial statements in our Annual Report on Form 10-K, as amended. This material weakness relating to the calculation and review of forfeiture rates affecting stock-based compensation expense as of June 30, 2006 is discussed further in Management's Report on Internal Control Over Financial Reporting (as revised) included in our Annual Report on Form 10-K, as amended.

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.

Management's Report on Internal Control Over Financial Reporting (as revised) in our Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2006 described certain remediation initiatives designed to address the five previously reported material weaknesses. During the quarter ended September 30, 2006, we continued to design enhancements to our controls and implemented a limited number of changes to our internal control environment. We have implemented or expect to implement the changes described below during our current fiscal year, and will design and implement additional changes as considered appropriate, which are intended to remediate the material weaknesses which existed as of June 30, 2006. We expect to test the effectiveness of such changes in connection with our annual testing of the effectiveness of internal controls. As a result of the five previously reported material weaknesses in our internal control over financial reporting, which were not remediated as of September 30, 2006, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were not effective as of September 30, 2006.

The remedial measures implemented by us to date will not in and of themselves remediate the material weaknesses, and certain of these remedial measures will require some time to be fully implemented or to take full effect. Prior to the remediation of these material weaknesses, there remains risk that the transitional controls, described below, on which we currently rely will fail to be sufficiently effective, which could result in material misstatement of our financial position or results of operations and require a restatement. During the quarter ended September 30, 2006, 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:

In order to improve controls over the periodic financial close process, we:

- Hired a Chief Financial Officer with expertise in internal controls and financial reporting;
- Initiated the planning phase of a long-term project to upgrade our existing financial applications, which is being designed to streamline the capturing of relevant data, improve the general ledger and

entity account level reporting structures and enhance the information query and reporting capability for the consolidated books worldwide;

- Initiated detailed review procedures by finance management for all manual journal entries recorded at the consolidated level prior to posting;
- Required that all complex non-routine transactions during the quarter ended September 30, 2006 were researched, detailed in written memoranda and reviewed by senior management prior to recording; and,
- Hired additional billing, accounting and collections staff in finance to support the continued consolidation of worldwide transaction processing in the Company's headquarters in Cambridge, MA.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we:

- Began our assessment of the accounting applications deployed to service accounts receivable which have been sold in the planning phase of the system upgrade project discussed above. This assessment is expected to continue into future quarters.

In order to improve controls over the accrual of goods and services received, we:

- Increased the frequency and timing of communications from executive and finance management to purchase requestors, and implemented additional manual procedures, to ensure any known liabilities were communicated to finance for timely recording at September 30, 2006.

After the quarter ended September 30, 2006 and prior to the date of filing of this quarterly report on Form 10-Q, we made the following changes in our internal control over financial reporting to address our previously reported material weaknesses and to further strengthen our internal controls. 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:

In order to improve controls over the periodic financial close process, we:

- Designed and implemented a new quarterly reconciliation of the subsidiary-level books to the consolidated books; and
- Initiated a new dual review procedure by finance management of all material balance sheet account reconciliations to ensure that all material reconciling items identified in balance sheet account reconciliations were accounted for properly and timely.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we:

- Initiated a new dual review procedure by finance management of all material balance sheet account reconciliations, including accounts receivable reconciliations, to ensure all cash receipts were timely applied to applicable accounts receivable balances and to ensure the appropriate liability was recorded in instances where the receivable had been sold to a financial institution; and
- Enhanced our review process by finance management of credit balances in accounts receivable to ensure proper classification as a liability or as a credit to accounts receivable.

In order to improve controls over the accounting for income taxes, we:

- Implemented a new review process by executive finance management of the quarterly tax accounts and calculations; and

- Improved internal reporting of financial account balances to the tax department.

In order to improve controls over the accrual of goods and services received, we:

- Designed and implemented a new process to review open purchase orders and subsequent payments for appropriate accounting treatment at September 30, 2006.

In order to improve controls over the calculation and review of forfeiture rates affecting stock-based compensation expense, we adjusted the calculation methodology for our stock-based compensation expense to include accurate forfeiture rates under the provisions of SFAS No. 123R.

