ASPEN TECHNOLOGY INC /DE/
Form 10-Q
February 08, 2011


# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended December 31, 2010**

**or**

**o 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** | **04-2739697** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **200 Wheeler Road Burlington, Massachusetts** | **01803** |
| (Address of principal executive offices) | (Zip Code) |

**(781) 221-6400**

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of January 31, 2011, there were 93,593,331 shares of the registrant s common stock (par value $0.10 per share) outstanding.

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Our registered trademarks include ASPENONE, ASPEN PLUS, ASPENTECH, the AspenTech logo, DMCPLUS, HTFS, HYSYS and INFOPLUS.21.

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**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

***Condensed Consolidated Financial Statements (unaudited)***

**ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited and in thousands, except per share data)**

| | Three Months Ended December 31, 2010 | Three Months Ended December 31, 2009 | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Subscription | $ 11,847 | $ 1,214 | $ 21,503 | $ 1,239 |
| Software | 13,486 | 8,976 | 22,797 | 20,058 |
| Total subscription and software | 25,333 | 10,190 | 44,300 | 21,297 |
| Services and other | 24,475 | 32,496 | 48,608 | 61,185 |
| Total revenue | 49,808 | 42,686 | 92,908 | 82,482 |
| **Cost of revenue:** | | | | |
| Subscription and software | 1,972 | 1,677 | 4,094 | 3,450 |
| Services and other | 11,583 | 14,792 | 22,709 | 30,488 |
| Total cost of revenue | 13,555 | 16,469 | 26,803 | 33,938 |
| Gross profit | 36,253 | 26,217 | 66,105 | 48,544 |
| **Operating expenses:** | | | | |
| Selling and marketing | 19,954 | 23,757 | 40,305 | 44,309 |
| Research and development | 12,096 | 12,515 | 24,671 | 23,409 |
| General and administrative | 13,425 | 19,228 | 29,982 | 34,642 |
| Restructuring charges | 78 | 32 | 155 | 303 |
| Total operating expenses | 45,553 | 55,532 | 95,113 | 102,663 |
| Loss from operations | (9,300) | (29,315) | (29,008) | (54,119) |
| Interest income | 3,534 | 5,083 | 7,236 | 10,532 |
| Interest expense | (1,653) | (2,480) | (2,897) | (4,891) |
| Other (expense) income, net | (735) | (222) | 1,929 | 2,047 |
| Loss before income taxes | (8,154) | (26,934) | (22,740) | (46,431) |
| Provision for income taxes | 2,115 | 3,723 | 2,997 | 5,288 |
| Net loss | $ (10,269) | $ (30,657) | $ (25,737) | $ (51,719) |
| **Loss per common share:** | | | | |
| Basic | $ (0.11) | $ (0.34) | $ (0.28) | $ (0.57) |
| Diluted | $ (0.11) | $ (0.34) | $ (0.28) | $ (0.57) |
| **Weighted average shares outstanding:** | | | | |
| Basic | 93,252 | 91,002 | 92,968 | 90,538 |
| Diluted | 93,252 | 91,002 | 92,968 | 90,538 |

See accompanying notes to these unaudited condensed consolidated financial statements.

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**ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited and in thousands, except share data)**

| | December 31, 2010 | June 30, 2010 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 131,642 | $ 124,945 |
| Accounts receivable, net of allowance for doubtful accounts of $3,757 and $4,685 | 28,708 | 31,738 |
| Current portion of installments receivable, net of allowance for doubtful accounts of $998 and $1,119 | 45,292 | 51,729 |
| Current portion of collateralized receivables | 19,584 | 25,675 |
| Unbilled services | 1,225 | 1,860 |
| Prepaid expenses and other current assets | 6,072 | 5,236 |
| Prepaid income taxes | 332 | 7,468 |
| Deferred tax assets | 1,681 | 1,632 |
| Total current assets | 234,536 | 250,283 |
| Non-current installments receivable, net of allowance for doubtful accounts of $1,157 and $1,196 | 65,636 | 76,869 |
| Non-current collateralized receivables | 22,053 | 25,755 |
| Property, equipment and leasehold improvements, net of accumulated depreciation of $29,997 and $29,769 | 7,693 | 8,057 |
| Computer software development costs, net of accumulated amortization of $68,011 and $67,251 | 2,028 | 2,367 |
| Goodwill | 18,161 | 17,361 |
| Non-current deferred tax assets | 11,746 | 11,597 |
| Other non-current assets | 2,786 | 2,424 |
| Total assets | $ 364,639 | $ 394,713 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Current portion of secured borrowing | $ 23,817 | $ 30,424 |
| Accounts payable | 6,259 | 6,092 |
| Accrued expenses and other current liabilities | 32,275 | 49,890 |
| Income taxes payable | 2,005 | 1,161 |
| Deferred revenue | 71,775 | 67,852 |
| Current deferred tax liability | 434 | 398 |
| Total current liabilities | 136,565 | 155,817 |
| Long-term secured borrowing | 42,946 | 45,711 |
| Long-term deferred revenue | 30,684 | 19,427 |
| Non-current deferred tax liability | 953 | 956 |
| Other non-current liabilities | 31,315 | 31,832 |
| Commitments and contingencies (Note 11) | | |
| Series D redeemable convertible preferred stock, $0.10 par value<br>Authorized 3,636 shares at December 31, 2010 and June 30, 2010<br>Issued and outstanding none at December 31, 2010 and June 30, 2010 | | |
| Stockholders equity: | | |
| Common stock, $0.10 par value Authorized 210,000,000 shares<br>Issued 93,784,765 shares at December 31, 2010 and 92,668,280 shares at June 30, 2010<br>Outstanding 93,455,071 shares at December 31, 2010 and 92,434,816 shares at June 30, 2010 | 9,378 | 9,267 |
| Additional paid-in capital | 523,082 | 515,729 |
| Accumulated deficit | (416,775) | (391,038) |
| Accumulated other comprehensive income | 8,246 | 7,525 |

| | | | | |
|---|---|---|---|---|
| Treasury stock, at cost 329,694 shares of common stock at December 31, 2010 and 233,464 at June 30, 2010 | | (1,755) | | (513) |
| Total stockholders equity | | 122,176 | | 140,970 |
| Total liabilities and stockholders equity | $ | 364,639 | $ | 394,713 |

See accompanying notes to these unaudited condensed consolidated financial statements.

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**ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited and in thousands)**

| | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (25,737) | $ (51,719) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,600 | 3,729 |
| Net foreign currency (gain) | (1,648) | (126) |
| Stock-based compensation | 5,042 | 11,532 |
| Loss on the disposal of assets | 415 | 43 |
| Deferred income taxes | 74 | 41 |
| Provision for bad debts | 97 | (75) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 3,009 | 14,467 |
| Unbilled services | 630 | (1,565) |
| Prepaid expenses, other assets and prepaid income taxes | 6,145 | 2,963 |
| Installments and collateralized receivables | 30,139 | 38,202 |
| Income taxes payable | 708 | 1,437 |
| Accounts payable, accrued expenses and other liabilities | (15,304) | (8,421) |
| Deferred revenue | 15,043 | (5,862) |
| Net cash provided by operating activities | 21,213 | 4,646 |
| Cash flows from investing activities: | | |
| Purchase of property, equipment and leasehold improvements | (1,876) | (1,592) |
| Capitalized computer software development costs | (380) | (265) |
| Net cash used in investing activities | (2,256) | (1,857) |
| Cash flows from financing activities: | | |
| Exercise of stock options | 3,420 | 3,652 |
| Proceeds from secured borrowings | 2,500 | |
| Repayment of secured borrowings | (16,241) | (16,365) |
| Repurchases of common stock | (1,242) | |
| Payment of tax withholding obligations related to restricted stock | (998) | (2,694) |
| Net cash used in financing activities | (12,561) | (15,407) |
| Effects of exchange rate changes on cash and cash equivalents | 301 | (158) |
| Increase (decrease) in cash and cash equivalents | 6,697 | (12,776) |
| Cash and cash equivalents, beginning of period | 124,945 | 122,213 |
| Cash and cash equivalents, end of period | $ 131,642 | $ 109,437 |
| | | |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | $ 3,071 | $ 4,894 |
| Income tax (refund) paid, net | (4,961) | 4,629 |

See accompanying notes to these unaudited condensed consolidated financial statements.

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## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Interim Unaudited Condensed Consolidated Financial Statements

The accompanying interim unaudited condensed consolidated financial statements (Interim Financial Statements) of Aspen Technology, Inc. and its subsidiaries have been prepared on the same basis as our annual consolidated financial statements. We condensed or omitted certain information and footnote disclosures normally included in our annual consolidated financial statements. Such Interim Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP), as defined in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 270, for interim financial information and with the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. It is suggested that these Interim Financial Statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2010, which are contained in our Annual Report on Form 10-K, as previously filed with the U.S. Securities and Exchange Commission (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 and all intercompany accounts and transactions have been eliminated in consolidation. The results of operations for the three and six months ended December 31, 2010 are not necessarily indicative of the results to be expected for subsequent quarters or for the full fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

Unless the context requires otherwise, references to we, our and us refer to Aspen Technology, Inc. and our subsidiaries.

### 2. Significant Accounting Policies

***Revenue Recognition***

We generate revenue from the following sources: (1) licensing software products; (2) providing post contract support (referred to as SMS) and training; and (3) providing professional services. We sell our software products to end users under fixed-term and perpetual licenses. As a standard business practice, we offer extended payment term options for our fixed-term license contracts, which are generally payable on an annual basis. Certain of our fixed-term license agreements include product mixing rights that allow customers the flexibility to change or alternate the use of multiple products included in the license arrangement after those products are delivered to the customer. We refer to these arrangements as token arrangements. Tokens are fixed units of measure. The amount of software usage is limited by the number of tokens purchased by the customer.

Prior to fiscal 2010, we primarily executed software license arrangements with contractual provisions that resulted in the upfront recognition of license revenue upon delivery of the software products, provided all other revenue recognition requirements were met. Beginning in July 2009, we began offering our aspenONE suite of products on a subscription basis, which provides customers with access to all products within the aspenONE suite or suites they license. As part of the aspenONE subscription based offering, customers receive, for no additional fee, SMS for the term of the license and the right to unspecified future software products that may be introduced into the licensed suite during the term of the arrangement. Under the aspenONE subscription offering, we recognize revenue over the term of the agreement on a subscription, or daily ratable basis, beginning when the first payment is due, typically 30 days after signing the agreement, provided all other revenue recognition requirements are met. Beginning in July 2009, we also began bundling SMS for the full contract term on our point product license arrangements. Previously, SMS on our multi-year term point product arrangements was offered for an initial one-year period, and then renewed annually thereafter at the customers option ( legacy term license arrangements ).

Over the next several years, we expect to transition substantially all of our customers to our aspenONE subscription offering or to point product arrangements with SMS bundled for the contract term. During this transition period, we may have arrangements where the software element will be recognized upfront, including perpetual licenses and amendments to existing legacy term arrangements. We do not expect revenue related to these sources to be significant in relation to our total revenue.

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Four basic criteria must be satisfied before software license revenue can be recognized: persuasive evidence of an arrangement between us and an end user; delivery of our product has occurred; the fee for the product is fixed or determinable; and collection of the fee is probable.

*Persuasive evidence of an arrangement* We use a contract signed by the customer as evidence of an arrangement for software licenses and SMS. For professional services we use a signed contract and a statement of work to evidence an arrangement. In cases where both a signed contract and a purchase order are required by the customer, we consider both taken together as evidence of the arrangement.

*Delivery of our product* Software and the corresponding access keys are generally delivered to customers via disk media with standard shipping terms of Free Carrier, Aspen Technology s warehouse (i.e., FCA, named place). Our software license agreements do not contain conditions for acceptance.

*Fee is fixed or determinable* We assess whether a fee is fixed or determinable at the outset of the arrangement. Significant judgment is involved in making this assessment.

Under our upfront revenue model, we are able to demonstrate that the fees are fixed or determinable for all arrangements, including those for our term licenses that contain extended payment terms. We have an established history of collecting under the terms of these contracts without providing concessions to customers. In addition, we also assess whether contract modifications to an existing term arrangement constitute a concession. In making this assessment, significant analysis is performed to ensure that no concessions are given. Our software license agreements do not include right of return or exchange. For license arrangements executed under the upfront revenue model, we recognize license revenue upon delivery of the software product, provided all other revenue recognition requirements are met.

