

ASPEN TECHNOLOGY INC /DE/
Form 10-Q
January 29, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2012

or

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

For the transition period from _____ to _____

Commission file number: 0-24786

ASPEN TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

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

200 Wheeler Road
Burlington, Massachusetts
(Address of principal executive offices)

01803
(Zip Code)

(781) 221-6400

(Registrant's telephone number, including area code)

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

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 No

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of January 22, 2013, there were 93,455,520 shares of the registrant's common stock (par value \$0.10 per share) outstanding.

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SIGNATURES

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

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements.***Consolidated Financial Statements (unaudited)***ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited and in thousands, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Revenue:				
Subscription and software	\$ 59,457	\$ 46,502	\$ 113,537	\$ 78,412
Services and other	17,852	20,053	35,229	39,368
Total revenue	77,309	66,555	148,766	117,780
Cost of revenue:				
Subscription and software	3,100	2,622	6,290	5,346
Services and other	9,273	10,303	18,421	21,400
Total cost of revenue	12,373	12,925	24,711	26,746
Gross profit	64,936	53,630	124,055	91,034
Operating expenses:				
Selling and marketing	23,303	22,318	44,894	45,764
Research and development	15,039	12,767	30,805	26,536
General and administrative	11,671	11,490	24,439	27,377
Restructuring charges	(6)	14	34	(59)
Total operating expenses	50,007	46,589	100,172	99,618
Income (loss) from operations	14,929	7,041	23,883	(8,584)
Interest income	955	2,034	2,054	4,265
Interest expense	(116)	(1,015)	(373)	(2,107)
Other expense, net	(57)	(425)	(334)	(2,457)
Income (loss) before provision for (benefit from) income taxes	15,711	7,635	25,230	(8,883)
Provision for (benefit from) income taxes	5,774	3,799	10,880	(983)
Net income (loss)	\$ 9,937	\$ 3,836	\$ 14,350	\$ (7,900)
Net income (loss) per common share:				
Basic	\$ 0.11	\$ 0.04	\$ 0.15	\$ (0.08)
Diluted	\$ 0.10	\$ 0.04	\$ 0.15	\$ (0.08)
Weighted average shares outstanding:				
Basic	93,512	93,902	93,470	93,983
Diluted	95,463	96,267	95,541	93,983

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited and in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Net income (loss)	\$ 9,937	\$ 3,836	\$ 14,350	\$ (7,900)
Other comprehensive (loss) income:				
Foreign currency translation adjustments	\$ (361)	(460)	\$ 607	\$ (653)
Total other comprehensive (loss) income	(361)	(460)	607	(653)
Comprehensive income (loss)	\$ 9,576	\$ 3,376	\$ 14,957	\$ (8,553)

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited and in thousands, except share data)

	December 31, 2012	June 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 175,224	\$ 165,242
Accounts receivable, net	39,531	31,450
Current portion of installments receivable, net	20,923	33,184
Collateralized receivables		6,297
Unbilled services	1,006	1,592
Prepaid expenses and other current assets	7,990	16,219
Prepaid income taxes	133	283
Current deferred tax assets	6,770	7,196
Total current assets	251,577	261,463
Non-current installments receivable, net	8,089	14,046
Property, equipment and leasehold improvements, net	7,727	7,037
Computer software development costs, net	1,618	1,689
Goodwill	19,851	19,399
Non-current deferred tax assets	49,173	58,559
Other non-current assets	7,403	6,142
Total assets	\$ 345,438	\$ 368,335
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Secured borrowings	\$	\$ 10,756
Accounts payable	4,502	2,566
Accrued expenses and other current liabilities	29,248	37,989
Income taxes payable	295	598
Current deferred revenue	141,538	143,578
Current deferred tax liabilities	232	232
Total current liabilities	175,815	195,719
Non-current deferred revenue	50,358	43,595
Other non-current liabilities	14,968	15,429
Commitments and contingencies (Note 10)		
Series D redeemable convertible preferred stock, \$0.10 par value		
Authorized 3,636 shares at December 31, 2012 and June 30, 2012		
Issued and outstanding none at December 31, 2012 and June 30, 2012		
Stockholders equity:		
Common stock, \$0.10 par value Authorized 210,000,000 shares		
Issued 98,294,064 shares at December 31, 2012 and 96,663,580 shares at June 30, 2012		
Outstanding 93,615,934 shares at December 31, 2012 and 93,465,955 shares at June 30, 2012	9,829	9,666
Additional paid-in capital	559,983	547,546
Accumulated deficit	(380,729)	(395,079)
Accumulated other comprehensive income	8,702	8,095
Treasury stock, at cost 4,678,130 shares of common stock at December 31, 2012 and 3,197,625 at June 30, 2012		
	(93,488)	(56,636)
Total stockholders equity	104,297	113,592
Total liabilities and stockholders equity	\$ 345,438	\$ 368,335

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	Six Months Ended December 31,	
	2012	2011
Cash flows from operating activities:		
Net income (loss)	\$ 14,350	\$ (7,900)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,687	2,693
Net foreign currency (gain) loss	(304)	1,218
Stock-based compensation	7,768	6,779
Deferred income taxes	9,858	(2,310)
Provision for bad debts	162	(403)
Other non-cash operating activities	28	13
Changes in assets and liabilities:		
Accounts receivable	(7,957)	(8,068)
Unbilled services	606	1,905
Prepaid expenses, prepaid income taxes, and other assets	5,905	768
Installments and collateralized receivables	25,101	26,728
Accounts payable, accrued expenses, and other liabilities	(8,503)	(8,592)
Deferred revenue	4,439	15,449
Net cash provided by operating activities	54,140	28,280
Cash flows from investing activities:		
Purchase of property, equipment and leasehold improvements	(2,567)	(922)
Insurance proceeds	2,222	
Purchase of technology intangibles	(527)	
Capitalized computer software development costs	(435)	(392)
Net cash used in investing activities	(1,307)	(1,314)
Cash flows from financing activities:		
Exercise of stock options	9,120	4,106
Proceeds from secured borrowings		4,982
Repayments of secured borrowings	(11,010)	(20,420)
Repurchases of common stock	(36,852)	(20,240)
Payment of tax withholding obligations related to restricted stock	(4,288)	(1,769)
Net cash used in financing activities	(43,030)	(33,341)
Effect of exchange rate changes on cash and cash equivalents	179	(355)
Increase (decrease) in cash and cash equivalents	9,982	(6,730)
Cash and cash equivalents, beginning of period	165,242	149,985
Cash and cash equivalents, end of period	\$ 175,224	\$ 143,255
Supplemental disclosure of cash flow information:		
Income tax paid, net	\$ 1,812	\$ 338
Interest paid	373	2,107

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Interim Unaudited Consolidated Financial Statements

The accompanying interim unaudited consolidated financial statements of Aspen Technology, Inc. and its subsidiaries have been prepared on the same basis as our annual consolidated financial statements. We 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) Topic 270, *Interim Reporting*, 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 unaudited consolidated financial statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2012, 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, 2012 are not necessarily indicative of the results to be expected for the subsequent quarter 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 expenses 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 its subsidiaries.

2. Significant Accounting Policies

(a) Overview of Licensing Model Changes

Transition to the aspenONE Licensing Model

Prior to fiscal 2010, we offered term or perpetual licenses to specific products, or specifically defined sets of products, which we refer to as point products. 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. Customers typically received one year of post-contract software maintenance and support, or SMS, with their license agreements and then could elect to renew SMS annually. Revenue from SMS was recognized ratably over the period in which the SMS was delivered.

In fiscal 2010, we introduced the following changes to our licensing model:

- (i) Began offering our aspenONE software on a subscription basis, allowing our customers access to all products within a licensed suite (aspenONE Engineering or aspenONE Manufacturing and Supply Chain). SMS is included for the entire term of the arrangement and customers are entitled to any software products or updates introduced into the licensed suite. We refer to this license arrangement as our aspenONE licensing model.

- (ii) Began to include SMS for the entire term on our point product term arrangements.

Revenue related to our aspenONE licensing model is recognized over the term of the arrangement on a ratable basis. During fiscal 2010 and 2011, license revenue related to our point product arrangements with SMS included for the entire term of the arrangement was generally recognized on the due date of each annual installment, provided all revenue recognition criteria were met. Beginning in fiscal 2012, we were unable to establish evidence of the fair value for the SMS component and revenue from these arrangements is now recognized on a ratable basis.

The changes to our licensing model introduced in fiscal 2010 did not change the method or timing of customer billings or cash collections. Since the introduction of these changes, our net cash provided by operating activities has increased in each annual period from \$33.0 million in fiscal 2009 to \$104.6 million in fiscal 2012. During these periods we have realized steadily improving cash flow due to growth of our portfolio of term license contracts, as well as from the renewal of customer contracts, on an installment basis, that were previously paid upfront.

