

CSG SYSTEMS INTERNATIONAL INC  
Form 10-Q  
August 07, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2007

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 0-27512

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**CSG SYSTEMS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

9555 Maroon Circle  
Englewood, Colorado 80112

47-0783182  
(I.R.S. Employer  
Identification No.)

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(Address of principal executive offices, including zip code)

(303) 200-2000

(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Shares of common stock outstanding at August 3, 2007: 41,631,543

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**CSG SYSTEM S INTERNATIONAL, INC.**

**FORM 10-Q For the Quarter Ended June 30, 2007**

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**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

|  | June 30,<br>2007  | December 31,<br>2006<br>(unaudited) |
|--|-------------------|-------------------------------------|
| <b><u>ASSETS</u></b>   |                   |                                     |
| Current assets:  |                   |                                     |
| Cash and cash equivalents  | \$ 179,378        | \$ 240,687                          |
| Short-term investments   | 159,100           | 174,803                             |
| <b>Total cash, cash equivalents and short-term investments</b>       | <b>338,478</b>    | <b>415,490</b>                      |
| Trade accounts receivable-   |                   |                                     |
| Billed, net of allowance of \$1,619 and \$1,143                      | 102,635           | 110,020                             |
| Unbilled and other   | 5,637             | 5,555                               |
| Deferred income taxes  | 9,166             | 8,927                               |
| Other current assets   | 5,700             | 5,636                               |
| <b>Total current assets</b>  | <b>461,616</b>    | <b>545,628</b>                      |
| Property and equipment, net of depreciation of \$67,017 and \$66,656 | 26,198            | 23,680                              |
| Software, net of amortization of \$33,615 and \$32,989               | 7,099             | 7,725                               |
| Goodwill   | 14,150            | 14,228                              |
| Client contracts, net of amortization of \$90,384 and \$82,486       | 33,993            | 36,024                              |
| Deferred income taxes  | 12,882            | 19,617                              |
| Other assets   | 6,010             | 6,594                               |
| <b>Total assets</b>  | <b>\$ 561,948</b> | <b>\$ 653,496</b>                   |
| <b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>                   |                   |                                     |
| Current liabilities:   |                   |                                     |
| Client deposits  | \$ 23,378         | \$ 23,645                           |
| Trade accounts payable   | 16,928            | 15,509                              |
| Accrued employee compensation  | 13,020            | 20,962                              |
| Deferred revenue   | 17,625            | 17,586                              |
| Income taxes payable   | 314               | 3,651                               |
| Other current liabilities  | 9,945             | 10,158                              |
| <b>Total current liabilities</b>                                     | <b>81,210</b>     | <b>91,511</b>                       |
| Non-current liabilities:   |                   |                                     |
| Long-term debt   | 230,000           | 230,000                             |
| Deferred revenue   | 9,650             | 8,632                               |
| Income taxes payable   | 4,243             |                                     |
| Other non-current liabilities  | 4,932             | 5,619                               |
| <b>Total non-current liabilities</b>                                 | <b>248,825</b>    | <b>244,251</b>                      |
| <b>Total liabilities</b>   | <b>330,035</b>    | <b>335,762</b>                      |

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|  |            |            |
|--|------------|------------|
| Stockholders' equity:  |            |            |
| Preferred stock, par value \$.01 per share; 10,000,000 shares authorized; zero shares issued and outstanding |            |            |
| Common stock, par value \$.01 per share; 100,000,000 shares authorized;                                      |            |            |
| 42,546,022 and 46,831,643 shares outstanding   | 621        | 616        |
| Additional paid-in capital   | 344,448    | 340,564    |
| Treasury stock, at cost, 19,582,708 and 14,776,238 shares  | (483,116)  | (360,259)  |
| Accumulated other comprehensive income (loss):   |            |            |
| Unrealized gain on short-term investments, net of tax  | 9          | 25         |
| Unrecognized pension plan losses and prior service costs, net of tax   | (852)      | (852)      |
| Accumulated earnings   | 370,803    | 337,640    |
| Total stockholders' equity   | 231,913    | 317,734    |
| Total liabilities and stockholders' equity   | \$ 561,948 | \$ 653,496 |

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

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

|  | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|--|---------------------------|-----------------|-------------------------|-----------------|
|  | <b>June 30,</b>           | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|  | <b>2007</b>               | <b>2006</b>     | <b>2007</b>             | <b>2006</b>     |
|  | <b>(unaudited)</b>        |                 | <b>(unaudited)</b>      |                 |
| <b>Revenues:</b>   |                           |                 |                         |                 |
| Processing and related services                              | \$ 90,313                 | \$ 87,715       | \$ 179,922              | \$ 174,136      |
| Software, maintenance and services                           | 9,191                     | 7,338           | 18,326                  | 13,877          |
| <b>Total revenues</b>  | <b>99,504</b>             | <b>95,053</b>   | <b>198,248</b>          | <b>188,013</b>  |
| <b>Cost of revenues:</b>                                     |                           |                 |                         |                 |
| Processing and related services                              | 43,339                    | 41,686          | 87,964                  | 84,590          |
| Software, maintenance and services                           | 6,648                     | 5,210           | 12,599                  | 9,726           |
| <b>Total cost of revenues</b>                                | <b>49,987</b>             | <b>46,896</b>   | <b>100,563</b>          | <b>94,316</b>   |
| <b>Gross margin (exclusive of depreciation)</b>              | <b>49,517</b>             | <b>48,157</b>   | <b>97,685</b>           | <b>93,697</b>   |
| <b>Operating expenses:</b>                                   |                           |                 |                         |                 |
| Research and development                                     | 14,127                    | 10,874          | 27,839                  | 20,775          |
| Selling, general and administrative                          | 10,719                    | 11,651          | 21,747                  | 21,588          |
| Depreciation   | 3,038                     | 2,699           | 5,906                   | 5,051           |
| Restructuring charges  | 472                       | 1,141           | 578                     | 2,290           |
| <b>Total operating expenses</b>                              | <b>28,356</b>             | <b>26,365</b>   | <b>56,070</b>           | <b>49,704</b>   |
| <b>Operating income</b>                                      | <b>21,161</b>             | <b>21,792</b>   | <b>41,615</b>           | <b>43,993</b>   |
| <b>Other income (expense):</b>                               |                           |                 |                         |                 |
| Interest expense   | (1,895)                   | (1,903)         | (3,681)                 | (3,788)         |
| Interest and investment income, net                          | 5,071                     | 5,277           | 10,610                  | 9,947           |
| Other, net   | 73                        | 3               | 135                     | (52)            |
| <b>Total other</b>   | <b>3,249</b>              | <b>3,377</b>    | <b>7,064</b>            | <b>6,107</b>    |
| <b>Income from continuing operations before income taxes</b> | <b>24,410</b>             | <b>25,169</b>   | <b>48,679</b>           | <b>50,100</b>   |
| <b>Income tax provision</b>                                  | <b>(8,788)</b>            | <b>(9,564)</b>  | <b>(17,282)</b>         | <b>(19,029)</b> |
| <b>Income from continuing operations</b>                     | <b>15,622</b>             | <b>15,605</b>   | <b>31,397</b>           | <b>31,071</b>   |
| <b>Discontinued operations:</b>                              |                           |                 |                         |                 |
| Income from discontinued operations                          |                           |                 |                         |                 |
| Income tax benefit   |                           |                 | 269                     |                 |
| <b>Discontinued operations, net of tax</b>                   |                           |                 | <b>269</b>              |                 |

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|                                      |           |           |           |           |
|--------------------------------------|-----------|-----------|-----------|-----------|
| Net income                           | \$ 15,622 | \$ 15,605 | \$ 31,666 | \$ 31,071 |
| Basic earnings per common share:     |           |           |           |           |
| Income from continuing operations    | \$ 0.37   | \$ 0.34   | \$ 0.72   | \$ 0.67   |
| Discontinued operations, net of tax  |           |           | 0.01      |           |
| Net income                           | \$ 0.37   | \$ 0.34   | \$ 0.73   | \$ 0.67   |
| Diluted earnings per common share:   |           |           |           |           |
| Income from continuing operations    | \$ 0.37   | \$ 0.33   | \$ 0.72   | \$ 0.66   |
| Discontinued operations, net of tax  |           |           | 0.01      |           |
| Net income                           | \$ 0.37   | \$ 0.33   | \$ 0.73   | \$ 0.66   |
| Weighted-average shares outstanding: |           |           |           |           |
| Basic                                | 41,928    | 46,527    | 43,156    | 46,714    |
| Diluted                              | 42,312    | 47,121    | 43,514    | 47,265    |