With the introduction of our aspenONE subscription offering and the changes to the licensing terms of our point product agreements sold on a fixed-term basis, we cannot assert that the fees in these arrangements are fixed or determinable because the rights provided to customers and the economics of the arrangements are not comparable to our historical transactions with other customers under the upfront revenue model. As a result, the amount of revenue recognized for these newer arrangements will be limited by the amount of customer payments that become due. For our aspenONE subscription transactions, this results in the fees being recognized ratably over the term of the contract. For our point product licenses sold with bundled SMS, this results in the license fee being recognized as each payment comes due, while the allocated portion of the SMS revenue is recognized ratably over its annual term.

*Collection of fee is probable* We assess the probability of collecting from each customer at the outset of the arrangement based on a number of factors, including the customer s payment history, its current creditworthiness, economic conditions in the customer s industry and geographic location, and general economic conditions. If in our judgment collection of a fee is not probable, revenue is recognized as cash is collected, provided all other conditions for revenue recognition have been met.

We allocate the arrangement consideration among the elements included in our multi-element arrangements using the residual method. Under the residual method, the vendor specific objective evidence, or VSOE, of the undelivered elements is deferred and the remaining portion of the arrangement fee for perpetual and term licenses is recognized as revenue upon delivery of the software, assuming all other revenue recognition criteria are met. If VSOE does not exist for an undelivered element in an arrangement, revenue is deferred until such evidence does exist for the undelivered elements, or until all elements are delivered, whichever is earlier.

We have established VSOE of fair value for SMS and professional services, but not for our software products. We assess VSOE of fair value for SMS based on an analysis of standalone SMS renewals using the bell-shaped curve approach. We use the optional renewals of SMS on our legacy term license arrangements to support VSOE of fair value for SMS bundled in our new fixed-term point product arrangements. The license product offerings and the SMS in the legacy term license arrangements and the new point product arrangements are the same.

As we are increasingly transitioning our legacy term license customers to point product arrangements with bundled SMS for the entire term of the arrangement, and we no longer market legacy term license arrangements, we expect our population of standalone annual renewals to decrease over time. As a result, there will come a point in time where we will be unable to support VSOE of fair value of SMS in our point product arrangements based on our legacy term license SMS renewals. When this occurs, we will be required to recognize revenue related to the license component on our point product arrangements ratably, on a subscription basis in a manner similar to the current recognition of subscription arrangements under our aspenONE subscription offering. We expect the impact of a loss of VSOE of fair value for SMS to be immaterial to our results of operations, since we currently recognize license revenue on point product arrangements over the term of the arrangement, annually, as payments become due.

**Subscription Revenue**

When a customer elects to license our products under our aspenONE subscription offering, SMS is included for the entire term of the arrangement, and the customer receives for the term of the arrangement, the right to any new unspecified future software products that may be introduced into the licensed aspenONE software suite. These agreements combine the right to use all software products within a given product suite with SMS for the term of the arrangement. Due to our obligation to provide unspecified future software products, we are required to recognize the revenue ratably (that is, on a daily ratable basis) over the term of the license, once the four revenue recognition criteria noted above are met. License and SMS revenue for arrangements sold under our aspenONE subscription offering are combined and presented together as subscription revenue in the consolidated statements of operations.

**Software Revenue**

Software revenue consists of all license transactions that do not contain rights to future unspecified software products for no additional fee. Specifically, it includes license revenue recognized under the upfront revenue model upon the delivery of the licensed products (i.e., both perpetual and term license arrangements); license revenue recognized over the term of the license agreements for fixed-term contracts including point product licenses with SMS bundled for the entire license term; and other license revenue derived from transactions that are being recognized over time as the result of not previously meeting one or more of the requirements for recognition under the upfront revenue model.

The license fees derived from the sale of fixed-term point product arrangements with SMS included for the arrangement term are recognized under the residual method, as payments come due. The related SMS is recognized over the term of the SMS agreement beginning with the due date of the annual payment and is reported in services and other revenue on the consolidated statement of operations. Occasionally, we expect certain customers to elect upfront payment terms. For these arrangements with upfront payment, all of the license revenue will be recognized upfront by applying the residual method of accounting when the above four revenue recognition requirements have been met.

Perpetual license arrangements do not include the same rights as those provided to customers under the aspenONE subscription offering. Accordingly, the license fees for perpetual license agreements will continue to be recognized upon delivery of the software products using the residual method provided all other revenue recognition requirements are met. The revenue attributable to perpetual software licenses is recognized in software revenue in the consolidated statement of operations.

**Services and Other**

**SMS Revenue**

For arrangements executed under the aspenONE subscription offering or where point product licenses are sold with SMS for the contract term, the customer commits to SMS for the entire term of the license arrangement. The revenue related to the SMS component of the aspenONE subscription offering is reported in subscription revenue in the consolidated statements of operations. The revenue related to the SMS component of point product licenses, for which we have VSOE, is reported in services and other revenue in the consolidated statement of operations.

Under the upfront revenue model, SMS is typically included with the license for the initial year of the license term. Under these arrangements, the fair value of SMS is deferred and subsequently amortized into services and other revenue in the consolidated statement of operations over the contractual term of the SMS arrangement. SMS renewals are at the option of the customer.

**Professional Services**

Professional services are provided to customers on a time-and-materials (T&M) or fixed-price basis and are generally recognized as the services are performed, assuming all other revenue recognition criteria have been met. We recognize professional services fees for our T&M contracts based upon hours worked and contractually agreed-upon hourly rates. Revenue from fixed-price engagements is recognized using the proportional performance method based on the ratio of costs incurred to the total estimated project costs. We believe that costs are the best available measure of performance. Professional services revenue is recognized within services and other revenue in the statement of operations. Project costs are based on standard rates, which vary by the consultant s professional level, plus all direct expenses incurred to complete the engagement that are not reimbursed by the client. All project costs are expensed as incurred. The use of the proportional performance method is dependent upon our ability to reliably estimate the costs to complete a project. We use historical experience as a basis for future estimates to complete current projects. Reimbursables received from customers for out-of-pocket expenses are recorded as revenue.

If the costs to complete a project are not estimable or the completion is uncertain, the revenue is recognized upon completion of the services. In those circumstances in which committed professional services arrangements are sold as a single arrangement with, or in contemplation of, a new license agreement, revenue is deferred and recognized on a ratable basis over the longer of the period the services are performed or the license term.

Occasionally, we provide professional services considered essential to the functionality of the software. We recognize the combined revenue from the sale of the software and related services using the percentage-of-completion method. When these professional services are combined with, and essential to, the functionality of an aspenONE subscription transaction, the amount of combined revenue will be recognized over the longer of the subscription term or the period the professional services are provided.

In the past, we have occasionally been required to commit unanticipated additional resources to complete projects, which have resulted in lower than anticipated income or losses on those contracts. We may experience similar situations in the future. Provisions for estimated losses on contracts are made during the period in which such losses become probable and can be reasonably estimated.

**Installments Receivable**

Installments receivable resulting from product sales under the upfront revenue model are discounted to present value at prevailing market rates (generally 8% to 9%) at the date the related contract is signed, based on the customers credit ranking. Finance fees are recognized using the effective interest method over the relevant license term and are classified as interest income. Installments receivable are split between current and non-current in our consolidated balance sheets based on the maturity date of the related installment. Non-current installments receivable consists of receivables with a due date greater than one year from the period-end date. Current installments receivable consists of invoices with a due date of less than one year but greater than 45 days from the period-end date. Once an installments receivable invoice is due within 45 days, it is reclassified as a trade accounts receivable on our consolidated balance sheet.

Our non-current installments receivable fall within the scope of Accounting Standards Update (ASU) No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. As our portfolio of financing receivables arise from the sale of our software licenses, the methodology for determining our allowance for doubtful accounts is based on the collective population and is not stratified by class or portfolio segment. We consider factors such as existing economic conditions, country risk, and customers past payment history in determining our allowance for doubtful accounts. We reserve against our installments receivable when the related trade accounts receivable has been past due for over a year, or when there is a specific risk of collectability. We write-off receivables when they have been deemed uncollectable, based on our judgment. In instances where we write off a given customers trade accounts receivables, we also write-off any related current and non-current installment receivables balances. We have not suspended the amortization of interest income for any of the installments receivable in our portfolio for uncollectability reasons.

The following table summarizes our current and non-current allowance for doubtful accounts for our installments receivable balances (in thousands):

| | Current | Non-Current | Total |
|---|---|---|---|
| **December 31, 2010** | | | |
| Installments Receivable, gross | $ 46,290 | $ 66,793 | $ 113,083 |
| Less: allowance for doubtful accounts | (998) | (1,157) | (2,155) |
| Installments Receivable, net | $ 45,292 | $ 65,636 | $ 110,928 |
| | | | |
| **June 30, 2010** | | | |
| Installments Receivable, gross | $ 52,848 | $ 78,065 | $ 130,913 |
| Less: allowance for doubtful accounts | (1,119) | (1,196) | (2,315) |
| Installments Receivable, net | $ 51,729 | $ 76,869 | $ 128,598 |

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Our installments receivable balance will continue to decrease over time, as licensing agreements previously executed under our upfront revenue model reach the end of their terms and are renewed under our new licensing models.  Under the aspenONE subscription offering and for point product arrangements sold with SMS bundled for the entire license term, payment amounts under extended payment term arrangements are not presented in the consolidated balance sheets as the related arrangement fees are not fixed or determinable. Accordingly, future installments under our new licensing models are not considered financing receivables.

**Deferred Revenue**

Under the aspenONE subscription offering, customers receive SMS for the full contract term, and receive rights to unspecified future products for no additional fee.  As VSOE does not exist for both of these undelivered elements, we are required to recognize the revenue ratably (i.e. on a subscription basis) over the term of the license. Therefore, deferred revenue is recorded as each payment comes due and revenue is recognized ratably over the associated license period.

Under the upfront revenue model and point product arrangements, a portion of the arrangement fee is generally recorded as deferred revenue due to the inclusion of an undelivered element, typically SMS. The amount of revenue allocated to undelivered elements is based on the VSOE of fair value for those elements using the residual method and is earned and recognized as revenue as each element is delivered. Deferred revenue related to these transactions generally consists of SMS and represents payments received in advance of services rendered as of the balance sheet dates.

***Legal fees and contingencies***

We accrue estimated liabilities for loss contingencies arising from claims, assessments, litigation and other sources when it is probable that a liability has been incurred and the amount of the claim assessment or damages can be reasonably estimated. We believe that we have sufficient accruals to cover any obligations resulting from claims, assessments or litigation that have met this criteria.

***Other***

For further information with regard to our Significant Accounting Policies, please refer to Note 2 of our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

**3.  Goodwill**

The changes in the carrying amount of goodwill by reporting unit for the first half of fiscal 2011 were as follows (in thousands):

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| | Reporting Unit | | | |
|---|---|---|---|---|
| | License | Professional Services | Maintenance and Training | Total |
| **Asset Class** | | | | |
| Balance as of June 30, 2010 | | | | |
| Goodwill | $ 68,059 | $ 5,102 | $ 14,871 | $ 88,032 |
| Accumulated impairment losses | (65,569) | (5,102) | | (70,671) |
| | $ 2,490 | $ | $ 14,871 | $ 17,361 |
| Effect of changes in currency translation | 12 | | 466 | 478 |
| Balance as of September 30, 2010 | | | | |
| Goodwill | $ 68,071 | $ 5,102 | $ 15,337 | $ 88,510 |
| Accumulated impairment losses | (65,569) | (5,102) | | (70,671) |
| | $ 2,502 | $ | $ 15,337 | $ 17,839 |
| Effect of changes in currency translation | (2) | | 324 | 322 |
| Balance as of December 31, 2010 | | | | |
| Goodwill | $ 68,069 | $ 5,102 | $ 15,661 | $ 88,832 |
| Accumulated impairment losses | (65,569) | (5,102) | | (70,671) |
| | $ 2,500 | $ | $ 15,661 | $ 18,161 |

We test goodwill for impairment annually at the reporting unit level using a fair value approach in accordance with the provisions of ASC 350, *Intangibles Goodwill and Other*. We conduct our annual impairment test in the second fiscal quarter of each year. The initial step requires us to determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of such reporting unit. If the fair value exceeds the carrying value, no impairment loss is recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount of impairment, if any, is then measured based upon the estimated fair value of goodwill at the valuation date. We performed our annual impairment test for each reporting unit as of December 31, 2010, and determined that the estimated fair values substantially exceeded the carrying values. As such, no impairment losses were recognized as a result of the analysis.