In addition, we will continue to plan and enhance our infrastructure and related processes to strengthen our internal control over financial reporting and address our material weaknesses as follows:

In order to improve controls over the periodic financial close process, we intend to:

- Continue to upgrade our existing financial applications and supporting processes and organizational structure, which will allow management to streamline the capturing of relevant data, improve the general ledger and entity account level reporting structures and enhance the information query and reporting capability for our operations on a global basis;
- Take steps to simplify the legal entity structure;
- Continue to evaluate and assess the adequacy and expertise of the finance and accounting staff on a global basis.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we intend to:

- Continue to require dual review by finance management of all material balance sheet account reconciliations, including accounts receivable reconciliations; and
- Continue our assessment of the adequacy of the financial applications and supporting processes and organizational structure deployed to service accounts receivable which have been sold.

In order to improve controls over the accounting for income taxes, we intend to:

- Further enhance our policies and procedures for determining and documenting income tax liabilities and deferred income tax assets and liabilities, as well as for preparing income tax provision calculations;
- Increase the number of personnel with specialized corporate and international tax expertise in the tax department.

In order to improve controls over the accrual of goods and services received, we intend to:

- Continue to automate the purchasing cycle including a system implementation and enhanced reporting that will allow for accurate and timely reports of purchases which require periodic accrual;
- Maintain ongoing reviews of open purchase and subsequent payments by finance and accounts payable management to ensure appropriate accounting treatment; and
- Continue frequent executive and finance management communications to purchase requestors to ensure communication of known liabilities to finance for timely recording.

In order to improve controls over the calculation and review of forfeiture rates affecting stock-based compensation expense, we intend to increase the level of management review of our stock-based

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compensation expense calculations to ensure forfeiture rates are accurately reflected under the provisions of SFAS No. 123R.

If the remedial measures described above are insufficient to address any of the five identified material weaknesses, or additional deficiencies that may arise in the future, material misstatements in our interim or annual financial statements may occur in the future. We are currently implementing an enhanced controls environment intended to address the material weaknesses in our internal control over financial reporting and to remedy the ineffectiveness of our disclosure controls and procedures. While this implementation phase is underway, we are relying on extensive manual procedures, including regular reviews, to assist us with meeting the objectives otherwise fulfilled by an effective controls environment. 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 IA. Risk Factors . We have identified five material weaknesses in our internal control over financial reporting as of September 30, 2006 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 and Wells Notice

In October 2004, the audit committee of the Company's board of directors commenced a detailed investigation of the accounting for certain software license and service agreement transactions entered into with certain alliance partners and other customers during fiscal years 2000 through 2002 (and later, fiscal 2000 to 2004), which investigation concluded in March 2005. In October 2004, the Company 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.

In June 2006, the Company received a Wells Notice letter from the SEC of possible civil enforcement action regarding the Company's originally filed financial statements for fiscal years 2000 through 2004, which the Company restated in March 2005 following the conclusion of the audit committee's review. In addition, the Company has been advised that Lawrence Evans, its former Chairman of the Board and Chief Executive Officer, David McQuillin, its former Chief Executive Officer, and Lisa Zappala, its former Chief Financial Officer, received separate Wells Notice letters in July 2006 regarding the same matter. Lawrence Evans is a current employee of the Company pursuant to an employment agreement entered into in June 2003, although he is no longer an executive officer.

The Company has cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney's Office and the SEC. The investigation by the U.S. Attorney's Office is ongoing in coordination with the SEC, to which the audit committee had initially reported the initiation of the audit committee's investigation. The Company is currently unable to determine whether resolution of these matters 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 these matters. However, the ultimate outcome could have a material adverse effect on the Company's financial position and results of operations.

Class Action and Opt Out Suits

In November 2004, two putative class action lawsuits were filed against the Company in the United States District Court for the 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, defined to include all persons who purchased our common stock between October 29, 1999 and March 15, 2005, inclusive, (the Class), entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action, which (the Stipulation). The Stipulation was filed with the Court on the same date and provided, among other things, for settlement and release of all direct and

indirect claims of the Class concerning matters covered by the Stipulation. On December 12, 2005, the Court granted preliminary approval of the settlement provided for in the Stipulation. After notice to the Class and after the hearing, on March 6, 2006, the Court granted final approval of the settlement, and the class action lawsuit was dismissed with prejudice. 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.