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

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|   | <b>Six Months Ended</b> |                   |
|---|-------------------------|-------------------|
|   | <b>June 30,</b>         | <b>June 30,</b>   |
|   | <b>2007</b>             | <b>2006</b>       |
|   | <b>(unaudited)</b>      |                   |
| <b>Cash flows from operating activities:</b>                                      |                         |                   |
| Net income  | \$ 31,666               | \$ 31,071         |
| Adjustments to reconcile net income to net cash provided by operating activities- |                         |                   |
| Depreciation  | 5,906                   | 5,051             |
| Amortization  | 9,115                   | 8,126             |
| Restructuring charge for abandonment of facilities                                | 308                     | 401               |
| Gain on short-term investments  | (2,355)                 | (209)             |
| Deferred income taxes   | 6,574                   | 5,849             |
| Excess tax benefits from stock-based compensation awards                          | (650)                   | (1,088)           |
| Stock-based employee compensation   | 4,852                   | 6,029             |
| Changes in operating assets and liabilities:                                      |                         |                   |
| Trade accounts and other receivables, net   | 7,303                   | 11,081            |
| Other current and non-current assets  | (70)                    | (2,699)           |
| Income taxes payable/receivable   | 3,053                   | 11,666            |
| Trade accounts payable and accrued liabilities                                    | (6,598)                 | (17,164)          |
| Deferred revenue  | 1,057                   | 2,615             |
| <b>Net cash provided by operating activities</b>                                  | <b>60,161</b>           | <b>60,729</b>     |
| <b>Cash flows from investing activities:</b>                                      |                         |                   |
| Net payments from the disposition of discontinued operations                      |                         | (436)             |
| Purchases of property and equipment   | (8,424)                 | (3,525)           |
| Proceeds from sale of aircraft held for sale                                      |                         | 7,376             |
| Purchases of short-term investments   | (139,258)               | (97,695)          |
| Proceeds from sale/maturity of short-term investments                             | 157,300                 | 73,700            |
| Acquisition of business, net of cash acquired                                     | (1,400)                 | (20,777)          |
| Acquisition of and investments in client contracts                                | (5,868)                 | (3,002)           |
| <b>Net cash provided by (used in) investing activities</b>                        | <b>2,350</b>            | <b>(44,359)</b>   |
| <b>Cash flows from financing activities:</b>                                      |                         |                   |
| Proceeds from issuance of common stock  | 1,435                   | 3,154             |
| Repurchase of common stock  | (125,905)               | (22,287)          |
| Payments on acquired equipment financing  |                         | (481)             |
| Excess tax benefits from stock-based compensation awards                          | 650                     | 1,088             |
| <b>Net cash used in financing activities</b>                                      | <b>(123,820)</b>        | <b>(18,526)</b>   |
| <b>Net decrease in cash and cash equivalents</b>                                  | <b>(61,309)</b>         | <b>(2,156)</b>    |
| Cash and cash equivalents, beginning of period                                    | 240,687                 | 346,113           |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$ 179,378</b>       | <b>\$ 343,957</b> |



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Supplemental disclosures of cash flow information:

Net cash paid during the period for-

|              |    |       |    |       |
|--------------|----|-------|----|-------|
| Interest     | \$ | 2,970 | \$ | 3,067 |
| Income taxes |    | 7,244 |    | 1,518 |

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

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**CSG SYSTEMS INTERNATIONAL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. GENERAL**

We have prepared the accompanying unaudited condensed consolidated financial statements as of June 30, 2007 and December 31, 2006, and for the three and six months ended June 30, 2007 and 2006, in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information, and pursuant to the instructions to Form 10-Q and the rules and regulations of the Securities and Exchange Commission (the SEC ). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of our financial position and operating results have been included. The unaudited condensed 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 our Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC. The results of operations for the three and six months ended June 30, 2007, are not necessarily indicative of the expected results for the entire year ending December 31, 2007.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates in Preparation of Condensed Consolidated Financial Statements.* The preparation of the accompanying Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that 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 revenues and expenses during the reporting periods. Actual results could differ from those estimates.

*Postage.* We pass through to our clients the cost of postage that is incurred on behalf of those clients, and typically require an advance payment on expected postage costs. These advance payments are included in client deposits in the accompanying Condensed Consolidated Balance Sheets and are classified as current liabilities regardless of the contract period. We net the cost of postage against the postage reimbursements, and include the net amount in processing and related services revenues. The cost of postage that has been shown net of the postage reimbursements from our clients for the three months ended June 30, 2007 and 2006 was \$48.6 million and \$48.0 million, respectively, and for the six months ended June 30, 2007 and 2006 was \$97.2 million and \$96.2 million, respectively.

*Short-term Investments and Other Financial Instruments.* Our financial instruments as of June 30, 2007 and December 31, 2006 include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and long-term debt. Because of their short maturities, the carrying amounts of cash equivalents, accounts receivable, and accounts payable approximate their fair value. Short-term investments are considered available-for-sale in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities , and thus are stated at fair value in our accompanying Condensed Consolidated Balance Sheets. As of June 30, 2007 and December 31, 2006, the fair value of our long-term debt, based upon quoted market prices, was approximately \$255 million and \$264 million, respectively. As of June 30, 2007 and December 31, 2006, the fair value of the contingent interest feature of our long-term debt, considered an embedded derivative, was \$0.3 million.

*Income Taxes.* Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board ( FASB ) Interpretation 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). This interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure.

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As a result of the implementation of FIN 48, we recognized reductions in our liability for unrecognized income tax benefits related to our continuing operations and discontinued operations of \$0.3 million and \$1.2 million, respectively, which were accounted for as an increase to our January 1, 2007 retained earnings balance. As of January 1, 2007, the total amount of unrecognized income tax benefits related to our continuing operations and discontinued operations totaled \$2.7 million and \$2.1 million, respectively, which included \$0.4 million of income tax-related accrued interest. If recognized, the total amount of unrecognized income tax benefits as of the date of adoption related to our continuing operations, or \$2.7 million, would affect our continuing operations' effective tax rate. We recognize income-tax related interest and penalties as part of income tax expense. As of June 30, 2007, we have not had a significant change in our liability for unrecognized income tax benefits since we adopted FIN 48 and we do not anticipate a significant change within the next twelve months.

We file income tax returns primarily in the U.S. Federal jurisdiction and in various state jurisdictions. As of June 30, 2007, the U.S. Federal statute of limitations has expired for years prior to 2004, and the statute of limitations has expired in our major state jurisdictions of Nebraska, Colorado and Florida for years prior to 2003, 2002, and 2003, respectively.

*Accounting Pronouncement Issued But Not Yet Effective.* In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115 (SFAS 159)", which permits an entity to choose to measure various financial instruments and certain other items at fair value. The provisions of SFAS 159 will be effective for us on January 1, 2008. We are currently in the process of analyzing the impact of adopting SFAS 159, but do not expect its adoption to have a significant impact on our financial statements.

**3. DISCONTINUED OPERATIONS**

In December 2005, we closed on agreements to sell: (i) our Global Software Services business (the "GSS Business") to Comverse, Inc., a division of Comverse Technology, Inc.; and (ii) our plaNet Consulting business (the "plaNet Business") to a group of private investors led by the plaNet management team. As a result, we have activity reflected as discontinued operations in the accompanying Condensed Consolidated Statements of Income. Cash flows have not been segregated between continuing operations and discontinued operations in the accompanying Condensed Consolidated Statements of Cash Flows.

The sale of the GSS Business and the plaNet Business were both subject to the determination of final purchase price adjustments. The accounts receivable related to the final purchase price adjustments had been determined as of December 31, 2005, and those amounts, totaling approximately \$4 million, were collected in the first quarter of 2006. The costs to sell the GSS Business and the plaNet Business were accrued as of December 31, 2005, and those amounts, totaling \$4.4 million, were paid in the first quarter of 2006. There were no other material transactions related to discontinued operations in the three and six months ended June 30, 2007 and 2006.

**4. STOCKHOLDERS' EQUITY AND EQUITY COMPENSATION PLANS**

*Stock Repurchase Program.* We currently have a stock repurchase program, approved by our Board of Directors, authorizing us to repurchase up to 30 million shares of our common stock from time-to-time as market and business conditions warrant (the "Stock Repurchase Program").

A summary of the shares repurchased during the three and six months ended June 30, 2007 and 2006 under the Stock Repurchase Program is as follows (in thousands, except per share amounts):

|                                  | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|----------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                  | 2007                        | 2006     | 2007                      | 2006      |
| Shares repurchased               | 1,805                       | 241      | 4,806                     | 909       |
| Total amount paid                | \$ 47,490                   | \$ 5,884 | \$ 122,857                | \$ 20,884 |
| Weighted-average price per share | \$ 26.30                    | \$ 24.41 | \$ 25.56                  | \$ 22.96  |

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As of June 30, 2007, the total shares repurchased under the Stock Repurchase Program since its inception in August 1999 is 20.4 million shares, at a total repurchase price of \$511.7 million (a weighted-average price of \$25.06 per share). As of June 30, 2007, the total remaining number of shares available for repurchase under the Stock Repurchase Program totaled 9.6 million shares.