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Impact of Licensing Model Changes

The principal accounting implications of the changes to our licensing model are as follows:

- The majority of our license revenue is no longer recognized on an upfront basis. Since the upfront model resulted in the net present value of multiple years of future installments being recognized at the time of shipment, we do not expect to recognize levels of revenue comparable to our pre-transition levels until a significant majority of license agreements executed under our upfront revenue model (i) reach the end of their original terms and (ii) are renewed. Accordingly, since the changes to our licensing model in fiscal 2010, our product-related revenue has been significantly less than the level achieved in the fiscal years preceding our licensing model changes.
- The changes to our licensing model resulted in operating losses for fiscal 2010, 2011 and 2012. These changes did not impact the incurrance or timing of our expenses, and there was no corresponding expense reduction to offset the lower revenue. Subscription and software revenue has steadily increased from the beginning of fiscal 2010 as a portion of the license agreements executed under our upfront revenue model have reached the end of their original term and have been renewed under either our aspenONE licensing model or as point product arrangements which include SMS for the contract term.
- The SMS component of our services and other revenue has decreased and been offset by a corresponding increase in subscription and software revenue as customers transition to our aspenONE licensing model or point product arrangements with Premier Plus SMS included for the full contract term. The entire arrangement fee, including the SMS component, is included within subscription and software revenue.
- Installment payments are not considered fixed or determinable, and as a result, are not included in installments receivable. Accordingly, our installments receivable balance has decreased as licenses previously executed under our upfront revenue model reached the end of their terms.
- The amount of our deferred revenue has increased as an increasing portion of revenue from our term license portfolio has been recognized on a ratable basis.

Introduction of our Premier Plus SMS Offering

Beginning in fiscal 2012, we introduced our Premier Plus SMS offering to provide more value to our customers. As part of this offering, customers receive 24x7 support, faster response times, dedicated technical advocates and access to web-based training modules. The Premier Plus SMS offering is only provided to customers that commit to SMS for the entire term of the arrangement. Our annually renewable legacy SMS offering continues to be available to customers with legacy term and perpetual license agreements.

The introduction of our Premier Plus SMS offering resulted in a change to the revenue recognition of point product arrangements that include Premier Plus SMS for the term of the arrangement. Beginning in fiscal 2012, revenue associated with point product arrangements that include the Premier Plus SMS offering is being recognized on a ratable basis, whereas prior to fiscal 2012, license revenue was recognized on the due date of each annual installment, provided all revenue recognition criteria were met. The introduction of our Premier Plus SMS offering did not change the revenue recognition for our aspenONE licensing arrangements.

(b) Revenue Recognition

We generate revenue from the following sources: (1) licensing software products; (2) providing 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 arrangements, 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.

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 signed contract as evidence of an arrangement for software licenses and SMS. For professional services we use a signed contract and a work proposal 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.

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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, our 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 a contract modification to an existing term arrangement constitutes a concession. In making this assessment, significant analysis is performed to ensure that no concessions are given. Our software license agreements do not include a right of return or exchange.

We cannot assert that the fees under our aspenONE licensing model and point product arrangements with Premier Plus SMS are fixed or determinable because the rights provided to customers, and the economics of the arrangements, are not comparable to our transactions with other customers under the upfront revenue model. As a result, the amount of revenue recognized for these arrangements is limited by the amount of customer payments that become due.

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.

Vendor-Specific Objective Evidence of Fair Value

We have established vendor-specific objective evidence of fair value, or VSOE, for certain SMS offerings, professional services, and training, but not for our software products or our Premier Plus SMS offering. We assess VSOE for SMS, professional services, and training, based on an analysis of standalone sales of the offerings using the bell-shaped curve approach. We do not have a history of selling our Premier Plus SMS offering to customers on a standalone basis, and as a result are unable to establish VSOE for this new deliverable.

We allocate the arrangement consideration among the elements included in our multi-element arrangements using the residual method. Under the residual method, the 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. Under the upfront revenue model, the residual license fee is recognized upon delivery of the software provided all other revenue recognition criteria were met. Arrangements that qualify for upfront recognition include sales of perpetual licenses, amendments to existing legacy term arrangements and renewals of legacy term arrangements.

Subscription and Software Revenue

Subscription and software revenue consists of product and related revenue from our (i) aspenONE licensing model, including the bundled SMS; (ii) point product arrangements with our Premier Plus SMS offering included for the contract term; (iii) legacy arrangements including (a) amendments to existing legacy term arrangements, (b) renewals of legacy term arrangements and (c) legacy arrangements that are being recognized over time as a result of not previously meeting one or more of the requirements for recognition under the upfront revenue model; and (iv) perpetual arrangements.

When a customer elects to license our products under our aspenONE licensing model, our Premier Plus SMS offering 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 and updates that may be introduced into the licensed aspenONE software suite. Due to our obligation to provide unspecified future software products and updates, we are required to recognize the total revenue ratably over the term of the arrangement, once the other revenue recognition criteria noted above have been met.

Our point product arrangements with Premier Plus SMS include SMS for the term of the arrangement. Since we do not have VSOE for our Premier Plus SMS offering, the SMS element of our point product arrangements is not separable. As a result, revenue is also recognized ratably over the term of the arrangement, once the other revenue recognition criteria have been met.

Perpetual license and legacy arrangements do not include the same rights as those provided to customers under the aspenONE licensing model and point product arrangements with Premier Plus SMS. We continue to have VSOE for the legacy SMS offering provided in support of these license arrangements and can therefore separate the undelivered elements. Accordingly, the license fees for perpetual licenses and legacy arrangements continue to be recognized upon delivery of the software products using the residual method, provided all other revenue recognition requirements have been met.

Table of Contents**Results of Operations Classification - Subscription and Software Revenue**

Prior to fiscal 2012, subscription and software revenue were each classified separately on our unaudited consolidated statements of operations, because each type of revenue had different revenue recognition characteristics, and the amount of revenue attributable to each was material in relation to our total revenue. Additionally, we were able to separate the residual amount of software revenue related to the software component of our point product arrangements which included SMS for the contract term, based on the VSOE for the SMS element.

As a result of the introduction of our Premier Plus SMS offering in the first quarter of fiscal 2012, the majority of our product-related revenue is now recognized on a ratable basis, over the term of the arrangement. Since the distinction between subscription and point product ratable revenue does not represent a meaningful difference from either a line of business or revenue recognition perspective, we have combined our subscription and software revenue into a single line item on our consolidated statements of operations beginning in the first quarter of fiscal 2012.

The following tables summarize the amount of subscription and software revenue recognized on a ratable basis and under a residual method for the three and six months ended December 31, 2012 and 2011, respectively. Ratable revenue refers to product revenue that is recognized evenly over the term of the related agreement, beginning when the first payment becomes due. The residual method refers to the recognition of the difference between the total arrangement fee and the undiscounted VSOE for the undelivered element, assuming all other revenue recognition requirements have been met.

	Three Months Ended December 31,		Three Months Ended December 31,	
	2012	2011	2012	2011
	(Dollars in thousands)		% of Total	
Subscription and software revenue:				
Ratable	\$ 52,550	\$ 31,726	88.4%	68.2%
Residual method (1)	6,907	14,776	11.6	31.8
Subscription and software revenue	\$ 59,457	\$ 46,502	100.0%	100.0%

	Six Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
	(Dollars in thousands)		% of Total	
Subscription and software revenue:				
Ratable	\$ 103,702	\$ 60,181	91.3%	76.7%
Residual method (1)	9,835	18,231	8.7	23.3
Subscription and software revenue	\$ 113,537	\$ 78,412	100.0%	100.0%

(1) Residual method revenue detail

Three Months Ended December 31,	Six Months Ended December 31,
------------------------------------	----------------------------------

	2012 (Dollars in thousands)		2011 (Dollars in thousands)	
Residual method revenue:				
Legacy arrangements	\$ 6,525	\$ 13,668	\$ 8,717	\$ 16,784
Perpetual arrangements	382	1,108	1,118	1,447
Total residual method revenue	\$ 6,907	\$ 14,776	\$ 9,835	\$ 18,231

Services and Other

SMS Revenue

SMS revenue includes the maintenance revenue recognized from arrangements for which we continue to have VSOE for the undelivered SMS offering (legacy SMS offering). For arrangements sold with our legacy SMS offering, SMS renewals are at the option of the customer, and the fair value of SMS is deferred and subsequently amortized over the contractual term of the SMS arrangement.

Professional Services Revenue

Professional services are provided to customers on a time-and-materials (T&M) or fixed-price basis. We recognize

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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. Project costs are typically 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. Additionally, we believe that costs are the best available measure of performance. Out-of-pocket expenses which are reimbursed by customers are recorded as revenue.

In certain circumstances, professional services revenue may be recognized over a longer time period than that which the services are performed. 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 circumstances in which professional services are sold as a single arrangement with, or in contemplation of, a new aspenONE license or point product arrangement with Premier Plus SMS, revenue is deferred and recognized on a ratable basis over the longer of (i) the period the services are performed, or (ii) the license term. When 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 completed contract or percentage-of-completion method.

We have occasionally been required to commit unanticipated additional resources to complete projects, which resulted in losses on those contracts. Provisions for estimated losses on contracts are made during the period in which such losses become probable and can be reasonably estimated.

Deferred Revenue

Deferred revenue includes amounts billed or collected in advance of revenue recognition, including arrangements under the aspenONE licensing model, for point product arrangements with Premier Plus SMS, legacy SMS offering, professional services, and training. Under the aspenONE licensing model and for point product arrangements with Premier Plus SMS, VSOE does not exist for the undelivered elements, and as a result the arrangement fees are recognized ratably (i.e., on a subscription basis) over the term of the license, and deferred revenue is recorded as each invoice comes due.