**4. Income Taxes**

Deferred income taxes are recognized based on temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the statutory tax rates and laws expected to apply to taxable income in the years in which the temporary differences are expected to reverse. Valuation allowances are provided against net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income and the timing of the temporary differences becoming deductible. Management considers, among other available information, scheduled reversals of deferred tax liabilities, projected future taxable income, limitations of availability of net operating loss carryforwards, and other matters in making this assessment.

We do not provide deferred taxes on unremitted earnings of foreign subsidiaries since we intend to indefinitely reinvest either currently or sometime in the foreseeable future. Unrecognized provisions for taxes on undistributed earnings of foreign subsidiaries, which are considered indefinitely reinvested, are not material to our consolidated financial position or results of operations. We are continuously subject to examination by the IRS, as well as various state and foreign jurisdictions. The IRS and other taxing authorities may challenge certain deductions and credits reported by us on our income tax returns. In July 2006, the FASB issued FIN 48, *Accounting for Uncertain Tax Positions*, (currently included as provisions of ASC Topic 740), which clarifies the criteria for recognition and measurement of benefits from uncertain tax positions. Under this guidance, 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, if the more likely than not threshold is passed, should be measured as the largest amount of tax benefit that is greater than 50 percent likely to be realized upon the ultimate settlement with a taxing authority that has full knowledge of all relevant information. Furthermore, any change in the recognition, de-recognition or measurement of a tax position should be recorded in the period in which the change

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occurs. We account for interest and penalties related to uncertain tax positions as part of the provision for income taxes.

**5. Fair Value**

Cash equivalents of $112.0 million are reported at fair value utilizing quoted market prices in identical markets, or Level 1 Inputs .

Financial instruments not measured or recorded at fair value in the accompanying financial statements consist of accounts receivable, installments receivable, collateralized receivables, accounts payable and secured borrowings. The estimated fair value of accounts receivable, installments receivable, collateralized receivables and accounts payable approximates the carrying value. The estimated fair value of secured borrowings exceeds the carrying value by $2.9 million as of December 31, 2010. The fair value of secured borrowings was calculated using the market approach, utilizing interest rates that were indirectly observable in markets for similar liabilities, or Level 2 Inputs .

**6. Supplementary Balance Sheet Information**

Accrued expenses and other current liabilities in the accompanying unaudited condensed consolidated balance sheets consist of the following (in thousands):

| | December 31, 2010 | June 30, 2010 |
|---|---|---|
| Royalties and outside commissions | $ 4,897 | $ 4,856 |
| Payroll and payroll-related | 10,195 | 21,862 |
| Restructuring accruals | 2,778 | 4,266 |
| Amounts due to financing institutions for collections | | 4,216 |
| Other | 14,405 | 14,690 |
| Total accrued expenses and other current liabilities | $ 32,275 | $ 49,890 |

Other non-current liabilities in the accompanying unaudited condensed consolidated balance sheets consist of the following (in thousands):

| | December 31, 2010 | June 30, 2010 |
|---|---|---|
| Restructuring accruals | $ 3,599 | $ 4,248 |
| Deferred rent | 2,126 | 2,193 |
| Royalties and outside commissions | 2,918 | 3,667 |
| Other | 22,672 | 21,724 |
| Total other non-current liabilities | $ 31,315 | $ 31,832 |

**7. Stock-Based Compensation**

*General Award Terms*

We issue stock options and restricted stock units to our employees and outside directors, pursuant to stockholder approved stock option plans. Option awards are generally granted with an exercise price equal to the market price of our stock at the date of grant; those options generally vest over four years and have 7 or 10-year contractual terms. Restricted stock units (RSUs) generally vest over four years. Historically, our practice has been to settle stock option exercises and restricted stock vesting through newly-issued shares.

*Stock-Based Compensation Accounting*

Our stock-based compensation is principally accounted for as awards of equity instruments. Our policy is to issue new shares upon the exercise of stock awards. We adopted the simplified method related to accounting for the

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tax effects of share-based payment awards to employees under ASC 718, *Compensation Stock Compensation* (ASC 718). We use the with-and-without approach for determining if excess tax benefits are realized under ASC 718. RSUs are valued at the stock price on the date of grant. We utilize the Black-Scholes option valuation model for estimating the fair value of options granted. The Black-Scholes option valuation model incorporates assumptions for stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. We recognize compensation costs on a straight-line basis over the requisite service period for time-vested awards.

The stock-based compensation expense and its classification (in thousands) in the statements of operations for the three and six months ended December 31, 2010 and 2009 were as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Recorded as expense: | | | | |
| Cost of service and other | $ 233 | $ 734 | $ 486 | $ 957 |
| Selling and marketing | 907 | 3,559 | 1,803 | 4,329 |
| Research and development | 287 | 1,250 | 576 | 1,391 |
| General and administrative | 918 | 4,082 | 2,177 | 4,855 |
| Total stock-based compensation | $ 2,345 | $ 9,625 | $ 5,042 | $ 11,532 |

During the period from mid-September 2007 until November 9, 2009, and from November 16, 2009 to December 21, 2009, we did not maintain our status as a timely filer with the SEC and we were unable to issue stock-based compensation to our directors and employees. On October 29, 2009 the Board of Directors approved the grant as of November 9, 2009 of 2,727,033 RSUs and 264,640 stock options under the 2005 Stock Incentive Plan and the 2001 Stock Option Plan. A portion of these awards vested upon issuance. The immediate vesting of a portion of the November 2009 grant caused the increased level of stock-based compensation expense for the second quarter and first half of fiscal 2010 compared to the current year periods. The lower level of stock-based compensation expense in the second quarter and first half of fiscal 2011 represents a more normal level of stock-based compensation expense.

The compensation committee and Board of Directors completed its annual program grant for fiscal 2011 in July 2010 and authorized and approved the grant as of August 2, 2010 of 764,828 RSUs and 948,664 stock options under the 2010 Equity Incentive Plan and the 2005 Stock Incentive Plan.

A summary of stock option and RSU activity under all equity plans in the first half of fiscal 2011 is as follows:

| | Stock Options | | | | Restricted Stock Units | |
|---|---|---|---|---|---|---|
| | **Shares** | **Weighted Average Exercise Price** | **Weighted Average Remaining Contractual Term** | **Aggregate Intrinsic Value (in 000 s)** | **Shares** | **Weighted Average Grant Date Fair Value** |
| Outstanding at June 30, 2010 | 5,395,870 | $ 7.19 | | | 1,512,263 | $ 9.58 |
| Granted | 948,664 | $ 10.93 | | | 764,828 | $ 10.93 |
| Settled (RSUs) | | | | | (245,337) | $ 9.97 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Exercised | (24,141) | $ | 5.68 | | | | | | |
| Cancelled / Forfeited | (54,613) | $ | 26.72 | | | | (26,543) | $ | 9.63 |
| Outstanding at September 30, 2010 | 6,265,780 | $ | 7.59 | | | | 2,005,211 | $ | 10.04 |
| Granted | 11,750 | $ | 12.16 | | | | 8,250 | $ | 12.20 |
| Settled (RSUs) | | | | | | | (46,710) | $ | 10.93 |
| Exercised | (467,976) | $ | 7.01 | | | | | | |
| Cancelled / Forfeited | (73,890) | $ | 29.76 | | | | (35,021) | $ | 9.92 |
| Outstanding at December 31, 2010 | 5,735,664 | $ | 7.36 | 5.1 | $ | 30,930 | 1,931,730 | $ | 10.03 |
| Exercisable at December 31, 2010 | 4,881,974 | $ | 6.74 | 4.4 | $ | 29,394 | | | |
| Vested and expected to vest as of December 31, 2010 | 5,526,757 | $ | 7.22 | 5.0 | $ | 30,554 | 1,719,744 | $ | 10.03 |

The weighted average grant-date fair value of RSUs granted during the first half of fiscal years 2011 and 2010 was $10.94 and $9.55, respectively. In the first half of fiscal years 2011 and 2010, the total fair value of shares settled from RSU grants was $3.0 million and $9.1 million, respectively.

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At December 31, 2010, the total unrecognized compensation cost related to unvested stock options and RSUs was $4.1 million and $18.1 million, respectively, and is expected to be recorded over the next four years as the awards vest.

The total intrinsic value of options exercised during the first half of fiscal years 2011 and 2010 was $2.7 million and $3.6 million, respectively. We received $3.4 million and $3.7 million in cash proceeds from option exercises during the first half of fiscal years 2011 and 2010, respectively. We paid $1.0 million and $2.7 million for withholding taxes on settled RSUs during the first half of fiscal years 2011 and 2010, respectively.

At December 31, 2010, common stock reserved for future issuance or settlement under equity compensation plans was 14.2 million shares.

**8. Common Stock**

On October 29, 2010, our Board of Directors approved a stock repurchase program for up to $40 million worth of our common stock. The timing and amount of any shares repurchased will be determined based on management s evaluation of market conditions and other factors. All share repurchases of our common stock have been recorded as treasury stock under the cost method. We repurchased 96,230 shares of our common stock for $1.2 million in the second quarter of fiscal 2011. As of December 31, 2010, the remaining dollar value under the stock repurchase program approved by our Board of Directors on October 29, 2010 was $38.8 million.

**9. Net Loss per Common Share**

Basic loss per share is determined by dividing the loss by the weighted average common shares outstanding during the period. Diluted loss per share is determined by dividing the loss by diluted weighted average shares outstanding during the period. Diluted weighted average shares reflect the dilutive effect, if any, of potential common shares. To the extent their effect is dilutive, employee equity awards and warrants, based on the treasury stock method, and other commitments to be settled in common stock are included in the calculation of diluted loss per share. For the three and six months ended December 31, 2010 and 2009, all potential common shares were anti-dilutive due to the net loss. The calculations of basic and diluted loss per share and basic and diluted weighted average shares outstanding are as follows (in thousands, except per share data):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net loss | $ (10,269) | $ (30,657) | $ (25,737) | $ (51,719) |
| Weighted average shares outstanding | 93,252 | 91,002 | 92,968 | 90,538 |
| Dilutive impact from common stock equivalents | | | | |
| | 93,252 | 91,002 | 92,968 | 90,538 |

| | | | | |
|---|---|---|---|---|
| Dilutive weighted average shares outstanding | | | | |
| | | | | |
| Loss per share | | | | |
| Basic | $ (0.11) | $ (0.34) | $ (0.28) | $ (0.57) |
| Dilutive | $ (0.11) | $ (0.34) | $ (0.28) | $ (0.57) |

The following potential common shares were excluded from the calculation of diluted weighted average shares outstanding because the exercise price of the common stock equivalents exceeded the average market price for our common stock and/or their inclusion would be anti-dilutive at the balance sheet date (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Common stock equivalents | 8,020 | 9,140 | 8,221 | 9,004 |

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**10. Comprehensive Loss**

Comprehensive 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 loss for the three and six months ended December 31, 2010 and 2009 were as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Net loss | $ (10,269) | $ (30,657) | $ (25,737) | $ (51,719) |
| Foreign currency translation adjustments | 292 | (118) | 721 | 1,476 |
| Total comprehensive loss | $ (9,977) | $ (30,775) | $ (25,016) | $ (50,243) |

**11. Commitments and Contingencies**

***(a) ATME arbitration***

Prior to October 6, 2009, we had an exclusive reseller relationship covering certain countries in the Middle East with AspenTech Middle East W.L.L., a Kuwaiti corporation (now known as Advanced Technology Middle East W.L.L.) that we refer to below as ATME. Under the reseller agreement, we had the right to terminate for a material breach in the event of ATME s willful misconduct or fraud. Effective October 6, 2009, we terminated the reseller relationship for material breach by ATME based on certain actions of ATME.

On November 2, 2009, ATME commenced an action in the Queen s Bench Division (Commercial Court) of the High Court of Justice (England & Wales) captioned In The Matter Of An Intended Arbitration Between AspenTech Middle East W.L.L. and Aspen Technology, Inc., 2009 Folio 1436, seeking preliminary injunctive relief restraining us from taking any steps to impede ATME from serving as our exclusive reseller in the countries covered by the reseller agreement with ATME. We filed evidence in opposition to that request for relief on November 12, 2009. At a hearing on November 13, 2009, the court dismissed ATME s application for preliminary injunctive relief. The court sealed an Order to this effect on November 23, 2009, and further ordered that ATME pay our costs of claim.