*Stock Repurchases for Tax Withholdings.* In addition to the above mentioned stock repurchases, a summary of shares repurchased from our employees and then cancelled during the three and six months ended June 30, 2007 and 2006 in connection with minimum tax withholding requirements resulting from the vesting of restricted stock under our stock incentive plans is as follows (in thousands):

|                    | Three Months Ended June 30, |        | Six Months Ended June 30, |          |
|--------------------|-----------------------------|--------|---------------------------|----------|
|                    | 2007                        | 2006   | 2007                      | 2006     |
| Shares repurchased | 12                          | 8      | 117                       | 62       |
| Total amount paid  | \$ 306                      | \$ 204 | \$ 3,048                  | \$ 1,404 |

*Stock-Based Awards.* Beginning in 2003, we began primarily granting restricted stock awards instead of stock options to employees and non-employee directors under our equity compensation plans. Historically, our restricted stock awards have vested annually over four years with no restrictions other than the passage of time (i.e., the shares are released upon calendar vesting with no further restrictions) ( Time-Based Awards ). Certain Time-Based Awards restricted stock become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment, and certain shares have other acceleration of vesting provisions related to retirement. The fair value of the Time-Based Awards (determined by using the closing market price of our common stock on the grant date) is charged to expense on a straight-line basis over the requisite service period for the entire award.

During the first quarter of 2007, we issued 96,250 restricted stock shares to key members of management (primarily members of executive management) that vest in equal installments over one to three years upon meeting either pre-established financial performance objectives or pre-established stock price objectives ( Performance-Based Awards ). The Performance-Based Awards were contingent upon stockholder approval of the financial performance and stock price objectives established in the awards and were approved by the stockholders at our May 2007 annual meeting. The Performance-Based Awards become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment. The fair value of the Performance-Based Awards (determined by using the closing market price of our common stock on the grant date) is charged to expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award is, in-substance, multiple awards.

A summary of our unvested restricted stock activity during the three and six months ended June 30, 2007 is as follows:

|                            | Three Months Ended | Six Months Ended |
|----------------------------|--------------------|------------------|
|                            | June 30, 2007      | June 30, 2007    |
|                            | Shares             | Shares           |
| Unvested awards, beginning | 1,329,114          | 1,143,301        |
| Awards granted             | 107,250            | 593,550          |
| Awards forfeited/cancelled | (39,110)           | (41,609)         |
| Awards vested              | (32,375)           | (330,363)        |
| Unvested awards, ending    | 1,364,879          | 1,364,879        |

We recorded stock-based compensation expense of \$2.9 million and \$3.2 million for the three months ended June 30, 2007 and 2006, respectively, and \$4.9 million and \$6.0 million for the six months ended June 30, 2007 and 2006, respectively.

**Table of Contents****5. EARNINGS PER COMMON SHARE**

*Calculation of Earnings Per Common Share.* Earnings per common share ( EPS ) have been computed in accordance with SFAS No. 128, Earnings Per Share. Basic EPS is computed by dividing net income (the numerator) by the weighted-average number of common shares outstanding during the period (the denominator). Diluted EPS is consistent with the calculation of basic EPS while considering the effect of potentially dilutive common shares outstanding during the period. Unvested shares of restricted stock are not included in the basic EPS calculation. Basic and diluted EPS are presented on the face of our Condensed Consolidated Statements of Income.

No reconciliation of the basic and diluted EPS numerators is necessary for the three and six months ended June 30, 2007 and 2006, as net income is used as the numerator for each period. The reconciliation of the EPS denominators is included in the following table (in thousands):

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 30,           |               | June 30,         |               |
|  | 2007               | 2006          | 2007             | 2006          |
| Basic common shares outstanding                | 41,928             | 46,527        | 43,156           | 46,714        |
| Dilutive effect of stock options               | 86                 | 282           | 88               | 284           |
| Dilutive effect of unvested restricted stock   | 298                | 312           | 270              | 267           |
| Dilutive effect of Convertible Debt Securities |                    |               |                  |               |
| <b>Diluted common shares outstanding</b>       | <b>42,312</b>      | <b>47,121</b> | <b>43,514</b>    | <b>47,265</b> |

Potentially dilutive common shares related to stock options and unvested shares of restricted stock of 0.2 million and 0.3 million for the three months ended June 30, 2007 and 2006, respectively, and 0.3 million for each of the six months ended June 30, 2007 and 2006, respectively, were excluded from the computation of diluted EPS as their effect was antidilutive.

Upon conversion, we will settle the \$230 million principal amount of our Convertible Debt Securities in cash, and have the option to settle our conversion obligation, to the extent it exceeds the principal amount, in our common stock, cash or any combination of our common stock and cash. As a result, the Convertible Debt Securities have a dilutive effect only in those quarterly periods in which our average stock price exceeds the current effective conversion price of \$26.77 per share. The current effective conversion price of \$26.77 per share may be adjusted in the future for certain events, to include stock dividends, stock splits/reverse splits, the issuance of warrants to purchase our stock at a price below the then-current market price, cash dividends, and certain purchases by us of our common stock pursuant to a self-tender offer or exchange offer.

**6. COMPREHENSIVE INCOME**

The components of our comprehensive income were as follows (in thousands):

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 30,           |                  | June 30,         |                  |
|   | 2007               | 2006             | 2007             | 2006             |
| Net income  | \$ 15,622          | \$ 15,605        | \$ 31,666        | \$ 31,071        |
| Other comprehensive income (loss), net of tax, if any: Unrealized gain (loss) on short-term investments | (12)               | 7                | (16)             | (36)             |
| <b>Comprehensive income</b>   | <b>\$ 15,610</b>   | <b>\$ 15,612</b> | <b>\$ 31,650</b> | <b>\$ 31,035</b> |

**7. DEBT**

Our long-term debt as of June 30, 2007 and December 31, 2006 consists of our Convertible Debt Securities. As of June 30, 2007: (i) none of the contingent conversion features have been achieved, and thus, the Convertible Debt Securities are not convertible by the holders; and (ii) we are

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in compliance with the provisions of the bond indenture related to the Convertible Debt Securities.

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We have made no borrowings on our \$100 million 2004 Revolving Credit Facility. As of the date of this filing, we: (i) are in compliance with the financial ratios and other covenants; and (ii) have the entire \$100 million available to us.

**8. LONG-LIVED ASSETS**

Our intangible assets subject to ongoing amortization consist primarily of client contracts and software. As of June 30, 2007 and December 31, 2006, the carrying values of these assets were as follows (in thousands):

|                  | June 30, 2007         |                          |                  | December 31, 2006     |                          |                  |
|------------------|-----------------------|--------------------------|------------------|-----------------------|--------------------------|------------------|
|                  | Gross Carrying Amount | Accumulated Amortization | Net Amount       | Gross Carrying Amount | Accumulated Amortization | Net Amount       |
| Client contracts | \$ 124,377            | \$ (90,384)              | \$ 33,993        | \$ 118,510            | \$ (82,486)              | \$ 36,024        |
| Software         | 40,714                | (33,615)                 | 7,099            | 40,714                | (32,989)                 | 7,725            |
| <b>Total</b>     | <b>\$ 165,091</b>     | <b>\$ (123,999)</b>      | <b>\$ 41,092</b> | <b>\$ 159,224</b>     | <b>\$ (115,475)</b>      | <b>\$ 43,749</b> |

The total amortization expense related to intangible assets for the three months ended June 30, 2007 and 2006 was \$4.3 million and \$3.8 million, respectively, and for the six months ended June 30, 2007 and 2006 was \$8.5 million and \$7.5 million, respectively. Based on the June 30, 2007 net carrying value of our intangible assets, the estimated total amortization expense for each of the five succeeding fiscal years ending December 31 are: 2007 \$17.2 million; 2008 \$17.2 million; 2009 \$4.0 million; 2010 \$4.0 million; and 2011 \$3.5 million.

**9. COMMITMENTS, GUARANTEES AND CONTINGENCIES**

*Product Warranties.* We generally warrant that our products and services will conform to published specifications, or to specifications provided in an individual client arrangement, as applicable. The typical warranty period is 90 days from delivery of the product or service. The typical remedy for breach of warranty is to correct or replace any defective deliverable, and if not possible or practical, we will accept the return of the defective deliverable and refund the amount paid under the client arrangement that is allocable to the defective deliverable. Historically, we have incurred minimal warranty costs, and as a result, do not maintain a warranty reserve.

*Product and Services Indemnifications.* Our arrangements with our clients generally include an indemnification provision that will indemnify and defend a client in actions brought against the client that claim our products and/or services infringe upon a copyright, trade secret, or valid patent. Historically, we have not incurred any significant costs related to such indemnification claims, and as a result, do not maintain a reserve for such exposure.

*Claims for Company Non-performance.* Our arrangements with our clients typically cap our liability for breach to a specified amount of the direct damages incurred by the client resulting from the breach. From time-to-time, these arrangements may also include provisions for possible liquidated damages or other financial remedies for our non-performance, or in the case of certain of our out-sourced customer care and billing solutions, provisions for damages related to service level performance requirements. The service level performance requirements typically relate to system availability and timeliness of service delivery. As of June 30, 2007, we believe we have adequate reserves, based on our historical experience, to cover any reasonably anticipated exposure as a result of our nonperformance for any past or current arrangements with our clients. The amount of the reserve maintained for this purpose is not material.

