ASTEA INTERNATIONAL INC
Form 10-Q
August 12, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2004

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: 0-26330

ASTEA INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	23-2119058
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
240 Gibraltar Road, Horsham, PA	19044
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (215) 682-2500

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No X

As of August 12, 2004, 2,953,877 shares of the registrant's Common Stock, par value $.01 per share, were outstanding.

ASTEA INTERNATIONAL INC.

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PART I - FINANCIAL INFORMATION

Item 1. CONSOLIDATED FINANCIAL STATEMENTS

ASTEA INTERNATIONAL INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2004 (Unaudited)	Dece
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,763,000	$
Restricted cash	300,000	
Receivables, net of reserves of $708,000 and $810,000	4,774,000	
Prepaid expenses and other	518,000	
Total current assets	10,355,000	
Property and equipment, net	397,000	
Capitalized software, net	1,328,000	
Other assets	36,000	
Total assets	$ 12,116,000	$ 1
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 2,653,000	$
Deferred revenues	3,789,000	
Total current liabilities	6,442,000	
Stockholders' equity:		
Preferred stock, $.01 par value, 5,000,000 shares authorized, none issued	-	
Common stock, $.01 par value, 5,000,000 shares authorized, 2,954,000 issued	30,000	
Additional paid-in capital	22,977,000	2
Cumulative translation adjustment	(814,000)	
Accumulated deficit	(16,309,000)	(1
Less: treasury stock at cost, 42,000 and 43,000 shares	(210,000)	
Total stockholders' equity	5,674,000	
Total liabilities and stockholders' equity	$ 12,116,000	$ 1

See accompanying notes to the consolidated financial statements.

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ASTEA INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		E
	2004	2003	2004
Revenues:			
Software license fees	$ 1,606,000	$ 312,000	$ 4,502,
Services and maintenance	2,810,000	2,826,000	5,798,
Total revenues	4,416,000	3,138,000	10,300,
Costs and expenses:			
Cost of software license fees	335,000	181,000	745,
Cost of services and maintenance	1,588,000	1,830,000	3,138,
Product development	316,000	587,000	721,
Sales and marketing	1,433,000	1,524,000	2,922,
General and administrative	445,000	531,000	1,001,
Total costs and expenses	4,117,000	4,653,000	8,527,
Income (loss) from operations	299,000	(1,515,000)	1,773,
Interest income, net	10,000	12,000	19,
Income (loss) before income taxes	309,000	(1,503,000)	1,792,
Income tax expense	-	-	
Net income (loss)	$ 309,000	$ (1,503,000)	$ 1,792,
Basic net income (loss) per share	$ 0.11	$ (0.51)	$ 0
Diluted net income (loss) per share	0.11	(0.51)	0
Shares outstanding used in computing basic income (loss) per share	2,932,000	2,921,000	2,927,
Shares outstanding used in computing diluted income (loss) per share	2,972,000	2,921,000	2,942,

See accompanying notes to the consolidated financial statements.

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ASTEA INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Six Ended Jun 2004
Cash flows from operating activities:	
Net income (loss)	$ 1,792,000
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization	601,000
Bad debt expense	76,000
Changes in operating assets and liabilities:	
Receivables	(985,000)
Prepaid expenses and other	86,000
Other assets	(2,000)
Accounts payable and accrued expenses	(275,000)
Deferred revenues	432,000
Net cash provided by operating activities	1,725,000
Cash flows from investing activities:	
Purchases of property and equipment	(34,000)
Capitalized software development costs	(560,000)
Net cash used in investing activities	(594,000)
Cash flows from financing activities:	
Proceeds from exercise of stock options and employee stock purchase plan	111,000
Effect of exchange rate changes on cash	41,000
Net increase in cash and cash equivalents	1,283,000
Cash, beginning of period	3,480,000
Cash, end of period	$ 4,763,000

See accompanying notes to the consolidated financial statements.