Relatedly, on November 11, 2009, we filed a request for arbitration against ATME in the International Court of Arbitration of the International Chamber of Commerce, captioned Aspen Technology, Inc. v. AspenTech Middle East W.L.L., Case No. 16732/VRO. Our request for arbitration asserted claims against ATME seeking a declaration that ATME committed a material breach of our agreement and that our termination of our agreement was lawful, and seeking damages for ATME s willful misconduct in connection with the reseller relationship. On November 18, 2009, ATME filed its answer to that request for arbitration and asserted counterclaims against us seeking a declaratory judgment that we unlawfully terminated our agreement with ATME and seeking damages for breach of contract by reason of our purported unlawful termination of our agreement. Our reply to those counterclaims was filed on or about December 18, 2009. Pursuant to a procedural order issued by the arbitral tribunal, a hearing was conducted between January 24, 2011 and February 2, 2011, and a supplemental hearing is to be scheduled in June 2011.

The reseller agreement with ATME contained a provision whereby we could be liable for a termination fee if the agreement were terminated other than for material breach. This fee is to be calculated based on a formula contained in the reseller agreement that we believe was originally developed based on certain assumptions about the future financial performance of ATME, as well as ATME s actual financial performance. Based on the formula and the financial information provided to us by ATME, which we have not had the opportunity to verify independently, a recent calculation based on the formula would result in a termination fee of between $60 million and $77 million. Under the terminated reseller agreement, no termination fee is owed on termination for material breach. If we are found to have breached the terms of our agreement with ATME, we could be liable for the full value of the termination fee, which may be greater or less than the number indicated above. We intend to pursue our claims against ATME, and to defend the counterclaims by ATME, vigorously.

On March 11, 2010, a Kuwaiti entity (known as ATME Group and affiliated with ATME) filed a lawsuit in a Kuwaiti court naming as defendants ATME, us and a reseller newly appointed by us in Kuwait. In this lawsuit, ATME Group claims that it was an exclusive reseller for ATME in Kuwait and, as such, is entitled to damages resulting from purported customer contracts in Kuwait. We intend to defend this action vigorously.

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***(b) Class action and opt-out claims***

In March 2006, we settled class action litigation, including related derivative claims, arising out of our originally filed consolidated financial statements for fiscal 2000 through 2004, the accounting for which we restated in March 2005. Certain members of the class (representing 1,457,969 shares of common stock (or less than 1% of the shares putatively purchased during the class action period)) opted out of the settlement and had the right to bring their own state or federal law claims against us, referred to as opt-out claims. Opt-out claims were filed on behalf of the holders of approximately 1.1 million of such shares. All but one of these actions were settled and/or dismissed. The remaining action is discussed below.

380544 Canada, Inc., et al. v. Aspen Technology, Inc., was filed on February 15, 2007 in the federal district court for the Southern District of New York and docketed as Civ. A. No. 1:07-cv-01204-JFK in that court. The claims in this action include claims against us and one or more of our former officers alleging securities and common law fraud, breach of contract, deceptive practices and/or rescissory damages liability, based on the restated results of one or more fiscal periods included in our restated consolidated financial statements referenced in the class action. This action was brought by persons who purchased 566,665 shares of our common stock in a private placement. Certain motions to dismiss filed by other defendants were resolved on May 5, 2009. The claims in the 380544 Canada action are for damages totaling at least $4.0 million, not including claims for attorneys fees. We plan to defend the 380544 Canada action vigorously.

***(c) Other***

In the ordinary course of business, we are also from time to time involved in lawsuits, claims, investigations, proceedings, and threats of litigation consisting of intellectual property, commercial and other matters. We are currently defending an April 2004 claim by a customer for approximately $5.0 million that certain of our software products and implementation services failed to meet its expectations, which we are defending vigorously.

**12. Segment and Geographic Information**

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. Our chief operating decision maker is our Chief Executive Officer.

The measurement of the controllable profit for all segments was changed in 2010 to include a greater allocation of expenses related to bonuses from unallocated costs to controllable expenses. This change conformed to management s current approach of cost allocation for internal reporting purposes. All periods presented have been conformed to management s current measurement approach.

We have three operating segments: license, professional services, and maintenance and training. The chief operating decision maker assesses financial performance and allocates resources based upon the three lines of business.

The license line of business is engaged in the development and licensing of software. The professional services line of business offers implementation, advanced process control, real-time optimization and other professional services in order to provide its customers with complete solutions. The maintenance and training line of business provides customers with a wide range of support services that include on-site support, telephone support, software updates and various forms of training on how to use our products.

The accounting policies of the operating segments are the same as those described in Note 2. We do 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):

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| | License | Maintenance, Training, and Other | Professional Services | Total |
|---|---|---|---|---|
| Three Months Ended December 31, 2010 | | | | |
| Segment revenue | $ 25,333 | $ 16,536 | $ 7,939 | $ 49,808 |
| Segment expenses | 14,798 | 3,346 | 6,140 | 24,284 |
| Segment operating profit (1) | $ 10,535 | $ 13,190 | $ 1,799 | $ 25,524 |
| Three Months Ended December 31, 2009 | | | | |
| Segment revenue | $ 10,190 | $ 19,663 | $ 12,833 | $ 42,686 |
| Segment expenses | 16,085 | 4,034 | 8,213 | 28,332 |
| Segment operating profit (1) | $ (5,895) | $ 15,629 | $ 4,620 | $ 14,354 |
| | | | | |
| Six Months Ended December 31, 2010 | | | | |
| Segment revenue | $ 44,300 | $ 34,006 | $ 14,602 | $ 92,908 |
| Segment expenses | 29,191 | 6,483 | 12,080 | 47,754 |
| Segment operating profit (1) | $ 15,109 | $ 27,523 | $ 2,522 | $ 45,154 |
| Six Months Ended December 31, 2009 | | | | |
| Segment revenue | $ 21,297 | $ 38,653 | $ 22,532 | $ 82,482 |
| Segment expenses | 30,577 | 7,758 | 18,184 | 56,519 |
| Segment operating profit (1) | $ (9,280) | $ 30,895 | $ 4,348 | $ 25,963 |

(1) The Segment operating profits reported reflect only the direct expenses of the operating segment and do not contain an allocation for selling and marketing, general and administrative, development, restructuring and other corporate expenses incurred in support of the segments.

**Reconciliation to Loss Before Income Taxes**

The following table presents a reconciliation of total segment operating profit to loss before income taxes for the three and six months ended December 31, 2010 and 2009 (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Total segment operating profit for reportable segments | $ 25,524 | $ 14,354 | $ 45,154 | $ 25,963 |
| Cost of subscription and software | (1,972) | (1,677) | (4,094) | (3,450) |
| Selling and marketing | (2,294) | (2,208) | (5,531) | (5,645) |
| Research and development | (9,835) | (9,507) | (20,184) | (18,517) |
| General and administrative and overhead | (18,300) | (20,620) | (39,156) | (40,635) |
| Stock-based compensation | (2,345) | (9,625) | (5,042) | (11,532) |
| Restructuring charges | (78) | (32) | (155) | (303) |
| Other (expense) income, net | (735) | (222) | 1,929 | 2,047 |
| Interest income (net) | 1,630 | 2,603 | 4,088 | 5,641 |
| Loss before income taxes | $ (8,405) | $ (26,934) | $ (22,991) | $ (46,431) |

**13. Subsequent Events**

We evaluated events occurring between the end of our fiscal quarter and the date the financial statements were issued. There were no subsequent events to be disclosed based on this evaluation.

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

You should read the following discussion in conjunction with our unaudited condensed consolidated financial statements and related notes beginning on page 3. In addition to historical information, this discussion contains forward-looking statements that involve risks and uncertainties. You should read Item 1A. Risk Factors for a discussion of important factors that could cause our actual results to differ materially from our expectations.

Our fiscal year ends on June 30, and references in this Quarterly Report to a specific fiscal year are the twelve months ended June 30 of such year (for example, fiscal 2011 refers to the year ending June 30, 2011).

**Business Overview**

We are a leading global provider of mission-critical process optimization software solutions, which are designed to manage and optimize plant and process design, operational performance, and supply chain planning. Our aspenONE software and related services have been developed for companies in the process industries. Customers use our solutions to improve their competitiveness and profitability by increasing throughput and productivity, reducing operating costs, enhancing capital efficiency, and decreasing working capital requirements.

We have more than 1,500 customers globally. Our customers include manufacturers in process industries such as energy, chemicals, pharmaceuticals, consumer packaged goods, power, metals and mining, pulp and paper, and biofuels, as well as engineering and construction firms that help design process manufacturing plants. As of June 30, 2010, our installed base included 19 of the 20 largest petroleum companies, all of the 20 largest chemical companies, and 15 of the 20 largest pharmaceutical companies.

**Transition to the aspenONE Subscription Offering**

In fiscal 2010 we began offering our aspenONE software under a subscription model, under which a customer can access all products within a licensed suite (aspenONE Engineering or aspenONE Manufacturing and Supply Chain). During the license term, a customer is entitled to receive post-contract support, which we refer to as SMS, as well as any software products introduced into the licensed suite. Revenue is recognized over the term of a license agreement on a subscription, or daily ratable basis. We typically issue invoices annually, and we record each invoiced payment as deferred revenue and then recognize revenue from that payment due date over the applicable period. Uninvoiced future contractual payments are not recorded on our consolidated balance sheet. We also continue to offer our customers the ability to license specifically defined sets of aspenONE products, referred to as point products, which in July 2009, we began licensing with SMS included for the entire term. Revenue is recognized on these arrangements over the contract term, as payments become due.

Prior to fiscal 2010, we offered term or perpetual licenses to point products without SMS included for the entire term of the arrangement. The majority of our license revenue was recognized under an upfront revenue model, in which the net present value of the aggregate license fees was recognized as revenue upon shipment of the point products. We typically invoiced customers annually and recorded the net present value of uninvoiced payments as installments receivable. Customers typically received one year of SMS bundled with their license agreements and then could elect to renew SMS annually. Revenue from SMS was recognized ratably over the period during which the SMS was delivered.

The transition to our aspenONE subscription offering and the inclusion of SMS for the entire term of our point product arrangements, have not changed the method or timing of our customer billing or cash collections. Consequently, we do not expect a material change to net cash provided by operating activities as a result of this transition. The principal accounting implications of the change in our licensing models are as follows:

- The majority of our license revenue is no longer recognized on an upfront basis. Our license revenue for fiscal 2010 and the first half of fiscal 2011 was significantly less than the level achieved in previous fiscal years. We do not expect to recognize levels of revenue comparable to prior fiscal years unless and until a significant majority of our existing license agreements have been renewed under our new licensing models. Because the timing of our incurrence of operating costs has not changed, the lower levels of revenue expected over the next few years will result in significant operating and net losses.

- The amount of our installments receivable will decrease over time, as license agreements executed under our upfront revenue model reach the end of their terms.

- The amount of our deferred revenue will increase over time, as installments for license transactions executed under our aspenONE subscription offering are deferred and recognized on a subscription basis. We will not, however, realize a significant increase in deferred revenue until a substantial portion of the license agreements previously executed under our upfront revenue model has been renewed under our new term licensing model.

For additional information about the recognition of revenue under the upfront revenue model and our new licensing models, please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations Revenue contained in Part II, Item 7 of our Form 10-K for our fiscal year ended June 30, 2010. Because of the accounting implications of our aspenONE subscription offering and the inclusion of SMS for the entire term of our point product arrangements, we believe that, for the next several years, a number of performance indicators based on U.S. generally accepted accounting principles, or GAAP, will be of limited value in assessing our performance, growth and financial condition. Accordingly, we are focusing on a number of other business metrics, including those described below under Key Business Metrics.

**Revenue**

We generate revenue primarily from the following sources:

- *Software licenses.* We provide integrated process optimization software solutions designed for the process industries. We license our software products on a term or perpetual basis, and we offer extended payment options for our term license agreements that generally require annual payments.

- *SMS and other.* Our SMS business consists primarily of providing customer technical support and access to software fixes and upgrades. We provide customer technical support services throughout the world by our three global call centers as well as via email and through our support website. Our training business provides customers with a variety of training solutions, including on-site, Internet-based, and customized training.

- *Professional services.* We offer professional services that include implementing and integrating our technology with customers existing systems in order to improve their plant performance and gain better operational data. Customers who use our professional services typically engage us to provide those services over periods of up to 24 months. We charge customers for professional services on a time-and-materials or fixed-price basis.

**Key Components of Operations**

***Revenue***

*Subscription Revenue.* Subscription revenue relates to the licensing of our products under our aspenONE subscription offering, where SMS is included for the entire term of the arrangement and the customer receives the right to unspecified future software products that may be introduced during the term of the arrangement for no additional fee. License and SMS revenue for arrangements sold under our aspenONE subscription offering are combined and presented together as subscription revenue in the consolidated statements of operations.