*Indemnifications Related to Sold Businesses.* In conjunction with the sale of the GSS and plaNet businesses in December 2005, we provided certain indemnifications to the buyers of these businesses which are considered routine in nature (such as employee, tax, or litigation matters that occurred while these businesses were under our ownership). Under the provisions of these indemnification agreements, payment by us is conditioned on the other party making a claim pursuant to the procedures in the indemnification

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agreements, and we are typically allowed to challenge the other party's claims. In addition, certain of our obligations under these indemnification agreements are limited in terms of time and/or amounts, and in some cases, we may have recourse against a third party if we are required to make certain indemnification payments.

We estimated the fair value of these indemnifications at \$2.8 million as of the closing dates for the sale of the GSS and plaNet businesses. Since the sale of the GSS and plaNet businesses, we have made no indemnification payments, and as of June 30, 2007, the indemnification liability was \$2.8 million. It is not possible to predict the maximum potential amount of future payments we may be required to make under these indemnification agreements due to the conditional nature of our obligations and the unique facts and circumstances associated with each indemnification provision. We believe that if we were required to make payments in excess of the indemnification liabilities we have recorded, the resulting loss would not have a material effect on our financial condition or results of operations. If any amounts required to be paid by us would differ from the amounts initially recorded as indemnification liabilities as of the closing dates for the sale of the GSS and plaNet businesses, the difference would be reflected in the discontinued operations section of our Condensed Consolidated Statements of Income.

*Indemnifications Related to Officers and the Board of Directors.* We have agreed to indemnify certain of our officers and members of our Board of Directors if they are named or threatened to be named as a party to any proceeding by reason of the fact that they acted in such capacity. We maintain directors' and officers' (D&O) insurance coverage to protect against such losses. We have not historically incurred any losses related to these types of indemnifications, and are not aware of any pending or threatened actions or claims against any officer or member of our Board of Directors. As a result, we have not recorded any liabilities related to such indemnifications as of June 30, 2007. In addition, as a result of the insurance policy coverage, we believe the estimated fair value of these indemnification agreements is not significant.

*Legal Proceedings.* From time-to-time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not presently a party to any material pending or threatened legal proceedings.

## **10. SUBSEQUENT EVENTS**

*ComTec, Inc.* On July 9, 2007, we acquired 100% of the voting equity interests of ComTec, Inc. ( ComTec ) for: (i) \$23.5 million in cash; and (ii) contingent payments of up to \$2.5 million over the next 12 months upon the achievement of certain predetermined operating criteria. ComTec is a provider of print and electronic statement processing services headquartered in Fairfield, New Jersey. We acquired ComTec to maximize customer interaction for clients by expanding our statement processing footprint and capabilities through the addition of enhanced statement production and electronic statement presentation hardware and software technologies, as well as for additional plant capacities. In addition, the acquisition increases our presence in our core video market, as well as in new industry verticals such as telecommunications, home security, healthcare, financial services, and utilities.

We are in the early stages of the ComTec purchase accounting, but estimate a significant portion of the purchase price will be allocated to amortizable intangible assets and to goodwill. The results of ComTec will be included in our results of operations for the period subsequent to the acquisition date. Pro forma information on our historical results of operations to reflect the acquisition of ComTec will not be presented as ComTec's results of operations during the prior periods are not material to our results of operations.

*Prairie Voice Services, Inc.* On July 27, 2007, we reached a definitive agreement to acquire Prairie Voice Services, Inc. ( Prairie ), a privately-held provider of interactive messaging services headquartered in Omaha, Nebraska. Prairie provides inbound and outbound automated voice, text/SMS, email and fax messaging services to manage: (i) workforce communications; (ii) collections; (iii) lead generation; (iv) automated order capture; (v) service outage notifications; and (vi) other business functions. We are acquiring Prairie to extend our suite of products and solutions to help our clients maximize the value of interactions with their customers. Additionally, this acquisition extends our reach into industry verticals such as financial services, telecommunications, direct response, and contact centers.



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The agreement provides that we will acquire Prairie for approximately \$39 million (net of estimated cash to be acquired), to be paid upon closing of the transaction which is currently anticipated to be in mid-August 2007, subject to the satisfaction of customary closing conditions. In addition, the merger agreement provides for contingent payments of up to \$6 million through the end of 2009 upon achievement of certain predetermined operating criteria.

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

The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto (the Financial Statements ) included in this Form 10-Q and the audited consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2006 (our 2006 10-K ).

### **Forward-Looking Statements**

This report contains a number of forward-looking statements relative to our future plans and our expectations concerning the North American customer care and billing industry, as well as the communications industry it serves, and similar matters. These forward-looking statements are based on assumptions about a number of important factors, and involve risks and uncertainties that could cause actual results to differ materially from estimates contained in the forward-looking statements. Some of the risks that are foreseen by management are outlined within Part II Item 1A., Risk Factors . Item 1A. constitutes an integral part of this report, and readers are strongly encouraged to review this section closely in conjunction with MD&A.

### **Market Conditions of the Communications Industry**

The North American communications industry has experienced significant consolidation and increased competition among communications providers, and there is the possibility of further consolidation. Market consolidation results in a fewer number of service providers who have massive scale and can deliver a total communications package. The significant plant upgrades and network rationalizations that have taken place have allowed service providers to focus their attention on new revenue and growth opportunities. In addition, new competitors, new technologies and unique partnerships are forcing service providers to be more creative in their approaches for rolling out new products and services and enhancing their customers' experiences. These factors, in combination with the improved financial condition of service providers, have resulted in a more positive outlook for the demand for scalable, flexible and cost efficient customer care and billing solutions, which we believe provides us with new revenue opportunities.

However, another facet of this market consolidation poses certain risks to our company. The consolidation of service providers decreases the potential number of buyers for our products and services, and carries the inherent risk that the consolidators may choose to move their purchased customers to a competitor's system. Should this consolidation result in a concentration of customer accounts being owned by companies with whom we do not have a relationship, or with whom competitors are entrenched, it could negatively affect our ability to maintain or expand our market share, thereby having a material adverse effect to our results of operations. In addition, service providers at times have chosen to use their size and scale to exert more pressure on pricing negotiations.

In addition, it is widely anticipated that communication service providers will continue their aggressive pursuit of providing convergent services. Traditional wireline and wireless telephone providers have recently entered the residential video market, a market dominated by our clients. Should these traditional telephone service providers be successful in their video strategy, it could threaten our clients' market share, and thus our processing revenues, as generally speaking, these companies do not currently use our products and services.

### **Management Overview of Quarterly Results**

*Our Company.* We are a leading provider of outsourced billing, customer care and print and mail solutions and services supporting the North American communications market. Our solutions support some of the world's largest and most innovative providers of bundled multi-channel video, Internet, and IP-based services. Our combination of solutions, services and expertise ensures that communication providers can continue to rapidly launch new service offerings, improve operational efficiencies and deliver a high-quality customer experience in a competitive and ever-changing marketplace.

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A summary of our results of operations for the second quarter of 2007 is as follows:

Our revenues for the second quarter of 2007 were \$99.5 million, up 4.7% when compared to \$95.1 million for the same period in 2006, however, relatively flat when compared to \$98.7 million for the first quarter of 2007. The year-over-year increase is primarily a result of increased utilization of our new and existing products and services by our clients.

Our operating expenses for the second quarter of 2007 were \$78.3 million, up 6.9% when compared to \$73.3 million for the same period in 2006, and flat when compared to \$78.3 million for the first quarter of 2007. The year-over-year increase in operating expenses relates primarily to an increase in employee-related costs, primarily as a result of increases in staff levels between periods to address our various growth initiatives, to include the significant investment we are making in research and development at this time, as discussed below.

Income from continuing operations (net of tax) for the second quarter of 2007, second quarter of 2006, and first quarter of 2007, was \$15.6 million, \$15.6 million, and \$15.8 million, respectively. Income from continuing operations per diluted share for these same periods was \$0.37, \$0.33, and \$0.35, respectively. The increase in earnings per diluted share is primarily due to a decrease in diluted shares outstanding as a result of our significant share repurchases made under our stock repurchase program for these periods over the last several quarters.

Net income for the second quarter of 2007 includes stock-based compensation expense of \$2.9 million, depreciation expense of \$3.0 million, and amortization of intangible assets of \$4.3 million. These non-cash charges totaled \$10.2 million (pretax impact), or \$0.15 per diluted share. Net income for the second quarter of 2006 includes stock-based compensation expense of \$3.2 million, depreciation expense of \$2.7 million and amortization of intangible assets of \$3.8 million. These non-cash charges totaled \$9.7 million (pretax impact), or \$0.13 per diluted share.