Item 1. CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ASTEA INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The consolidated financial statements at June 30, 2004 and for the three and six month periods ended June 30, 2004 and 2003 of Astea International Inc. and subsidiaries (the "Company") are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company's 2003 Annual Report on Form 10-K which are hereby incorporated by reference in this quarterly report on Form 10-Q. Results of operations and cash flows for the six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the full year.

2. STOCKHOLDERS' EQUITY/COMPREHENSIVE LOSS

The reconciliation of stockholders' equity and comprehensive loss from December 31, 2003 to June 30, 2004 is summarized as follows:

	Common Stock	Additional Paid-In Capital	Cumulative Currency Translation Adjustment	Accumulated Deficit	Treasu Stoc
Balance at December 31, 2003	$30,000	$ 22,792,000	$ (776,000)	$ (18,100,000)	$ (212,0
Issuance of common stock under Employee Stock Purchase Plan	-		-	(1,000)	2,0
Exercise of stock options	-	111,000	-	-	
Stock issued for satisfaction of liability	-	74,000	-	-	
Cumulative translation adjustment	-	-	(38,000)	-	
Net income for the period	-	-	-	1,792,000	
Balance at June 30, 2004	$30,000	$ 22,977,000	$ (814,000)	(16,309,000)	$(210,0

3. CHANGE IN ACCOUNTING ESTIMATE

During the first quarter of 2004, the Company re-evaluated the estimated lives of its capitalized software assets related to licenses and determined that the estimated life of 3 years currently used should be reduced to 2 years, based on the rate of product release and the current sales trend. The impact of the change in the estimated life resulted in an increase in amortization, and reduction in net income, of $83,000, or $0.03 per diluted share for the three months ended June 30, 2004 and $166,000 or $0.06 per diluted share for the six months ended June 30, 2004.

4. INCOME TAX EXPENSE

The Company has utilized a portion of its net operating loss carry forwards for the three months and six months ended June 30, 2004 to reduce any tax provisions on its pre-tax income. At June 30, 2004, the Company maintains a 100% valuation allowance for its remaining net deferred tax assets based on the uncertainty of the realization of future taxable income.

5. STOCK BASED COMPENSATION

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123 ("SFAS 148"). SFAS 148 amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, this Statement amends Accounting Principles Board ("APB") Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. SFAS 148 is effective for financial statements for fiscal years ending after December 15, 2002. The Company plans to continue to use the intrinsic valuation method for stock compensation.

The Company accounts for options and the employee stock purchase plan under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for the Company's stock options and employee stock purchase plan been determined consistent with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net loss and basic and diluted net loss per share would have been:

	Three months ended June 30,		Six mo J
	2004	2003	2004

		(unaudited)		(unaudited)		(unaudited)
Net income (loss) - as reported	$	309,000	$	(1,503,000)	$	1,792,000
Add: Stock-based compensation included in net income as reported, net or related tax effects		-		-		-
Deduct stock-based compensation determined under fair value based methods for all awards, net of related tax effects		(78,000)		(120,000)		(110,000)
Net income (loss) - pro forma	$	231,000	$	(1,623,000)	$	1,682,000
Basic income per share - as reported	$	0.11	$	(0.51)	$	0.62
Diluted income (loss) per share as reported	$	0.10	$	(0.51)	$	0.61
Basic income (loss) per share - pro forma	$	0.08	$	(0.56)	$	0.57
Diluted income (loss) per share pro forma	$	0.07	$	(0.56)	$	0.56

The weighted average fair value of those options granted during the quarters ended June 30, 2004 and 2003 was estimated at $3.23 and $0.76, respectively. The weighted average fair value of those options granted during the six months ended June 30, 2004 and 2003 was estimated at $3.12 and $0.63. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: risk-free interest rate of 4.61% and 3.38% for 2004 and 2003 grants, respectively; an expected life of six years; volatility of 132% and 144%; and a dividend yield of zero for 2004 and 2003 grants, respectively.

