

ASPEN TECHNOLOGY INC /DE/
Form 10-Q
April 29, 2014
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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 March 31, 2014

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 April 22, 2014, there were 92,071,575 shares of the registrant's common stock (par value \$0.10 per share) outstanding.

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AspenOne is one of our registered trademarks. All other trade names, including Premier Plus, trademarks and service marks appearing in this Form 10-Q are the property of their respective owners.

Our fiscal year ends on June 30, and references to a specific fiscal year are the twelve months ended June 30 of such year (for example, fiscal 2014 refers to the year ended June 30, 2014).

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)**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in Thousands, Except per Share Data)			
Revenue:				
Subscription and software	\$ 91,309	\$ 69,994	\$ 258,916	\$ 202,794
Services and other	12,278	9,363	31,005	25,329
Total revenue	103,587	79,357	289,921	228,123
Cost of revenue:				
Subscription and software	5,332	4,998	14,974	15,244
Services and other	9,956	7,651	24,835	22,116
Total cost of revenue	15,288	12,649	39,809	37,360
Gross profit	88,299	66,708	250,112	190,763
Operating expenses:				
Selling and marketing	24,267	22,958	71,376	67,852
Research and development	21,791	15,772	52,641	46,577
General and administrative	10,858	11,685	33,747	36,124
Restructuring charges	(19)	(41)	(15)	(7)
Total operating expenses	56,897	50,374	157,749	150,546
Income from operations	31,402	16,334	92,363	40,217
Interest income	275	807	969	2,861
Interest expense	(6)	(12)	(32)	(385)
Other income (expense), net	(472)	(18)	(1,807)	(352)
Income before provision for income taxes	31,199	17,111	91,493	42,341
Provision for income taxes	10,356	6,598	32,388	17,478
Net income	\$ 20,843	\$ 10,513	\$ 59,105	\$ 24,863
Net income per common share:				
Basic	\$ 0.23	\$ 0.11	\$ 0.64	\$ 0.27
Diluted	\$ 0.22	\$ 0.11	\$ 0.63	\$ 0.26
Weighted average shares outstanding:				
Basic	92,414	93,730	92,891	93,556
Diluted	93,365	95,400	93,951	95,475

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in Thousands)			
Net income	\$ 20,843	\$ 10,513	\$ 59,105	\$ 24,863
Other comprehensive income (loss):				
Net unrealized gains (losses) on available for sale securities, net of tax effects of \$5 and (\$42) for the three and nine months ended March 31, 2014, and \$10 for each of the three and nine months ended March 31, 2013	(10)	(19)	78	(19)
Foreign currency translation adjustments	(70)	(932)	1,263	(325)
Total other comprehensive income (loss)	(80)	(951)	1,341	(344)
Comprehensive income	\$ 20,763	\$ 9,562	\$ 60,446	\$ 24,519

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2014	June 30, 2013
	(Dollars in Thousands, Except Share Data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 181,483	\$ 132,432
Short-term marketable securities	75,357	57,015
Accounts receivable, net	31,031	36,988
Current portion of installments receivable, net	2,243	13,769
Unbilled services	1,282	1,965
Prepaid expenses and other current assets	8,477	9,665
Prepaid income taxes	323	288
Current deferred tax assets	18,224	33,229
Total current assets	318,420	285,351
Long-term marketable securities	18,092	35,353
Non-current installments receivable, net	850	963
Property, equipment and leasehold improvements, net	7,167	7,829
Computer software development costs, net	1,536	1,742
Goodwill	18,869	19,132
Non-current deferred tax assets	13,821	25,250
Other non-current assets	4,275	7,128
Total assets	\$ 383,030	\$ 382,748
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,116	\$ 846
Accrued expenses and other current liabilities	31,605	34,421
Income taxes payable	2,319	1,697
Current deferred revenue	207,303	178,341
Current deferred tax liabilities	156	156
Total current liabilities	242,499	215,461
Non-current deferred revenue	42,337	53,012
Other non-current liabilities	11,991	12,377
Commitments and contingencies (Note 11)		
Series D redeemable convertible preferred stock, \$0.10 par value Authorized 3,636 shares as of March 31, 2014 and June 30, 2013 Issued and outstanding none as of March 31, 2014 and June 30, 2013		
Stockholders' equity:		
Common stock, \$0.10 par value Authorized 210,000,000 shares Issued 100,862,392 shares at March 31, 2014 and 99,945,545 shares at June 30, 2013 Outstanding 92,254,182 shares at March 31, 2014 and 93,683,769 shares at June 30, 2013		
	10,086	9,995
Additional paid-in capital	588,458	575,770
Accumulated deficit	(290,712)	(349,817)
Accumulated other comprehensive income	8,603	7,263
Treasury stock, at cost 8,608,210 shares of common stock at March 31, 2014 and 6,261,776 shares of common stock at June 30, 2013	(230,232)	(141,313)
Total stockholders' equity	86,203	101,898

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Total liabilities and stockholders' equity	\$	383,030	\$	382,748
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See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended March 31,	
	2014	2013
	(Dollars in Thousands)	
Cash flows from operating activities:		
Net income	\$ 59,105	\$ 24,863
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,855	4,114
Net foreign currency loss (gain)	1,444	(667)
Stock-based compensation	11,102	11,295
Deferred income taxes	25,827	15,668
Provision for bad debts	1,144	31
Excess tax benefits from stock-based compensation	(137)	
Other non-cash operating activities	1,358	365
Changes in assets and liabilities:		
Accounts receivable	5,066	2,395
Unbilled services	667	(645)
Prepaid expenses, prepaid income taxes, and other assets	4,327	4,888
Installments receivable	11,933	32,365
Accounts payable, accrued expenses, and other liabilities	(1,111)	(11,186)
Deferred revenue	17,309	29,138
Net cash provided by operating activities	141,889	112,624
Cash flows from investing activities:		
Purchase of marketable securities	(35,542)	(75,713)
Maturities of marketable securities	33,362	
Purchase of property, equipment and leasehold improvements	(2,630)	(3,018)
Insurance proceeds		2,222
Purchase of technology intangibles	(400)	(902)
Capitalized computer software development costs	(601)	(593)
Net cash used in investing activities	(5,811)	(78,004)
Cash flows from financing activities:		
Exercise of stock options	7,475	15,430
Repayments of secured borrowings		(11,010)
Repurchases of common stock	(88,919)	(59,251)
Payment of tax withholding obligations related to restricted stock	(5,935)	(5,758)
Excess tax benefits from stock-based compensation	137	
Net cash used in financing activities	(87,242)	(60,589)
Effect of exchange rate changes on cash and cash equivalents	215	(231)
Increase (decrease) in cash and cash equivalents	49,051	(26,200)
Cash and cash equivalents, beginning of period	132,432	165,242
Cash and cash equivalents, end of period	\$ 181,483	\$ 139,042
Supplemental disclosure of cash flow information:		
Income taxes paid, net	\$ 5,717	\$ 2,692
Interest paid	32	385

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 have omitted certain information and footnote disclosures normally included in our annual consolidated financial statements. Such interim unaudited consolidated 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, 2013, 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 nine months ended March 31, 2014 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.

Reclassifications

Certain line items in prior period financial statements have been reclassified to conform to currently reported presentations.

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) We 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) We 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 ratably 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, with the introduction of our Premier Plus SMS offering, we were unable to establish evidence of the fair value for the SMS component, and revenue from these arrangements is now recognized on a ratably basis.

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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 \$146.6 million in fiscal 2013. 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 in fiscal 2010 are as follows:

- Prior to fiscal 2010, the majority of our license revenue was 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, the changes to our licensing model resulted in a reduction in our software license revenue for fiscal 2010, 2011 and 2012 as compared to the fiscal years preceding our licensing model changes. These changes did not impact the incurrence or timing of our expenses, and there was no corresponding expense reduction to offset the lower revenue, resulting in operating losses for fiscal 2010, 2011 and 2012. By fiscal 2013, a sufficient number of license arrangements had been renewed on the aspenONE licensing model to generate ratable revenue sufficient to support an operating profit.
- Since fiscal 2010, the SMS component of our services and other revenue (legacy SMS revenue) has decreased, and been offset by a corresponding increase in subscription and software revenue as customers have transitioned to our aspenONE licensing model. Under our aspenONE licensing model and for 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.

Legacy SMS revenue is no longer significant in relation to our total revenue due to the number of our term license arrangements that have been converted to the aspenONE licensing model. As a result, beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. Prior to fiscal 2014, legacy SMS revenue was included within services and other revenue in our unaudited consolidated statements of operations. For further information, please refer to the Revenue Reclassification section below.

- Installment payments from aspenONE agreements and from point product arrangements with SMS included for the contract term 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 more 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 in fiscal 2012 resulted in a change to the revenue recognition of point product arrangements that include Premier Plus SMS for the term of the arrangement. Since we do not have vendor-specific objective evidence of fair value, or VSOE, for our Premier Plus SMS offering, the SMS element of our point product arrangements is not separable, resulting in revenue being recognized ratably over the term of the arrangement, once the other revenue recognition criteria have been met. 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)

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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.

Delivery of our product Software and the corresponding access keys are generally delivered to customers electronically or via disk media with standard shipping terms of FOB Origin. 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. For license arrangements executed under the upfront revenue model, we recognize license revenue upon delivery of the software product, provided all other revenue recognition requirements are met.

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 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. During fiscal 2011, we used optional renewals of SMS on our legacy term license arrangements to support VSOE for SMS included in our fixed term point product arrangements which include SMS for the term of the arrangement. 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 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.