Members of the Class who opted out of the settlement (representing 1,457,969 shares of common stock, or less than 1% of the shares putatively purchased during the Class Action period) may bring their own individual actions, (Opt Out Claims). To date, state law Opt Out Claims, including claims of fraud, statutory treble damages, deceptive practices, and/or rescissory damages liability, based on the restated results of one or more fiscal periods included in the restated financial statements referenced in the Class Action, have been filed in Massachusetts Superior Court. The Company has responded by motion to dismiss on the grounds that the claims fail properly to state a claim. If not dismissed or settled on terms acceptable to us, the Company plans to defend the Opt Out Claims vigorously.

Pursuant to the terms of the Class Action settlement, the Company paid \$1.9 million and its insurance carrier paid \$3.7 million into a settlement fund for a total of \$5.6 million. The Company's \$1.9 million payment was recorded in general and administrative expenses in the quarter ended September 30, 2005. 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.

On September 6, 2006, the Company also announced that, in connection with the preparation of financial statements for the fiscal year-ended June 30, 2006, a subcommittee of independent directors was appointed to review the Company's accounting treatment for stock option grants for prior years. Following that announcement, the Company and certain of its officers and directors were named defendants in a purported federal securities class action lawsuits filed in Massachusetts federal district court, alleging violations of the Exchange Act and claiming material misstatements concerning its financial condition and results. In response to the Company's motion to dismiss the complaint, the parties stipulated to voluntary dismissal of the plaintiff's claims with prejudice on September 26, 2006 without any payment by the Company.

Derivative Suits

On December 1, 2004, a putative derivative action lawsuit was filed as a related action to the first filed of the Class Actions (described above) in the United States District Court for the District of Massachusetts, captioned Caviness v. Evans, et al., Civil Action No. 04-12524 (D. Mass.), (the Derivative Action). The complaint, as subsequently amended, alleged, among other things, that the former and current director and officer defendants caused the Company to issue false and misleading financial statements, and brought derivative claims for the following: breach of fiduciary duty for insider trading; breach of fiduciary duty; abuse of control; gross mismanagement; waste of corporate assets; and unjust enrichment.

On August 18, 2005, the Court granted defendants' motion to dismiss the Derivative Action for failure of the plaintiff to make a pre-suit demand on the Company's board of directors to take the actions referenced in the Derivative Action complaint.

On April 12, 2005, the Company received a letter on behalf of another shareholder, demanding that the board of directors of the Company take actions substantially similar to those referenced in the Derivative Action. On February 28, 2006, the Company received a letter on behalf of Mr. Caviness, demanding that the Company take actions referenced in the Derivative Action complaint. The board of

directors responded to both of the foregoing letters that the board has taken the letters under advisement pending further regulatory investigation developments, which the board continues to monitor and with which the Company continues to cooperate. In its responses, the board also requested confirmation of each person's status as a stockholder of Aspen Technology, Inc., and, with respect to the most recent letter, also referred the purported stockholder to the March 6, 2006 final approval of the settlement of direct and indirect claims of the Class in the Class Actions.

On September 27, 2006, a purported derivative action was filed in Massachusetts state court against the Company and certain present and former officers and directors captioned *Rapine v. AspenTech* (Civ. No. 06-3455). The complaint alleged that the Company breached its fiduciary duty in connection with the Company's restatement of financial statements stemming from its review of past stock option grants. On October 16, 2006, the Company removed the case to federal court and moved to dismiss it on the grounds that the plaintiff had failed to make the requisite pre-suit demand on the Company's board of directors, and because the Company was advised that the claims are largely barred by the March 6, 2006 Class Action settlement. The court has not ruled on the motion to dismiss. The Company cannot estimate the ultimate outcome of the case at this preliminary stage.

Other

From time to time, the Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. The outcome of these matters is currently not determinable, and there can be no assurance that such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

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 ending 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.

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 occur, we would likely experience reductions, delays, and postponements of customer purchases that will negatively impact our revenue and operating results.