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6. MAJOR CUSTOMERS

In the second quarter of 2004, there was one major customer that accounted for 14% of total revenues. In the second quarter of 2003, the Company had no customers that accounted for 10% of its total revenue. For the first six months of 2004 there was one major customer that accounted for 22% of total revenues and for the first six months of 2003, there were no customers that accounted for 10% of total revenues.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

This document contains various forward-looking statements and information that are based on management's beliefs, assumptions made by management and information currently available to management. Such statements are subject to various risks and uncertainties, which could cause actual results to vary materially from those contained in such forward-looking statements. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected or projected. Certain of these, as well as other risks and uncertainties are described in more detail herein and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

The Company develops, markets and supports service management software solutions for companies that sell and service capital equipment. Clients include Fortune 500 to mid-size companies that automate equipment sales and service business processes to increase competitive advantages, top-line revenue growth, profitability, and customer loyalty. The Company supports a global client base with a worldwide sales and service network that conducts business through Company facilities in the United States, United Kingdom, Australia, the Netherlands, and Israel.

Over the past year, the Company has been in the process of making the transition from a pure field service software provider to a provider of a comprehensive suite of service management solutions. In addition to field service, the suite also streamlines and automates processes for managing sales and marketing, multi-channel customer contact centers and professional services. The Company continues to focus on companies in industries that sell and service equipment.

The Company continues to make a significant investment in product development in support of the transition. The Company believes that its investment in development along with its continued commitment to marketing its service management suite will favorably position the Company as economic conditions continue to improve.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are more fully described in Note 2 of the Notes to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K. The preparation of financial statements in conformity with accounting principles generally accepted within the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying financial statements and related notes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below; however, application of these accounting policies involves the exercise of judgments and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Revenue Recognition

Revenues are recognized in accordance with Statement of Position (SOP) 97-2, which provides guidelines on the recognition of software license fee revenue. Principally, revenue may be recognized when persuasive evidence of an arrangement exists, delivery has occurred, the license fee is fixed and determinable and the collection of the fee is

probable. The Company allocates a portion of its software revenue to post-contract support activities or to other services or products provided to the customer free of charge or at non-standard discounts when provided in conjunction with the licensing arrangement. Amounts allocated are based upon standard prices charged for those services or products. Software license fees for resellers or other members of the indirect sales channel are based on a fixed percentage of the Company's standard prices. The Company recognizes software license revenue for such contracts based upon the terms and conditions provided by the reseller to its customer.

Revenue from post-contract support is recognized ratably over the term of the contract on a straight-line basis. Consulting and training service revenue is generally unbundled and recognized at the time the service is performed. Fees from licenses sold together with consulting services are generally recognized upon shipment, provided that the contract has been executed, delivery of the software has occurred, fees are fixed and determinable and collection is probable. In instances where the aforementioned criteria have not been met, both the license and the consulting fees are recognized under the percentage of completion method of contract accounting.

In limited instances, the Company will enter into contracts for which revenue is recognized under contract accounting. The accounting for such arrangements requires judgment, which impacts the timing of revenue recognition and provision for estimated losses, if applicable.

Accounts Receivable

The Company evaluates the adequacy of its allowance for doubtful accounts at the end of each quarter. In performing this evaluation, the Company analyzes the payment history of its significant past due accounts, subsequent cash collections on these accounts and comparative accounts receivable aging statistics. Based on this information, along with consideration of the general strength of the economy, the Company develops what it considers to be a reasonable estimate of the uncollectible amounts included in accounts receivable. This estimate involves significant judgment by the management of the Company. Actual uncollectible amounts may differ from the Company's estimate.