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Subscription and Software Revenue

Subscription and software revenue consists of product and related revenue from our (i) aspenONE licensing model, including Premier Plus 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; (iv) legacy SMS arrangements; and (v) 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 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 associated with point product arrangements with Premier Plus SMS included for the contract term is 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.

Legacy SMS revenue includes revenue from our SMS offering provided in support of perpetual and legacy term license arrangements. Customers typically received SMS for one year and then could elect to renew SMS annually. We continue to have VSOE of fair value for the undelivered SMS component, which is deferred and subsequently amortized into revenue ratably over the contractual term of the SMS arrangement.

Revenue Reclassification

Prior to fiscal 2014, legacy SMS revenue was classified within services and other revenue in our consolidated statements of operations. Cost of legacy SMS revenue was included within cost of services and other revenue. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. We reclassified legacy SMS revenue into subscription and software revenue in our unaudited consolidated statements of operations based on the following rationale:

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- i) Since fiscal 2010, legacy SMS revenue has decreased, and been offset by a corresponding increase in subscription and software revenue as customers have transitioned to our aspenONE licensing model and to point product arrangements with Premier Plus SMS.

- ii) Legacy SMS revenue is no longer significant in relation to our total revenue due to the number of our term license arrangements that have been converted to the aspenONE licensing model.

- iii) Legacy SMS revenue will continue to decrease as expiring license arrangements are renewed on the aspenONE licensing model.

- iv) We manage legacy SMS as a part of our broader software licensing business. The distinction between legacy SMS revenue and revenue from aspenONE licensing and point product arrangements with Premier Plus SMS included for the full contract term no longer represents a meaningful difference from a line of business standpoint since we assess business performance on a combined basis.

- v) Legacy SMS revenue and revenue from our aspenONE license arrangements share the same revenue recognition methodology and are both recognized on a ratable basis.

The following table summarizes the impact of revenue and cost of revenue reclassifications for the three and nine months ended March 31, 2014 and 2013:

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Classification in Unaudited Consolidated Statements of Operations for the Three and Nine Months Ended March 31,			Three Months Ended March 31,		Nine Months Ended March 31,	
2014	2013		2014	2013	2014	2013
(Dollars in Thousands)						
Legacy SMS revenue	Subscription and software	Services and other	\$ 8,633	\$ 9,095	\$ 23,844	\$ 28,358
Cost of Legacy SMS revenue	Subscription and software	Services and other	\$ 1,595	\$ 1,769	\$ 4,321	\$ 5,725

Prior to fiscal 2014, services and other revenue included revenue related to professional services, training, legacy SMS and other revenue. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations.

The following tables summarize the impact of legacy SMS revenue and cost of revenue reclassification on our previously presented unaudited consolidated statements of operations for the three and nine months ended March 31, 2013:

Impact on Unaudited Consolidated Statements of Operations for the Three Months Ended March 31, 2013				
	As Previously Reported	Reclassifications	As Currently Reported	
(Dollars in Thousands)				
Subscription and software revenue:				
Legacy SMS	\$	\$ 9,095	\$	9,095
Subscription and software	60,899		60,899	
	\$ 60,899	\$ 9,095	\$ 69,994	
Services and other revenue:				
Legacy SMS	\$	\$ (9,095)	\$	(9,095)
Professional services, training and other	18,458		18,458	
	\$ 18,458	\$ (9,095)	\$ 9,363	
Cost of subscription and software revenue:				
Cost of legacy SMS revenue	\$	\$ 1,769	\$	1,769
Cost of subscription and software revenue	3,229		3,229	
	\$ 3,229	\$ 1,769	\$ 4,998	
Cost of services and other revenue:				
Cost of legacy SMS revenue	\$	\$ (1,769)	\$	(1,769)
Cost of professional services, training and other revenue	9,420		9,420	
	\$ 9,420	\$ (1,769)	\$ 7,651	

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Impact on Unaudited Consolidated Statements of Operations for the Nine Months Ended March 31, 2013				
	As Previously Reported	Reclassifications	As Currently Reported	
	(Dollars in Thousands)			
Subscription and software revenue:				
Legacy SMS	\$		\$ 28,358	\$ 28,358
Subscription and software		174,436		174,436
	\$	174,436	\$ 28,358	\$ 202,794
Services and other revenue:				
Legacy SMS	\$		\$ (28,358)	\$ (28,358)
Professional services, training and other		53,687		53,687
	\$	53,687	\$ (28,358)	\$ 25,329
Cost of subscription and software revenue:				
Cost of legacy SMS revenue	\$		\$ 5,725	\$ 5,725
Cost of subscription and software revenue		9,519		9,519
	\$	9,519	\$ 5,725	\$ 15,244
Cost of services and other revenue:				
Cost of legacy SMS revenue	\$		\$ (5,725)	\$ (5,725)
Cost of professional services, training and other revenue		27,841		27,841
	\$	27,841	\$ (5,725)	\$ 22,116

*Services and Other***Professional Services Revenue**

Professional services are provided to customers on a time-and-materials (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 the period over 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.

Training Revenue

We provide training services to our customers, including on-site, Internet-based and customized training. Revenue is recognized in the period in which the services are performed.

Deferred Revenue

Deferred revenue includes amounts billed or collected in advance of revenue recognition, including arrangements under the aspenONE licensing model, point product arrangements with Premier Plus SMS, legacy SMS arrangements, 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. Deferred revenue is recorded as each invoice becomes due.

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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 classified as 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 March 31, 2014.

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, 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. In instances when an installment receivable that is reserved for ages into a trade account receivable, the related reserve is transferred to our trade accounts receivable allowance.

We write-off receivables when they are considered uncollectable based on our judgment. In instances when we write-off specific customer's trade accounts receivable, we also write off any related current and non-current installments receivable balances.

As of March 31, 2014, our gross current and non-current installments receivable of \$2.3 million and \$0.9 million, respectively, are presented net of unamortized discounts of less than \$0.1 million each and net of allowance for doubtful accounts of less than \$0.1 million for current installments receivable. There was no allowance for doubtful accounts for non-current installments receivable as of March 31, 2014.

As of June 30, 2013, our gross current and non-current installments receivable of \$14.4 million and \$1.1 million are presented net of unamortized discounts of \$0.6 million and \$0.1 million and net of allowance for doubtful accounts of \$0.1 million each, 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. Please refer to Note 11 for a discussion of these matters and related liability accruals.

(e) Foreign Currency Transactions

Foreign currency exchange gains and losses generated from the settlement and remeasurement of transactions denominated in currencies other than the functional currency of our subsidiaries are recognized in our results of operations as incurred as a component of other income (expense), net. Net foreign currency losses were \$0.5 million and \$1.8 million during the three and nine months ended March 31, 2014, and less than \$0.1 million and \$0.4 million during the three and nine months ended March 31, 2013, respectively.

(f) Other

For further information with regard to our Significant Accounting Policies, please refer to Note 2 of our Consolidated Financial

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Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

3. Marketable Securities

The following table summarizes the fair value, the amortized cost and unrealized holding gains (losses) on our marketable securities as of March 31, 2014 and June 30, 2013:

	Fair Value	Cost	Unrealized Gains	Unrealized Losses
March 31, 2014:				
U.S. corporate bonds	\$ 75,357	\$ 75,322	\$ 41	\$ (6)
Total short-term marketable securities	\$ 75,357	\$ 75,322	\$ 41	\$ (6)
U.S. corporate bonds	\$ 18,092	\$ 18,088	\$ 12	\$ (8)
Total long-term marketable securities	\$ 18,092	\$ 18,088	\$ 12	\$ (8)
June 30, 2013:				
U.S. corporate bonds	\$ 57,015	\$ 57,046	\$ 8	\$ (39)
Total short-term marketable securities	\$ 57,015	\$ 57,046	\$ 8	\$ (39)
U.S. corporate bonds	\$ 35,353	\$ 35,402	\$	\$ (49)
Total long-term marketable securities	\$ 35,353	\$ 35,402	\$	\$ (49)

Our marketable securities are classified as available-for-sale and reported at fair value on the unaudited consolidated balance sheets. Net unrealized gains (losses) are reported as a separate component of accumulated other comprehensive income, net of tax. Realized gains and losses on investments are recognized in earnings as incurred. Our investments consist primarily of investment grade fixed income corporate debt securities with maturity dates ranging from April 2014 through March 2016.

We review our marketable securities for impairment at each reporting period to determine if any of our securities have experienced an other-than-temporary decline in fair value in accordance with the provisions of ASC Topic 320, *Investments- Debt and Equity Securities*. We consider factors, such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of its amortized cost basis. If we believe that other-than-temporary decline in fair value has occurred, we write down investments to fair value and recognize credit losses in earnings and other impairment losses in accumulated other comprehensive income. As of March 31, 2014 and 2013, our marketable securities were not considered other-than-temporarily impaired and, as such, we did not recognize impairment losses during the three and nine months ended March 31, 2014 and 2013, respectively. Unrealized losses are attributable to changes in interest rates.

4. Goodwill

During the first quarter of fiscal 2014, we re-aligned our reporting units to reflect our revised operating and reportable segment structure (refer to Note 12). As a result of this re-alignment, we reassigned the carrying amount of goodwill of \$15.4 million to our subscription and software reporting unit.