For arrangements under the upfront revenue model, a portion of the arrangement fee is generally recorded as deferred revenue due to the inclusion of an undelivered element, typically our legacy SMS offering or professional services. The amount of revenue allocated to undelivered elements is based on the VSOE for those elements using the residual method, and is earned and recognized as revenue as each element is delivered.

(c) Installments Receivable

Installments receivable resulting from product sales under the upfront revenue model are discounted to present value at prevailing market rates at the date the contract is signed, taking into consideration the customer's credit rating. The finance element is recognized using the effective interest method over the relevant license term and is classified as interest income. Installments receivable are split between current and non-current in our unaudited consolidated balance sheets based on the maturity date of the related installment. Non-current installments receivable consist of receivables with a due date greater than one year from the period-end date. Current installments receivable consist 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 becomes due within 45 days, it is reclassified as a trade accounts receivable in our unaudited consolidated balance sheets. As a result, we did not have any past due installments receivable as of December 31, 2012.

Our non-current installments receivable are 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 arises from the sale of our software licenses, the methodology for determining our allowance for doubtful accounts is based on the collective population of receivables and is not stratified by class or portfolio segment. We consider factors such as existing economic conditions, country risk, and customer's credit rating and past payment history in determining our allowance for doubtful accounts. We reserve against our installments receivable when the related trade accounts receivable have been past due for over a year, or when there is a specific risk of uncollectability. Our specific reserve reflects the full value of the related installments receivable for which collection has been deemed uncertain. Our specific reserve represented 95% and 89% of our total installments receivable allowance for doubtful accounts at December 31, 2012 and June 30, 2012, respectively. In instances when an installment receivable that is reserved ages into trade accounts receivable, the related reserve is transferred to our trade accounts receivable allowance.

We write off receivables when they have been deemed uncollectable based on our judgment. In instances when we write off specific customers trade accounts receivable, we also write off any related current and non-current installments receivable balances. Any incremental interest income for installments receivable that has been reserved is offset by an additional provision to the allowance for doubtful accounts.

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As of December 31, 2012, our gross current and non-current installments receivable of \$22.0 million and \$9.0 million are presented net of unamortized discounts of \$0.9 million and \$0.8 million and net of allowance for doubtful accounts of \$0.2 million and \$0.1 million, respectively. Provision for bad debts related to current and non-current installment receivables was not significant during the three and six months ended December 31, 2012 and 2011, respectively.

As of June 30, 2012, our gross current and non-current installment receivables of \$35.0 million and \$15.9 million are presented net of unamortized discounts of \$1.6 million and \$1.8 million, and net of allowance for doubtful accounts of \$0.2 million and less than \$0.1 million, respectively.

Under the aspenONE licensing model and for point product arrangements with Premier Plus SMS included for the contract term, the installment payments are not considered fixed or determinable and, as a result, are not included as installments receivable on our unaudited consolidated balance sheet.

(d) Loss 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 these criteria. Refer to Note 10 for discussion of these matters and related liability accruals.

(e) 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, 2012.

3. Goodwill

The changes in the carrying amount of goodwill by reporting unit for the six months ended December 31, 2012 are as follows (dollars in thousands):

Asset Class	License	Reporting Unit		Total
		SMS, Training, and Other	Professional Services	

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Balance as of June 30, 2012								
Goodwill	\$	69,570	\$	15,398	\$	5,102	\$	90,070
Accumulated impairment losses		(65,569)				(5,102)		(70,671)
	\$	4,001	\$	15,398	\$		\$	19,399
Effect of currency translation								
		83		369				452
Balance as of December 31, 2012								
Goodwill	\$	69,653	\$	15,767	\$	5,102	\$	90,522
Accumulated impairment losses		(65,569)				(5,102)		(70,671)
	\$	4,084	\$	15,767	\$		\$	19,851

We test goodwill for impairment annually (or more often if impairment indicators arise), at the reporting unit level in accordance with the provisions of ASC 350, *Intangibles Goodwill and Other*.

We adopted ASU No. 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, during fiscal 2012. In accordance with the provisions of ASU No. 2011-08, we must first assess qualitative factors to determine whether the existence of events or circumstances indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we determine based on this assessment that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we are required to perform the two-step goodwill impairment test. The first step requires us to determine the fair value of each reporting unit and compare it to the carrying amount, including goodwill, of such reporting unit. If the fair value exceeds the carrying amount, no impairment loss is recognized. However, if the carrying amount of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount of impairment, if any, is measured based upon the implied fair value of goodwill at the valuation date.

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Fair value of a reporting unit is determined using a combined weighted average of a market-based approach (utilizing fair value multiples of comparable publicly traded companies) and an income-based approach (utilizing discounted projected cash flows). In applying the income-based approach, we would be required to make assumptions about the amount and timing of future expected cash flows, growth rates and appropriate discount rates. The amount and timing of future cash flows would be based on our most recent long-term financial projections. The discount rate we would utilize would be determined using estimates of market participant risk-adjusted weighted-average costs of capital and reflect the risks associated with achieving future cash flows.

We have elected December 31 as the annual impairment assessment date and perform additional impairment tests if triggering events occur. We performed our annual impairment test for each reporting unit as of December 31, 2012, and, based upon the results of our qualitative assessment, determined that it is not likely that their respective fair values are less than their carrying amounts. As such, we did not perform the two-step goodwill impairment test and did not recognize impairment losses during the three and six months ended December 31, 2012.

4. Income Taxes

The effective tax rate for the periods presented is primarily the result of income earned in the U.S., taxed at U.S. federal and state statutory income tax rates, income earned in foreign tax jurisdictions which are taxed at their applicable rates, as well as the impact of permanent differences between book and tax income. Our effective tax rate for the three months ended December 31, 2012 and 2011 was 36.8% and 49.8%, respectively. Our effective tax rate for the six months ended December 31, 2012 was 43.1% compared to a benefit rate of 11.1% for the six months ended December 31, 2011. Our effective tax rate for the three and six months ended December 31, 2012 differs from the U.S. federal statutory income tax rate primarily as a result of the impact of permanent items, including non-deductible stock-based compensation expense.

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 future generation of 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 carry-forwards, and other matters in making this assessment. At December 31, 2012, our total valuation allowance was approximately \$5.6 million.

We do not provide deferred taxes on unremitted earnings of foreign subsidiaries since we intend to indefinitely reinvest those earnings 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.

5. Fair Value

We determine fair value by utilizing a fair value hierarchy that ranks the quality and reliability of the information used in its determination. Fair values determined using Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability

to access. Fair values determined using Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves for similar assets and liabilities.

Cash equivalents of \$155.0 million and \$144.0 million as of December 31, 2012, and June 30, 2012, respectively, are reported at fair value utilizing quoted market prices in identical markets, or Level 1 inputs. Our cash equivalents consist of short-term, highly liquid investments with remaining maturities of three months or less when purchased.

Financial instruments not measured or recorded at fair value in the accompanying unaudited consolidated 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 their carrying value. The estimated fair value of secured borrowings exceeded the carrying value by \$0.2 million as of June 30, 2012. Secured borrowings were repaid in full or repurchased during the second quarter of fiscal 2013. 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

The following table summarizes our accounts receivable, net of the related allowance for doubtful accounts and unamortized discounts, as of December 31, 2012 and June 30, 2012 (dollars in thousands). Refer to Note 2(c) for a summary of our installments receivable balances. Collateralized receivables are presented in the unaudited consolidated balance sheet and in the table below as of June 30, 2012, net of discounts for future interest established at inception of the installment arrangement.

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	Gross	Unamortized Discounts	Allowance	Net
December 31, 2012:				
Accounts Receivable	\$ 41,522	\$	\$ 1,991	\$ 39,531
	\$ 41,522	\$	\$ 1,991	\$ 39,531
June 30, 2012:				
Accounts Receivable	\$ 33,432	\$	\$ 1,982	\$ 31,450
Collateralized Receivables - current	6,500	203		6,297
	\$ 39,932	\$ 203	\$ 1,982	\$ 37,747

Collateralized receivables were collected in full or repurchased during the second quarter of fiscal 2013. Repurchased receivables, net of discounts for future interest, were reclassified into accounts receivable or installments receivable during the period then ended.

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

	December 31, 2012	June 30, 2012
Royalties and outside commissions	\$ 4,224	\$ 4,875
Payroll and payroll-related	13,771	21,558
Other	11,253	11,556
Total accrued expenses and other current liabilities	\$ 29,248	\$ 37,989

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

	December 31, 2012	June 30, 2012
Deferred rent	\$ 1,114	\$ 1,532
Other*	13,854	13,897
Total other non-current liabilities	\$ 14,968	\$ 15,429

* Other is comprised primarily of our reserve for uncertain tax liabilities of \$11.8 million and \$12.2 million as of December 31, 2012 and June 30, 2012, respectively.

7. Stock-Based Compensation

General Award Terms

We issue stock options and restricted stock units (RSUs) to our employees and outside directors, pursuant to stockholder-approved equity compensation plans. Option awards are granted with an exercise price equal to the market price of our stock at the closing price on the trading day prior to the date of grant; those options generally vest over four years and expire within 7 or 10 years of grant. RSUs generally vest over four years. Historically, our practice has been to settle stock option exercises and RSU 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 tax effects of share-based payment awards to employees under ASC Topic 718, *Compensation - Stock Compensation* (ASC 718). We use the with-and-without approach for determining if excess tax benefits are realized under ASC 718.