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

Securities litigation and government investigations based on the results of an internal investigation into certain of our software accounting practices may require that we incur substantial additional expenses and expend significant additional management time and may damage our reputation and have a material adverse effect on our business, financial condition and results of operations.

In March 2005, as a result of an internal investigation of our accounting for certain software license and service agreements, we restated our consolidated financial statements for fiscal years 1999 through 2004, including the interim quarters for fiscal years 2003 and 2004.

Following this restatement, we and certain of our then-current and former officers and directors were named defendants in securities class action and derivative lawsuits filed in Massachusetts federal district court, alleging that our financial statements that were restated constituted violations of the Securities Exchange Act and claiming material misstatements concerning our financial condition and results. In March 2006, the court approved a \$5.6 million settlement with the class, of which we paid \$1.9 million and our insurance carrier paid \$3.7 million.

Members of the class representing 1,457,969 shares of common stock opted out of the March 2006 settlement and therefore may choose to initiate their own state law claims against us, which we refer to as opt-out claims, based on the restated results referenced in the earlier class action. To date, the former stockholders of two companies that we purchased have filed separate opt-out claims, including claims of fraud, statutory treble damages, deceptive practices and rescissory damages liability, against us in Massachusetts superior court based on the restated results of one or more fiscal periods included in the restated financial statements. We can provide no assurances as to the outcome of these opt-out claims or the likelihood of the filing of additional opt-out claims, and these claims may result in judgments against us for significant damages. Regardless of the outcome, such litigation has resulted in the past, and may continue to result in the future, in significant legal expenses and may require significant attention and resources of management, all of which could result in losses and damages that have a material adverse effect on our business.

In October 2004, we 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 2000 to 2002, associated documents dating from January 1, 1999, and additional materials. In June 2006, we received a Wells Notice letter from the SEC of possible civil enforcement action regarding our originally filed financial statements for fiscal 2000 through fiscal 2004. A Wells Notice letter invites the recipient to address why a civil enforcement action is unnecessary or inappropriate. We can provide no assurance that the U.S. Attorney's Office, the SEC or another regulatory agency will not bring an enforcement proceeding against us, our officers and employees or former officers and employees based on the restated financial statements. Any such proceeding would divert the resources of management and could result in

significant expenses. In addition, even if we are successful in defending against such an enforcement action, such a proceeding may cause our customers, employees and investors to lose confidence in our company, which could result in significant costs to us and adversely affect the market price of our common stock.

We have been advised that Lawrence Evans, our former Chairman of the Board and Chief Executive Officer, David McQuillin, our former Chief Executive Officer, and Lisa Zappala, our former Chief Financial Officer, received separate Wells Notice letters in July 2006 regarding our originally filed financial statements for fiscal 2000 through fiscal 2004. Lawrence Evans is a current employee of our company pursuant to an employment agreement entered into in June 2003, although he is no longer an executive officer. Any enforcement proceeding by the SEC against any or all of these former executive officers may harm our reputation and cause our customers, employees and investors to lose confidence in our company, which would result in significant costs to us and adversely affect the market price of our common stock.

We are required to advance legal fees (subject to undertakings of repayment if required) and may be required to indemnify certain of our current or former directors and officers (including each of the three former executive officers whom we understand have received Wells Notice letters, as discussed above) in connection with civil, criminal or regulatory proceedings or actions, and such indemnification commitments may be costly. Our director and officer liability insurance policies provide only limited liability protection relating to such actions 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 any proceeding or lawsuit, or if we are unable to achieve a favorable settlement thereof, our financial condition could be materially harmed. Also, increased premiums could materially harm our financial results in future periods. The inability to obtain 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.

A determination by the FTC that we have failed to comply with our existing consent decree could have a material adverse effect on our business and financial condition.

In December 2004, we entered into a consent decree with the Federal Trade Commission, or FTC, with respect to a civil administrative complaint filed by the FTC in August 2003 alleging that our acquisition of Hyprotech in May 2002 was anticompetitive in violation of Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. In connection with the consent decree, we entered into transactions with Honeywell and Bentley Systems in which we transferred our AXSYS product line, our operator training business, and rights to the intellectual property of the Hyprotech product line.