The changes in the carrying amount of goodwill by reporting unit for the nine months ended March 31, 2014 are as follows:

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Asset Class	Reporting Unit			Total
	Subscription and software	Services		
(Dollars in Thousands)				
Balance as of June 30, 2013				
Goodwill	\$ 84,701	\$ 5,102		\$ 89,803
Accumulated impairment losses	(65,569)	(5,102)		(70,671)
	\$ 19,132	\$	\$	19,132
Effect of currency translation				
	(263)			(263)
Balance as of March 31, 2014				
Goodwill	\$ 84,438	\$ 5,102		\$ 89,540
Accumulated impairment losses	(65,569)	(5,102)		(70,671)
	\$ 18,869	\$	\$	18,869

We test goodwill for impairment annually (or more often if impairment indicators arise), at the reporting unit level. We 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 perform the two-step goodwill impairment test. The first step requires us to determine the fair value of the 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.

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 31st as the annual impairment assessment date and perform additional impairment tests if triggering events occur. We performed our annual impairment test for the subscription and software reporting unit as of December 31, 2013, and, based upon the results of our qualitative assessment, determined that it was not likely that its fair value was less than its carrying amount. As such, we did not perform the two-step goodwill impairment test and did not recognize impairment losses as a result of our analysis. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value, goodwill will be evaluated for impairment between annual tests. No triggering events indicating goodwill impairment occurred during the three and nine months ended March 31, 2014.

5. Income Taxes

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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 taxed at the applicable rates, as well as the impact of permanent differences between book and tax income.

Our effective tax rate for the three months ended March 31, 2014 was 33.2% as compared to 38.6% for the corresponding period of the prior fiscal year. Our effective tax rate for the nine months ended March 31, 2014 was 35.4% as compared to 41.3% for the corresponding period of the prior fiscal year. During the three and nine months ended March 31, 2014 and 2013, our income tax expense was driven primarily by pre-tax profitability in our domestic and foreign operations and the impact of permanent items, predominately a U.S. domestic production activity deduction slightly offset by non-deductible stock-based compensation expense. We did not qualify for a U.S. domestic production activity deduction in fiscal 2013 as a result of cumulative losses generated in the U.S. during prior periods and carried forward into fiscal 2013. Our effective tax rate for the three and nine months ended March 31, 2014 and 2013 differs from the U.S. federal statutory income tax rate primarily as a result of the impact of the permanent items.

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

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

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

6. 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 \$151.3 million and \$117.0 million as of March 31, 2014 and June 30, 2013, respectively, are reported at fair value utilizing Level 1 inputs. Our cash equivalents consist of short-term, highly liquid investments with remaining maturities of three months or less when purchased.

Marketable securities of \$93.4 million and \$92.4 million as of March 31, 2014 and June 30, 2013, respectively, are reported at fair value calculated in accordance with the market approach, utilizing market consensus pricing models with quoted prices that are directly or indirectly observable, or Level 2 inputs.

Financial instruments not measured or recorded at fair value in the accompanying unaudited consolidated financial statements consist of accounts receivable, installments receivable and accounts payable. The estimated fair value of these financial instruments approximates their carrying value.

7. Supplementary Balance Sheet Information

The following table summarizes our accounts receivable, net of the related allowance for doubtful accounts, as of March 31, 2014 and June 30, 2013. Refer to Note 2(c) for a summary of our installments receivable balances.

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	Gross	Allowance (Dollars in Thousands)	Net
March 31, 2014:			
Accounts receivable	\$ 33,891	\$ 2,860	\$ 31,031
	\$ 33,891	\$ 2,860	\$ 31,031
June 30, 2013:			
Accounts receivable	\$ 38,603	\$ 1,615	\$ 36,988
	\$ 38,603	\$ 1,615	\$ 36,988

As of March 31, 2014, one customer's receivable balance represented approximately 11% of our total receivables.

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

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	March 31, 2014		June 30, 2013
	(Dollars in Thousands)		
Royalties and outside commissions	\$ 3,950	\$	4,312
Payroll and payroll-related	17,025		18,702
Other	10,630		11,407
Total accrued expenses and other current liabilities	\$ 31,605	\$	34,421

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

	March 31, 2014		June 30, 2013
	(Dollars in Thousands)		
Deferred rent	\$ 459	\$	862
Other*	11,532		11,515
Total other non-current liabilities	\$ 11,991	\$	12,377

* Other is comprised primarily of our reserve for uncertain tax liabilities of \$9.5 million and \$10.4 million as of March 31, 2014 and June 30, 2013, respectively.

8. 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 closing price of our stock 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 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-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 option awards granted during the three months ended March 31, 2014 was \$17.09. There were no awards granted during the three months ended March 31, 2013. The weighted average estimated fair value of option awards granted during the nine months ended March 31, 2014 and 2013 was \$11.55 and \$9.76, respectively.

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

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	Nine Months Ended March 31,	
	2014	2013
Risk-free interest rate	1.3%	0.6%
Expected dividend yield	0.0%	0.0%
Expected life (in years)	4.6	4.8
Expected volatility factor	39.4%	48.9%

The stock-based compensation expense and its classification in the unaudited consolidated statements of operations for the three and nine months ended March 31, 2014 and 2013 are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
(Dollars in Thousands)				
Recorded as expenses:				
Cost of services and other	\$ 282	\$ 325	\$ 910	\$ 984
Selling and marketing	832	994	2,653	2,943
Research and development	1,523	770	3,267	2,253
General and administrative	927	1,438	4,272	5,115
Total stock-based compensation	\$ 3,564	\$ 3,527	\$ 11,102	\$ 11,295

A summary of stock option and RSU activity under all equity plans for the nine months ended March 31, 2014 is as follows:

	Stock Options			Restricted Stock Units		
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in 000 s)	Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2013	1,852,118	\$ 14.68		\$ 26,140	1,030,839	\$ 17.69
Granted	351,999	\$ 33.04			414,983	\$ 33.05
Settled (RSUs)					(451,051)	\$ 18.34
Exercised	(623,494)	\$ 11.99				
Cancelled / Forfeited	(217,149)	\$ 19.64			(247,004)	\$ 20.17
Outstanding at March 31, 2014	1,363,474	\$ 19.86	7.20	\$ 30,708	747,767	\$ 25.01
Vested and exercisable at March 31, 2014	727,651	\$ 15.66	6.21	\$ 19,429		
Vested and expected to vest as of March 31, 2014	1,252,853	\$ 19.37	7.09	\$ 28,803	617,435	\$ 24.87

The weighted average grant-date fair value of RSUs granted during the three and nine months ended March 31, 2014 was \$43.70 and \$33.05, respectively, and during the nine months ended March 31, 2013 was \$23.40. There were no RSUs granted during the three months ended March 31, 2013. During the three months ended March 31, 2014 and 2013, the total fair value of shares vested from RSU grants was \$4.8

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million and \$4.0 million, respectively, and during the nine months ended March 31, 2014 and 2013 was \$17.0 million and \$17.1 million, respectively.

At March 31, 2014, the total future unrecognized compensation cost related to stock options and RSUs was \$4.6 million and \$14.4 million, respectively, and is expected to be recorded over a weighted average period of 2.5 years and 2.6 years, respectively.

The total intrinsic value of options exercised during the three months ended March 31, 2014 and 2013 was \$7.6 million and \$22.6 million, respectively. The total intrinsic value of options exercised during the nine months ended March 31, 2014 and 2013 was \$16.8

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million and \$45.8 million, respectively. We received \$7.5 million and \$15.4 million in cash proceeds from option exercises during the nine months ended March 31, 2014 and 2013, respectively. We paid \$5.9 million and \$5.8 million for withholding taxes on vested RSUs during the nine months ended March 31, 2014 and 2013, respectively.

At March 31, 2014, common stock reserved for future issuance or settlement under equity compensation plans was 6.7 million shares.

9. Stockholders Equity

Stock Repurchases

On April 23, 2014, our Board of Directors approved a share repurchase program for up to \$200 million worth of our common stock. This share repurchase program replaced the program previously approved by the Board of Directors on April 23, 2013 which was terminated on April 23, 2014 and had a value of up to \$150 million and remaining capacity of approximately \$37.5 million at that time. The program approved on April 23, 2013 had replaced a repurchase program with a value of up to \$100 million which had been approved by the Board of Directors on October 24, 2012. The program approved on October 24, 2012 had replaced a repurchase program with a value of up to \$100 million which had been approved by the Board of Directors on November 1, 2011. 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 2,346,434 shares of our common stock for \$88.9 million during the nine months ended March 31, 2014. We repurchased 3,064,151 shares of our common stock for \$84.7 million during fiscal 2013. As of March 31, 2014, the remaining dollar value under the stock repurchase program approved on April 23, 2013 was \$45.5 million.

Accumulated Other Comprehensive Income

As of March 31, 2014, accumulated other comprehensive income was comprised of foreign translation adjustments of \$8.6 million and net unrealized gains on available for sale securities of less than \$0.1 million. As of June 30, 2013, accumulated other comprehensive income was comprised of foreign translation adjustments of \$7.3 million and net unrealized losses on available for sale securities of (\$0.1) million.

10. 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

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share based on the treasury stock method.