We utilize the Black-Scholes option valuation model for estimating the fair value of options granted. The Black-Scholes option valuation model incorporates assumptions regarding expected stock price volatility, the expected life of the option, the risk-

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free interest rate, dividend yield and the market value of our common stock. The expected stock price volatility is determined based on our stock's historic prices over a period commensurate with the expected life of the award. The expected life of an option represents the period for which options are expected to be outstanding as determined by historic option exercises and cancellations. The risk-free interest rate is based on the U.S. Treasury yield curve for notes with terms approximating the expected life of the options granted. The expected dividend yield is zero, based on our history and expectation of not paying dividends on common shares. We recognize compensation costs on a straight-line basis, net of estimated forfeitures, over the requisite service period for time-vested awards.

The weighted average estimated fair value of awards granted during the three months ended December 31, 2012 and 2011 was \$9.83 and \$6.49, respectively. The weighted average estimated fair value of awards granted during the six months ended December 31, 2012 and 2011 was \$9.76 and \$6.48, respectively.

We utilized the Black-Scholes option valuation model with the following weighted average assumptions:

	Six Months Ended December 31,	
	2012	2011
Risk-free interest rate	0.6%	1.2%
Expected dividend yield	0.0%	0.0%
Expected life (in years)	4.8	4.6
Expected volatility factor	48.9%	49.6%

The stock-based compensation expense and its classification in the unaudited consolidated statements of operations for the three and six months ended December 31, 2012 and 2011 are as follows (dollars in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Recorded as expenses:				
Cost of services and other	\$ 316	\$ 314	\$ 659	\$ 617
Selling and marketing	972	1,229	1,949	2,399
Research and development	742	353	1,483	701
General and administrative	1,423	1,175	3,677	3,062
Total stock-based compensation	\$ 3,453	\$ 3,071	\$ 7,768	\$ 6,779

A summary of stock option and RSU activity under all equity plans for the six months ended December 31, 2012 is as follows:

Shares	Stock Options			Restricted Stock Units	
	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in 000 s)	Shares	Weighted Average Grant Date Fair Value

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Outstanding at June 30, 2012	4,180,265	\$	9.03		\$	59,034	1,327,071	\$	12.73
Granted	498,264		23.40				588,148		23.40
Settled (RSUs)							(507,763)		13.39
Exercised	(1,289,786)		7.07						
Cancelled / Forfeited	(46,544)		11.02				(36,991)		14.69
Outstanding at December 31, 2012	3,342,199	\$	11.90	5.81	\$	52,611	1,370,465	\$	17.01
Vested and exercisable at December 31, 2012	2,184,035	\$	9.13	4.39	\$	40,418		\$	
Vested and expected to vest as of December 31, 2012	3,163,443	\$	11.61	5.65	\$	50,722	1,185,520	\$	17.03

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The weighted average grant-date fair value of RSUs granted during the three and six months ended December 31, 2012 was \$25.84 and \$23.40, respectively, and during the three and six months ended December 31, 2011 was \$16.52 and \$15.52, respectively. During the three months ended December 31, 2012 and 2011, the total fair value of shares vested from RSU grants was \$6.8 million and \$1.7 million, respectively, and during the six months ended December 31, 2012 and 2011 was \$13.1 and \$5.5 million, respectively.

At December 31, 2012, the total future unrecognized compensation cost related to stock options and RSUs was \$7.6 million and \$21.1 million, respectively, and is expected to be recorded over a weighted average period of 2.8 years and 2.8 years, respectively.

The total intrinsic value of options exercised during the three months ended December 31, 2012 and 2011 was \$12.5 million and \$3.2 million, respectively. The total intrinsic value of options exercised during the six months ended December 31, 2012 and 2011 was \$23.2 million and \$5.0 million, respectively. We received \$9.1 million and \$4.1 million in cash proceeds from option exercises during the six months ended December 31, 2012 and 2011, respectively. We paid \$4.3 million and \$1.8 million for withholding taxes on vested RSUs during the six months ended December 31, 2012 and 2011, respectively.

At December 31, 2012, common stock reserved for future issuance or settlement under equity compensation plans was 9.3 million shares.

8. Common Stock

On October 24, 2012, our Board of Directors approved a share repurchase program for up to \$100 million worth of our common stock. This share repurchase program replaced the prior share repurchase program approved by the Board of Directors on November 1, 2011 for up to \$100 million, which had approximately \$41.8 million of remaining capacity on October 24, 2012. The program approved on November 1, 2011 had replaced a repurchase program with a value of up to \$40 million which had been approved by the Board of Directors on October 29, 2010. The timing and amount of any shares repurchased are based on market conditions and other factors. All share repurchases of our common stock have been recorded as treasury stock under the cost method.

We repurchased 1,480,505 shares of our common stock for \$36.9 million during the six months ended December 31, 2012. We repurchased 2,496,595 shares of our common stock for \$46.1 million during fiscal 2012. As of December 31, 2012, the remaining dollar value under the stock repurchase program approved on October 24, 2012 was \$87.7 million.

9. Net Income (Loss) Per Share

Basic income (loss) per share is determined by dividing net income (loss) by the weighted average common shares outstanding during the period. Diluted income (loss) per share is determined by dividing net income (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 other commitments to be settled in common stock are included in the calculation of diluted net income (loss) per share based on the treasury stock method.

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For the three and six months ended December 31, 2012 and the three months ended December 31, 2011, certain employee equity awards were anti-dilutive based on the treasury stock method. For the six months ended December 31, 2011, all potential common shares were anti-dilutive due to the net loss. The calculations of basic and diluted net income (loss) per share and basic and diluted weighted average shares outstanding are as follows (dollars and shares in thousands, except per share data):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Net income (loss)	\$ 9,937	\$ 3,836	\$ 14,350	\$ (7,900)
Weighted average shares outstanding	93,512	93,902	93,470	93,983
Dilutive impact from:				
Share-based payment awards	1,951	2,365	2,071	
Dilutive weighted average shares outstanding	95,463	96,267	95,541	93,983
Income (loss) per share				
Basic	\$ 0.11	\$ 0.04	\$ 0.15	\$ (0.08)
Dilutive	\$ 0.10	\$ 0.04	\$ 0.15	\$ (0.08)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Employee equity awards	472	791	1,034	7,010

10. Commitments and Contingencies

In the ordinary course of business, we from time to time pursue lawsuits and claims to enforce our intellectual property rights and to address other intellectual property, commercial and miscellaneous matters. In addition, we are also from time to time involved in other lawsuits, claims, investigations, proceedings and threats of litigation. These include a March 2010 claim against us by an entity affiliated with a former reseller of ours, and an April 2004 claim by a customer for approximately \$5.0 million that certain of our software products and implementation services failed to meet the customer's expectations.

The results of litigation and claims cannot be predicted with certainty, and unfavorable resolutions are possible and could materially affect our results of operations, cash flows or financial position. In addition, regardless of the outcome, litigation could have an adverse impact on us because of litigation fees and costs, diversion of management resources and other factors.

While the outcome of the proceedings and claims referenced above cannot be predicted with certainty, there are no such matters as of December 31, 2012, that, in the opinion of management, might have a material adverse effect on our financial position, results of operations or cash flows. Liabilities, if applicable, related to the aforementioned matters discussed in this Note have been included in our accrued liabilities at December 31, 2012 and June 30, 2012, and are not material to our financial position for the periods then ended.

As of December 31, 2012 we do not believe that there is a reasonable possibility of a loss exceeding the amounts already accrued for the proceedings or matters discussed above.

11. 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 President and Chief Executive Officer.

We have three operating segments: license; SMS, training, and other; and professional services. 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 SMS, training, and other 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 professional services line of business offers implementation, advanced process control, real-time optimization and other professional services in order to provide customers with complete solutions.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies (refer to Note 2 in the financial statements in our Form 10-K for the year ended June 30, 2012). 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.

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The following table presents a summary of operating segments (dollars in thousands):

	License	SMS, Training, and Other	Professional Services	Total
Three Months Ended December 31, 2012				
Segment revenue	\$ 59,457	\$ 11,626	\$ 6,226	\$ 77,309
Segment expenses	17,738	1,865	5,529	25,132
Segment operating profit (1)	\$ 41,719	\$ 9,761	\$ 697	\$ 52,177
Three Months Ended December 31, 2011				
Segment revenue	\$ 46,502	\$ 14,401	\$ 5,652	\$ 66,555
Segment expenses	16,863	2,513	5,845	25,221
Segment operating profit (loss) (1)	\$ 29,639	\$ 11,888	\$ (193)	\$ 41,334
Six Months Ended December 31, 2012				
Segment revenue	\$ 113,537	\$ 23,329	\$ 11,900	\$ 148,766
Segment expense	32,833	3,689	11,050	47,572
Segment operating profit (1)	\$ 80,704	\$ 19,640	\$ 850	\$ 101,194
Six Months Ended December 31, 2011				
Segment revenue	\$ 78,412	\$ 28,568	\$ 10,800	\$ 117,780
Segment expense	33,415	5,206	12,243	50,864
Segment operating profit (loss) (1)	\$ 44,997	\$ 23,362	\$ (1,443)	\$ 66,916

(1) The segment operating profits (losses) reported reflect the direct expenses of the operating segment and contain certain allocations of selling and marketing, general and administrative, research and development, and do not contain restructuring and other corporate expenses incurred in support of the segments.