Capitalized Software Research and Development Costs

The Company accounts for its internal software development costs in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Accordingly, all costs incurred subsequent to attaining technological feasibility are capitalized and amortized over a period not to exceed three years. Technological feasibility is attained when software products reach Beta release. Costs incurred prior to the establishment of technological feasibility are charged to product development expense. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future revenues, estimated economic life and changes in software and hardware technologies. Upon the general release of the software product to customers, capitalization ceases and such costs are amortized, using the straight-line method, on a product-by-product basis over the estimated life. During the first quarter of 2004, the Company revised the estimated life for its capitalized software products from three years to two years based on current sales trends and the rate of product releases. All research and development expenditures are charged to research and development expense in the period incurred.

Results of Operations

Comparison of Three Months Ended June 30, 2004 and 2003

Revenues

Revenues increased $1,278,000, or 41%, to $4,416,000 for the three months ended June 30, 2004 from $3,138,000 for the three months ended June 30, 2003. Software license fee revenues increased $1,294,000, or 415%, from the same period last year. Services and maintenance fees for the three months ended June 30, 2004 amounted to $2,810,000, a .6% decrease from the same quarter in 2003.

The Company's international operations contributed $1,752,000 of revenues in the second quarter of 2004 which was a 42% increase over revenues generated during the second quarter of 2003. The Company's revenues from international operations amounted to 40% of the total revenue for the second quarter in 2004 compared to 39% of total revenues for the same quarter in 2003. The increase in revenues is due to the increase in sales from the Company's operations in Japan and from operations in Europe.

Software license fee revenues increased 415% to $1,606,000 in the second quarter of 2004 from $312,000 in the second quarter of 2003. Astea Alliance license revenues increased $1,078,000 or 346%, to $1,390,000 in the second quarter of 2004 from $312,000 in the second quarter of 2003. The increase is primarily attributable to one major customer that accounted for 14% of total revenue in the second quarter of 2004. The Company also sold $217,000 of additional DISPATCH-1 licenses to an existing customer in the second quarter of 2004. There were no license sales of DISPATCH-1 in the second quarter of 2003. The Company does not anticipate future license sales of DISPATCH-1.

Services and maintenance revenues decreased marginally to $2,810,000 in the second quarter of 2004 from $2,826,000 in the second quarter of 2003. The Astea Alliance service and maintenance revenues increased by $68,000 or 3% compared to the second quarter of 2003. More than offsetting this increase was an $84,000 decrease in DISPATCH-1 service and maintenance revenues, which resulted from an expected decrease in demand.

Costs of Revenues

Cost of software license fees increased 85% to $335,000 in the second quarter of 2004 from $181,000 in the second quarter of 2003. Included in the cost of software license fees is the fixed cost of capitalized software amortization. During the first quarter of 2004, the Company revised the estimated useful life of its capitalized software products from 3 years to 2 years. This revision increased amortization for the period to $230,000 as compared to $150,000 in the second quarter of 2003. The cost of software license fees also increased due to the greater level of software license sales. The software licenses gross margin percentage was 79% in the second quarter of 2004 compared to 42% in the second quarter of 2003. The increase in gross margin was attributable to the mix of products sold in 2004 as well as the relationship of the fixed cost of amortized capitalized software to a lower level of sales in 2003.

Cost of services and maintenance decreased 13% to $1,588,000 in the second quarter of 2004 from $1,830,000 in the second quarter of 2003. The decrease in cost of service and maintenance is primarily attributed to a reduction in headcount from last year to this year. The services and maintenance gross margin percentage was 43% in the second quarter of 2004 compared to 35% in the second quarter of 2003. The increase in services and maintenance gross margin was primarily due to increased utilization of Astea Alliance service professionals.