For the three and nine months ended March 31, 2014 and 2013, certain employee equity awards were anti-dilutive based on the treasury stock method. The calculations of basic and diluted net income (loss) per share and basic and diluted weighted average shares outstanding are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars and Shares in Thousands, Except per Share Data)			
Net income	\$ 20,843	\$ 10,513	\$ 59,105	\$ 24,863
Weighted average shares outstanding	92,414	93,730	92,891	93,556
Dilutive impact from:				
Share-based payment awards	951	1,670	1,060	1,919
Dilutive weighted average shares outstanding	93,365	95,400	93,951	95,475
Income per share				
Basic	\$ 0.23	\$ 0.11	\$ 0.64	\$ 0.27
Dilutive	\$ 0.22	\$ 0.11	\$ 0.63	\$ 0.26

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Shares in Thousands)			
Employee equity awards	61	438	325	947

11. Commitments and Contingencies*Operating Leases*

In January 2014, we entered into a lease agreement for office space in Bedford, Massachusetts. The initial term of the lease with respect to 105,874 square feet of office space will commence on November 1, 2014 and on February 1, 2015 with respect to an additional 36,799 square feet of space. The initial term of the lease will expire approximately ten years and five months following the term commencement date. Subject to the terms and conditions of the lease, we may extend the term of the lease for two successive terms of five years each. Base annual rent will range between approximately \$2.2 million and \$3.9 million over the term of the lease in addition to our proportionate share of operating expenses and real estate taxes.

Future minimum non-cancelable lease payments under the terms of the lease amount to approximately \$35.8 million and are as follows:

Year Ended June 30,	Payments (Dollars in Thousands)
2015	\$ 947
2016	3,258
2017	3,329
2018	3,400
2019	3,472
Thereafter	21,401
Total	\$ 35,807

Other

In the ordinary course of business, we are, from time to time, involved in lawsuits, claims, investigations, proceedings and threats of litigation, including proceedings related to intellectual property rights. These matters include an April 2004 claim by a customer that certain of our software products and implementation services failed to meet the customer's expectations. In March 2014, a judgment was issued in favor of the claimant customer against us in the amount of approximately \$2.6 million plus interest and a portion of legal fees. We plan to appeal the

judgment.

While the outcome of the proceedings and claims referenced above cannot be predicted with certainty, there are no such matters, as of March 31, 2014 that, in the opinion of management, are reasonably possible to 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 March 31, 2014 and June 30, 2013, and are not material to our financial position for the periods then ended. As of March 31, 2014, we do not believe that there is a reasonable possibility of a material loss exceeding the amounts already accrued for the proceedings or matters discussed above. However, the results of litigation (including the above-referenced appeal) 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. Also, 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.

Table of Contents**12. Segment Information**

Operating segments are defined as components of an enterprise that engage in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and to assess performance. Our chief operating decision maker is our President and Chief Executive Officer.

Prior to fiscal 2014, we had three operating and reportable segments: license; SMS, training and other; and professional services. As our customers have transitioned to our aspenONE licensing model, legacy SMS revenue has decreased, and been offset by a corresponding increase in revenue from aspenONE licensing arrangements and from point product arrangements with Premier Plus SMS (for further information on transition to the aspenONE licensing model and its impact on revenue and our results of operations, please refer to Note 2). As a result, legacy SMS revenue is no longer significant in relation to our total revenue and no longer represents a significant line of business.

We manage legacy SMS as a part of our broader software licensing business and assess business performance on a combined basis. Our President and Chief Executive Officer evaluates software licensing and maintenance on an aggregate basis in deciding how to assess performance. Effective July 1, 2013, we re-aligned our operating and reportable segments into i) subscription and software; and ii) services.

The subscription and software segment is engaged in the licensing of process optimization software solutions and associated support services. The services segment includes professional services and training.

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 of our Form 10-K for the year ended June 30, 2013). We do not track assets or capital expenditures by operating segments. Consequently, it is not practical to present assets, capital expenditures, depreciation or amortization by operating segments.

Our prior period reportable segment information has been reclassified to reflect the current segment structure and conform to the current period presentation.

The following table presents a summary of our reportable segments' profits:

	Subscription and software	Services	Total	
	(Dollars in Thousands)			
Three Months Ended March 31, 2014				
Segment revenue	\$ 91,309	\$ 12,278	\$	103,587
Segment expenses (1)	(51,390)	(9,956)		(61,346)
Segment profit	\$ 39,919	\$ 2,322	\$	42,241

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Three Months Ended March 31,
2013

Segment revenue	\$	69,994	\$	9,363	\$	79,357
Segment expenses (1)		(43,728)		(7,651)		(51,379)
Segment profit	\$	26,266	\$	1,712	\$	27,978

Nine Months Ended March 31,
2014

Segment revenue	\$	258,916	\$	31,005	\$	289,921
Segment expenses (1)		(138,991)		(24,835)		(163,826)
Segment profit	\$	119,925	\$	6,170	\$	126,095

Nine Months Ended March 31,
2013

Segment revenue	\$	202,794	\$	25,329	\$	228,123
Segment expenses (1)		(129,673)		(22,116)		(151,789)
Segment profit	\$	73,121	\$	3,213	\$	76,334

(1) Our reportable segments' operating expenses include expenses directly attributable to the segments. Segment expenses do not include allocations of general and administrative; restructuring; interest income, net; and other (income) expense, net. As a result of operating and reportable segments realignment, certain costs are more directly attributable to our new operating segments. Starting with the first quarter of fiscal 2014, segment expenses include selling and marketing, research and

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development, stock-based compensation and certain corporate expenses incurred in support of the segments. Please refer to Note 12 in our Consolidated Financial Statements and Notes thereto included in our Annual Report on the Form 10-K for the fiscal year ended June 30, 2013 for a basis of measurement of our reportable segments' operating expenses prior to the first quarter of fiscal 2014.

Reconciliation to Income Before Income Taxes

The following table presents a reconciliation of total segment profit to income before income taxes for the three and nine months ended March 31, 2014 and 2013:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in Thousands)			
Total segment profit for reportable segments	\$ 42,241	\$ 27,978	\$ 126,095	\$ 76,334
General and administrative	(10,858)	(11,685)	(33,747)	(36,124)
Restructuring charges	19	41	15	7
Other income (expense), net	(472)	(18)	(1,807)	(352)
Interest income (net)	269	795	937	2,476
Income before income taxes	\$ 31,199	\$ 17,111	\$ 91,493	\$ 42,341

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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 3. 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 30th, and references in this Quarterly Report to a specific fiscal year are to the twelve months ended June 30th of such year (for example, fiscal 2014 refers to the year ending on June 30, 2014).

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 1,750 customers globally. Our customers in the process industries include energy, chemicals, engineering and construction, as well as consumer packaged goods, power, metals and mining, pulp and paper, pharmaceuticals and biofuels.

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, or 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) We 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) We 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, with the introduction of our Premier Plus SMS offering, 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 \$146.6 million in fiscal 2013. 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.

As of March 31, 2014, a significant percentage of our active license agreements has been transitioned to our aspenONE licensing model. In the foreseeable future, we anticipate that a significant portion of our remaining legacy term license arrangements will transition to the aspenONE licensing model as existing license agreements reach the end of their respective original terms. During this transition period, we may continue to have arrangements where the software element will be recognized upfront, including perpetual licenses, amendments to existing legacy term arrangements, and in limited cases, renewals of existing legacy term arrangements. However, we do not expect revenue related to these sources to be significant in relation to our total revenue.

Impact of Licensing Model Changes

The principal accounting implications of the changes to our licensing model in fiscal 2010 are as follows:

- Prior to fiscal 2010, the majority of our license revenue was 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, the changes to our licensing model resulted in a reduction in our software license revenue for fiscal 2010, 2011 and 2012 as compared to the fiscal years preceding our licensing model changes. These changes did not impact the incurrence or timing of our expenses, and there was no corresponding expense reduction to offset the lower revenue, resulting in operating losses for fiscal 2010, 2011 and 2012. By fiscal 2013, a sufficient number of license arrangements had been renewed on the aspenONE licensing model to generate ratable revenue sufficient to support an operating profit. The revenue transition will not be fully completed until fiscal 2016.
- The transition will not be complete until the remaining term license agreements executed under our upfront revenue model reach the end of their original term. Many of our license arrangements were five or six years in duration when the aspenONE licensing model was introduced at the start of fiscal 2010, and consequently, a number of agreements executed under the upfront revenue model will not reach the end of their original term until fiscal 2016.
- Since fiscal 2010, the SMS component of our services and other revenue (legacy SMS revenue) has decreased, and been offset by a corresponding increase in subscription and software revenue as customers have transitioned to our aspenONE licensing model. Under our aspenONE licensing model and for 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.

Legacy SMS revenue is no longer significant in relation to our total revenue due to the number of our term license arrangements that have been converted to the aspenONE licensing model. As a result, beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. Prior to fiscal 2014, legacy SMS revenue was included within services and other revenue in our unaudited consolidated statements of operations. For further information, please refer to the Revenue Reclassification section below. Legacy SMS revenue is expected to continue to decrease until the remaining active license arrangements are converted to our aspenONE licensing model with SMS included for the full contract term.

- Installment payments from aspenONE agreements and from point product arrangements with SMS included for the contract term 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 increased, and is expected to continue to increase, as more revenue from our term license portfolio is recognized on a ratable basis.

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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 in fiscal 2012 resulted in a change to the revenue recognition of point product arrangements that include Premier Plus SMS for the term of the arrangement. Since we do not have vendor-specific objective evidence of fair value, or VSOE, for our Premier Plus SMS offering, the SMS element of our point product arrangements is not separable, resulting in revenue being recognized ratably over the term of the arrangement, once the other revenue recognition criteria have been met. 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, 2013. Due to the accounting 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, including revenue, gross profit, operating income and net income, should be reviewed in conjunction with certain non-GAAP and other business measures in assessing our performance, growth and financial condition. We utilize a number of non-GAAP and other key business metrics, including those described below under Key Business Metrics, to track our business performance as we continue transitioning to our aspenONE licensing model. None of these metrics should be considered as an alternative to any measure of financial performance calculated in accordance with GAAP.