Reconciliation to Income (Loss) Before Income Taxes

The following table presents a reconciliation of total segment operating profit to income (loss) before income taxes for the three and six months ended December 31, 2012 and 2011 (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Total segment operating profit for reportable segments	\$ 52,177	\$ 41,334	\$ 101,194	\$ 66,916
Cost of subscription and software	(3,100)	(2,622)	(6,290)	(5,346)
Marketing	(2,479)	(2,448)	(6,000)	(6,315)
Research and development	(12,299)	(10,573)	(25,285)	(22,145)
General and administrative	(9,417)	(9,475)	(19,151)	(22,581)
Information technology and overhead	(6,506)	(6,090)	(12,783)	(12,393)
Stock-based compensation	(3,453)	(3,071)	(7,768)	(6,779)

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Restructuring charges	6	(14)	(34)	59
Other expense, net	(57)	(425)	(334)	(2,457)
Interest income (net)	839	1,019	1,681	2,158
Income (loss) before income taxes	\$ 15,711	\$ 7,635	\$ 25,230	\$ (8,883)

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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 consolidated financial statements and related notes beginning on page 4. In addition to historical information, this discussion contains forward-looking statements that involve risks and uncertainties. You should read Item 1A. Risk Factors, of Part II 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 to the twelve months ended June 30 of such year (for example, fiscal 2013 refers to the year ending on June 30, 2013).

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 specifically for companies in the process industries, including the energy, chemicals, and engineering and construction 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.

Our software incorporates our proprietary empirical models of manufacturing and planning processes and reflects the deep domain expertise we have amassed from focusing on solutions for the process industries for over 30 years. We have developed our applications to design and optimize processes across three principal business areas: engineering, manufacturing and supply chain. We are a recognized market and technology leader in providing process optimization software for each of these business areas.

We have established sustainable competitive advantages within our industry based on the following strengths:

- Innovative products that can enhance our customers' profitability;
- Long-term customer relationships;
- Large installed base of users of our software; and
- Long-term license contracts with historically high renewal rates.

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 and build process manufacturing plants.

We primarily license our software products through a subscription offering which we refer to as our aspenONE licensing model. Our aspenONE products are organized into two suites: 1) engineering and 2) manufacturing and supply chain (MSC). The aspenONE licensing model provides customers with access to all of the products within the aspenONE suite(s) they license. Customers can change or alternate the use of multiple products in a licensed suite through the use of exchangeable units of measurement, called tokens, licensed in quantities determined by the customer. This licensing system enables customers to use products as needed and to experiment with different products to best solve whatever critical business challenges they face. Customers can increase their usage of our software by purchasing additional tokens as business needs evolve. We believe easier access to all of the aspenONE products will lead to increased software usage and higher revenue over time.

Transition to the aspenONE Licensing Model

Prior to fiscal 2010, we offered term or perpetual licenses to specific products, or specifically defined sets of products, which we refer to as point products. 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, provided all revenue recognition criteria were met. Customers typically received one year of post-contract software maintenance and support, or SMS, with their license agreements and then could elect to renew SMS annually. Revenue from SMS was recognized ratably over the period in which the SMS was delivered.

In fiscal 2010, we introduced the following changes to our licensing model:

- (i) Began offering our software on a subscription basis allowing our customers access to all products within a licensed suite (aspenONE Engineering or aspenONE Manufacturing and Supply Chain). SMS is included for the entire term of the arrangement and customers are entitled to any software products or updates introduced into the licensed suite. We refer to this license arrangement as our aspenONE licensing model.

- (ii) Began to include SMS for the entire term on our point product term arrangements.

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Revenue related to our aspenONE licensing model is recognized over the term of the arrangement on a ratable basis. During fiscal 2010 and 2011, license revenue related to our point product arrangements with SMS included for the entire term of the arrangement was generally recognized on the due date of each annual installment, provided all revenue recognition criteria were met. Beginning in fiscal 2012, we were unable to establish evidence of the fair value for the SMS component and revenue from these arrangements is now recognized on a ratable basis.

The changes to our licensing model introduced in fiscal 2010 did not change the method or timing of customer billings or cash collections. Since the introduction of these changes, our net cash provided by operating activities has increased in each annual period from \$33.0 million in fiscal 2009 to \$104.6 million in fiscal 2012. During these periods we have realized steadily improving cash flow due to growth of our portfolio of term license contracts, as well as from the renewal of customer contracts, on an installment basis, that were previously paid upfront.

Impact of Licensing Model Changes

The principal accounting implications of the changes to our licensing model are as follows:

- The majority of our license revenue is no longer recognized on an upfront basis. Since the upfront model resulted in the net present value of multiple years of future installments being recognized at the time of shipment, we do not expect to recognize levels of revenue comparable to our pre-transition levels until a significant majority of license agreements executed under our upfront revenue model (i) reach the end of their original terms and (ii) are renewed. Accordingly, since the changes to our licensing model in fiscal 2010, our product-related revenue has been significantly less than the level achieved in the fiscal years preceding our licensing model changes.
- The changes to our licensing model resulted in operating losses for fiscal 2010, 2011 and 2012. These changes did not impact the incurrence or timing of our expenses, and there was no corresponding expense reduction to offset the lower revenue. Subscription and software revenue has steadily increased from the beginning of fiscal 2010 as a portion of the license agreements executed under our upfront revenue model have reached the end of their original term and have been renewed under either our aspenONE licensing model or as point product arrangements which include SMS for the contract term. To the extent the remaining term license agreements executed under our upfront revenue model expire and are renewed, we expect to recognize levels of revenue and operating profit comparable to, or higher than, our pre-transition levels.
- The SMS component of our services and other revenue has, and is expected to continue to, decrease and continue to be offset by a corresponding increase in subscription and software revenue as customers transition to our aspenONE licensing model or point product arrangements with Premier Plus SMS included for the full contract term. The entire arrangement fee, including the SMS component, is included within subscription and software revenue.
- Installment payments are not considered fixed or determinable, and as a result, are not included in installments receivable. Accordingly, our installments receivable balance has, and is expected to continue to, decrease as licenses previously executed under our upfront revenue model reach the end of their terms.

- The amount of our deferred revenue has, and is expected to continue to, increase as an increasing portion of revenue from our term license portfolio is recognized on a ratable basis.

Introduction of our Premier Plus SMS Offering

Beginning in fiscal 2012, we introduced our Premier Plus SMS offering to provide more value to our customers. As part of this offering, customers receive 24x7 support, faster response times, dedicated technical advocates and access to web-based training modules. The Premier Plus SMS offering is only provided to customers that commit to SMS for the entire term of the arrangement. Our annually renewable legacy SMS offering continues to be available to customers with legacy term and perpetual license agreements.

The introduction of our Premier Plus SMS offering resulted in a change to the revenue recognition of point product arrangements that include Premier Plus SMS for the term of the arrangement. Beginning in fiscal 2012, revenue associated with point product arrangements that include the Premier Plus SMS offering is being recognized on a ratable basis, whereas prior to fiscal 2012, license revenue was recognized on the due date of each annual installment, provided all revenue recognition criteria were met. The introduction of our Premier Plus SMS offering did not change the revenue recognition for our aspenONE licensing arrangements.

For additional information about the recognition of revenue under the upfront revenue model and our aspenONE licensing model, 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, 2012. Due to the accounting

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implications resulting from the changes to our licensing model, we believe that 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 until a significant majority of our license agreements executed under our upfront revenue model reach the end of their original terms and are renewed under our aspenONE licensing model. 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 specifically for the process industries. We license our software products, together with SMS, primarily on a term basis, and we offer extended payment options for our term license agreements that generally require annual payments, which we also refer to as installments.
- *SMS and training.* Our SMS business consists primarily of providing customer technical support and access to software fixes and updates. We provide customer technical support services throughout the world from our customer support 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 and software revenue consists of product and related revenue from the following sources: (i) aspenONE licensing model, including the bundled SMS; (ii) point product arrangements with our Premier Plus SMS offering included for the contract term (referred to as point product arrangements with Premier Plus SMS); (iii) legacy arrangements including (a) amendments to existing legacy term arrangements, (b) renewals of legacy term arrangements and (c) legacy arrangements that are being recognized over time as a result of not previously meeting one or more of the requirements for recognition under the upfront revenue model; and (iv) perpetual arrangements.

Results of Operations Classification - Subscription and Software Revenue

Prior to fiscal 2012, subscription and software revenue were each classified separately on our unaudited consolidated statements of operations, because each type of revenue had different revenue recognition characteristics, and the amount of revenue attributable to each was material in relation to our total revenue. Additionally, we were able to separate the residual amount of software revenue related to the software component of our point product arrangements which included SMS for the contract term, based on the VSOE for the SMS element.

As a result of the introduction of our Premier Plus SMS offering in the first quarter of fiscal 2012, the majority of our product-related revenue is now recognized on a ratable basis, over the term of the arrangement. Since the distinction between subscription and point product ratable revenue does not represent a meaningful difference from either a line of business or revenue recognition perspective, we have combined our subscription and software revenue into a single line item on our consolidated statements of operations beginning in the first quarter of fiscal 2012.