*Software Revenue.* Software revenue consists of all license transactions that do not contain rights to future unspecified software products for no additional fee. Specifically, software revenue includes:

- license revenue recognized under the upfront revenue model upon the delivery of the licensed software (that is, both perpetual and term license agreements);

- license revenue recognized over the term of the license agreements, including point product licenses with SMS included for the entire license term, but excluding license revenue from license agreements executed under our aspenONE subscription offering, which is recorded as subscription revenue; and

- other license revenue derived from transactions that are being recognized over time as the result of not previously meeting one or more of the requirements for recognition under the upfront revenue model.

*Services and Other Revenue.* Our services and other revenue consists primarily of revenue related to professional services, SMS (other than SMS bundled with license agreements executed under our aspenONE subscription offering, which is recorded as subscription revenue) and training. The amount and timing of this revenue depend on a number of factors, including:

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- the number, value and rate per hour of service transactions booked during the current and preceding periods;
- the number and availability of service resources actively engaged on billable projects;
- the timing of milestone acceptance for engagements contractually requiring customer sign-off;
- the timing of negotiating and signing maintenance renewals;
- the timing of collection of cash payments when collectability is uncertain; and
- the size of the installed base of license contracts.

***Cost of Revenue***

*Cost of Subscription and Software.* The cost of subscription and software revenue consists of royalties, amortization of capitalized software costs, distribution fees, the costs of providing SMS related to our aspenONE subscription offering and costs related to delivery of software.

*Cost of Services and Other.* Our cost of services and other revenue consists primarily of personnel-related and external consultant costs associated with providing professional services, SMS on arrangements not licensed on a subscription basis and training to customers. The costs of providing SMS for our aspenONE subscription offering are included in cost of subscription and software.

***Operating Expenses***

*Selling and Marketing Expense.* Selling expenses consist primarily of the personnel and travel expenses related to the effort expended to license our products and services to current and potential customers, as well as for overall management of customer relationships. Marketing expenses include expenses needed to promote our company and our products and to acquire market research and measure customer opinions to help us better understand our customers and their business needs.

*Research and Development Expense*. Research and development expenses primarily consist of personnel and external consultant expenses related to the creation of new products and to enhancements and engineering changes to existing products.

*General and Administrative Expense.* General and administrative expenses include the costs of corporate and support functions, such as executive leadership and administration groups, finance, legal, human resources and corporate communications, and other costs such as outside professional and consultant fees and provision for bad debts.

*Restructuring Charges.* Restructuring charges result from the closure or consolidation of our facilities, or from qualifying reductions in headcount.

***Other Income and Expenses***

*Interest Income.* Interest income is recorded for the accretion of interest on the installment payments of our term software license contracts when revenue is recognized upfront at net present value, and to a lesser extent from the investment of cash balances in short-term instruments.

*Interest Expense.* Interest expense consists of charges primarily related to our secured borrowings. Secured borrowings are derived from our borrowing arrangements with unrelated financial institutions.

*Other Income (Expense), Net.* Other income (expense), net is comprised primarily of foreign currency exchange gains (losses) generated from the settlement and remeasurement of transactions denominated in currencies other than the functional currency of our operating units. We may enter into foreign currency forward contracts to attempt to minimize the adverse impact related to unfavorable exchange rate movements, although we have not done so since fiscal 2008. Historically, our foreign currency forward contracts have not been designated as hedging instruments and, therefore, do not qualify for fair value or cash flow hedge treatment under the criteria of Accounting Standards Codification, or ASC, Topic 815, *Derivatives and Hedging*. Therefore, any unrealized gains and losses on the foreign currency forward contracts, as well as the underlying transactions we are attempting to shield from exchange rate movements, would be recognized as a component of other income (expense), net.

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*Provision for Income Taxes.* Provision for income taxes is comprised of the taxes currently payable as a result of domestic and foreign operations and the net tax effects of book-tax timing differences. We record interest and penalties related to income tax matters as income tax expense. We expect the amount of income tax expense, if any, to vary each reporting period depending upon fluctuations in our taxable income and our ability to utilize tax benefits from net loss carryforwards.

**Key Business Metrics**

***Background***

With the adoption of our new licensing models, which include our aspenONE subscription offering and the inclusion of SMS for the entire term of our point products arrangements, our revenue has been significantly less than in preceding fiscal years. We expect that our revenue will increase as customers renew their licensing arrangements under our new licensing models. We do not expect to recognize levels of revenue comparable to prior fiscal years unless and until a significant majority of our existing license agreements have been renewed under our new licensing models. As a result, we believe that, for the next few years, a number of our performance indicators based on U.S. generally accepted accounting principles, or GAAP, including revenue, gross profit, operating income (loss) and net income (loss), will be of limited value in assessing our performance, growth and financial condition. Accordingly, we instead are focusing on certain non-GAAP and other business metrics, including the key metrics set forth below, to track our business performance. None of these metrics should be considered as an alternative to any measure of financial performance calculated in accordance with GAAP.

To supplement our statements of cash flows presented on a GAAP basis, we use the non-GAAP measure of free cash flow to analyze cash flows generated from our operations. Management believes that this financial measure is useful to investors because it permits investors to view our performance using the same tools that management uses to gauge progress in achieving our goals. We believe this measure is also useful to investors because it is an indication of cash flow that may be available to fund further investments in future growth initiatives and it is also useful as the basis for comparing our performance with that of our competitors. To supplement our presentation of total cost of revenue and total operating costs presented on a GAAP basis, we use a non-GAAP measure of adjusted total costs, which excludes certain non-cash and non-recurring expenses. Management believes that this financial measure is useful to investors because it demonstrates our commitment to cost containment. The presentation of these non-GAAP measures is not meant to be considered in isolation or as an alternative to cash flows from operating activities as a measure of liquidity or as an alternative to total cost of revenue and total operating costs as a measure of our total costs.

***Total Term Contract Value***

*Total term contract value,* or TCV, is an estimate of the renewal value, as of a specific date, of our active portfolio of term license agreements. TCV is calculated by multiplying the terminal annual payment for each active term license agreement by the original length of the existing license term, and then aggregating this amount for all active term license agreements. Accordingly, TCV represents the full renewal value of all of our term license agreements under the hypothetical assumption that all of those agreements are simultaneously renewed for the identical license terms and at the same terminal annual payment amounts as the terminal payment of the original contract.

TCV includes the value of SMS for any multi-year license agreements for which SMS is committed for the entire license term. TCV does not include any amounts for perpetual licenses, professional services, training or standalone renewal SMS. TCV is calculated using constant currency assumptions for agreements denominated in currencies other than U.S. dollars in order to remove the impact of currency fluctuations between comparison dates.

We believe TCV is a useful metric for analyzing our business performance, particularly while we are transitioning to our aspenONE subscription offering and revenue comparisons between fiscal periods do not reflect the actual growth rate of our business. Comparing TCV for different dates provides insight into the growth and retention rate of our business during the period between those dates. TCV increases as the result of:

- new term license agreements with new or existing customers;

- renewals or modifications of existing license agreements that result in higher license fees due to price escalation or an increase in the number of tokens (fixed units of software usage) or products licensed; and

- renewals of existing license agreements that increase the length of the license term.

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The renewal of an existing license agreement will not increase TCV unless the renewal results in higher license fees or a longer license term. TCV is adversely affected by customer non-renewals and by renewals that result in lower license fees or a shorter license term. Our standard license term historically has been between five and six years, and we do not expect this standard term to change in the future. Many of our contracts have escalating annual payments throughout the term of the arrangement. By calculating TCV based on the terminal year annual payment, we are typically using the highest annual fee from the existing arrangement to calculate the hypothetical renewal value of our portfolio of term arrangements.

We estimate that TCV was $1.2 billion as of June 30, 2010. Our portfolio of active license agreements as of June 30, 2010 reflected a mix of (a) license agreements that included SMS for the entire license term and (b) legacy license agreements that did not include SMS. We estimate that TCV was $1.0 billion as of June 30, 2009. SMS was not included as part of our term license arrangements prior to fiscal 2010, and no SMS was included in estimated TCV as of June 30, 2009. For comparability purposes, we estimated license-only TCV growth for fiscal 2010 by removing the SMS portion of TCV as of June 30, 2010, using our established VSOE rate of fair value for SMS. On this comparable license-only basis, we estimate that TCV grew by approximately 10% during fiscal 2010, principally as the result of an increase in the number of tokens or products licensed. Overall, we estimate that TCV, with SMS included as of June 30, 2010, increased by approximately 17% during fiscal 2010.

We estimate that TCV with SMS included grew 4.4% in the second quarter of fiscal 2011 and 7.1% in the first half of fiscal 2011. On a comparable license-only basis, we estimate that TCV grew by approximately 3.5% in the second quarter of fiscal 2011 and 5.2% in the first half of fiscal 2011.

***Bookings***

*Bookings* are a measure of the business closed during a period and represent the amount of contractually committed subscription and software fees, including any bundled SMS. Bookings do not include (a) the amount of fees for professional services, training or standalone renewal SMS or (b) the amount of subscription and software fees remaining under pre-existing license agreements that were replaced prior to the scheduled expiration date. The contractual arrangements that contribute to bookings represent binding payment commitments by customers over periods that typically range from five to six years, although individual customer commitments can be for longer or shorter periods. The following table presents our bookings for the three and six months ended December 31, 2010 and 2009 (in thousands):

| | Three Months Ended | | Three Month Period-to-Period Change | | Six Months Ended | | Six Month Period-to-Period Change | |
|---|---|---|---|---|---|---|---|---|
| | December 31, 2010 | December 31, 2009 | $ | % | December 31, 2010 | December 31, 2009 | $ | % |
| Bookings | $ 85,797 | $ 95,255 | $ (9,458) | (9.9)% | $ 160,213 | $ 134,282 | $ 25,931 | 19.3% |

Period over-period bookings comparisons may not be particularly meaningful. The amount of bookings in a period is a function of a) the volume, duration and value of contracts renewed during the period and b) the amount of bookings that contribute to growth of total contract value (as described above). Contract renewals may occur on or near the expiration date of the existing contract (natural renewal), or alternatively, customers may elect to renew their contracts substantially in advance of the expiration date (early renewal). The timing and value of contract renewals has a significant impact on quarter-over-quarter and year-over-year comparisons of bookings. Therefore, short-term bookings trends are not indicative of the growth of the business. Accordingly, we primarily focus on bookings contribution to growth in total contract value and to growth in billings backlog and future cash collections as future indicators of revenue and cash flow growth.

Bookings in the first half of fiscal 2011 increased $25.9 million, or 19.3%, compared to the first half of fiscal 2010. This increase is predominantly due to lower than normal bookings in the first quarter of fiscal 2010 related to the sales cycle start-up associated with the introduction of the aspenONE subscription offering.  Fiscal year 2010 represented the initial year of the aspenONE subscription offering. Bookings in the full fiscal year 2010 were exceptionally strong, as many customers elected to renew their contracts early in order to take advantage of our new offering. We do not expect a comparable level of early renewal booking activity in fiscal 2011 and therefore expect full fiscal year 2011 bookings to be lower than fiscal 2010.  Although we expect total bookings to be lower in fiscal 2011, we expect both the amount and relative proportion of bookings that contribute to growth in TCV to be slightly higher in fiscal 2011, relative to fiscal year 2010.

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***Future Cash Collections and Billings Backlog***

*Future cash collections* is the sum of billings backlog, accounts receivable, undiscounted installments receivable and undiscounted collateralized receivables. *Billings backlog* represents the aggregate value of uninvoiced bookings from prior and current periods.

Prior to fiscal 2010, the majority of bookings was recognized as revenue in the period booked and reflected on our balance sheet as installments receivable, or if sold, as collateralized receivables. Installments receivable and collateralized receivables were discounted to net present value at prevailing market rates at the time of the transaction. Amounts collected for collateralized receivables are applied to pay the related secured borrowings and are not available for any other expenditures.

Under our aspenONE subscription offering and for point product arrangements with SMS included for the entire term of the arrangement, extended contractual payments are not considered fixed or determinable and, as a result, are not included in installments receivable or collateralized receivables. These future payments are included in billings backlog, which is not reflected on our consolidated balance sheets. We believe future cash collections is a useful metric because it provides insight into the cash generation capability of our business. Under the upfront revenue model, we did not previously monitor billings backlog or future cash collections since we believed that accounts receivable, installments receivable, collateralized receivables and certain other measures were appropriate indicators of estimated cash generation at that time.