Segments Re-alignment

Prior to fiscal 2014, we had three operating and reportable segments: license; SMS, training and other; and professional services. As our customers have transitioned to our aspenONE licensing model, legacy SMS revenue has decreased and been offset by a corresponding increase in revenue from aspenONE licensing arrangements and from point product arrangements with Premier Plus. As a result, legacy SMS revenue is no longer significant in relation to our total revenue and no longer represents a significant line of business.

We manage legacy SMS as a part of our broader software licensing business and assess business performance on a combined basis. Our President and Chief Executive Officer evaluates software licensing and maintenance on an aggregate basis in deciding how to assess performance. Effective July 1, 2013, we re-aligned our operating and reportable segments into i) subscription and software; and ii) services.

The subscription and software segment is engaged in the licensing of process optimization software solutions and associated support services. The services segment includes professional services and training.

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For additional information on segment revenues and their operating results, please refer to Note 12 Segment and Geographic Information in the Notes to the Unaudited Consolidated Financial Statements. Our prior period reportable segment information has been reclassified to reflect the current segment structure and conform to the current period presentation.

Revenue

We generate revenue primarily from the following sources:

- *Subscription and software.* 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. We provide customers technical support and access to software fixes and updates. Our technical support services are provided from our customer support centers throughout the world, as well as via email and through our support website.

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- *Services and other.* We provide training and professional services to our customers. Our professional services are focused on implementing our technology in order to improve customers' 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. We provide training services to our customers, including on-site, Internet-based and customized training.

Key Components of Operations

Revenue

Subscription and software revenue consists of product and related revenue from the following sources:

- (i) aspenONE licensing model, including 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;
- (iv) legacy SMS arrangements; and
- (v) perpetual arrangements.

Revenue Reclassification

Prior to fiscal 2014, legacy SMS revenue was classified within services and other revenue in our consolidated statements of operations. Cost of legacy SMS revenue was included within cost of services and other revenue. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. We reclassified legacy SMS revenue into subscription and software revenue in our unaudited consolidated statements of operations based on the following rationale:

- i) Since fiscal 2010, legacy SMS revenue has decreased, and been offset by a corresponding increase in subscription and software revenue as customers have transitioned to our aspenONE licensing model and to point product arrangements with Premier Plus SMS.

- ii) Legacy SMS revenue is no longer significant in relation to our total revenue due to the number of our term license arrangements that have been converted to the aspenONE licensing model.

- iii) We expect legacy SMS revenue to continue to decrease as expiring license arrangements are renewed on the aspenONE licensing model.

- iv) We manage legacy SMS as a part of our broader software licensing business. The distinction between legacy SMS revenue and revenue from aspenONE licensing and point product arrangements with Premier Plus SMS included for the full contract term no longer represents a meaningful difference from a line of business standpoint since we assess business performance on a combined basis.

- v) Legacy SMS revenue and revenue from our aspenONE license arrangements share the same revenue recognition methodology and are both recognized on a ratable basis.

The following table summarizes the impact of revenue and cost of revenue reclassifications for the three and nine months ended March 31, 2014 and 2013:

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Classification in Unaudited Consolidated Statements of Operations for the Three and Nine Months Ended March 31,			Three Months Ended March 31,		Nine Months Ended March 31,	
2014	2013		2014	2013	2014	2013
(Dollars in Thousands)						
Legacy SMS revenue	Subscription and software	Services and other	\$ 8,633	\$ 9,095	\$ 23,844	\$ 28,358
Cost of Legacy SMS revenue	Subscription and software	Services and other	\$ 1,595	\$ 1,769	\$ 4,321	\$ 5,725

Prior to fiscal 2014, services and other revenue included revenue related to professional services, training, legacy SMS and other revenue. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations.

The following tables summarize the impact of legacy SMS revenue and cost of revenue reclassification on our previously presented unaudited consolidated statement of operations for the three and nine months ended March 31, 2013:

Impact on Unaudited Consolidated Statements of Operations for the Three Months Ended March 31, 2013				
	As Previously Reported	Reclassifications	As Currently Reported	
(Dollars in Thousands)				
Subscription and software revenue:				
Legacy SMS	\$	\$ 9,095	\$	9,095
Subscription and software	60,899		60,899	
	\$ 60,899	\$ 9,095	\$ 69,994	
Services and other revenue:				
Legacy SMS	\$	\$ (9,095)	\$	(9,095)
Professional services, training and other	18,458		18,458	
	\$ 18,458	\$ (9,095)	\$ 9,363	
Cost of subscription and software revenue:				
Cost of legacy SMS revenue	\$	\$ 1,769	\$	1,769
Cost of subscription and software revenue	3,229		3,229	
	\$ 3,229	\$ 1,769	\$ 4,998	
Cost of services and other revenue:				
Cost of legacy SMS revenue	\$	\$ (1,769)	\$	(1,769)
Cost of professional services, training and other revenue	9,420		9,420	
	\$ 9,420	\$ (1,769)	\$ 7,651	

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Impact on Unaudited Consolidated Statements of Operations for the Nine Months Ended March 31, 2013				
	As Previously Reported	Reclassifications (Dollars in Thousands)	As Currently Reported	
Subscription and software revenue:				
Legacy SMS	\$		\$ 28,358	\$ 28,358
Subscription and software		174,436		174,436
	\$	174,436	\$ 28,358	\$ 202,794
Services and other revenue:				
Legacy SMS	\$		\$ (28,358)	\$ (28,358)
Professional services, training and other		53,687		53,687
	\$	53,687	\$ (28,358)	\$ 25,329
Cost of subscription and software revenue:				
Cost of legacy SMS revenue	\$		\$ 5,725	\$ 5,725
Cost of subscription and software revenue		9,519		9,519
	\$	9,519	\$ 5,725	\$ 15,244
Cost of services and other revenue:				
Cost of legacy SMS revenue	\$		\$ (5,725)	\$ (5,725)
Cost of professional services, training and other revenue		27,841		27,841
	\$	27,841	\$ (5,725)	\$ 22,116

Services and Other Revenue. Our services and other revenue consists primarily of revenue related to professional services 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 arrangement;
- the number, value and rate per hour of service transactions booked during the current and preceding periods;
- the number and availability of service resources actively engaged on billable projects;
- the timing of milestone acceptance for engagements contractually requiring customer sign-off;
- the timing of 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 (i) royalties, (ii) amortization of capitalized software and purchased technology intangibles, (iii) distribution fees, (iv) costs of providing Premier Plus SMS bundled with our aspenONE licensing and point product arrangements; and (v) costs of providing legacy SMS.

Prior to fiscal 2014, costs of providing legacy SMS were presented within cost of services and other revenue in our unaudited consolidated statements of operations. Beginning with the first quarter of fiscal 2014, costs of our legacy SMS business are presented within cost of subscription and software revenue in our unaudited consolidated statements of operations.

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 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 conduct market research to help us better understand our customers and their business needs.

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Research and Development Expenses. Research and development expenses consist primarily of personnel 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 from the investment in marketable securities and short-term money market instruments.

Interest Expense. During the nine months ended March 31, 2013, interest expense consisted primarily of charges related to our secured borrowings which were repaid in full in fiscal 2013. During the nine months ended March 31, 2014, interest expense is comprised of miscellaneous interest charges.

Other Income (Expense), Net. Other income (expense), net is comprised primarily of foreign currency exchange gains (losses) generated from the settlement and remeasurement of transactions denominated in currencies other than the functional currency of our operating units.

Provision for (Benefit from) Income Taxes. Provision for income taxes is comprised of domestic and foreign taxes. Benefits from income taxes are comprised of any 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 a component of income tax expense.

Key Business Metrics

Background

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The changes to our licensing model in fiscal 2010 resulted in a reduction in our product-related revenue for each period starting with fiscal 2010, as compared to the fiscal years preceding our licensing model 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 reflective of the value of our active license agreements until the remaining term 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 a number of our performance indicators based on GAAP, including revenue, gross profit, operating income and net income, should be reviewed in conjunction with certain non-GAAP and other business measures in assessing our performance, growth and financial condition. We utilize the following non-GAAP and other key business metrics to track our business performance as we continue transitioning to our aspenONE licensing model:

- Total term contract value
- Annual spend
- Adjusted total costs
- Free cash flow

None of these metrics should be considered as an alternative to any measure of financial performance calculated in accordance with GAAP.

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

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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.

We estimate that TLCV grew by approximately 2.7% during the third quarter of fiscal 2014, from \$1.75 billion at December 31, 2013 to \$1.79 billion at March 31, 2014, and by approximately 8.5% during the first nine months of fiscal 2014, from \$1.65 billion at June 30, 2013. We estimate that TCV grew by approximately 3.0% during the third quarter of fiscal 2014, from \$2.05 billion at December 31, 2013 to \$2.1 billion at March 31, 2014, and by approximately 9.4% during the first nine months of fiscal 2014, from \$1.93 billion at June 30, 2013. The growth was attributable primarily to an increase in the number of tokens or products sold.

Annual Spend

Annual spend is a derivative metric that is closely related to TCV. TCV is an estimate of the renewal value of our active portfolio of term license agreements, as of a specific date. Annual spend is an estimate of the annualized value of our active portfolio of term agreements, as of a specific date. Annual spend is calculated by taking the most recent annual invoice value of each of our active term contracts and then aggregating this amount for all active term licenses. Annual spend also includes the annualized value of standalone SMS agreements purchased in conjunction with term license agreements. We believe that the annual spend metric may be helpful to investors attempting to analyze and model subscription and software revenue while we transition to our aspenONE licensing model. Comparing annual spend for different dates provides insight into the growth and retention rates of our business, and since annual spend represents the estimated annualized billings associated with our active term license agreements, it provides insight into a normalized value for subscription and software revenue.