We continue to generate strong cash flows from our operations. As of June 30 2007, we had cash, cash equivalents, and short-term investments of \$338.5 million, as compared to \$367.6 million as of March 31, 2007, and \$415.5 million as of December 31, 2006. The \$77.0 million decrease from year-end is attributed primarily to the repurchase of 4.8 million shares of our common stock for \$122.9 million, discussed in further detail below, offset to a certain degree by cash generated from our operations.

Cash flows from operating activities for the second quarter of 2007 were \$24.5 million, compared to \$38.7 million for the second quarter of 2006, and \$35.7 million for the first quarter of 2007. The second quarter of 2006 was positively impacted by favorable changes in working capital items during the quarter, primarily related to the reduction in the accounts receivable balance, while the first quarter of 2007 was positively impacted by approximately \$10 million as we received an additional monthly processing invoice payment from a key client before quarter end. See the Liquidity section below for further discussion.

Other key statistics for the quarter were as follows:

Total customer accounts processed on our systems as of June 30, 2007 were 45.1 million, an increase from 44.9 million as of June 30, 2006, and a decrease from the 45.4 million customer accounts processed as of March 31, 2007.

During the second quarter of 2007, we completed the last significant migration of cable customer accounts processed on our systems to our Advanced Convergent Platform ( ACP ). As a result, nearly 100% of our cable clients are now being processed on ACP. See the Business section of our 2006 10-K for additional discussion of this effort.

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During the second quarter of 2007, we repurchased 1.8 million shares of our common stock for \$47.5 million (a weighted average price of \$26.30 per share). This brings our total share repurchases towards our planned \$350 million stock repurchase amount to \$165.3 million, leaving \$184.7 million left on this buyback commitment.

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### Acquisition Activities

*ComTec, Inc.* On July 9, 2007, we acquired 100% of the voting equity interests of ComTec, Inc. ( ComTec ) for: (i) \$23.5 million in cash; and (ii) contingent payments of up to \$2.5 million over the next 12 months upon the achievement of certain predetermined operating criteria. ComTec is a provider of print and electronic statement processing services headquartered in Fairfield, New Jersey. We acquired ComTec to maximize customer interaction for clients by expanding our statement processing footprint and capabilities through the addition of enhanced statement production and electronic statement presentation hardware and software technologies, as well as additional plant capacities. In addition, the acquisition increases our presence in our core video market, as well as in new industry verticals such as telecommunications, home security, healthcare, financial services, and utilities. We expect ComTec to contribute approximately \$10-\$12 million to our full year 2007 revenues and we expect that ComTec will have a slightly dilutive impact to our full year 2007 results from operations.

*Prairie Voice Services, Inc.* On July 27, 2007, we reached a definitive agreement to acquire Prairie Voice Services, Inc. ( Prairie ), a privately-held provider of interactive messaging services headquartered in Omaha, Nebraska for: (i) approximately \$39 million (net of estimated cash to be acquired), to be paid upon closing of the transaction which is currently anticipated to be in mid-August 2007, subject to the satisfaction of customary closing conditions; and (ii) contingent payments of up to \$6 million through the end of 2009 upon achievement of certain predetermined operating criteria. Prairie provides inbound and outbound automated voice, text/SMS, email and fax messaging services to manage: (i) workforce communications; (ii) collections; (iii) lead generation; (iv) automated order capture; (v) service outage notifications; and (vi) other business functions. We are acquiring Prairie to extend our suite of products and solutions to help our clients maximize the value of interactions with their customers. Additionally, this acquisition extends our reach into industry verticals such as financial services, telecommunications, direct response, and contact centers. If the acquisition closes as expected, we expect that Prairie will contribute approximately \$7-\$8 million to our full year 2007 revenues. Excluding the impacts of certain acquisition-related charges, which are not estimatable at this time, we do not expect the acquisition of Prairie to have a material impact on our overall results of operations for the full year 2007.

### Significant Client Relationships

*Client Concentration.* As discussed above, the North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a limited number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues is generated from a limited number of clients. For the three months ended June 30, 2007 and March 31, 2007, over 70% of our total revenues were generated from our four largest clients, which include Comcast Corporation ( Comcast ), EchoStar Communications Corporation ( EchoStar ), Time Warner Inc. ( Time Warner ), and Charter Communications ( Charter ). Revenues from these clients represented the following percentages of our total revenues for the three months ended June 30, 2007, March 31, 2007, and June 30, 2006:

|             | June 30, | Three Months Ended | June 30, |
|-------------|----------|--------------------|----------|
|             | 2007     | March 31,          | 2006     |
|             | 2007     | 2007               | 2006     |
| Comcast (1) | 28%      | 29%                | 24%      |
| EchoStar    | 21%      | 21%                | 19%      |
| Time Warner | 13%      | 12%                | 10%      |
| Charter     | 9%       | 9%                 | 11%      |

- (1) The increase in our percentage of revenues generated from Comcast for the three months ended March 31, 2007 when compared to the quarter ended June 30, 2006, is primarily due to the movement of additional customer accounts, who were already on our systems, to Comcast's ownership in the first quarter, as well as additional special project work we performed for Comcast during the quarter.

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As of June 30, 2007, December 31, 2006, and June 30, 2006, the percentages of net billed accounts receivable balances attributable to our largest clients were as follows:

|              | June 30, | As of<br>December 31, | June 30, |
|--------------|----------|-----------------------|----------|
|              | 2007     | 2006                  | 2006     |
| Comcast      | 31%      | 27%                   | 23%      |
| EchoStar (2) | 21%      | 29%                   | 30%      |
| Time Warner  | 9%       | 10%                   | 9%       |
| Charter      | 11%      | 10%                   | 12%      |

- (2) The decrease in percentage of accounts receivable from EchoStar as of June 30, 2007 compared to December 31, 2006 is due primarily to EchoStar making an additional processing invoice payment during the first quarter to make their account current, and to a lesser degree, EchoStar making payment on certain outstanding consulting work.

See our 2006 10-K for additional discussion of our business relationships and contractual terms with the above mentioned significant clients.

*Risk of Client Concentration.* In the near term, we expect approximately 70% of our total revenues to continue to be generated from our four largest clients, Comcast, EchoStar, Time Warner, and Charter. There are inherent risks whenever a large percentage of total revenues are concentrated with a limited number of clients. One such risk is that, should a significant client: (i) terminate or fail to renew its contract with us, in whole or in part, for any reason; (ii) significantly reduce the number of customer accounts processed on our systems, the price paid for our services, or the scope of services that we provide; or (iii) experience significant financial or operating difficulties, it could have a material adverse effect on our financial condition and results of operations (including possible impairment, or significant acceleration of the amortization of intangible assets).

**Stock-Based Compensation Expense**

Stock-based compensation expense is included in the following captions in the accompanying Condensed Consolidated Statements of Income (in thousands):

|  | Three Months Ended |          | Six Months Ended |          |
|--|--------------------|----------|------------------|----------|
|  | June 30,           | June 30, | June 30,         | June 30, |
|  | 2007               | 2006     | 2007             | 2006     |
| Cost of processing and related services    | \$ 858             | \$ 1,152 | \$ 1,451         | \$ 2,204 |
| Cost of software, maintenance and services | 186                | 194      | 334              | 355      |
| Research and development                   | 313                | 381      | 499              | 684      |
| Selling, general and administrative        | 1,448              | 1,468    | 2,496            | 2,786    |
| Restructuring                              | 72                 |          | 72               |          |
| Total stock-based compensation expense     | \$ 2,877           | \$ 3,195 | \$ 4,852         | \$ 6,029 |

**Critical Accounting Policies**

The preparation of our Financial Statements in conformity with accounting principles generally accepted in the U.S. ( GAAP ) requires us to select appropriate accounting policies, and to make judgments and estimates affecting the application of those accounting policies. In applying our accounting policies, different business conditions or the use of different assumptions may result in materially different amounts reported in our Financial Statements.

We have identified the most critical accounting policies that affect our financial condition and results of operations. The critical accounting policies were determined by considering accounting policies that involve the most complex or subjective decisions or assessments. The most

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critical accounting policies identified relate to: (i) revenue recognition; (ii) allowance for doubtful accounts receivable; (iii) impairment assessments of long-lived assets; (iv) loss contingencies; (v) income taxes; and (vi) capitalization of internal software development costs. These critical accounting policies and our other significant accounting policies are discussed in greater detail in our 2006 10-K.

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*Total Revenues.* Total revenues for the: (i) three months ended June 30, 2007 increased 4.7% to \$99.5 million, from \$95.1 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased 5.4% to \$198.2 million, from \$188.0 million for the six months ended June 30, 2006. The components of total revenues are discussed in more detail below.