Because a substantial majority of our future bookings will reflect arrangements under our aspenONE subscription offering, we expect billings backlog to grow over time and expect installments receivable and collateralized receivables to decline. When all contracts have been renewed under our new licensing models, the only sources of cash that will continue to be excluded from future cash collections will be amounts attributable to professional services, training and any remaining standalone SMS renewals.

The following table provides our future cash collections as of the dates presented (in thousands):

| | December 31, 2010 | June 30, 2010 |
|---|---|---|
| Billings backlog | $ 490,434 | $ 389,354 |
| Accounts receivable, net | 28,708 | 31,738 |
| Installments receivable, undiscounted (non-GAAP) (1) | 124,329 | 147,315 |
| Collateralized receivables, undiscounted (non-GAAP) (1) | 44,854 | 56,461 |
| Future cash collections | $ 688,325 | $ 624,868 |

(1) Excludes unamortized discount.

The growth in billings backlog and future cash collections in the first half of fiscal 2011 reflected our customers continued adoption of our aspenONE subscription offering. We expect that billings backlog and future cash collections will continue to grow steadily as we convert and renew existing customers to multi-year contracts, which now include SMS for the full term of the arrangement. In addition, we are actively engaged in transitioning customers from perpetual license arrangements to our new licensing model. Prior to fiscal 2008, we licensed our aspenONE Manufacturing and Supply Chain suite primarily on a perpetual basis, and as we convert these customers to our new licensing model, their licensing fees and SMS will become part of billings backlog and future cash collections.

Installments and collateralized receivables are shown at net present value on our consolidated balance sheets. Future cash collections excludes the unamortized discount on installments and collateralized receivables. Amounts collected for collateralized receivables are applied to pay the related secured borrowings and are not available for any other expenditures. We are providing the following reconciliation for the periods presented to reconcile to undiscounted installments and collateralized receivables, as included in our future cash collections metric, with GAAP installment receivables, net and GAAP collateralized receivables, net (in thousands):

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| | | December 31, 2010 | | June 30, 2010 |
|---|---|---|---|---|
| Installments receivable, undiscounted (non-GAAP) | $ | 124,329 | $ | 147,315 |
| Unamortized discount | | (13,401) | | (18,717) |
| Installments receivable, net | $ | 110,928 | $ | 128,598 |
| | | | | |
| Collateralized receivables, undiscounted (non-GAAP) | $ | 44,854 | $ | 56,461 |
| Unamortized discount | | (3,217) | | (5,031) |
| Collateralized receivables, net | $ | 41,637 | $ | 51,430 |

***Adjusted Total Costs***

The following table presents our total cost of revenue and total operating expenses, as adjusted for stock-based compensation expense, for the indicated periods (in thousands):

| | Three Months Ended | | Three Month Period-to-Period Change | | Six Months Ended | | Six Month Period-to-Period Change | |
|---|---|---|---|---|---|---|---|---|
| | December 31, 2010 | December 31, 2009 | $ | % | December 31, 2010 | December 31, 2009 | $ | % |
| Total cost of revenue | $ 13,555 | $ 16,469 | $ (2,914) | (17.7)% | $ 26,803 | $ 33,938 | $ (7,135) | (21.0)% |
| Total operating expenses | 45,553 | 55,532 | (9,979) | (18.0) | 95,113 | 102,663 | (7,550) | (7.4) |
| Total expenses | $ 59,108 | $ 72,001 | $ (12,893) | (17.9)% | $ 121,916 | $ 136,601 | $ (14,685) | (10.8)% |
| Less: | | | | | | | | |
| Stock-based compensation | $ (2,345) | $ (9,625) | $ 7,280 | (75.6) | $ (5,042) | $ (11,532) | $ 6,490 | (56.3) |
| Adjusted total costs (non-GAAP) | $ 56,763 | $ 62,376 | $ (5,613) | (9.0)% | $ 116,874 | $ 125,069 | $ (8,195) | (6.6)% |

Total expenses decreased $12.9 million and $14.7 million in the second quarter and first half of fiscal 2011, respectively, compared to the same periods of the prior fiscal year. Adjusted total costs, which consist of total cost of revenue and total operating expenses, adjusted to exclude stock-based compensation, decreased by $5.6 million and $8.2 million for the second quarter and first half of fiscal 2011, respectively, compared to the same periods in the prior fiscal year.

Stock-based compensation expense decreased $7.3 million and $6.5 million in the second quarter and first half of fiscal 2011, respectively, compared to the prior year periods. During the period from mid-September 2007 until November 9, 2009 and from November 16, 2009 to December 21, 2009, we did not maintain our status as a timely filer with the SEC and we were unable to issue stock-based compensation to our directors and employees. In the second quarter of fiscal 2010, we became current with our filings and we issued 2.7 million restricted stock units and 0.3 million stock options to our directors and employees. A portion of these awards vested upon issuance. The stock-based compensation cost recognized during the second quarter of fiscal 2010 associated with the November grant represents $9.2 million of the total $9.6 million of expense. The lower level of stock-based compensation expense in the second quarter and first half of fiscal 2011 represents a more normal level of stock-based compensation expense.

The most significant components of the period-over-period decrease in adjusted total costs for the second quarter of fiscal 2011 were a $2.7 million reduction in finance related expenses and a $2.2 million decrease in professional services costs (excluding stock-based compensation expense).

The most significant components of the period-over-period decrease in adjusted total costs for the first half of fiscal 2011 were a $6.8 million reduction in finance related expenses and a $6.4 million decrease in professional services costs (excluding stock-based compensation expenses). These decreases were partially offset by increased legal and related expenses of $2.6 million, which included expenses related to the secondary offering of our common stock effective as of September 22, 2010, and increased payroll and benefit related costs of $2.0 million within research and development expense.

We expect the transition to the aspenONE subscription offering to provide us with a significant opportunity to standardize and further improve our sales and administrative processes. Overall, we anticipate adjusted total costs to decrease slightly for fiscal 2011 compared to the prior fiscal year, primarily as a result of our lower level of current year expense related to audit and accounting fees and consultants and contractor fees.

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***Free Cash Flow***

*Free cash flow* is calculated as net cash provided by operating activities less the sum of (a) purchase of property, equipment and leasehold improvements and (b) capitalized computer software development costs.

Customer collections and, consequently, cash flow from operating activities and free cash flow are primarily driven by license and services billings, rather than recognized revenue. As a result, our changes in revenue recognition since the introduction of our aspenONE subscription offering will not have an adverse impact on cash receipts. Until existing license contracts are renewed and license related revenue returns to prior year levels, we believe free cash flow is a more relevant measure of our financial performance than income statement profitability measures such as total revenue, gross profit, operating profit and net income. Additionally, we also believe that free cash flow is often used by security analysts, investors and other interested parties in the evaluation of software companies.

The following table provides a reconciliation of net cash flow to free cash flow provided by operating activities for the periods presented (in thousands):

| | Six Months Ended | |
|---|---|---|
| | **December 31, 2010** | **December 31, 2009** |
| Net cash provided by operating activities | $ 21,213 | $ 4,646 |
| Purchase of property, equipment and leasehold improvements | (1,876) | (1,592) |
| Capitalized computer software development costs | (380) | (265) |
| Free cash flow (non-GAAP) | $ 18,957 | $ 2,789 |

Going forward, we expect free cash flow to increase as customers continue to renew contracts that were previously paid upfront.  As part of our historical contract arrangements, customers could elect to pay for their term licenses upfront rather than over the contract term. The upfront payment would normally be equal to the net present value of the annual cash payments, typically discounted at an 8% rate. As the global economy deteriorated in 2009, some of our customers changed from paying upfront to paying in installments. Additionally, during this period, we started selling our aspenONE for Manufacturing and Supply Chain suite predominantly on a term basis rather than on a perpetual basis, enabling our customers to pay in annual installments rather than upfront. These prior period practices of upfront payments resulted in increased cash flow variability, both in the period of the payment, and the subsequent years of the contract term.   We have moved away from upfront payments in recent years, and as a result, we expect cash flows to normalize over the next several years.  We anticipate the transition to normalized cash flow to be quicker than the transition to normalized revenue.

We believe we will realize improved free cash flow as we benefit from the continued growth of our portfolio of term license contracts and our focused cost structure management.

**Critical Accounting Estimates and Judgments**

Our consolidated financial statements are prepared in accordance with GAAP. The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, 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.

We believe that the assumptions and estimates associated with the following critical accounting policies have the greatest potential impact on our consolidated financial statements:

- revenue recognition;
- impairment of long-lived assets, goodwill, and intangible assets;
- computer software development costs;
- loss contingencies; and
- accounting for income taxes.

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***Revenue Recognition***

Four basic criteria must be satisfied before license revenue can be recognized: persuasive evidence of an arrangement between us and an end user; delivery of our product has occurred; the fee for the product is fixed or determinable; and collection of the fee is probable. Our management uses its judgment concerning the satisfaction of these four basic criteria, particularly the criteria relating to the determination of whether the arrangement fees are fixed or determinable and to the collectability of the arrangement fees, during evaluation of each revenue transaction.

*Fee is fixed or determinable* We assess whether a fee is fixed or determinable at the outset of the arrangement. Significant judgment is involved in making this assessment. Under our upfront revenue model, we are able to demonstrate that the fees are fixed or determinable for all arrangements, including those for our term licenses that contain extended payment terms. We have an established history of collecting under the terms of these contracts without providing concessions to customers. In addition, we also assess whether contract modifications to an existing term arrangement constitute a concession. In making this assessment, significant analysis is performed to ensure that no concessions are given. Our software license agreements do not include right of return or exchange.

With the introduction of our aspenONE subscription offering and the changes to the licensing terms for point products licensed on a fixed-term basis, we cannot assert that the fees in these new arrangements are fixed or determinable because the rights provided to customers and the economics of the arrangements are not comparable to our historical transactions with other customers under the upfront revenue model. As a result, the amount of revenue recognized for these arrangements will be limited by the amount of customer payments currently due. For our aspenONE licenses this generally results in the fees being recognized ratably over the term of the contracts. For our point product licenses with bundled SMS, this generally results in the license fee being recognized as each payment comes due, while the allocated portion of the SMS revenue is recognized ratably over its annual term.

*Collection of fee is probable* We assess the probability of collecting from each customer at the outset of the arrangement based on a number of factors, including the customer s payment history, its current creditworthiness, economic conditions in the customer s industry and geographic location, and general economic conditions. If in our judgment collection of a fee is not probable, revenue is recognized as cash is collected, provided all other conditions for revenue recognition have been met.

*VSOE of Fair Value for SMS and Professional Services*

We have established VSOE for SMS and professional services, but not for our software products. We assess VSOE of fair value for SMS based on an analysis of standalone SMS renewals using the bell-shaped curve approach. We use the optional renewals of SMS on our legacy term license arrangements to support VSOE of fair value for SMS bundled in our fixed-term point product arrangements. The license product offerings and the SMS in the legacy term arrangements and the fixed-term point product arrangements are the same.

As we are increasingly transitioning our legacy term license customers to new point product arrangements with bundled SMS for the entire term of the arrangement and we no longer market legacy term license arrangements, we expect our population of standalone annual renewals to decrease over time. As a result, there will come a point in time where we will be unable to support VSOE of fair value of SMS in our point product arrangements based on our legacy term license SMS renewals. When this occurs, we will be required to recognize revenue related to the license component on our point product arrangements ratably, on a subscription basis. Additionally, SMS revenue will be included as subscription revenue, in a manner similar to the current recognition of subscription arrangements under our aspenONE subscription offering. We expect the impact of a loss of VSOE of fair value for SMS to be immaterial to our results of operations, since we currently recognize license revenue on point product arrangements over the term of the arrangement, as payments become due.

*Professional Services Revenue*

We provide professional services on a time-and-materials or fixed-price basis. We recognize professional services fees for time-and-materials contracts based upon hours worked and contractually agreed-upon hourly rates. We recognize revenue from fixed-price engagements using the proportional performance method, based on the ratio of costs incurred, substantially all of which are labor-related, to the total estimated project costs. The use of the proportional performance method depends upon our ability to reliably estimate the direct costs to complete a project. We use historical experience as a basis for future estimates to complete current projects. Additionally, management believes that costs are the best available measure of performance. Reimbursable amounts received from customers

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for out-of-pocket expenses are recorded as revenue. If the costs to complete a project are not estimable or the completion is uncertain, the revenue is recognized upon completion of the services.