Annual spend increases as a 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
- Escalation of annual payments in our active term contracts.

Annual spend is adversely affected by term license and standalone SMS agreements that are not renewed. Unlike TCV and

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TLCV, the value of annual spend is not impacted by changes to contract duration.

We estimate that annual spend grew by approximately 3.3% during the third quarter of fiscal 2014, from \$356.1 million at December 31, 2013 to \$368.0 million at March 31, 2014, and by approximately 8.9% during the first nine months of fiscal 2014, from \$337.9 million at June 30, 2013. The growth was attributable primarily to an increase in the number of tokens or products sold.

Adjusted Total Costs

We use a non-GAAP measure of adjusted total costs, which excludes certain non-cash and non-recurring expenses, to supplement our presentation of total cost of revenue and total operating costs presented on a GAAP basis. Management believes that this financial measure is useful to investors because it approximates the cash operating costs of the business. The presentation of adjusted total costs is not meant to be considered as an alternative to total cost of revenue and total operating costs as a measure of our total costs.

The following table presents our total cost of revenue and total operating expenses, as adjusted for stock-based compensation expense, non-capitalized acquired technology, restructuring charges, and amortization of purchased technology intangibles, for the indicated periods:

	Three Months Ended March 31,		Period-to-Period Change		Nine Months Ended March 31,		Period-to-Period Change	
	2014	2013	\$	%	2014	2013	\$	%
	(Dollars in Thousands, Except Percentages)							
Total cost of revenue	\$ 15,288	\$ 12,649	\$ 2,639	20.9%	\$ 39,809	\$ 37,360	\$ 2,449	6.6%
Total operating expenses	56,897	50,374	6,523	13.0	157,749	150,546	7,203	4.8
Total expenses	72,185	63,023	9,162	14.5	197,558	187,906	9,652	5.1
Less:								
Stock-based compensation	(3,564)	(3,527)	(37)	1.0	(11,102)	(11,295)	193	(1.7)
Non-capitalized acquired technology	(4,856)		(4,856)	100.0	(4,856)		(4,856)	100.0
Restructuring charges	19	41	(22)	(53.7)	15	7	8	*
Amortization of purchased technology intangibles	(224)	(201)	(23)	11.4	(698)	(503)	(195)	38.8
Adjusted total costs (non-GAAP)	\$ 63,560	\$ 59,336	\$ 4,224	7.1%	\$ 180,917	\$ 176,115	\$ 4,802	2.7%

* Not meaningful

Non-Capitalized Acquired Technology

In the third quarter of fiscal 2014, we acquired certain technology that we plan to modify and enhance prior to release as a commercially available product. At the time we acquired the technology, the project to develop a commercially available product did not meet the accounting definition of having reached technological feasibility and therefore the cost of the acquired technology was expensed as a research and development expense. We continue to expect that we will develop the acquired technology into a commercially available product. Since the expensing of the acquired technology is a one-time, non-recurring item, we exclude it in our calculation of adjusted total costs.

Comparison of the Three Months Ended March 31, 2014 and 2013

Total expenses increased by \$9.2 million during the three months ended March 31, 2014 as compared to the same period of the prior fiscal year. Please refer to the Results of Operations section below for additional information on period-over-period expense fluctuations.

Adjusted total costs consist of total cost of revenue and total operating expenses, adjusted to exclude stock-based compensation, non-capitalized acquired technology, restructuring charges and amortization of purchased technology intangibles. Adjusted total costs increased by \$4.2 million during the three months ended March 31, 2014 as compared to the same period of the prior fiscal year. The period-over-period increase was primarily attributable to higher cost of revenue of \$2.3 million recognized on a professional service project accounted for under the completed contract method, and higher compensation costs of \$1.8 million, inclusive of health care costs of \$0.6 million, severance costs of \$0.6 million and commissions of \$0.5 million.

Stock-based compensation expense during the three months ended March 31, 2014 was consistent with the same period of the prior fiscal year.

Comparison of the Nine Months Ended March 31, 2014 and 2013

Total expenses increased by \$9.7 million during the nine months ended March 31, 2014 as compared to the same period of the prior fiscal year. Please refer to the Results of Operations section below for additional information on period-over-period expense fluctuations.

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Adjusted total costs increased by \$4.8 million during the nine months ended March 31, 2014 as compared to the same period of the prior fiscal year. The period-over-period increase was primarily attributable to higher cost of revenue of \$3.9 million recognized on professional service projects accounted for under the completed contract method, higher commissions of \$2.4 million and higher bad debt expense of \$0.7 million. These increases were partially offset by lower legal and accounting costs of \$2.3 million.

Stock-based compensation expense decrease of \$0.2 million was primarily attributable to award forfeitures resulting from terminations that occurred in fiscal 2014 and certain awards reaching the end of their vesting period in fiscal 2013, partially offset by the incremental expense associated with the August 2013 annual program grant.

Free Cash Flow

We use a 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 useful as a basis for comparing our performance with that of our competitors. The presentation of free cash flow is not meant to be considered in isolation or as an alternative to cash flows from operating activities as a measure of liquidity.

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

We do not expect to recognize levels of revenue reflective of the value of our active license agreements until the remaining term 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 our income statement profitability measures based on GAAP, such as total revenue, gross profit, operating income and net income, should be reviewed in conjunction with free cash flow to measure of our financial performance. Customer collections and, consequently, cash flows from operating activities and free cash flow are primarily driven by license and services billings, rather than the timing of revenue. The introduction of our aspenONE licensing model has not had an adverse impact on cash receipts. 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:

	Nine Months Ended March 31,	
	2014	2013
	(Dollars in Thousands)	
Net cash provided by operating activities	\$ 141,889	\$ 112,624
Purchase of property, equipment, and leasehold improvements	(2,630)	(3,018)
Insurance proceeds		2,222
Capitalized computer software development costs	(601)	(593)

Non-capitalized acquired technology		3,856		
Free cash flow (non-GAAP)	\$	142,514	\$	111,235

Total free cash flow increased \$31.3 million during the nine months ended March 31, 2014 as compared to the same period of the prior fiscal year. In the third quarter of fiscal 2014, we acquired certain technology that we plan to modify and enhance for release as a commercially available product. At the time we acquired the technology, the project to develop a commercially available product did not meet the accounting definition of having reached technological feasibility and therefore the cost of the acquired technology was expensed as research and development. We continue to expect that we will develop the acquired technology into a commercially available product. We have excluded the expense of the acquired technology from free cash flow to be consistent with past treatment of other transactions where the acquired assets were capitalized.

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. We expect our free cash flow to increase as our portfolio of term license contracts grows.

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

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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 electronically or via disk media with standard shipping terms of FOB Origin. 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. For license arrangements executed under the upfront revenue model, we recognize license revenue upon delivery of the software product, provided all other revenue recognition requirements are met.

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 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 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.

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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 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; (iv) legacy SMS arrangements; and (v) 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 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 associated with point product arrangements with Premier Plus SMS included for the contract term is recognized ratably over the term of the arrangement, once the other revenue recognition criteria have been met.

Perpetual and legacy term license 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.

Legacy SMS revenue includes revenue from our SMS offering provided in support of perpetual and legacy term license arrangements. Customers typically received SMS for one year and then could elect to renew SMS annually. We continue to have VSOE of fair value for the undelivered SMS component, which is deferred and subsequently amortized into revenue ratably over the contractual term of the SMS arrangement.

We expect legacy SMS revenue to continue to decrease as additional customers transition to our aspenONE licensing model. Prior to fiscal 2014, legacy SMS revenue was significant in relation to our total revenue and was classified within services and other revenue in our unaudited consolidated statements of operations. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. For further information, please refer to the Revenue Reclassification section.

Services and Other Revenue

Professional Services Revenue

Professional services are provided to customers on a time-and-materials (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 the period over 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.

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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.

Training Revenue

We provide training services to our customers, including on-site, Internet-based and customized training. Revenue is recognized in the period in which the services are performed.

Accounting for Income Taxes and Loss Contingencies

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, 2013 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 Nine Months Ended March 31, 2014 and 2013*

The following table sets forth the results of operations and the period-over-period percentage change in certain financial data for the three and nine months ended March 31, 2014 and 2013:

Revenue:						
Services and other	12,278	9,363	31.1	31,005	25,329	22.4
Cost of revenue:						
Services and other	9,956	7,651	30.1	24,835	22,116	12.3
Gross profit	88,299	66,708	32.4	250,112	190,763	31.1
Selling and marketing	24,267	22,958	5.7	71,376	67,852	5.2
General and administrative	10,858	11,685	(7.2)	33,747	36,124	(6.6)
Total operating expenses	56,897	50,374	13.0	157,749	150,546	4.8
Interest income	275	807	(66.0)	969	2,861	(66.1)
Other income (expense), net	(472)	(18)	*	(1,807)	(352)	*
Provision for income taxes	10,356	6,598	57.0	32,388	17,478	85.3

* Not meaningful

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The following table sets forth the results of operations as a percentage of net revenue for certain financial data for the three and nine months ended March 31, 2014 and 2013:

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Revenue:				
Services and other	11.9	11.8	10.7	11.1
Cost of revenue:				
Services and other	9.6	9.6	8.5	9.7
Gross profit	85.2	84.1	86.3	83.6
Selling and marketing	23.4	28.9	24.6	29.8
General and administrative	10.5	14.7	11.6	15.8
Total operating expenses	54.9	63.5	54.4	66.0
Interest income	0.3	1.0	0.3	1.3
Other (expense) income, net	(0.5)		(0.6)	(0.1)
Provision for income taxes	10.0	8.4	11.2	7.7

Revenue

Total revenue during the three and nine months ended March 31, 2014 increased by \$24.2 million and \$61.8 million as compared to the corresponding periods of the prior fiscal year. The increase was attributable to higher subscription and software revenue of \$21.3 million and \$56.1 million and higher services and other revenue of \$2.9 million and \$5.7 million, respectively.