Product Development

Product development expense decreased 46% to $316,000 in the second quarter of 2004 from $587,000 in the second quarter of 2003. Gross development expense before capitalization of software costs was $658,000 in the second quarter of 2004 compared to $707,000 during the same period in 2003. The Company includes the capitalization of software costs in product development. Capitalized software totaled $342,000 in the second quarter of 2004 compared to $120,000 during the same period in 2003. The increase in software capitalization is a result of product development initiatives geared towards the release of Astea Alliance version 6.7 during the third quarter of 2004. Product development expense as a percentage of revenues decreased 7% in the second quarter of 2004 compared with 19% in the second quarter of 2003. The decrease in margin is the result of the increase in software capitalization combined with the increased license sales volume.

Sales and Marketing

Sales and marketing expense decreased 6% to $1,433,000 in the second quarter of 2004 from $1,524,000 in the second quarter of 2003. The decrease in sales and marketing is attributable to a reduction in sales staffing costs partially offset by increased marketing expenses related to the timing of marketing initiatives. As a percentage of revenues, sales and marketing expenses decreased to 32% in 2004 from 49% in the second quarter of 2003.

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General and Administrative

General and administrative expenses decreased 16% to $444,000 during the second quarter of 2004 from $531,000 in the second quarter of 2003. As a percentage of revenue, general and administrative expenses decreased to 10% in the second quarter of 2004 from 17% in the second quarter of 2003. The decrease is primarily attributable to the higher level of revenue combined with a reduction of bad debt expenses associated with improved collection activity.

Interest Income, Net

Net interest income decreased $2,000 to $10,000 in the second quarter of 2004 from $12,000 in the second quarter of 2003. The decrease of interest income is generally attributable to less cash on hand than in 2003, as well as an overall reduction in interest rates paid on invested cash.

International Operations

Total revenue from the Company's international operations increased during the second quarter of 2004 to $1,752,000 compared to $1,238,000 for the second quarter of 2003. The increase in revenue from international operations was primarily attributable to the increase in revenues from Japan and European operations. International operations generated net income of $223,000 for the second quarter ended June 30, 2004 compared to a net loss of $432,335 in the same quarter in 2003.

Comparison of Six Months Ended June 30, 2004 and 2003

Revenues

Revenues increased $3,174,000, or 45%, to $10,300,000 for the six months ended June 30, 2004 from $7,126,000 for the six months ended June 30, 2003. Software license fee revenues increased $3,168,000, or 237%, from the same period last year. Services and maintenance fees for the six months ended June 30, 2004 amounted to $5,798,000, a .1% increase from the same quarter in 2003.

The Company's international operations contributed $3,238,000 of revenues in the first six months of 2004 compared to $2,601,000 in the first six months of 2003.

This represents a 24% increase from the same period last year and 31% of total revenues in the first six months of 2004. The increase in revenues is due to the increase in sales from the Company's operations in Japan and Europe partially offset by a slight decrease in sales from operations in Australia.

Software license fee revenues increased 237% to $4,502,000 in the first six months of 2004 from $1,334,000 in the first six months of 2003. The increase is primarily attributable to a number of larger sales that closed during the first half of the year. Astea Alliance license revenues increased $2,786,000 or 209% in the first six months of 2004 from $1,334,000 in the first six months of 2003. There were no license sales of the DISPATCH-1 product during the first six months of 2003 as compared to $383,000 during the same period in 2004.

Services and maintenance revenues increased marginally to $5,798,000 in the first six months of 2004 from $5,792,000 in the first six months of 2003. The increase primarily relates to service and maintenance revenues from Astea Alliance which increased $263,000, or 6%, to $4,659,000 from $4,396,000 in the first six months of 2003. The increase in Astea Alliance service and maintenance revenues is a direct result of the growth of the Astea Alliance customer base. Partially offsetting the increase in Astea Alliance service and maintenance revenues was a decrease of $256,000 in DISPATCH-1 service and maintenance revenues, which resulted from an expected decrease in demand.