Services and Other Revenue. Our services and other revenue consists primarily of revenue related to professional services, standalone renewals of our legacy SMS offering and training. The amount and timing of this revenue depend on a number of factors, including:

- whether the professional services arrangement was sold as a single arrangement with, or in contemplation of, a new aspenONE licensing transaction;
- 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;

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- 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. Our cost of subscription and software revenue consists of royalties, amortization of capitalized software and purchased intangibles, distribution fees, the costs of providing SMS on arrangements where the related revenue is recorded as subscription and software revenue, 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 customers professional services, SMS on arrangements for which we have VSOE for the SMS element, and training.

Operating Expenses

Selling and Marketing Expenses. 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 to help us better understand our customers and their business needs.

Research and Development Expenses. Research and development expenses consist primarily 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 Expenses. 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 Expense, Net. Other expense, net is comprised primarily of foreign currency exchange (losses) gains 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 (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 expense, net.

Provision for (Benefit from) Income Taxes. The provision for income taxes is comprised of domestic and foreign taxes, and deferred benefit on U.S. losses for which it is more likely than not that we will be able to utilize these benefits in the future. The benefit from income taxes is comprised of the deferred benefit for tax deductions and credits that we expect to utilize in the future. 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 by jurisdiction.

Key Business Metrics

Background

Since the changes to our licensing model in fiscal 2010, our product-related revenue has been significantly less than the level

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achieved in the fiscal years preceding the changes. Since the upfront model resulted in the net present value of multiple years of future installments being recognized at the time of shipment, we do not expect to recognize levels of revenue comparable to our pre-transition levels until a significant majority of license agreements executed under our upfront revenue model (i) reach the end of their original terms and (ii) are renewed. 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 until a significant majority of our license agreements executed under our upfront revenue model reach the end of their original terms and are renewed under our aspenONE licensing model or under a point product arrangement with Premier Plus SMS. Accordingly, we 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 unaudited consolidated 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 investments in future growth initiatives and it is also useful as a 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 approximates the cash operating costs of the business. 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 current 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. 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 also estimate a *license-only TCV*, which we refer to as TLCV, by removing the SMS portion of TCV using our historic estimated selling price for SMS. Our portfolio of active license agreements currently reflects a mix of (a) license agreements that include SMS for the entire license term and (b) legacy license agreements that do not include SMS. TLCV provides a consistent basis for assessing growth, particularly while customers are continuing to transition to arrangements that include SMS for the term of the arrangement.

We believe TCV and TLCV are useful metrics for analyzing our business performance, particularly while we are transitioning to our aspenONE licensing model or to point product arrangements with Premier Plus SMS included for the full term and revenue comparisons between fiscal periods do not reflect the actual growth rate of our business. Comparing TCV and TLCV for different dates provides insight into the growth and retention rate of our business during the period between those dates.

TCV and TLCV increase 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 (units of software usage) or products licensed; and
- renewals of existing license agreements that increase the length of the license term.

The renewal of an existing license agreement will not increase TCV and TLCV unless the renewal results in higher license fees or a longer license term. TCV and TLCV are 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 and TLCV 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.

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We estimate that TLCV grew by approximately 2.9% during the second quarter of fiscal 2013, from \$1.50 billion at September 30, 2012 to \$1.54 billion at December 31, 2012, and by approximately 5.3% during the first half of fiscal 2013, from \$1.46 billion at June 30, 2012. The growth was attributable primarily to an increase in the number of tokens or products licensed.

We estimate that TCV grew by approximately 3.3% during the second quarter of fiscal 2013, from \$1.72 billion at September 30, 2012 to \$1.78 billion at December 31, 2012, and by approximately 6.1% during the first half of fiscal 2013, from \$1.68 billion at June 30, 2012. The growth was attributable primarily to an increase in the number of tokens or products licensed.

Adjusted Total Costs

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

	Three Months Ended				Six Months Ended			
	December 31,		Period-to-Period Change		December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Total cost of revenue	\$ 12,373	\$ 12,925	\$ (552)	(4.3)%	\$ 24,711	\$ 26,746	\$ (2,035)	(7.6)%
Total operating expenses	50,007	46,589	3,418	7.3	100,172	99,618	554	0.6
Total expenses	62,380	59,514	2,866	4.8%	124,883	126,364	(1,481)	(1.2)%
Less:								
Stock-based compensation	(3,453)	(3,071)	(382)	12.4	(7,768)	(6,779)	(989)	14.6
Restructuring charges	6	(14)	20	*	(34)	59	(93)	*
Amortization of purchased intangibles	(199)		(199)	*	(302)		(302)	*
Adjusted total costs (non-GAAP)	\$ 58,734	\$ 56,429	\$ 2,305	4.1%	\$ 116,779	\$ 119,644	\$ (2,865)	(2.4)%

* Not meaningful

Comparison of the Three Months Ended December 31, 2012 and 2011

Total expenses increased by \$2.9 million for the three months ended December 31, 2012 compared to the same period of the prior fiscal year. Adjusted total costs increased by \$2.3 million for the three months ended December 31, 2012 compared to the same period of the prior fiscal year. The period-over-period increase was primarily attributable to higher compensation and related costs of \$2.0 million and other less significant items that totaled \$1.3 million, net, partially offset by lower legal costs of \$1.0 million.

Stock-based compensation expense increased \$0.4 million primarily due to the incremental expense associated with the August 2012 annual program grant, which had a higher valuation than awards granted in previous periods. Amortization of purchased intangibles increased \$0.2 million due to the expense associated with assets acquired during the second half of fiscal 2012 and during the three months ended September 30, 2012. Please refer to the Results of Operations section below for additional information on period-over-period expense fluctuations.

Comparison of the Six Months Ended December 31, 2012 and 2011

Total expenses decreased by \$1.5 million for the six months ended December 31, 2012 compared to the same period of the prior fiscal year. Adjusted total costs decreased by \$2.9 million for the six months ended December 31, 2012 compared to the same period of the prior fiscal year. The period-over-period decrease was primarily attributable to a reduction in legal costs of \$2.7 million, lower office and related expenses of \$0.6 million and other individually insignificant decreases that totaled \$0.6 million, net. These decreases were partially offset by higher compensation and related costs of \$1.0 million.

Stock-based compensation expense increased \$1.0 million primarily due to the incremental expense associated with the August 2012 annual program grant, which had a higher valuation than awards granted in previous periods. . Please refer to the Results of Operations section below for additional information on period-over-period expense fluctuations.

Free Cash Flow

Free cash flow is calculated as net cash provided by operating activities less the net impact of (a) purchases of property, equipment and leasehold improvements (b) insurance proceeds and (c) capitalized computer software development costs.

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Customer collections and, consequently, cash flows from operating activities and free cash flow are primarily driven by license and services billings, rather than recognized revenue. As a result, the introduction of our aspenONE licensing model has not had an adverse impact on cash receipts. Until existing term 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 income (loss) and net income (loss). Additionally, we also believe that free cash flow is often used by securities analysts, investors and other interested parties in the evaluation of software companies.

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

	Six Months Ended December 31,	
	2012	2011
Net cash provided by operating activities	\$ 54,140	\$ 28,280
Purchase of property, equipment, and leasehold improvements	(2,567)	(922)
Insurance proceeds	2,222	
Capitalized computer software development costs	(435)	(392)
Free cash flow (non-GAAP)	\$ 53,360	\$ 26,966

Total free cash flow increased \$26.4 million during the six months ended December 31, 2012 as compared to the same period of the prior fiscal year.

We have realized steadily improving free cash flow due to growth of our portfolio of term license contracts as well as from the renewal of customer contracts on an installment basis that were previously paid upfront. Over the past few years we have reduced the incentive for customers to pay upfront by reducing the discount rate used to calculate the upfront payment. We expect our free cash flow to continue to improve as our portfolio of term license contracts continues to grow.

Critical Accounting Estimates and Judgments

Our unaudited consolidated financial statements are prepared in accordance with GAAP. The preparation of our interim 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 unaudited consolidated financial statements:

- revenue recognition;
- accounting for income taxes; and
- loss contingencies.

Revenue Recognition

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 signed contract as evidence of an arrangement for software licenses and SMS. For professional services we use a signed contract and a work proposal 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, our warehouse (i.e., FCA, named place). Our software license agreements do not contain conditions for acceptance.

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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 a contract modification to an existing term arrangement constitutes a concession. In making this assessment, significant analysis is performed to ensure that no concessions are given. Our software license agreements do not include a right of return or exchange.

We cannot assert that the fees under our aspenONE licensing model and point product arrangements with Premier Plus SMS are fixed or determinable because the rights provided to customers, and the economics of the arrangements, are not comparable to our transactions with other customers under the upfront revenue model. As a result, the amount of revenue recognized for these arrangements is limited by the amount of customer payments that become due.

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.

Vendor-Specific Objective Evidence of Fair Value

We have established vendor-specific objective evidence of fair value, or VSOE, for certain SMS offerings, professional services, and training, but not for our software products or our Premier Plus SMS offering. We assess VSOE for SMS, professional services, and training based on an analysis of standalone sales of these offerings using the bell-shaped curve approach. We do not have a history of selling our Premier Plus SMS offering to customers on a standalone basis, and as a result are unable to establish VSOE for this new deliverable.