We are subject to ongoing compliance obligations under the FTC consent decree and to subpoenas and other requests for information and documents from the FTC related to whether we have complied with the FTC consent decree. Ensuring our continued compliance with the FTC consent decree may subject us to increased legal fees and other expenses and obligations. If the FTC were to determine that we have not complied with our obligations under the consent decree, we could be subject to one of a variety of remedies, any of which might materially limit our ability to operate under our current business plan and might have a material adverse effect on our operating results and financial condition.

Claims based on the results of a recent internal review into our accounting for stock-based compensation may require that we incur substantial additional expenses and expend significant additional management time.

In connection with the preparation of our consolidated financial statements for fiscal 2006, a subcommittee of independent members of our board of directors determined that certain stock option grants during fiscal 1995 through fiscal 2004 were accounted for improperly and concluded that stock-based compensation associated with certain grants was misstated in fiscal 1995 through fiscal 2005 and in the nine months ended March 31, 2006. As a result of these errors, certain option grants result in nonqualified deferred compensation for purposes of Section 409A of the Internal Revenue Code, resulting in the imposition of an excise tax on the value of the options in the year in which they vest. In September 2006, we restated our financial statements for fiscal 1997 through fiscal 2005 and the first three quarters of fiscal 2006. These restated financial statements were contained in our Annual Report on Form 10-K for the year ended June 30, 2006. However, it is possible that we may be required to file amended Forms 10-K for the fiscal years prior to 2006.

On September 27, 2006, a purported derivative action filed in Massachusetts state court against us and certain present and former officers and directors captioned *Rapine v. AspenTech* (Civ. No. 06-3455). The complaint alleged that we breached our fiduciary duty in connection with our restatement of financial statements stemming from our review of past stock option grants. On October 16, 2006, we removed the case to federal court and moved to dismiss it on the grounds that the plaintiff had failed to make the requisite pre-suit demand on our board of directors, and because we were advised that the claims are largely also barred by a prior class action settlement approved by the federal court on March 6, 2006. The court has not ruled on the motion to dismiss. We can express no view on the likely outcome of the case at this preliminary stage.

We may be named as a defendant in additional securities litigation or derivative lawsuits by current or former stockholders based on the restated financial statements. Further, we may be subject to claims relating to adverse tax consequences with respect to stock options covered by the restatement. Defending against potential claims would likely require significant attention and resources of management and could result in significant legal expenses.

Moreover, we cannot assure you that we will not be subject to regulatory actions by government agencies. Any such proceeding would divert the resources of management, could result in significant expenses and could cause our customers, employees and investors to lose confidence in our company.

We have identified five material weaknesses in our internal control over financial reporting as of September 30, 2006 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) under the Securities Exchange Act. Our management assessed the effectiveness of our internal control over financial reporting as of September 30, 2006 and identified five material weaknesses, which weaknesses were previously reported and described in our Annual Report on Form 10-K, as amended, for fiscal 2006 and in Item 4 Controls and Procedures in this report. 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, 2006 and again at September 30, 2006 consisted of:

- inadequate and ineffective controls over the periodic financial close process;
- ineffective and inadequate controls in the accounts receivable function over the process to record customer invoice payments timely and accurately;
- inadequate and ineffective controls over the accounting for income taxes;
- inadequate and ineffective controls over accrual of goods and services received; and
- inadequate and ineffective controls over the calculation and review of forfeiture rates affecting stock-based compensation expense.

For further information about these material weaknesses, please see Item 4. Controls and Procedures in this report and Item 9A. Controls and Procedures Changes in Internal Control Over Financial Reporting and Management's Report on Internal Control over Financial Reporting in our Annual Report on Form 10-K, as amended, for fiscal 2006. Because of these material weaknesses, our management concluded, as of September 30, 2006, 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.

Our management previously had identified six material weaknesses in our internal control over financial reporting as of June 30, 2005 and, in each of fiscal 2005 and 2006, our management has identified significant deficiencies in our internal control over financial reporting. We implemented a number of remedial measures in fiscal 2006, but three of the six previously identified weaknesses continued to constitute material weaknesses as of September 30, 2006. In addition, during each of the fourth quarter of fiscal 2006 and the first quarter of fiscal 2007, our management identified an additional new material weakness in our internal control over financial reporting. We are implementing additional remedial measures designed to address the material weaknesses identified as of September 30, 2006. If these remedial initiatives are insufficient to address the four 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 Global 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 controls could also adversely affect the results of the periodic management evaluations 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.