*Processing and related services revenues.* Processing and related services revenues for the: (i) three months ended June 30, 2007 increased \$2.6 million or 3.0% to \$90.3 million, from \$87.7 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$5.8 million or 3.3% to \$179.9 million, from \$174.1 million for the six months ended June 30, 2006. The increase in processing and related services revenues between periods is primarily a result of the following: (i) increased utilization of new and existing products and services by our clients, to include such things as higher usage of marketing services and various ancillary customer care solutions, which include things such as order workflow tools, professional services, system interfaces, and reporting tools; and to a lesser degree (ii) annual contractual price escalators for certain client contracts.

Additional information related to processing and related services revenues is as follows:

Amortization of the client contracts intangible asset (reflected as a reduction of processing and related services revenues) for the: (i) three months ended June 30, 2007 and 2006 was \$3.6 million and \$3.1 million, respectively; and (ii) six months ended June 30, 2007 and 2006 was \$7.2 million and \$6.5 million, respectively.

Total customer accounts processed on our systems as of June 30, 2007 were 45.1 million, up slightly when compared to 44.9 million as of June 30, 2006, however, a slight decrease when compared to 45.4 million as of March 31, 2007. The decrease in sequential quarters is primarily due to the expected transition of certain customer accounts onto a client's internal system during the quarter, and to a lesser degree, certain smaller subscriber deconversions related to the clean-up of some of the Adelphia matters between Time Warner and Comcast, as discussed in the 2006 10-K. We expect the number of customer accounts processed on our systems to trend up slightly over the remainder of the year.

*Software, Maintenance and Services Revenues.* Software, maintenance and services revenues for the: (i) three months ended June 30, 2007 increased \$1.9 million, or 25.3% to \$9.2 million, from \$7.3 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$4.4 or 32.1% million to \$18.3 million, from \$13.9 million for the six months ended June 30, 2006. The increase between periods is related primarily to our emphasis to expand our professional services organization, to include the acquisition of Telution on March 1, 2006. Software, maintenance and services revenues for the three months ended March 31, 2007 were \$9.1 million.

*Cost of Revenues.* See our 2006 10-K for a description of the types of costs that are included in the individual line items for cost of revenues.

*Cost of Processing and Related Services.* The cost of processing and related services for the: (i) three months ended June 30, 2007 increased \$1.6 million, or 4.0% to \$43.3 million, from \$41.7 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$3.4 million, or 4.0% to \$88.0 million, from \$84.6 million for the six months ended June 30, 2006. The increase between periods is primarily due to an increase in data processing costs as a result of additional enhancements being made to ACP and increased transactions by our customers. The gross margin percentage for processing and related services was: (i) 52.0% for the three months ended June 30, 2007 compared to 52.5% for the three months ended June 30, 2006; and (ii) 51.1% for the six months ended June 30, 2007 compared to 51.4% for the six months ended June 30, 2006.

*Cost of Software, Maintenance and Services.* The cost of software, maintenance and services for the: (i) three months ended June 30, 2007 increased \$1.4 million, or 27.6% to \$6.6 million, from \$5.2 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$2.9 million, or 29.5% to \$12.6 million, from \$9.7 million for the six months ended



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June 30, 2006. The increase between periods in cost of software, maintenance and services is due primarily to: (i) an increase in employee-related costs, due to an increase in personnel assigned internally to software maintenance projects; and (ii) 2007 having the full impact of the Telution acquisition, to include the amortization of the Telution acquired intangible assets. Additionally, the increase in expense is relatively consistent with the increase in revenues between these periods.

The gross margin percentage for software, maintenance and services was: (i) 27.7% for the three months ended June 30, 2007, as compared to 29.0% for the three months ended June 30, 2006; and (ii) 31.3% for the six months ended June 30, 2007, as compared to 29.9% for the six months ended June 30, 2006. The changes in the gross margin percentages are primarily attributed to the change in mix of these revenues between periods.

*Gross Margin (Exclusive of Depreciation).* The overall gross margin percentage (exclusive of depreciation) for the: (i) three months ended June 30, 2007 was 49.8%, compared to 50.7% for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 was 49.3%, compared to 49.8% for the six months ended June 30, 2006. The changes in the overall gross margin percentages between periods are due to the factors discussed above.

*Research and Development ( R&D ) Expense.* R&D expense for the: (i) three months ended June 30, 2007 increased \$3.2 million, or 29.9% to \$14.1 million, from \$10.9 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$7.0 million, or 34.0% to \$27.8 million, from \$20.8 million for the six months ended June 30, 2006. The increase between periods is primarily due to an increase in employee-related costs, as more employees were being dedicated to R&D efforts. As a percentage of total revenues, R&D expense was: (i) 14.2% for the three months ended June 30, 2007 compared to 11.4% for the three months ended June 30, 2006; and (ii) 14.0% for the six months ended June 30, 2007, compared to 11.0% for the six months ended June 30, 2006. We did not capitalize any internal software development costs during the three and six months ended June 30, 2007 and 2006.

Our more recent R&D efforts involve the ongoing evolution of our ACP platform and related software products, to include the integration of the acquired Telution assets and the utilization of new software technologies. The continued evolution of ACP is in response to market demands that our products have architectural flexibilities and features (e.g., service oriented architecture, or SOA) that are more easily integrated with other computer systems, which will enhance our ability to expand the capabilities and features of our products on a more timely basis, including those necessary to service new and expanded product offerings (e.g., Voice over IP, and voice and high-speed Internet services to small-medium businesses, or commercial services , etc.). These R&D efforts will also allow us to separate certain software components that have historically been tightly integrated with the ACP platform, so as to allow such components to be marketed on a stand-alone basis where a specific client requirement and/or business need dictates, to include the possible use of our products across non-CSG customer care and billing systems. At this time, we expect our future R&D efforts to continue to focus on similar tasks as noted above. In the near term, we expect that the percentage of our total revenues spent on R&D to be relatively consistent with the first two quarters of 2007 which reflected R&D expenses as a percentage of total revenues of approximately 14%, with the level of our R&D spend highly dependent upon the opportunities that we see in our markets.

*Selling, General and Administrative ( SG&A ) Expense.* SG&A expense for the: (i) three months ended June 30, 2007 decreased \$1.0 million, or 8.0% to \$10.7 million, from \$11.7 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 was \$21.7 million, relatively consistent when compared to \$21.6 million for the six months ended June 30, 2006.

*Depreciation Expense.* Depreciation expense for the: (i) three months ended June 30, 2007 increased \$0.3 million, or 12.6%, to \$3.0 million, from \$2.7 million for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 increased \$0.8 million, or 16.9% to \$5.9 million, from \$5.1 million for the six months ended June 30, 2006. The capital expenditures during the three and six months ended June 30, 2007 consisted principally of: (i) computer hardware and related equipment; and (ii) facilities and internal infrastructure items. Depreciation expense for all property and equipment is reflected separately in the aggregate and is not included in the cost of revenues or the other components of operating expenses.

*Restructuring Charges.* Restructuring charges included in total operating expenses, and the impact (net of related estimated income tax expense) these restructuring charges had on net income and diluted earnings per share, for the three and six months ended June 30, 2007 and 2006 are as follows (in thousands, except diluted earnings per share):

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|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2007                           | 2006     | 2007                         | 2006     |
| Involuntary employee terminations   | \$ 222                         | \$ 525   | \$ 193                       | \$ 1,612 |
| Facility abandonments   | 177                            | 614      | 312                          | 723      |
| Other   | 73                             | 2        | 73                           | (45)     |
| Total restructuring charges   | \$ 472                         | \$ 1,141 | \$ 578                       | \$ 2,290 |
| Impact of restructuring charges on results of operations (i.e. have reduced operating results): |                                |          |                              |          |
| Net income  | \$ 302                         | \$ 707   | \$ 373                       | \$ 1,420 |
| Diluted earnings per share  | \$ 0.01                        | \$ 0.02  | \$ 0.01                      | \$ 0.03  |

The involuntary employee termination expense during 2006 relates to retention and severance costs related to personnel working on the terminated FairPoint Communications, Inc. outsourced processing services contract.

*Operating Income.* Operating income for the: (i) three months ended June 30, 2007 was \$21.2 million, or 21.3% of total revenues, compared to \$21.8 million, or 22.9% of total revenues for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 was \$41.6 million, or 21.0% of total revenues, compared to \$44.0 million, or 23.4% of total revenues for the six months ended June 30, 2006. The decrease in operating income and operating margins between periods is primarily due to an overall increase in R&D expenditures, as discussed above, and is reflective of our commitment to expand our R&D and related support function expenses in order to address the opportunities we see with our clients' changing needs.

Total non-cash charges related to depreciation, amortization, and stock-based compensation expense included in the determination of operating income for the: (i) three months ended June 30, 2007 and 2006 were \$10.2 million and \$9.7 million, respectively; and (ii) six months ended June 30, 2007 and 2006 were \$19.3 million and \$18.6 million, respectively.