We allocate the arrangement consideration among the elements included in our multi-element arrangements using the residual method. Under the residual method, the 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. Under the upfront revenue model, the residual license fee is recognized upon delivery of the software provided all other revenue recognition criteria were met. Arrangements that qualify for upfront recognition include sales of perpetual licenses, amendments to existing legacy term arrangements and renewals of legacy term arrangements.

Subscription and Software Revenue

Subscription and software revenue consists of product and related revenue from our (i) aspenONE licensing model, including the bundled SMS; (ii) point product arrangements with our Premier Plus SMS offering included for the contract term; (iii) legacy arrangements including (a) amendments to existing legacy term arrangements, (b) renewals of legacy term arrangements and (c) legacy arrangements that are being recognized over time as a result of not previously meeting one or more of the requirements for recognition under the upfront revenue model; and (iv) perpetual arrangements.

When a customer elects to license our products under our aspenONE licensing model, our Premier Plus SMS offering 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 and updates that may be introduced into the licensed aspenONE software suite. Due to our obligation to provide unspecified future software products and updates, we are required to recognize the total revenue ratably over the term of the arrangement, once the other revenue recognition criteria noted above have been met.

Our point product arrangements with Premier Plus SMS include SMS for the term of the arrangement. Since we do not have VSOE for our Premier Plus SMS offering, the SMS element of our point product arrangements is not separable. As a result, revenue is also recognized ratably over the term of the arrangement, once the other revenue recognition criteria have been met.

Perpetual license and legacy arrangements do not include the same rights as those provided to customers under the aspenONE licensing model and point product arrangements with Premier Plus SMS. We continue to have VSOE for the legacy SMS offering provided in support of these license arrangements and can therefore separate the undelivered elements. Accordingly, the license fees for perpetual licenses and legacy arrangements continue to be recognized upon delivery of the software products using the residual method, provided all other revenue recognition requirements have been met.

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Services and Other

SMS Revenue

SMS revenue includes the maintenance revenue recognized from arrangements for which we continue to have VSOE for the undelivered SMS offering (legacy SMS offering). For arrangements sold with our legacy SMS offering, SMS renewals are at the option of the customer, and the fair value of SMS is deferred and subsequently amortized over the contractual term of the SMS arrangement.

Professional Services Revenue

Professional services are provided to customers on a time-and-materials, (or T&M), or fixed-price basis. 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. Project costs are typically 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. Additionally, we believe that costs are the best available measure of performance. Out-of-pocket expenses which are reimbursed by customers are recorded as revenue.

In certain circumstances, professional services revenue may be recognized over a longer time period than that which the services are performed. 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 circumstances in which professional services are sold as a single arrangement with, or in contemplation of, a new aspenONE license or point product arrangement with Premier Plus SMS, revenue is deferred and recognized on a ratable basis over the longer of (i) the period the services are performed, or (ii) the license term. When 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 completed contract or percentage-of-completion method.

We have occasionally been required to commit unanticipated additional resources to complete projects, which resulted in losses on those contracts. Provisions for estimated losses on contracts are made during the period in which such losses become probable and can be reasonably estimated.

Please refer to Management's Discussion and Analysis of Financial Condition and Result of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended June 30, 2012 for a discussion of our critical accounting policies and estimates related to accounting for income taxes and loss contingencies.

Table of Contents**Results of Operations***Comparison of the Three and Six Months Ended December 31, 2012 and 2011*

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, 2012 and 2011 (in thousands, except percentages):

	Three Months Ended December 31,		Increase / (Decrease) Change %	Six Months Ended December 31,		Increase / (Decrease) Change %
	2012	2011		2012	2011	
Revenue:						
Subscription and software	\$ 59,457	\$ 46,502	27.9%	\$ 113,537	\$ 78,412	44.8%
Services and other	17,852	20,053	(11.0)	35,229	39,368	(10.5)
Total revenue	77,309	66,555	16.2	148,766	117,780	26.3
Cost of revenue:						
Subscription and software	3,100	2,622	18.2	6,290	5,346	17.7
Services and other	9,273	10,303	(10.0)	18,421	21,400	(13.9)
Total cost of revenue	12,373	12,925	(4.3)	24,711	26,746	(7.6)
Gross profit	64,936	53,630	21.1	124,055	91,034	36.3
Operating expenses:						
Selling and marketing	23,303	22,318	4.4	44,894	45,764	(1.9)
Research and development	15,039	12,767	17.8	30,805	26,536	16.1
General and administrative	11,671	11,490	1.6	24,439	27,377	(10.7)
Restructuring charges	(6)	14	*	34	(59)	*
Total operating expenses	50,007	46,589	7.3	100,172	99,618	0.6
Income (loss) from operations	14,929	7,041	112.0	23,883	(8,584)	*
Interest income	955	2,034	(53.0)	2,054	4,265	(51.8)
Interest expense	(116)	(1,015)	(88.6)	(373)	(2,107)	(82.3)
Other expense, net	(57)	(425)	(86.6)	(334)	(2,457)	(86.4)
Income (loss) before provision for (benefit from) income taxes	15,711	7,635	105.8	25,230	(8,883)	*
Provision for (benefit from) income taxes	5,774	3,799	52.0	10,880	(983)	*
Net income (loss)	\$ 9,937	\$ 3,836	159.0%	\$ 14,350	\$ (7,900)	*%

* 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, 2012 and 2011:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Revenue:				
Subscription and software	76.9%	69.9%	76.3%	66.6%
Services and other	23.1	30.1	23.7	33.4
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Subscription and software	4.0	3.9	4.2	4.5
Services and other	12.0	15.5	12.4	18.2
Total cost of revenue	16.0	19.4	16.6	22.7
Gross profit	84.0	80.6	83.4	77.3
Operating expenses:				
Selling and marketing	30.1	33.5	30.2	38.9
Research and development	19.5	19.2	20.7	22.5
General and administrative	15.1	17.3	16.4	23.2
Restructuring charges	(0.0)	0.0	0.0	(0.1)
Total operating expenses	64.7	70.0	67.3	84.6
Income (loss) from operations	19.3	10.6	16.1	(7.3)
Interest income	1.2	3.1	1.4	3.6
Interest expense	(0.2)	(1.5)	(0.3)	(1.8)
Other expense, net	(0.1)	(0.6)	(0.2)	(2.1)
Income (loss) before provision for (benefit from) income taxes	20.3	11.5	17.0	(7.5)
Provision for (benefit from) income taxes	7.5	5.7	7.3	(0.8)
Net income (loss)	12.9%	5.8%	9.6%	(6.7)%

Revenue

Total revenue during the three and six months ended December 31, 2012 increased by \$10.8 million and \$31.0 million compared to the corresponding period of the prior fiscal year. The increase was due to higher subscription and software revenue of \$13.0 million and \$35.1 million, partially offset by lower services and other revenue of \$2.2 million and \$4.1 million, respectively.

Subscription and Software Revenue**Period-to-Period Change**

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	Three Months Ended December 31,				Six Months Ended December 31,				Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%	\$	%
Subscription and software revenue	\$ 59,457	\$ 46,502	\$ 12,955	27.9%	\$ 113,537	\$ 78,412	\$ 35,125		\$	44.8%
As a percent of revenue	76.9%	69.9%			76.3%	66.6%				

The increase in subscription and software revenue during the three and six months ended December 31, 2012, compared to the corresponding periods of the prior fiscal year, was primarily the result of a larger base of arrangements being recognized on a ratable basis during the current quarter and first half of fiscal 2013. We expect subscription and software revenue to continue to increase as customers renew expiring contracts formerly on the upfront revenue model. While we are transitioning to our aspenONE licensing model, we do not expect to recognize levels of revenue comparable to our pre-transition levels until a significant majority of license agreements executed under our upfront revenue model (i) reach the end of their original terms and (ii) are renewed.

The following tables summarize the amount of subscription and software revenue recognized on a ratable basis and under the residual method for the three and six months ended December 31, 2012 and 2011, respectively. As illustrated below, the introduction of our aspenONE licensing model and the inclusion of our Premier Plus SMS offering with point product arrangements resulted in a substantial majority of our subscription and software revenue being recognized on a ratable basis in the first half of fiscal 2013 and 2012, respectively.

Table of Contents**Subscription and software revenue:**

Ratable	\$	52,550	\$	31,726	88.4%	68.2%
Residual method (1)		6,907		14,776	11.6	31.8%
Subscription and software revenue	\$	59,457	\$	46,502	100.0%	100.0%

	Six Months Ended December 31,		Six Months Ended December 31,			
	2012 (Dollars in thousands)	2011	2012 % of Total	2011		
Subscription and software revenue:						
Ratable	\$	103,702	\$	60,181	91.3%	76.7%
Residual method (1)		9,835		18,231	8.7	23.3%
Subscription and software revenue	\$	113,537	\$	78,412	100.0%	100.0%

(1) Residual method revenue detail

	Three Months Ended December 31,		Six Months Ended December 31,			
	2012	2011	2012	2011		
Residual method revenue:						
Legacy arrangements	\$	6,525	\$	13,668	\$	8,717
Perpetual arrangements		382		1,108		1,118
Total residual method revenue	\$	6,907	\$	14,776	\$	9,835
					\$	16,784
						1,447
						18,231

As noted in the table above, we recognized \$6.5 million and \$8.7 million of revenue related to legacy arrangements during the three and six months ended December 31, 2012, compared to \$13.7 million and \$16.8 million in the corresponding periods of the prior fiscal year. Revenue related to legacy arrangements recognized during the three and six months ended December 31, 2011 included \$6.0 million due to a renewal of a legacy term arrangement. No such event occurred in the current fiscal year. We expect residual method revenue from legacy arrangements to decrease and be replaced with term-based licensing agreements that are recognized on a ratable basis. We do not expect revenue related to point products licensed on a perpetual basis to be a significant source of revenue during the remainder of fiscal 2013 and beyond.