Our international operations are complex and if we fail to manage those operations effectively, the growth of our business would be limited and our operating results would be adversely affected.

We have 29 offices in 20 countries. We sell our products primarily through a direct sales force located throughout the world. In the event that we are unable to adequately staff and maintain our foreign subsidiary operations, we could face difficulties managing our international operations, including our ability to compile consolidated financial statements in a timely manner. We also rely, to a lesser extent, on distributors and resellers to sell our products and market our services internationally, and our inability to manage and maintain those relationships would limit our ability to generate revenue outside the United States. The complexities of our operations also require us to make significant financial expenditures to ensure that our operations are compliant with regulatory requirements in numerous foreign jurisdictions. To the extent we are unable to manage the various risks associated with our complex international operations effectively, the growth and profitability of our business may be adversely affected.

Our business may suffer if we fail to address challenges associated with transacting business internationally.

We derived approximately 60% of our total revenues from customers outside the United States in fiscal 2005 and 2006. 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 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
- adverse tax consequences.

In addition, 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.

Competition from software offered by current competitors and new market entrants, as well as from internally developed solutions, could adversely affect our ability to sell our software products and related services and could result in pressure to price our products in a manner that reduces our margins.

Our markets in general are highly competitive.

- Our engineering software competes with products of businesses such as ABB, Chemstations, Honeywell, KBC, Shell Global Solutions, Simulation Sciences (a division of Invensys) and WinSim (formerly ChemShare).

- Our plant operations software competes with products of companies such as ABB, Honeywell, Invensys, Rockwell and Siemens and components of SAP's product offerings.
- Our supply chain management software competes with products of companies such as Honeywell, i2 Technologies, Manugistics (a subsidiary of JDA Software Group) and Infor 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 the past, such as ABB, Agile, EDS, Honeywell, Invensys, Oracle, Parametric Technology, SAP and Siemens. We also face competition in all areas of our business from large companies in the process industries that have internally developed their own proprietary software solutions.

Many of our current and potential competitors have greater financial, technical, marketing, service and other resources than we have. As a result, these companies may be able to offer lower prices, additional products or services, or other incentives that we cannot match or offer. These competitors may be in a stronger position to respond more quickly to new technologies and may be able to undertake more extensive marketing campaigns. They also may adopt more aggressive pricing policies and make more attractive offers to potential customers, employees and strategic partners. 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 in the marketplace. Competitors with greater financial resources may make strategic acquisitions to increase their ability to gain market share or improve the quality or marketability of their products.

Competition could seriously impede our ability to sell additional software products and related services on terms favorable to us. Businesses may continue to enhance their internally developed solutions, rather than investing in commercial software such as ours. Our current and potential commercial competitors may develop and market new technologies that render our existing or future products obsolete, unmarketable or less competitive. In addition, if these competitors develop products with similar or superior functionality to our products, we may need to decrease the prices for our products in order to remain competitive. If we are unable to maintain our current pricing due to competitive pressures, our margins will be reduced and our operating results will be negatively affected. We cannot assure you that we will be able to compete successfully against current or future competitors or that competitive pressures will not materially adversely affect our business, financial condition and operating results.

If we fail to develop new software products or enhance existing products and services, we will be unable to implement our product strategy successfully and 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 competitors 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 are implementing a product strategy that unifies our software solutions under the aspenONE brand with differentiated aspenONE vertical solutions targeted at specific process industries. We cannot assure you that our product strategy will result in products that will meet market needs and achieve significant market acceptance.

Defects or errors in our software products could harm our reputation, impair our ability to sell our products and result in significant costs to us.