Total revenue recognized during the three and nine months ended March 31, 2014 included \$7.6 million related to the completion of a significant customer arrangement recognized under completed contract accounting. This amount was recognized as \$4.9 million of subscription and software revenue and as \$2.7 million of services and other revenue.

Subscription and Software Revenue

Subscription and software revenue	\$ 91,309	\$ 69,994	\$ 21,315	30.5%	\$ 258,916	\$ 202,794	\$ 56,122	27.7%
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As a percent of revenue	88.1%	88.2%	89.3%	88.9%
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The increase in subscription and software revenue during the three and nine months ended March 31, 2014 as compared to the corresponding periods of the prior fiscal year was primarily the result of a larger base of license arrangements being recognized on a ratable basis combined with revenue recognition on the significant customer arrangement recognized under completed contract accounting, as noted above.

We expect subscription and software revenue to continue to increase as customers transition to our aspenONE licensing model. The transition will not be complete until fiscal 2016 since many of our license arrangements were five or six years in duration when the aspenONE licensing model was introduced at the start of fiscal 2010.

Prior to fiscal 2014, legacy SMS revenue was significant in relation to our total revenue and was classified within services and other revenue in our unaudited consolidated statements of operations. Beginning with the first quarter of fiscal 2014, legacy SMS revenue is included within subscription and software revenue in our unaudited consolidated statements of operations. For further information, please refer to the Revenue Reclassification section.

Table of Contents**Services and Other Revenue**

Services and other revenue	\$	12,278	\$	9,363	\$	2,915	31.1%	\$	31,005	\$	25,329	\$	5,676	22.4%
As a percent of revenue		11.9%		11.8%					10.7%		11.1%			

Services and other revenue consists primarily of revenue related to professional services and training.

The increase in services and other revenue of \$2.9 million during the three months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year was attributable to higher professional services revenue of \$2.4 million and higher training revenue of \$0.5 million, respectively.

The period-over-period increase in professional services revenue of \$2.4 million during the three months ended March 31, 2014 was primarily attributable to \$2.7 million of revenue recognized under completed contract accounting, slightly offset by revenue decreases on other professional service arrangements resulting from the timing of the services delivery.

The increase in services and other revenue of \$5.7 million during the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year was attributable to higher professional services revenue of \$5.1 million and higher training revenue of \$0.6 million, respectively.

The period-over-period increase in professional services revenue of \$5.1 million during the nine months ended March 31, 2014 was primarily attributable to the timing of revenue recognition on certain large arrangements. During the nine months ended March 31, 2014, we recognized \$2.7 million of previously deferred professional services revenue on the significant customer arrangement recognized under completed contract accounting, as noted above. Additionally, during the nine months ended March 31, 2014, professional services revenue included \$1.9 million of revenue recognized on a ratable basis on another large arrangement. By comparison, we deferred revenue of \$1.0 million on this arrangement during the corresponding period of the prior fiscal year.

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

Cost of subscription and software revenue	\$	5,332	\$	4,998	\$	334	6.7%	14,974	\$	15,244	\$	(270)	-1.8%
Gross margin		94.2%		92.9%				94.2%		92.5%			

Cost of subscription and software revenue during the three and nine months ended March 31, 2014 was consistent with the same period of the prior fiscal year.

Prior to fiscal 2014, cost of legacy SMS revenue was presented within cost of services and other revenue in our unaudited consolidated statements of operations. Beginning with the first quarter of fiscal 2014, cost of legacy SMS revenue is presented within cost of subscription and software revenue in our unaudited consolidated statements of operations. For further information, please refer to the Revenue Reclassification section.

Cost of Services and Other Revenue

	Three Months Ended March 31,		Period-to-Period Change		Nine Months Ended March 31,		Period-to-Period Change							
	2014	2013	\$	%	2014	2013	\$	%						
Cost of services and other revenue	\$	9,956	\$	7,651	\$	2,305	30.1%	\$	24,835	\$	22,116	\$	2,719	12.3%
Gross margin		18.9%		18.3%					19.9%		12.7%			

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Cost of services and other revenue includes the cost of providing professional services and training.

Cost of services and other revenue increased by \$2.3 million and \$2.7 million during the three and nine months ended March 31, 2014 as compared to the same periods of the prior fiscal year.

The timing of revenue and expense recognition on professional service arrangements can impact the comparability of cost of professional services revenue from period to period. We recognized net costs of \$2.3 million on the significant customer arrangement recognized under completed contract accounting during the three and nine months ended March 31, 2014, as discussed in the Revenue section. By comparison, we deferred costs of \$0.1 million and \$0.2 million on this arrangement during the corresponding periods of the prior fiscal year.

The increase in cost of services and other revenue of \$2.7 million during the nine months ended March 31, 2014 as compared to the corresponding period of the prior fiscal year was primarily attributable to the timing of expense recognition on professional service arrangements, as noted above. These increases were partially offset by lower cost of professional services revenue of \$0.9 million due to lower compensation and other operating costs.

Gross margin on services and other revenue during the three months ended March 31, 2014 was consistent with the same period of the prior fiscal year.

Gross margin on services and other revenue increased from 12.7% during the nine months ended March 31, 2013 to 19.9% during the corresponding period of the current fiscal year primarily due to higher revenue, lower compensation and other operating costs on professional services and the impact of cost deferrals related to the timing of expense recognition on professional service arrangements, as noted above.

Selling and Marketing Expense


Selling and marketing expense	\$	24,267	\$	22,958	\$	1,309	5.7%	\$	71,376	\$	67,852	\$	3,524	5.2%
As a percent of revenue		23.4%		28.9%					24.6%		29.8%			

The period-over-period increase in selling and marketing expense of \$1.3 million during the three months ended March 31, 2014 was primarily the result of higher commission expense of \$0.5 million and severance costs of \$0.4 million.

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The period-over-period increase in selling and marketing expense of \$3.5 million during the nine months ended March 31, 2014 was primarily the result of higher commission expense of \$2.4 million, severance costs of \$0.7 million and higher third-party commissions of \$0.5 million.

Research and Development Expense



Research and development expense	\$	21,791	\$	15,772	\$	6,019	38.2%	\$	52,641	\$	46,577	\$	6,064	13.0%
As a percent of revenue		21.0%		19.9%					18.2%		20.4%			

Research and development expenses increased by approximately \$6.0 million in the three and nine months ended March 31, 2014 as compared to the same periods of the prior fiscal year primarily as a result of expensing \$4.9 million of acquired technology and an increase in stock based compensation. In the third quarter of fiscal 2014, we acquired certain technology that we plan to modify and enhance for release as a commercially available product. At the time we acquired the technology, the project to develop a commercially available product did not meet the accounting definition of having reached technological feasibility and as such the cost of the acquired technology was expensed as research and development expense. We continue to expect that we will develop the acquired technology into a commercially available product.

Table of Contents**General and Administrative Expense**

General and administrative expense	\$	10,858	\$	11,685	\$	(827)	-7.2%	\$	33,747	\$	36,124	\$	(2,377)	-6.6%
As a percent of revenue		10.5%		14.7%					11.6%		15.8%			

The period-over-period decrease in general and administrative expense of \$0.8 million during the three months ended March 31, 2014 was primarily attributable to lower stock-based compensation expense of \$0.6 million resulting from an increase of forfeitures in the period.

The period-over-period decrease in general and administrative expense of \$2.4 million during the nine months ended March 31, 2014 was primarily attributable to lower legal and accounting costs of \$2.2 million, lower stock-based compensation expense of \$0.9 million resulting from an increase of forfeitures in the period, partially offset by higher bad debt expense of \$0.7 million.

Interest Income

	Three Months Ended		Period-to-Period Change		Nine Months Ended		Period-to-Period Change	
	March 31, 2014	March 31, 2013	\$	%	March 31, 2014	March 31, 2013	\$	%
Interest income	\$ 275	\$ 807	\$ (532)	-65.9%	\$ 969	\$ 2,861	\$ (1,892)	-66.1%
As a percent of revenue	0.3%	1.0%			0.3%	1.3%		

(Dollars in Thousands, Except Percentages)

The period-over-period decrease in interest income during the three and nine months ended March 31, 2014 was attributable to the decrease of our installments receivable portfolio. We expect interest income to continue to decrease going forward as our installments receivable balance continues to decrease.

Interest Expense

	Three Months Ended		Period-to-Period Change		Nine Months Ended		Period-to-Period Change	
	March 31, 2014	March 31, 2013	\$	%	March 31, 2014	March 31, 2013	\$	%

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(Dollars in Thousands, Except Percentages)

Interest expense	\$	(6)	\$	(12)	\$	6	-50.0%	\$	(32)	\$	(385)	\$	353	-91.7%
As a percent of revenue		0.0%		0.0%					0.0%		-0.2%			

Interest expense during the three months ended March 31, 2014 was consistent with the same period of the prior fiscal year.

The period-over-period decrease in interest expense during the nine months ended March 31, 2014 was attributable to the pay-down of our secured borrowings that were repaid in full during fiscal 2013.