Costs of Revenues

Cost of software license fees increased 82% to $745,000 in the first six months of 2004 from $410,000 in the first six months of 2003. Included in the cost of software license fees is the fixed cost of capitalized software amortization. Capitalized software amortization was $460,000 and $300,000 in the first six months of 2004 and

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2003, respectively. The cost of software license fees also increased due to the greater level of software license sales in the first six months of 2004. The software licenses gross margin percentage was 83% in the first six months of 2004 compared to 69% in the first six months of 2003. This increase in gross margin was attributable to the increase in license sales.

Cost of services and maintenance decreased 10% to $3,138,000 in the first six months of 2004 from $3,474,000 in the first six months of 2003. The decrease in cost of service and maintenance is primarily attributed to a reduction in headcount from last year to this year. The services and maintenance gross margin percentage was 46% in the first six months of 2004 compared to 40% in the first six months of 2003. The increase in services and maintenance gross margin was primarily due to increased utilization of Astea Alliance service professionals.

Product Development

Product development expense decreased 34% to $721,000 in the first six months of 2004 from $1,094,000 in the first six months of 2003. Gross development expense before capitalization of software costs was $1,281,000 for the first six months of 2004 compared to $1,334,000 for the same period in 2003. The Company includes the capitalization of software costs in product development. Capitalized software totaled $560,000 in the first six months of 2004 compared to $240,000 during the same period in 2003. The increase in software capitalization is a result of product development initiatives geared towards the release of Astea Alliance version 6.7 during the third quarter of 2004. Product development as a percentage of revenues was 7% in the first six months of 2004 compared with 15% in the first six months of 2003. The decrease in margin is the result of the increase in software capitalization combined with the increased sales volume.

Sales and Marketing

Sales and marketing expense decreased 6% to $2,922,000 in the first six months of 2004 from $3,098,000 in the first six months of 2003. The decrease in sales and marketing is attributable to a reduction in sales staffing costs partially offset by increased marketing costs related to the increase in marketing initiatives. As a percentage of revenues, sales and marketing expenses decreased to 28% from 43% in the first six months of 2003, which is the direct result of increased revenues and lower costs.

General and Administrative

General and administrative expenses decreased 5% to $1,000,000 in the first six months of 2004 from $1,049,000 in the first six months of 2003. The decrease in general and administrative expenses is due to a reduction in bad debt expense. As a percentage of revenues, general and administrative expenses decreased to 10% from 15% in the first six months of 2003. The decrease is attributable to the significant increase in revenues.

Interest Income, Net

Net interest income decreased $10,000 from $29,000 in the first six months of 2003 to $19,000 in the first six months of 2004. The decrease resulted primarily from a decrease in the amount of investments.

International Operations

Total revenue from the Company's international operations increased by $637,000, or 24%, to $3,238,000 in the first six months of 2004 from $2,601,000 in the first six months in 2003. The increase in revenue from international operations was primarily attributable to the increase in revenues from Japan operations. International operations generated net income of $168,000 for the first six months ended June 30, 2004 compared to a loss of $541,000 in the same period in 2003.

Liquidity and Capital Resources

Net cash provided by operating activities was $1,725,000 for the six months ended June 30, 2004 compared to cash provided by operations of $772,000 for the six months ended June 30, 2003. The increase in cash provided by operations was primarily attributable to a significant increase in revenues.

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The Company's investing activities used $594,000 for investing activities in the first six of 2004 compared to using $393,000 in the first six months of 2003. The increase in cash used is attributable to an increase in software capitalization partially offset by a decrease in purchases of property and equipment.

The Company generated $111,000 of cash from financing activities during the six months ended June 30, 2004 and 2003 related to proceeds from the exercise of stock options and the issuance of stock through the employee stock purchase plan.

At June 30, 2004, the Company had a working capital ratio of 1.61:1, with cash, cash equivalents and restricted cash of $5,063,000. The Company believes that it has adequate cash resources to make the investments necessary to maintain or improve its current position and to sustain its continuing operations for the next twelve months. The Board of Directors from time to time reviews the Company's forecasted operations and financial condition to determine whether and when payment of a dividend or dividends is appropriate. The Company does not anticipate that its operations or financial condition will be affected materially by inflation.