Our software products are complex and may contain undetected defects or errors. We have not suffered significant harm from any defects or errors to date, but we have from time to time found defects in our products and we may discover additional defects in the future. We may not be able to detect and correct defects or errors before releasing products. Consequently, we or our customers may discover defects or errors after our products have been implemented. We have in the past issued, and may in the future need to issue, corrective releases of our products to remedy defects or errors. The occurrence of any defects or errors could result in:

- lost or delayed market acceptance and sales of our products;
- delays in payment to us by customers;
- product returns;
- injury to our reputation;
- diversion of our resources;
- legal claims, including product liability claims, against us;
- increased service and warranty expenses or financial concessions; and
- increased insurance costs.

Defects and errors in our software products could result in an increase in service and warranty costs or claims for substantial damages against us.

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, supply chain and optimization, entail the risk of product liability claims and associated damages. 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 and supply chain processes at large facilities, often for mission critical applications. Any errors, defects, performance problems or other failure of our software could result in significant liability to us for damages or for violations of environmental, safety and other laws and regulations. We are currently defending such claims that our software products and implementation services have failed to meet customer expectations, and our software products and implementation services could continue to give rise to warranty and other 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, foreign, state or local laws or ordinances or unfavorable judicial decisions. A substantial product liability judgment against us could materially and adversely harm our operating results and financial condition. Also, 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.

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. 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.

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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.

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. 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.

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 No. 97-2, as amended by SOP No. 98-4 and SOP No. 98-9, and in accordance with SOP No. 81-1. The accounting profession continues to discuss certain provisions of relevant accounting literature with the objective of providing additional guidance on potential interpretations 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 U.S. 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.

If we are not successful in attracting and retaining highly qualified personnel, 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, technical and accounting personnel. Competition for qualified personnel in the software industry is intense. 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. Our future success will depend in large part on our ability to attract a sufficient number of highly qualified personnel, and there can be no assurance that we will be able to do so.

We have experienced changes in our senior management that could affect our business and operations.

We have made significant changes in our senior management team, including the hiring of a new Senior Vice President, Finance and Chief Financial Officer in September 2006. Because of these significant changes, our management team may not be able to work together effectively to successfully develop and implement our business strategies and financial operations. In addition, management will need to devote significant attention and resources to preserve and strengthen relationships with employees, customers and the investor community. If our new management team is unable to achieve these goals, our ability to grow our business and successfully meet operational challenges could be impaired.

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 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.

Risks Related to Our Common Stock

Our common stockholders will experience dilution as a result of the conversion of our Series D preferred and the exercise of our outstanding warrants or options, and our payment of accumulated dividends will either result in further dilution to our common stockholders or require our payment of a significant amount of cash.

The terms of our outstanding securities may result in substantial dilution to existing common stockholders. As of September 30, 2006, a total of 53,461,512 shares of common stock were outstanding and outstanding shares of Series D preferred were convertible into a total of 33,336,400 additional shares of common stock. Our common stockholders would be subject to substantial dilution if the Series D preferred were converted into common stock.

In addition, 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 upon declaration by the board of directors, in its discretion, or upon conversion or redemption of the Series D preferred. As of September 30, 2006, there was \$31.3 million in accumulated but undeclared dividends on the Series D preferred. Accumulated dividends, when and if declared by our board, must be paid in cash, unless we elect to pay the dividends in common stock and we are able to satisfy specified conditions

Furthermore, as of September 30, 2006, we had outstanding (a) warrants that were then exercisable to purchase a total of 3,075,798 shares of common stock at a weighted average exercise price of \$5.66 per share and (b) options to purchase a total of 5,518,565 shares of common stock at a weighted average exercise price of \$8.32. Moreover, as of September 30, 2006 there were outstanding unvested options to purchase 3,618,445 shares at a weighted average exercise price of \$5.63 per share. Our common stockholders would be subject to substantial dilution if our outstanding warrants or options were exercised for common stock.

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 certain of our 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 certain warrants issued to the holders of the Series D-1 preferred. In May 2006, we received a demand letter from the Series D-1 preferred holders, in accordance with the terms of their investor rights agreement with us, requesting the registration of all of the shares of common stock into which their shares of Series D-1 preferred are convertible and their warrants are exercisable in an underwritten public offering. As of September 30, 2006, the total number of shares of common stock that would be covered by this registration demand letter is approximately 31,499,336.
- *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 certain 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.

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 conditions in the computer software or hardware industries, may have a significant impact on the market price of our common stock.