*Income Tax Provision.* Income tax provision for the: (i) three months ended June 30, 2007 was \$8.8 million, or an effective income tax rate of 36.0%, compared to an income tax provision of \$9.6 million, or an estimated effective income tax rate of 38.0% for the three months ended June 30, 2006; and (ii) six months ended June 30, 2007 was \$17.3 million, or an effective income tax rate of 35.5%, compared to an income tax provision of \$19.0 million, or an estimated effective income tax rate of 38.0%, for the six months ended June 30, 2006. The decreases in the effective income tax rates for the three and six month periods ended June 30, 2007 over the comparable periods in 2006 is primarily due to: (i) the recognition of income tax benefits from research and experimentation tax credits; and (ii) the recognition of certain income tax benefits during the first quarter of 2007, primarily as the result of the expiration of a U.S. Federal statute of limitation. At this time, we estimate that our overall effective income tax rate for the full year 2007 will range between 36% and 37%.

As of June 30, 2007, our \$22.0 million of net deferred income tax assets represented approximately 4% of total assets. We continue to believe that sufficient taxable income will be generated in the future in order to realize the benefit of these net deferred income tax assets. Our assumptions of future profitable operations are supported by our strong operating performances over the last several years.

**Liquidity***Cash and Liquidity*

As of June 30, 2007 our principal sources of liquidity included cash, cash equivalents, and short-term investments of \$338.5 million, compared to \$367.6 as of March 31, 2007 and \$415.5 million as of December 31, 2006. We generally invest our excess cash balances in low-risk, short-term investments to limit our exposure to market risks. We have ready access to all of our cash, cash equivalents, and short-term investment balances.

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In addition to the above sources of liquidity, we also have a five-year, \$100 million senior secured revolving credit facility (the 2004 Revolving Credit Facility ) with a syndicate of U.S. financial institutions that expires in September 2009. The 2004 Revolving Credit Facility has a \$40 million sub-facility for standby and commercial letters of credit and a \$10 million sub-facility for same day advances. We have made no borrowings under the 2004 Revolving Credit Facility. Our ability to borrow under the 2004 Revolving Credit Facility is subject to a limitation of total indebtedness based upon the results of consolidated leverage and interest coverage ratio calculations, and a minimum liquidity requirement. As of the date of this filing, we have the entire \$100 million available to us.

**Cash Flows From Operating Activities**

We calculate our cash flows from operating activities in accordance with GAAP, beginning with net income, adding back the impact of non-cash items (e.g., depreciation, amortization, stock-based compensation, etc.), and then factoring in the impact of changes in working capital items. See our 2006 10-K for a description of the primary uses and sources of our cash flows from operating activities.

Our net cash flows from operating activities, broken out between operations and changes in working capital assets and liabilities, for the indicated periods are as follows (in thousands):

|  | Operations | Changes in<br>Working<br>Capital Assets<br>and Liabilities | Net Cash<br>Provided by<br>Operating<br>Activities<br>Quarter Totals |
|--|------------|--|--|
| <b>Cash Flows from Operating Activities:</b> |            |  |  |
| 2006:  |            |  |  |
| March 31                                     | \$ 25,872  | \$ (3,894)   | \$ 21,978  |
| June 30 (1)                                  | 29,358     | 9,393  | 38,751   |
| September 30                                 | 31,489     | (2,937)  | 28,552   |
| December 31                                  | 29,549     | (680)  | 28,869   |
| 2007:  |            |  |  |
| March 31 (2)                                 | 27,199     | 8,464  | 35,663   |
| June 30                                      | 28,217     | (3,719)  | 24,498   |

- (1) Cash flows from operating activities for the second quarter of 2006 were positively impacted by favorable changes in working capital items during the quarter, primarily related to the reduction in the accounts receivable balance.
- (2) Cash flows from operating activities for the first quarter of 2007 were positively impacted by approximately \$10 million as we received an additional monthly processing invoice payment from a key client before quarter end. As a result, we received four monthly processing invoice payments from this key client during the first quarter of 2007, as compared to three monthly processing invoice payments in all other quarters presented above.

We believe the table presented above demonstrates our ability to consistently generate strong cash flows and the importance of managing our working capital items. As the table above illustrates, the operations portion of our cash flows from operating activities remains relatively consistent between periods. The variations in our net cash provided by operating activities is primarily the result of the changes in our working capital assets and liabilities related to our operations.

Significant fluctuations in key working capital items between December 31, 2006 and June 30, 2007 that impacted our cash flows from operating activities are as follows:

**Billed Trade Accounts Receivable**

Management of our billed trade accounts receivable is important in maintaining strong quarterly cash flows from operating activities. Our billed trade accounts receivable balance includes billings for several non-revenue items (primarily postage, sales tax, and deferred revenue items). As a result, we evaluate our performance in collecting our accounts receivable through our calculation of days billings outstanding ( DBO ) rather than a typical days sales outstanding ( DSO ) calculation. DBO is calculated based on the billings for the period (including non-revenue items) divided by the average monthly net trade accounts receivable balance for the period.



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Our gross and net billed trade accounts receivable and related allowance for doubtful accounts receivable ( Allowance ) as of the end of the indicated periods, and our DBOs for the quarters then ended, are as follows (in thousands, except DBOs):

| Quarter Ended    | Gross      | Allowance  | Net Billed | DBO |
|------------------|------------|------------|------------|-----|
| 2006:            |            |            |            |     |
| March 31         | \$ 110,415 | \$ (1,008) | \$ 109,407 | 60  |
| June 30 (1)      | 97,404     | (1,059)    | 96,345     | 63  |
| September 30 (1) | 108,707    | (1,143)    | 107,564    | 62  |
| December 31      | 111,163    | (1,143)    | 110,020    | 64  |
| 2007:            |            |            |            |     |
| March 31 (2)     | 104,677    | (1,577)    | 103,100    | 63  |
| June 30          | 104,254    | (1,619)    | 102,635    | 61  |

- (1) The change in gross and net billed trade accounts receivable between March 31, 2006, June 30, 2006, and September 30, 2006 relates primarily to fluctuations in the timing of invoicing and payments from certain clients at or around each quarter end.
- (2) The decrease in gross and net billed trade accounts receivable at March 31, 2007 is due primarily to the receipt of an additional monthly processing invoice payment from a key client of approximately \$10 million before quarter end.

**Deferred Income Taxes**

The decrease of \$6.5 million in total net deferred income tax assets from \$28.5 million as of December 31, 2006 to \$22.0 million as of June 30, 2007 is primarily due to the increase in deferred tax liabilities related to our Convertible Debt Securities and the reduction in deferred income tax assets related to tax amortization exceeding book amortization for our intangible assets.

**Accrued Employee Compensation**

Accrued employee compensation decreased \$8.0 million, from \$21.0 million as of December 31, 2006 to \$13.0 million as of June 30, 2007 primarily as a result of the payment of the 2006 management bonuses in March 2007.

**Cash Flows From Investing Activities**

Our typical investing activities consist of purchases/sales of short-term investments, purchases of property and equipment, and investments in client contracts, which are discussed below:

*Purchases/Sales of Short-term Investments.* We generally invest our excess cash balances in low-risk, cash equivalents or short-term investments to limit our exposure to market risks. These cash equivalents and short-term investments are readily convertible back into cash. During the six months ended June 30, 2007, we purchased \$139.3 million and sold (or had mature) \$157.3 million of short-term investments. We continually evaluate the appropriate mix of our investment of excess cash balances between cash equivalents and short-term investments in order to maximize our investment returns and will likely purchase and sell additional short-term investments in the future.

*Property and Equipment/Client Contracts.* Our capital expenditures for the six months ended June 30, 2007 and 2006 for property and equipment, and investments in client contracts, excluding the acquisition of Telution, were as follows (in thousands):

|                           | Six Months Ended June 30, |          |
|---------------------------|---------------------------|----------|
|                           | 2007                      | 2006     |
| Property and equipment \$ | \$ 8,424                  | \$ 3,525 |
| Client contracts \$       | 5,868                     | 3,002    |

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The property and equipment expenditures during the first six months of 2007 consisted principally of computer hardware and related equipment, statement production equipment, and facilities and internal infrastructure items.

The investments in client contracts for the six months ended June 30, 2007 and 2006 relate primarily to client incentive payments (\$5.1 million and \$2.2 million respectively) and the deferral of costs related to conversion/set-up services provided under long-term processing contracts (\$0.8 million and \$0.8 million, respectively).

### ***Cash Flows From Financing Activities***

Our financing activities typically consist of activities with our common stock.

*Repurchase of Common Stock.* As discussed above, during the six months ended June 30, 2007 and 2006, we repurchased shares of our common stock under the guidelines of the Stock Repurchase Program for \$122.9 million and \$20.9 million, respectively. In addition, outside of the Stock Repurchase Program, during the six months ended June 30, 2007 and 2006, we repurchased from our employees and then cancelled approximately 117,000 shares and 62,000 shares of our common stock for \$3.0 million and \$1.4 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted stock under our stock incentive plans.