In the past, we have occasionally been required to commit unanticipated additional resources to complete projects, which have resulted in lower than anticipated income or losses on those contracts. We may experience similar situations in the future. Provisions for estimated losses on contracts are made during the period in which such losses become probable and can be reasonably estimated. To date, such losses have not been significant.

Please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended June 30, 2010 for a discussion of our critical accounting policies and estimates related to impairment of long-lived assets, goodwill, and intangible assets, computer software development costs, loss contingencies and accounting for income taxes.

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**Results of Operations**

***Comparison of the Three and Six Months Ended December 31, 2010 and 2009***

The following table sets forth the results of operations and the period-over-period percentage change in certain financial data for the three and six months ended December 31, 2010 and 2009 (in thousands, except percentages):

| | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| **Revenue:** | | | | | | |
| Subscription | $ 11,847 | $ 1,214 | *% | $ 21,503 | $ 1,239 | *% |
| Software | 13,486 | 8,976 | 50.2 | 22,797 | 20,058 | 13.7 |
| Total subscription and software | 25,333 | 10,190 | 148.6 | 44,300 | 21,297 | 108.0 |
| Services and other | 24,475 | 32,496 | (24.7) | 48,608 | 61,185 | (20.6) |
| Total revenue | 49,808 | 42,686 | 16.7 | 92,908 | 82,482 | 12.6 |
| **Cost of revenue:** | | | | | | |
| Subscription and software | 1,972 | 1,677 | 17.6 | 4,094 | 3,450 | 18.7 |
| Services and other | 11,583 | 14,792 | (21.7) | 22,709 | 30,488 | (25.5) |
| Total cost of revenue | 13,555 | 16,469 | (17.7) | 26,803 | 33,938 | (21.0) |
| Gross profit | 36,253 | 26,217 | 38.3 | 66,105 | 48,544 | 36.2 |
| **Operating expenses:** | | | | | | |
| Selling and marketing | 19,954 | 23,757 | (16.0) | 40,305 | 44,309 | (9.0) |
| Research and development | 12,096 | 12,515 | (3.3) | 24,671 | 23,409 | 5.4 |
| General and administrative | 13,425 | 19,228 | (30.2) | 29,982 | 34,642 | (13.5) |
| Restructuring charges | 78 | 32 | 143.8 | 155 | 303 | (48.8) |
| Total operating expenses | 45,553 | 55,532 | (18.0) | 95,113 | 102,663 | (7.4) |
| Loss from operations | (9,300) | (29,315) | (68.3) | (29,008) | (54,119) | (46.4) |
| Interest income | 3,534 | 5,083 | (30.5) | 7,236 | 10,532 | (31.3) |
| Interest expense | (1,653) | (2,480) | (33.3) | (2,897) | (4,891) | (40.8) |
| Other (expense) income, net | (735) | (222) | 231.1 | 1,929 | 2,047 | (5.8) |
| Loss before income taxes | (8,154) | (26,934) | (69.7) | (22,740) | (46,431) | (51.0) |
| Provision for income taxes | 2,115 | 3,723 | (43.2) | 2,997 | 5,288 | (43.3) |
| Net loss | $ (10,269) | $ (30,657) | (66.5)% | $ (25,737) | $ (51,719) | (50.2)% |

**Not meaningful.*

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The following table sets forth the results of operations as a percentage of net revenue in certain financial data for the three and six months ended December 31, 2010 and 2009:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| **Revenue:** | | | | |
| Subscription | 23.8% | 2.8% | 23.1% | 1.5% |
| Software | 27.1 | 21.0 | 24.5 | 24.3 |
| Total subscription and software | 50.9 | 23.9 | 47.7 | 25.8 |
| Services and other | 49.1 | 76.1 | 52.3 | 74.2 |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 |
| **Cost of revenue:** | | | | |
| Subscription and software | 4.0 | 3.9 | 4.4 | 4.2 |
| Services and other | 23.3 | 34.7 | 24.4 | 37.0 |
| Total cost of revenue | 27.2 | 38.6 | 28.8 | 41.1 |
| Gross profit | 72.8 | 61.4 | 71.2 | 58.9 |
| **Operating expenses:** | | | | |
| Selling and marketing | 40.1 | 55.7 | 43.4 | 53.7 |
| Research and development | 24.3 | 29.3 | 26.6 | 28.4 |
| General and administrative | 27.0 | 45.0 | 32.3 | 42.0 |
| Restructuring charges | 0.2 | 0.1 | 0.2 | 0.4 |
| Total operating expenses | 91.5 | 130.1 | 102.4 | 124.5 |
| Loss from operations | (18.7) | (68.7) | (31.2) | (65.6) |
| Interest income | 7.1 | 11.9 | 7.8 | 12.8 |
| Interest expense | (3.3) | (5.8) | (3.1) | (5.9) |
| Other (expense) income, net | (1.5) | (0.5) | 2.1 | 2.5 |
| Loss before income taxes | (16.4) | (63.1) | (24.5) | (56.3) |
| Provision for income taxes | 4.2 | 8.7 | 3.2 | 6.4 |
| Net loss | (20.6)% | (71.8)% | (27.7)% | (62.7)% |

*Revenue*

Total revenue in the second quarter and first half of fiscal 2011 increased by $7.1 million and $10.4 million, respectively, compared to the corresponding period of the prior year.  The increase was due to higher subscription and software revenue of $15.1 million and $23.0 million, respectively, partially offset by lower services and other revenue of $8.0 million and $12.6 million, respectively.

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**Subscription Revenue**

| | Three Months Ended December 31, | | Period-to-Period Change | | Six Months Ended December 31, | | Period-to-Period Change | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | $ | % | 2010 | 2009 | $ | % |
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Subscription revenue | $ 11,847 | $ 1,214 | $ 10,633 | * | $ 21,503 | $ 1,239 | $ 20,264 | *% |
| As a percent of revenue | 23.8% | 2.8% | | | 23.1% | 1.5% | | |

**Not meaningful.*

The increase in subscription revenue in the second quarter and first half of fiscal 2011 is a result of a larger base of aspenONE subscription bookings from previous quarters being recognized as revenue on a subscription basis in the current quarter. The minimal amount of subscription revenue in the second quarter and first half of fiscal 2010 was a result of subscription arrangements not being offered prior to fiscal 2010. We expect subscription revenue to continue to increase as customers renew existing contracts under our aspenONE subscription offering and subscription contracts become a more significant portion of our term license portfolio.

**Software Revenue**

| | Three Months Ended December 31, | | Period-to-Period Change | | Six Months Ended December 31, | | Period-to-Period Change | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | $ | % | 2010 | 2009 | $ | % |
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Software revenue | $ 13,486 | $ 8,976 | $ 4,510 | 50.2% | $ 22,797 | $ 20,058 | $ 2,739 | 13.7% |
| As a percent of revenue | 27.1% | 21.0% | | | 24.5% | 24.3% | | |

Of the total software revenue recorded in the second quarter of fiscal 2011, $8.3 million related to revenue from legacy term software arrangements that was not recorded in prior periods (due to the arrangement not meeting all of the requirements for upfront revenue recognition), an increase of $2.9 million from the second quarter of fiscal 2010; $4.2 million related to point product arrangements with SMS included for the entire term, an increase of $2.6 million from the second quarter of fiscal 2010; $0.7 million related to new amendments to existing legacy term arrangements that qualified for upfront revenue recognition in the period, a decrease of $0.9 million from the amount of upfront revenue in the second quarter of fiscal 2010; and $0.3 million related to perpetual arrangements, a decrease of $0.1 million from the second quarter of fiscal 2010.

Of the total software revenue recorded in the first half of fiscal 2011, $10.9 million related to revenue from legacy term software arrangements that was not recorded in prior periods (due to the arrangement not meeting all of the requirements for upfront revenue recognition), a decrease of $1.2 million from the first half of fiscal 2010; $9.8 million related to point product arrangements with SMS included for the entire term, an increase of $7.5 million from the first half of fiscal 2010; $1.0 million related to new amendments to legacy term arrangements that qualified for upfront revenue recognition in the period, a decrease of $4.3 million from the amount of upfront revenue in the first half of fiscal 2010; and $1.1 million related to perpetual arrangements, an increase of $0.7 million from the first half of fiscal 2010.

We expect legacy software revenue to continue to decrease and be replaced with subscription or point product software revenue as legacy arrangements are renewed on our new licensing models. Going forward, we anticipate that most of our software revenue will be related to term license arrangements and the revenue will be recognized over the contract term. We do not expect point products licensed on a perpetual basis to be a significant source of revenue.

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**Services and Other Revenue**

[redacted]

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Professional services revenue | $ 7,939 | $ 12,833 | $ (4,894) | (38.1)% | $ 14,602 | $ 22,532 | $ (7,930) | (35.2)% |
| SMS and other revenue | 16,536 | 19,663 | (3,127) | (15.9) | 34,006 | 38,653 | (4,647) | (12.0) |
| Services and other revenue | $ 24,475 | $ 32,496 | $ (8,021) | (24.7)% | $ 48,608 | $ 61,185 | $ (12,577) | (20.6)% |
| As a percent of revenue | 49.1% | 76.1% | | | 52.3% | 74.2% | | |

**Not meaningful.*

Professional Services Revenue

The period-over-period decreases in professional services revenue for the second quarter and first half of fiscal 2011 primarily relate to decreased customer demand for professional services and higher professional services revenue deferrals. We often compete with a number of qualified competitors when bidding for professional service contracts, particularly in developed markets where our products are well established. Having a robust network of providers that can provide professional services to support the deployment and utilization of our software is beneficial to our licensing and SMS businesses. However, this competitive environment has had an unfavorable impact on our professional services business.

Under the aspenONE subscription offering, revenue from committed professional service arrangements that are sold as a single arrangement with, or in contemplation of, a new aspenONE licensing transaction is deferred and recognized on a ratable basis over the longer of (a) the period the services are performed or (b) the term of the related software arrangement. As our typical contract term approximates five years, professional services revenue on these types of arrangements will usually be recognized over a longer period than under the upfront revenue model. We deferred an additional $0.6 million and $1.1 million in the second quarter and first half of fiscal 2011, respectively, related to professional services bundled with aspenONE subscription offering transactions compared to the prior year periods. We expect professional services deferred revenue related to new aspenONE licensing transactions to continue to grow in fiscal 2011 as the number of bundled transactions increase.

Additionally, during the second quarter of fiscal 2010 we recognized approximately $3.0 million of previously deferred professional services revenue due to achieving certain project milestones. We did incur any recognition event of comparable size during the second quarter or first half of fiscal 2011.

SMS and Other Revenue

SMS and other revenue decreased for the second quarter and first half of fiscal 2011, primarily due to customers transitioning to the aspenONE subscription offering, and, to a lesser extent, the continued trend of customers electing to replace perpetual license arrangements with new term contracts. Under the aspenONE subscription offering, SMS is included in subscription revenue, whereas it was presented as services and other revenue under the upfront revenue model.

Our SMS business grew modestly during the first half of fiscal 2011 compared to the prior year period, when considering (i) the portion of SMS included in subscription revenue, (ii) perpetual renewals replaced with term-based contracts and (ii) SMS revenue, as reported within services and other revenue in the income statement.

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*Expenses*

**Cost of Subscription and Software Revenue**

[redacted]

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cost of subscription and software revenue | $ 1,972 | $ 1,677 | $ 295 | 17.6% | $ 4,094 | $ 3,450 | $ 644 | 18.7% |
| Gross margin | 92.2% | 83.5% | | | 90.8% | 83.8% | | |

We allocate the portion of SMS costs associated with providing services on our subscription products to cost of subscription and software revenue.  Prior to the introduction of the aspenONE subscription offering in fiscal 2010, none of the costs associated with providing SMS were included within the cost of subscription and software.  As more customers transition to the aspenONE license model, SMS costs included in cost of subscription and software will increase.

The period-over-period increases in cost of subscription and software revenue for the second quarter and first half of fiscal 2011 were primarily due to a larger percentage of SMS services being provided to customers as part of our aspenONE subscription offering, as described above. These expense increases were partially offset by decreases in the amortization of capitalized software costs.

**Cost of Services and Other Revenue**

[redacted]

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cost of services and other revenue | $ 11,583 | $ 14,792 | $ (3,209) | (21.7)% | $ 22,709 | $ 30,488 | $ (7,779) | (25.5)% |
| Gross margin | 52.7% | 54.5% | | | 53.3% | 50.2% | | |

Cost of Professional Services Revenue

The largest component of the reduction in cost of services and other revenue in the second quarter of fiscal 2011 pertained to our professional services business, which accounted for $2.7 million of the period-over-period decrease. The decrease was primarily related to the reduction of staffing levels in the professional services organization and the timing of expense recognition on specific projects. We reduced our staffing levels in fiscal 2010 to better align our cost structure with the decreased demand for professional services.  The cost of professional services revenue also decreased approximately $1.0 million due to the timing of expense recognition related to two large professional service projects.