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. In March 2006, we settled a

putative class action lawsuit that was pending against us in U.S. District Court, District of Massachusetts, as described under Securities litigation and investigations based on the results of a 2005 internal investigation into certain of our software accounting practices may require that we incur substantial additional expenses and expend significant additional management time and may damage our reputation. This type of litigation could result in substantial liability and costs and divert management's attention and resources.

Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from executing our business plan.

We expect that our current cash balances, cash-equivalents, short-term investments, proceeds from the anticipated 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, or other unforeseen difficulties.

Our ability to obtain additional financing will depend on a number of factors, including market conditions, our operating performance, the quality of our installment contracts and investor interest. These factors may make the timing, amount, terms and conditions of any financing unattractive. 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 additional capital raised through the sale of equity or convertible debt securities may dilute your percentage ownership of our common stock. Furthermore, any new equity securities we issue could have rights, preferences and privileges superior to our common stock. Capital raised through debt financings could require us to make periodic interest payments and could impose potentially restrictive covenants on the conduct of our business.

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

As of September 30, 2006, the Series D preferred (on an as-converted basis) represented 37.4% of our outstanding common stock and the warrants issued to the original purchasers of the Series D-2 preferred were exercisable for shares representing 2.3% of our outstanding common stock (ignoring certain limitations on the ability to convert such shares or exercise such warrants). As a result, the holders of the Series D preferred and such warrants, if acting together, would have the ability to delay or prevent a change in control of our 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, our charter and our 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. We have also adopted a stockholder rights plan that could significantly dilute the equity interests of a person seeking to acquire control of our company without the approval of our board of directors.

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Item 6. Exhibits

| Exhibit Number | Description | Filed with this | Incorporated by Reference | | Exhibit Number |
|----------------|--|-----------------|---------------------------|----------------------|----------------|
| | | Form 10-Q | Form | Filing Date with SEC | |
| 10.1 | Loan Agreement, dated as of September 27, 2006, among Aspen Technology Funding 2006-II LLC, Aspen Technology, Inc., Portfolio Financial Servicing Company, Inc., Key Equipment Finance Inc., Keybank National Association, and Relationship Funding Company, LLC | X | | | |
| 10.2 | Tenth Loan Modification Agreement, dated as of September 14, 2006, between Silicon Valley Bank and Aspen Technology, Inc. | | 10-K | September 28, 2006 | 10.84 |
| 10.3 | Eleventh Loan Modification Agreement, dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc. | X | | | |
| 10.4 | Sixth Loan Modification Agreement (EXIM), dated as of September 14, 2006, between Silicon Valley Bank and Aspen Technology, Inc. | | 10-K | September 28, 2006 | 10.85 |
| 10.5 | Seventh Loan Modification Agreement - EXIM dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc. | X | | | |
| 10.6 | Partial Release and Acknowledgement Agreement, dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc. | X | | | |
| 10.7 * | Form of Terms and Conditions of Stock Option Agreement Granted Under 2001 Restated Stock Option Plan | X | | | |
| 10.8 * | Form of Terms and Conditions of Stock Option Agreement Granted Under 2005 Stock Incentive Plan | X | | | |
| 10.9 * | Form of Restricted Stock Unit Agreement Granted under 2005 Stock Incentive Plan. | X | | | |
| 10.10 * | Form of Restricted Stock Unit Agreement-G Granted under 2005 Stock Incentive Plan. | | | | |
| 10.11 * | Form of Executive Retention Agreement entered into as of September 26, 2006, by Aspen Technology, Inc. and each of Frederic G. Hammond, Manolis E. Kotzabasakis, Bradley T. Miller, C. Steven Pringle and Blair F. Wheeler | | | | |
| 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. | X | | | |
| 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. | X | | | |
| 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. | X | | | |
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* Management contract or compensatory plan

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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: November 14, 2006 | ASPEN TECHNOLOGY, INC. By: | /s/ MARK E. FUSCO Mark E. Fusco <i>President and Chief Executive Officer</i> |
| Date: November 14, 2006 | By: | /s/ BRADLEY T. MILLER Bradley T. Miller <i>Senior Vice President and Chief Financial Officer</i> |

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EXHIBIT INDEX

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