Other Income (Expense), Net

	Three Months Ended		Period-to-Period Change		Nine Months Ended		Period-to-Period Change							
	March 31, 2014	March 31, 2013	\$	%	March 31, 2014	March 31, 2013	\$	%						
	(Dollars in Thousands, Except Percentages)													
Other income (expense), net	\$	(472)	\$	(18)	\$	(454)	*	\$	(1,807)	\$	(352)	\$	(1,455)	*
As a percent of revenue		-0.5%		0.0%					-0.6%		-0.1%			

* Not meaningful

Other income (expense), net is comprised primarily of unrealized and realized foreign currency exchange gains and losses generated from the settlement and remeasurement of transactions denominated in currencies other than the functional currency of our operating units. Other income (expense), net also includes miscellaneous non-operating gains and losses.

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During the three months ended March 31, 2014 and 2013, other income (expense), net was comprised of \$0.5 million and less than \$0.1 million of net currency losses, respectively. During the nine months ended March 31, 2014 and 2013, other income (expense), net was comprised of \$1.8 million and \$0.4 million of net currency losses, respectively.

Provision for Income Taxes

	Three Months Ended March 31,		Period-to-Period Change		Nine Months Ended March 31,		Period-to-Period Change	
	2014	2013	\$	%	2014	2013	\$	%
(Dollars in Thousands, Except Percentages)								
Provision for income taxes	\$ 10,356	\$ 6,598	\$ 3,758	57.0%	\$ 32,388	\$ 17,478	\$ 14,910	85.3%
Effective tax rate	33.2%	38.6%			35.4%	41.3%		

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 taxed at the applicable rates, as well as the impact of permanent differences between book and tax income.

Our effective tax rate for the three months ended March 31, 2014 was 33.2% as compared to 38.6% for the corresponding period of the prior fiscal year. Our effective tax rate for the nine months ended March 31, 2014 was 35.4% as compared to 41.3% for the corresponding period of the prior fiscal year. During the three and nine months ended March 31, 2014 and 2013, our income tax expense was driven primarily by pre-tax profitability in our domestic and foreign operations and the impact of permanent items, predominately a U.S. domestic production activity deduction slightly offset by non-deductible stock-based compensation expense. We did not qualify for a U.S. domestic production activity deduction in fiscal 2013 as a result of cumulative losses generated in the U.S. during prior periods and carried forward into fiscal 2013.

Liquidity and Capital Resources**Resources**

In recent years, we have financed our operations with cash generated from operating activities. As of March 31, 2014, our principal sources of liquidity consisted of \$151.3 million in cash and cash equivalents and \$93.4 million of marketable securities. As of March 31, 2013, our principal sources of liquidity consisted of \$139.0 million in cash and cash equivalents and \$75.1 million of marketable securities.

We believe our existing cash and cash equivalents and marketable securities, together with our cash flows from operating activities will be sufficient to meet our anticipated cash needs for at least the next twelve months. To the extent our cash and cash equivalents, marketable securities and cash flows from operating activities are insufficient to fund future activities, we may need to raise additional funds through the financing of receivables or from public or private equity or debt financings. We also may need to raise additional funds in the event we decide to make one or more acquisitions of businesses, technologies or products. If additional funding is required, we may not be able to effect a

receivable, equity or debt financing on terms acceptable to us or at all.

Our cash equivalents of \$151.3 million and \$139.0 million consist primarily of money market funds as of March 31, 2014 and March 31, 2013, respectively. Our investments in marketable securities of \$93.4 million and \$75.1 million as of March 31, 2014 and March 31, 2013 consist primarily of investment grade fixed income corporate debt securities with maturities ranging from less than one month to 23 months. The fair value of our portfolio is affected by interest rate movements, credit and liquidity risks. The objective of our investment policy is to manage our cash and investments to preserve principal and maintain liquidity, while earning a return on our investment portfolio by investing available funds. We diversify our investment portfolio by investing in multiple types of investment-grade securities and using a third-party investment manager.

The following table summarizes our cash flow activities for the periods indicated:

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	Nine Months Ended March,	
	2014	2013
(Dollars in Thousands)		
Cash flow provided by (used in):		
Operating activities	\$ 141,889	\$ 112,624
Investing activities	(5,811)	(78,004)
Financing activities	(87,242)	(60,589)
Effect of exchange rates on cash balances	215	(231)
Increase (decrease) in cash and cash equivalents	\$ 49,051	\$ (26,200)

Operating Activities

Our primary source of cash is from the annual installments associated with our software license arrangements and related software support services, and to a lesser extent from professional services and training. We believe that cash inflows from our term license business will grow as we benefit from the continued growth of our portfolio of term license contracts.

Cash from operating activities provided \$141.9 million during the nine months ended March 31, 2014. This amount resulted from net income of \$59.1 million, adjusted for non-cash items of \$44.6 million and net sources of cash of \$38.2 million due to decreases in operating assets of \$22.0 million and increases in operating liabilities of \$16.2 million.

Cash flow from operations for the nine months period ended March 31, 2014 was reduced by a \$4.9 million expense related to the purchase of non-capitalized acquired technology. Other past acquisitions of technology qualified for capitalization and therefore the cash outflow was shown in the investing section of the consolidated statements of cash flow. See the *Adjusted Total Costs, Free Cash Flow and Results of Operations sections of Managements Discussion and Analysis of Financial Condition and Results of Operations* for further discussion of the non-capitalized acquired technology transaction.

Non-cash expenses within net income consisted primarily of deferred income tax expense of \$25.8 million, stock-based compensation expense of \$11.1 million and depreciation and amortization of \$3.9 million.

A net decrease in operating assets of \$22.0 million and an increase in operating liabilities of \$16.2 million contributed \$38.2 million to net cash from operating activities. Sources of cash consisted of increases in deferred revenue of \$17.3 million, decreases in installments receivable totaling \$11.9 million, decreases in accounts receivable of \$5.1 million, decreases in prepaid expenses, prepaid income taxes and other assets totaling \$4.3 million and decreases in unbilled services of \$0.7 million. Partially offsetting these sources of cash were net decreases in accounts payable, accrued expenses and other current liabilities of \$1.1 million.

Investing Activities

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During the nine months ended March 31, 2014, we used \$5.8 million of cash for investing activities. The cash used consisted primarily of \$35.5 million for purchases of marketable securities related to a program which we initiated during the third quarter of fiscal 2013 to make direct investments in these assets. Partially offsetting this use of cash was the receipt of \$33.4 million from maturities of marketable securities.

Additional uses of cash during the period included \$2.6 million related to capital expenditures, primarily for computer hardware and software, \$0.6 million related to capitalized computer software development costs and \$0.4 million related to the purchase of technology intangibles.

Financing Activities

During the nine months ended March 31, 2014, we used \$87.2 million of cash for financing activities. We paid \$88.9 million for the repurchase of our common stock and paid withholding taxes of \$5.9 million on vested and settled restricted stock units. Sources of cash in the period included proceeds of \$7.5 million from the exercise of employee stock options.

Contractual Obligations

In January 2014, we entered into a lease agreement for office space in Bedford, Massachusetts. The initial term of the lease with respect to 105,874 square feet of office space will commence on November 1, 2014 and on February 1, 2015 with respect to an additional 36,799 square feet of space. The initial term of the lease will expire approximately ten years and five months following the term commencement date. Subject to the terms and conditions of the lease, we may extend the term of the lease for two successive terms of five years each. Base annual rent will range between approximately \$2.2 million and \$3.9 million over the term of the lease in addition to our proportionate share of operating expenses and real estate taxes.

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Future minimum non-cancelable lease payments under the terms of the lease amount to approximately \$35.8 million and are as follows:

	Total	Payments Due by Period			
		Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
Operating leases	\$ 35,807	\$ 138	\$ 6,558	\$ 6,836	\$ 22,275
	\$ 35,807	\$ 138	\$ 6,558	\$ 6,836	\$ 22,275

The lease has a leasehold improvement allowance of approximately \$6.4 million. Any capital expenditures with respect to the leased premises in excess of that amount are expected to be funded from our cash flows from operating activities.

Except for the commitments under the aforementioned lease agreement, we are not currently a party to any other material purchase contracts related to future capital expenditures, and we do not expect our future investment in capital expenditures to be materially different from recent levels.

Recently Issued and Adopted Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU No. 2013-11 provides guidance on the financial statement presentation of unrecognized tax benefits when net operating losses, similar tax losses, or tax credit carryforwards exist. ASU No. 2013-11 requires entities to present unrecognized tax benefits as reductions of deferred tax assets for net operating losses, tax credit carryforwards, or similar losses if they are available to settle any additional income tax liabilities as a result of a tax position disallowance under the tax laws of the applicable jurisdiction. Unrecognized tax benefits should be presented as liabilities and should not be combined with deferred tax assets if net operating losses, tax credit carryforwards, or similar losses are not available to settle any additional income tax liabilities as a result of the tax position disallowance, and the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose.

ASU No. 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively. Early adoption of ASU No. 2013-11 is permitted. We adopted ASU No. 2013-11 during the fourth quarter of fiscal 2013. The adoption of ASU No. 2013-11 did not have a material effect on our financial position, results of operations or cash flows.

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU No. 2013-02 requires entities to present by component significant amounts reclassified out of accumulated other comprehensive income either on the face of the statement where net income is presented or in the notes to the financial statements. ASU No. 2013-02 is effective for annual and interim periods beginning after December 31, 2012 and should be applied prospectively. We adopted ASU No. 2013-02 during the third quarter of fiscal 2013. The adoption of ASU No. 2013-02 did not have a material effect on our financial position, results of operations or cash flows.

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