The largest component of the reduction in cost of services and other revenue in the first half of fiscal 2011 pertained to our professional services business, which accounted for $6.9 million of the period-over-period decrease. The decrease was primarily related to the reduction of resources used for professional services projects and the timing of expense recognition on specific projects.  We reduced our staffing levels in fiscal 2010 to better align our cost structure with the decreased demand for professional services.  The cost of professional services revenue also decreased approximately $2.0 million due to the timing of expense recognition related to two large professional service projects.

Cost of SMS and Other Revenue

Cost of SMS and other revenue decreased $0.5 million and $0.9 million in the second quarter and first half of fiscal 2011, respectively, as compared to the same periods in fiscal 2010, primarily related to the presentation of SMS costs associated with providing services on our aspenONE subscription offering. As the subscription business grows, we expect the cost of SMS revenue to continue to migrate from cost of services and other revenue to cost of subscription and software revenue. Eventually, we expect the majority of our cost of SMS revenue to be presented in cost of subscription and software revenue.  We expect the reported gross profit margin of services and other revenue to decline over the next several years, as SMS revenue is reclassified to subscription revenue, since SMS revenue has a high gross profit margin relative to the other revenue streams included in services and other revenue.

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**Selling and Marketing Expense**

[redacted]

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Selling and marketing expense | $ 19,954 | $ 23,757 | $ (3,803) | (16.0)% | $ 40,305 | $ 44,309 | $ (4,004) | (9.0)% |
| As a percent of revenue | 40.1% | 55.7% | | | 43.4% | 53.7% | | |

The period-over-period decrease in selling and marketing expense for the second quarter of fiscal 2011 was primarily the result of lower stock-based compensation expense of $2.7 million and to a lesser extent, lower compensation expense, including lower commissions.

The period-over-period decrease in selling and marketing expense for the first half of fiscal 2011 was primarily the result of lower stock-based compensation expense of $2.5 million and to a lesser extent, lower compensation expense, including lower commissions.

**Research and Development Expense**

[redacted]

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Research and development expense | $ 12,096 | $ 12,515 | $ (419) | (3.3)% | $ 24,671 | $ 23,409 | $ 1,262 | 5.4% |
| As a percent of revenue | 24.3% | 29.3% | | | 26.6% | 28.4% | | |

The period-over-period decrease in research and development expense for the second quarter of fiscal 2011 was primarily the result of lower stock-based compensation expense of $1.0 million, partially offset by higher payroll and benefit related costs.

The period-over-period increase in research and development expense for the second half of fiscal 2011was the result of higher payroll and benefit related costs of $2.0 million, partially offset by lower stock-based compensation expense of $0.8 million.

**General and Administrative Expense**

| | Three Months Ended December 31, | Period-to-Period Change | Six Months Ended December 31, | Period-to-Period Change |
|---|---|---|---|---|

| | 2010 | 2009 | $ | % | 2010 | 2009 | $ | % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| General and administrative expense | $ 13,425 | $ 19,228 | $ (5,803) | (30.2)% | $ 29,982 | $ 34,642 | $ (4,660) | (13.5)% |
| As a percent of revenue | 27.0% | 45.0% | | | 32.3% | 42.0% | | |

The period-over-period decrease in general and administrative expense for the second quarter of fiscal 2011 is primarily attributable to lower stock-based compensation of $3.2 million, cost reductions related to consultants and contractors of $1.4 million and lower audit and related expenses of $1.4 million.

The period-over-period decrease in general and administrative expense for the first half of fiscal 2011 is primarily attributable to cost reductions related to consultants and contractors of $3.8 million, lower audit and related expenses of $3.0 million and lower stock-based compensation of $2.7 million. These expense reductions were partially offset by higher legal and related costs of $2.6 million and, to a lesser extent, higher payroll and benefit related expenses.

The decrease in consultants and contractors fees is the result of our effort throughout fiscal 2010 to hire full-time finance personnel to replace and further reduce our reliance on more costly external consultants. In the second quarter and first half of fiscal 2010, significant audit costs were incurred associated with the audit and filing of all of our fiscal 2009 Form 10-Q s and Form 10-K. By comparison, our second quarter and first half of fiscal 2011 audit and related expenses were for current period filings. The increase in legal fees in the first half of fiscal 2011 as compared to the same period in fiscal 2010 was due to our increased use of external legal services during the fiscal year, including services related to the Form S-1 filed during the first quarter of fiscal 2011.

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**Restructuring Charges**

| | Three Months Ended December 31, 2010 | Three Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Restructuring charges | $ 78 | $ 32 | $ 46 | 143.8% | $ 155 | $ 303 | $ (148) | (48.8)% |
| As a percent of revenue | 0.2% | 0.1% | | | 0.2% | 0.4% | | |

There were no new restructuring events in the first half of fiscal 2011. The activity in restructuring charges for the second quarter and first half of fiscal 2011 was the result of accretion and adjustments to existing facilities-related restructuring plans.

**Interest Income**

| | Three Months Ended December 31, 2010 | Three Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Interest income | $ 3,534 | $ 5,083 | $ (1,549) | (30.5)% | $ 7,236 | $ 10,532 | $ (3,296) | (31.3)% |
| As a percent of revenue | 7.1% | 11.9% | | | 7.8% | 12.8% | | |

The period-over-period decreases in interest income for the second quarter and first half of fiscal 2011 were primarily attributable to the continued decrease of our collateralized and installment receivables portfolios. We expect interest income to continue to decrease going forward.

**Interest Expense**

| | Three Months Ended December 31, 2010 | Three Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Interest expense | $ (1,653) | $ (2,480) | $ 827 | (33.3)% | $ (2,897) | $ (4,891) | $ 1,994 | (40.8)% |
| As a percent of revenue | (3.3)% | (5.8)% | | | (3.1)% | (5.9)% | | |

The period-over-period decreases in interest expense for the second quarter and first half of fiscal 2011 were primarily attributable to lower average secured borrowing balances, resulting from the continued pay-down of our existing secured borrowing arrangements. We expect interest expense to continue to decrease going forward.

**Other (Expense) Income, Net**

| | Three Months Ended December 31, 2010 | Three Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % | Six Months Ended December 31, 2010 | Six Months Ended December 31, 2009 | Period-to-Period Change $ | Period-to-Period Change % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Other (expense) income, net | $ (735) | $ (222) | $ (513) | 231.1% | $ 1,929 | $ 2,047 | $ (118) | (5.8)% |
| As a percent of revenue | (1.5)% | (0.5)% | | | 2.1% | 2.5% | | |

Other income (expense), net is comprised primarily of unrealized and realized foreign currency exchange gains and losses generated from the settlement and remeasurement of transactions denominated in currencies other than the functional currency of our operating units. The loss for the second quarter of fiscal 2011was primarily due to currency gains due to the strengthening of the Canadian dollar and Japanese Yen against the US dollar being offset by losses recognized from the weakening of the Pound Sterling and Euro in the second quarter of fiscal 2011. The loss recorded in the second quarter of the prior fiscal year was primarily the result of the weakening of the Euro and Japanese Yen against the US dollar.

The gain for the first half of fiscal 2011 was primarily due to the currency gains due to the strengthening of the Japanese Yen, Euro, Canadian dollar, and Pound Sterling against the US dollar in the first half of fiscal 2011. The gain recorded in the first half of the prior fiscal year was primarily the result of the strengthening of the Canadian dollar, Japanese Yen, and Euro against the US dollar.

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**Provision for Income Taxes**

| | Three Months Ended December 31, 2010 | 2009 | Period-to-Period Change $ | % | Six Months Ended December 31, 2010 | 2009 | Period-to-Period Change $ | % |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Provision for income taxes | $ 2,115 | $ 3,723 | $ (1,608) | (43.2)% | $ 2,997 | $ 5,288 | $ (2,291) | (43.3)% |
| As a percent of revenue | 4.2% | 8.7% | | | 3.2% | 6.4% | | |

The period-over-period decrease in the provision for income taxes for the second quarter of fiscal 2011 was primarily due to a decrease in the foreign provision for income taxes and a decrease in foreign withholding taxes. We made cash payments totaling $1.7 million in the second quarter of fiscal year 2011, which were offset by cash refunds of $0.1 million.

The period-over-period decrease in provision for income taxes for the first half of fiscal 2011 was primarily due to a decrease in the foreign provision for income taxes and a decrease in foreign withholding taxes. We made cash payments totaling $3.0 million in the first half of fiscal year 2011, which were offset by cash refunds of $8.0 million.

**Liquidity and Capital Resources**

***Resources***

We have historically financed our operations with cash generated from operating activities and borrowings secured by our installment receivable contracts. As of December 31, 2010, our principal sources of liquidity consisted of $131.6 million in cash and cash equivalents and up to $18.8 million of borrowing capacity under our credit facility. The amount of borrowing capacity available under the credit facility varies in accordance with the terms of the agreement. We are not currently dependent upon short-term funding.

We believe our existing cash and cash equivalents and our cash flow from operating activities will be sufficient to meet our anticipated cash needs for at least the next twelve months. To the extent our cash and cash equivalents, cash flow from operating activities, and credit facility borrowing are insufficient to fund our future activities, we may need to raise additional funds through the financing of additional receivables or from public or private equity or debt financings. We also may need to raise additional funds in the event we determine in the future to effect one or more acquisitions of businesses, technologies and products. If additional funding is required, we may not be able to effect a receivable, equity or debt financing on terms acceptable to us or at all.

The following table summarizes our cash flow activities for the periods indicated (in thousands):

| | Six Months Ended December 31, 2010 | 2009 |
|---|---|---|
| Cash flow provided by (used in): | | |
| Operating activities | $ 21,213 | $ 4,646 |
| Investing activities | (2,256) | (1,857) |
| Financing activities | (12,561) | (15,407) |
| Effect of exchange rates on cash balances | 301 | (158) |
| Increase (decrease) in cash and cash equivalents | $ 6,697 | $ (12,776) |

*Operating Activities*

Cash generated by operating activities is our primary source of liquidity. Operating activities provided cash of $21.2 million during the first half of fiscal 2011. This amount resulted from net loss of $25.7 million, adjusted for non-cash charges of $6.5 million and a net $40.4 million source of cash due to decreases in operating assets and increases in operating liabilities.

Non-cash items within net loss for the first half of fiscal 2011 consisted primarily of $5.0 million of stock-based compensation and $2.6 million of depreciation and amortization and were offset by $1.6 million of net unrealized foreign currency gains.

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Our cash balance increased in part due to a net $40.4 million decrease in operating assets and increase in operating liabilities. The cash generated from this change consisted primarily of (a) decreases in installment and collateralized receivables totaling $30.1 million, (b) an increase in deferred revenue of $15.0 million, (c) a decrease in prepaid expenses, other assets, and prepaid income taxes of $6.1 million, and (d) a decrease in accounts receivable of $3.0 million. These sources of cash were partially offset by decreases in accounts payable, accrued expenses and other liabilities totaling $15.3 million.

Looking ahead, we expect to continue to generate positive cash flow from operations. We anticipate that existing cash balances, together with funds generated from operations, will be sufficient to finance our operations and meet our cash requirements for the foreseeable future.

*Investing Activities*

During the first half of fiscal 2011, we used $1.9 million of cash for capital expenditures, primarily related to computer hardware and software expenditures. We do not expect our investment in capital expenditures to be materially different from our investments in prior fiscal years. Capitalized software development costs increased $0.1 million in the first half of fiscal 2011.

*Financing Activities*

During the first half of fiscal 2011 we used $12.6 million of cash for financing activities. We made net payments on secured borrowings of $13.7 million ($16.2 million of repayments offset by $2.5 million of proceeds); paid $1.2 million for the repurchases of our common stock; paid withholding taxes of $1.0 million on vested and settled restricted stock units; and, received proceeds of $3.4 million from the exercise of employee stock options during the first half of fiscal 2011.

The $13.7 million of net repayments of secured borrowings includes $4.2 million of payments for amounts that were reported in accrued expenses and other current liabilities at June 30, 2010. The $4.2 million represents the value of previously financed receivables from contracts that were replaced with new arrangements in the fourth quarter of fiscal 2010. Upon superseding the original arrangements, the secured borrowings collateralized by these receivables became immediately due and payable, and as such, were reclassified to current liabilities.