Services and Other Revenue

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change		
	2012	2011	\$	%	2012	2011	\$	%	
Professional services revenue	\$	6,226	\$	5,652	\$	574	10.2%	\$	11,900
		11,626		14,401		(2,775)	(19.3)		10,800
									28,568
									(5,239)
									(18.3)

SMS and other revenue								
Services and other revenue	17,852	20,053	(2,201)	(11.0)%	35,229	39,368	(4,139)	(10.5)%
As a percent of revenue	23.1%	30.1%			23.7%	33.4%		

Professional Services Revenue

Professional services revenue during the three and six months ended December 31, 2012 increased \$0.6 million and \$1.1 million, respectively, compared to the corresponding periods of the prior fiscal year.

The period-over-period increase in professional services revenue was primarily due to increased professional services activity, partially offset by revenue deferrals on arrangements which did not meet the requirements for revenue recognition. During the three and six months ended December 31, 2012, we deferred the recognition of \$1.3 million and \$2.0 million of professional services revenue on arrangements being recognized on the completed contract method. By comparison, during the three and six months ended December 30, 2011, we deferred the recognition of \$0.4 million and \$0.7 million of revenue on similar arrangements.

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Under the aspenONE licensing model, 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 the period over which the services are performed. During the three and six months ended December 31, 2012, we had net revenue deferrals of \$0.7 million and \$1.5 million for professional services bundled with aspenONE transactions. By comparison, we had net revenue deferrals of \$0.6 million and \$2.3 million on similar arrangements during the three and six months ended December 31, 2011.

SMS and Other Revenue

SMS and other revenue includes revenue from annually renewed legacy SMS, offered in support of our perpetual and legacy term arrangements.

SMS and other revenue decreased by \$2.8 million and \$5.2 million during the three and six months ended December 31, 2012 compared to the corresponding periods of the prior fiscal year. The decrease was primarily due to customers transitioning from legacy term and perpetual arrangements to term license arrangements that include Premier Plus SMS for the contract term. Under our aspenONE licensing model and for point product arrangements with Premier Plus SMS, the entire arrangement fee is included within subscription and software revenue. We expect legacy SMS revenue to continue to decrease as additional customers transition to our aspenONE licensing model. Over the next few years we expect that SMS revenue will represent less than 10% of our total revenue, at which time we would include SMS revenue in our subscription and software line in our unaudited consolidated statements of operations.

*Expenses***Cost of Subscription and Software Revenue**

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Cost of subscription and software revenue	\$ 3,100	\$ 2,622	\$ 478	18.2%	6,290	5,346	\$ 944	17.7%
Gross margin	94.8%	94.4%			94.5%	93.2%		

The period-over-period increase in cost of subscription and software revenue during the three and six months ended December 31, 2012 was due to a larger percentage of SMS services being provided to customers under our aspenONE licensing model and point product arrangements with Premier Plus SMS. We allocate the portion of SMS cost associated with providing support services on these arrangements to match the expense with the related revenue. As more customers transition to the aspenONE licensing model, more of the related SMS costs will be included in cost of subscription and software revenue.

Cost of Services and Other Revenue

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Cost of services and other revenue	\$ 9,273	\$ 10,303	\$ (1,030)	(10.0)%	\$ 18,421	\$ 21,400	\$ (2,979)	(13.9)%
Gross margin	48.1%	48.6%			47.7%	45.6%		

Cost of services and other revenue includes the cost of providing professional services, training, annually renewed legacy SMS, and other revenue.

Cost of Professional Services Revenue

The cost of professional services revenue decreased \$0.4 million and \$1.4 million during the three and six months ended December 31, 2012 compared to the corresponding periods of the prior fiscal year. The decrease was primarily attributable to lower compensation and related costs.

Table of ContentsCost of SMS and Other Revenue

Cost of SMS and other revenue decreased \$0.6 million and \$1.6 million during the three and six months ended December 31, 2012 compared to the corresponding periods of the prior fiscal year. The period-over-period decrease in cost of SMS and other revenue was primarily due to the growth of our subscription-based revenue and the associated higher allocation of SMS support costs being reported in cost of subscription and software revenue. 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 the costs of our SMS business to be presented in cost of subscription and software revenue.

Gross margin on cost of services and other revenue decreased from 48.6% during the three months ended December 31, 2011 to 48.1% during the corresponding period of the current fiscal year primarily due to continued migration of SMS revenue to subscription and software revenue as a result of transitioning to our aspenONE licensing model. Gross margin on cost of services and other revenue increased from 45.6% during the six months ended December 31, 2011 to 47.7% during the corresponding period of the current fiscal year primarily due to the reduction in the cost of professional services as noted above. As the gross margin on SMS has historically been higher than on professional services, and SMS revenue continues to migrate to subscription and software revenue, we expect the gross margin on services and other revenue to trend downward, however it may be variable on a quarter to quarter basis.

Selling and Marketing Expense

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Selling and marketing expense	\$ 23,303	\$ 22,318	\$ 985	4.4%	\$ 44,894	\$ 45,764	\$ (870)	(1.9)%
As a percent of revenue	30.1%	33.5%			30.2%	38.9%		

The period-over-period increase in selling and marketing expense during the three months ended December 31, 2012 was primarily the result of higher compensation and related costs of \$1.8 million, and other less significant items that totaled \$0.8 million, net, partially offset by lower stock-based compensation expense of \$0.3 million and lower commissions of \$1.3 million.

The period-over-period decrease in selling and marketing expense during the six months ended December 31, 2012 was primarily the result of lower commissions of \$3.1 million and lower stock-based compensation of \$0.4 million, partially offset by higher compensation and related costs of \$2.1 million and other less significant items that totaled \$0.5 million, net.

Research and Development Expense

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	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Research and development expense	\$ 15,039	\$ 12,767	\$ 2,272	17.8%	\$ 30,805	\$ 26,536	\$ 4,269	16.1%
As a percent of revenue	19.5%	19.2%			20.7%	22.5%		

The period-over-period increase in research and development expense during the three months ended December 31, 2012 was primarily the result of higher compensation and related costs of \$2.2 million, including higher stock-based compensation expense of \$0.4 million. These increases are primarily due to higher headcount.

The period-over-period increase in research and development expense during the six months ended December 31, 2012 was primarily the result of higher compensation and related costs of \$4.3 million, including higher stock-based compensation expense of \$0.8 million. These increases are primarily due to higher headcount.

General and Administrative Expense

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
General and administrative expense	\$ 11,671	\$ 11,490	\$ 181	1.6%	\$ 24,439	\$ 27,377	\$ (2,938)	(10.7)%
As a percent of revenue	15.1%	17.3%			16.4%	23.2%		

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The period-over-period increase in general and administrative expense during the three months ended December 31, 2012 was primarily attributable to higher compensation and related costs of \$0.4 million, increased provisions for bad debt of \$0.6 million and other less significant items that totaled \$0.2 million, net, partially offset by a reduction in legal costs of \$1.0 million.

The period-over-period decrease in general and administrative expense during the six months ended December 31, 2012 was primarily attributable to a reduction in legal costs of \$2.7 million and other less significant items that totaled \$0.7 million, net, partially offset by increased provisions for bad debt of \$0.5 million.

In fiscal 2012, the Company benefited from the collection of previously reserved receivables resulting in a net reduction in bad debt expense of \$0.4 million and \$0.5 million during the three and six month periods ended December 31, 2011, respectively. No similar events occurred in fiscal 2013.

Interest Income

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Interest income	\$ 955	\$ 2,034	\$ (1,079)	(53.0)%	\$ 2,054	\$ 4,265	\$ (2,211)	(51.8)%
As a percent of revenue	1.2%	3.1%			1.4%	3.6%		

The period-over-period decrease in interest income during the three and six months ended December 31, 2012 was primarily attributable to the continued decrease of our installments receivables portfolios. We expect interest income to continue to decrease going forward.

Interest Expense

	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Interest expense	\$ (116)	\$ (1,015)	\$ 899	(88.6)%	\$ (373)	\$ (2,107)	\$ 1,734	(82.3)%
As a percent of revenue	(0.2)%	(1.5)%			(0.3)%	(1.8)%		

The period-over-period decrease in interest expense during the three and six months ended December 31, 2012 was primarily attributable to the continued pay-down of our secured borrowings which were repaid in full during the second quarter of fiscal 2013.

Other Expense, Net

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	Three Months Ended December 31,		Period-to-Period Change		Six Months Ended December 31,		Period-to-Period Change	
	2012	2011	\$	%	2012	2011	\$	%
Other expense, net	\$ (57)	\$ (425)	\$ 368	(86.6)%	\$ (334)	\$ (2,457)	\$ 2,123	(86.4)%
As a percent of revenue	(0.1)%	(0.6)%						