Variability of Quarterly Results and Potential Risks Inherent in the Business

The Company's operations are subject to a number of risks, which are described in more detail in the Company's prior SEC filings. Risks which are peculiar to the Company on a quarterly basis, and which may vary from quarter to quarter, include but are not limited to the following:

- The Company's quarterly operating results have in the past varied and may in the future vary significantly depending on factors such as the size, timing and recognition of revenue from significant orders, the timing of new product releases and product enhancements, and market acceptance of these new releases and enhancements, increases in operating expenses, and seasonality of its business.

- The Company's future success will depend in part on its ability to increase licenses of AllianceEnterprise and other new product offerings, and to develop new products and product enhancements to complement its existing field service, sales automation and customer support offerings.

- The enterprise software market is intensely competitive.

- International sales for the Company's products and services, and the Company's expenses related to these sales, continue to be a substantial component of the Company's operations. International sales are subject to a variety of risks, including difficulties in establishing and managing international operations and in translating products into foreign languages.

- The market price of the common stock could be subject to significant fluctuations in response to, and may be adversely affected by, variations in quarterly operating results, changes in earnings estimates by analysts, developments in the software industry, adverse earnings or other financial announcements of the Company's customers and general stock market conditions, as well as other factors.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest Rate Risk. The Company's exposure to market risk for changes in interest rates relate primarily to the Company's investment portfolio. The Company does not have any derivative financial instruments in its portfolio. The Company places its investments in instruments that meet high credit quality standards. The Company is adverse to principal loss and ensures the safety and preservation of its invested funds by limiting default risk, market risk and reinvestment risk. As of June 30, 2004, the Company's investments consisted of U.S. government commercial paper. The Company does not expect any material loss with respect to its investment portfolio.

Foreign Currency Risk. The Company does not use foreign currency forward exchange contracts or purchased currency options to hedge local currency cash flows or for trading purposes. All sales arrangements with international customers are denominated in foreign currency. The Company does not expect any material loss with respect to foreign currency risk.

Item 4. CONTROLS AND PROCEDURES

Our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our controls and procedures related to our reporting and disclosure obligations as of June 30, 2004, which is the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are sufficient to provide that (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by our and our consolidated subsidiaries other employees, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms promulgated by the Securities and Exchange Commission.

There were no changes that occurred during the fiscal quarter ended June 30, 2004 that have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. The Company is not involved in any legal proceedings, which would, in management's opinion, have a material adverse effect on the Company's business or results of operations.

Item 2. Changes in Securities and Use of Proceeds

There have been no changes in securities during the quarter ended June 30, 2004.

Item 3. Defaults Upon Senior Securities

There have been no defaults by the Company on any Senior Securities during the quarter ended June 30, 2004.

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

No matters were submitted to a vote of the Company's stockholders during the second quarter of the fiscal year covered by this report through the solicitation of proxies or otherwise. The Annual Meeting of Stockholders of the Company is scheduled for August 19, 2004.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - CEO and Principal Executive Officer

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - CFO and Principal Financial and Chief Accounting Officer

32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - President and Principal Executive Officer

32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - CFO and Principal Financial and Chief Accounting Officer

(B) Reports on Form 8-K

On May 12, 2004, the Company filed a report on Form 8-K with respect to the press release issued as of that date reporting the results for the three months ended March 31, 2004. The Company also announced the appointment of its new Chief Financial Officer, George S. Rapp.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized this 12th day of August 2004.

ASTEA INTERNATIONAL INC.

By: /s/Zack Bergreen

Zack Bergreen
Chief Executive Officer
(Principal Executive Officer)

By: /s/George S. Rapp

George S. Rapp
Chief Financial Officer
(Principal Financial and Chief Accounting Officer)