### **Capital Resources**

As of June 30, 2007, we had \$338.5 million of cash, cash equivalents, and short-term investments available to fund our operations, and we expect to generate material amounts of additional cash during the remainder of 2007. The following are the key items to consider in assessing our sources and uses of capital resources as of June 30, 2007:

*Acquisitions.* On July 9, 2007, we acquired 100% of the voting equity interests of ComTec for: (i) \$23.5 million in cash; and (ii) contingent payments of up to \$2.5 million over the next 12 months upon the achievement of certain predetermined operating criteria. In addition, on July 30, 2007, we announced that we had reached a definitive agreement to acquire Prairie, a privately-held provider of interactive messaging services headquartered in Omaha, Nebraska for: (i) \$39 million (net of cash acquired) and (ii) contingent payments of up to \$6 million through the end of 2009 upon the achievement of certain predetermined operating criteria. The acquisition of Prairie is currently anticipated to close in mid-August, subject to the satisfaction of customary closing conditions.

*Stock Repurchase Program.* We currently have a stock repurchase program, approved by our Board of Directors, authorizing us to repurchase up to 30 million shares of our common stock from time-to-time as market and business conditions warrant (the Stock Repurchase Program). During the first six months of 2007, we repurchased 4.8 million shares of our stock, at a total price of \$122.9 million, or \$25.56 per share, under our Stock Repurchase Program. As a result, as of June 30, 2007, the remaining number of shares authorized for repurchase under the Stock Repurchase Program is 9.6 million shares.

In July 2006, we announced our intention to specifically repurchase \$350 million of our outstanding common stock under our Stock Repurchase Program and in August 2006, we established a new Rule 10b5-1 Plan to facilitate this repurchase amount. From August 2006 through June 30, 2007, we have repurchased 6.4 million shares of our common stock for \$165.3 million (a weighted-average price of \$25.89 per share) toward this planned repurchase amount, leaving \$184.7 million left to be repurchased towards this \$350 million commitment.

The number of shares repurchased under our new Rule 10b5-1 Plan is primarily based upon predetermined factors established by management of our company. These factors are evaluated on a periodic basis for possible adjustment. Over time, there will likely be some variability around the share repurchases due to changing market conditions. Although the quarterly pace at which we repurchase our shares, and the ultimate time period to complete this planned share buyback amount, cannot be reasonably estimated due to various market factors, to include the impact of our stock price, it is reasonably likely that we will spend material amounts of our capital resources on our buyback program in the near term.

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*Purchases of Property and Equipment.* In the first six months of 2007, we spent \$8.4 million on property and equipment. For 2007, we expect to spend approximately \$15 to \$18 million on capital expenditures. As of June 30, 2007, we have made no significant capital expenditure commitments.

*Convertible Debt Securities.* Our Convertible Debt Securities bear interest at a rate of 2.5% per annum, which is payable semiannually in arrears on June 15 and December 15 of each year. The Convertible Debt Securities are callable by us for cash, on or after June 20, 2011. The Convertible Debt Securities can be put back to us by the holders for cash at June 15, 2011, 2016 and 2021, or upon a change of control, at a repurchase price equal to 100% of the principal amount of the Convertible Debt Securities, plus accrued interest. Holders of the Convertible Debt Securities can convert their securities: (i) at any time the price of our common stock trades over \$34.80 per share (130% of the \$26.77 effective conversion price) for a specified period of time; (ii) at any time the trading price of the Convertible Debt Securities fall below 98% of the average conversion value for the Convertible Debt Securities for a specified period of time; (iii) upon us exercising our right to redeem the Convertible Debt Securities at any time after June 20, 2011; (iv) at any time upon the occurrence of specified corporate transactions, to include a change in control (as defined in the Bond Indenture); and (v) if a certain level of dividends are declared, or a certain number of shares of our common stock are repurchased under a self-tender offer by us. We do not expect any of the conversion triggers to occur during the next 12 months. As a result, in the near-term, we expect our annual debt service costs related to the Convertible Debt Securities to be limited to the annual interest payments of \$5.8 million.

The Convertible Debt Securities are convertible into our common stock, under the specified conditions and settlement terms outlined above, at an initial conversion rate of 37.3552 shares per \$1,000 principal amount of Convertible Debt Securities, which is equal to an effective conversion price of \$26.77 per share. The Bond Indenture includes anti-dilution provisions for the holders such that the conversion rate (and thus, the effective conversion price) can be adjusted in the future for certain events, to include stock dividends, stock splits/reverse splits, the issuance of warrants to purchase our stock at a price below the then-current market price, cash dividends, and certain purchases by us of our common stock pursuant to a self-tender offer or exchange offer. A lower effective conversion price may have several impacts to us, including a greater potential for: (i) the occurrence of the conversion trigger based upon the price of our common stock; and (ii) the Convertible Debt Securities having an impact on our diluted earnings per share if our average common stock price exceeds the then-current effective conversion price. The repurchase of up to \$350 million of our outstanding common stock, as discussed above, will have no impact on the current effective conversion price, or any other terms in the Bond Indenture.

*2004 Revolving Credit Facility.* The interest rate for borrowings under the 2004 Revolving Credit Facility, except for same day advances, is chosen at our option and is based upon a base rate or adjusted LIBOR rate, plus an applicable margin. The base rate represents the higher of a floating prime rate and a floating rate equal to 50 basis points in excess of the Federal Funds Effective Rate. The interest rate for same day advances is based upon base rate, plus an applicable margin. The applicable margins are dependent on our leverage ratio, as defined, and range from zero to 100 basis points for base rate loans and 125 to 225 basis points for LIBOR loans. As of June 30, 2007, we had made no borrowings under the 2004 Revolving Credit Facility, and at this time, we do not expect to make any borrowings under the 2004 Revolving Credit Facility during 2007. We pay a quarterly commitment fee on the unused portion of the 2004 Revolving Credit Facility. This rate is dependent on our leverage ratio and ranges from 25 to 50 basis points per annum. As of June 30, 2007, the commitment fee rate was 37.5 basis points per annum. As of the date of this filing, we have 100%, or \$100 million, of the 2004 Revolving Credit Facility available to us.

In summary, we expect to: (i) as part of our growth strategy, continue to evaluate potential business and asset acquisitions, and investments in market share expansion with our existing and potential new clients; and (ii) continue to repurchase our outstanding common stock under our Stock Repurchase Program. We also expect to continue to make investments in client contracts, capital equipment, and R&D. We believe that: (i) our current cash, cash equivalents, and short-term investments balance, together with cash expected to be generated from future operating activities; (ii) the amount available under the 2004 Revolving Credit Facility; and (iii) other possible sources of additional debt are available to us, will be sufficient to meet our anticipated cash requirements for at least the next 12 months.

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### **Ratio of Earnings to Fixed Charges**

The ratio of earnings to fixed charges is computed by dividing fixed charges into earnings. Earnings is defined as income before income taxes, plus fixed charges. Fixed charges consist of interest expense (including the amortization of deferred financing costs) and the estimated interest component of rental expense. Our consolidated ratio of earnings to fixed charges for the six months ended June 30, 2007, was 10.25:1.00. See Exhibit 12.10 to this document for information regarding the calculation of our ratio of earnings to fixed charges.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

As discussed in our 2006 10-K, we are exposed to market risks related to changes in interest rates, and fluctuations and changes in the market value of our short-term investments. We have not historically entered into derivatives or other financial instruments for trading or speculative purposes.

#### ***Interest Rate Risk***

*Market Risk Related to Long-Term Debt.* We are exposed to interest rate risk related to long-term debt from two sources: our Convertible Debt Securities, and our 2004 Revolving Credit Facility.

The interest rate on the Convertible Debt Securities is fixed, and thus, as it relates to our borrowings under the Convertible Debt Securities, we are not exposed to changes in interest rates. Commencing on June 15, 2011, in any six-month interest period where the average trading price of the Convertible Debt Securities immediately preceding that six-month interest period equals 120% or more of the principal amount of the Convertible Debt Securities, we will pay contingent interest equal to 0.25% of that average trading price.

The interest rate for borrowings under the 2004 Revolving Credit Facility, except for same day advances, is chosen at our option, and is based upon a base rate or adjusted LIBOR rate, plus an applicable margin. The base rate represents the higher of a floating prime rate and a floating rate equal to 50 basis points in excess of the Federal Funds Effective Rate. The interest rate for same day advances is based upon base rate, plus an applicable margin. The applicable margins are dependent on our leverage ratio, as defined, and range from zero to 100 basis points for base rate loans and 125 to 225 basis points for LIBOR loans. As of June 30, 2007, we had made no borrowings under the 2004 Revolving Credit Facility.

*Market Risk Related to Cash Equivalents and Short-term Investments.* Our cash and cash equivalents as of June 30, 2007, and December 31, 2006 were \$179.4 million and \$240.7 million, respectively. Our cash balances are typically swept into overnight money market accounts on a daily basis, and excess funds are invested in low-risk, somewhat longer term, cash equivalent instruments and short-term investments. We have minimal market risk for our cash and cash equivalents due to the relatively short maturities of the instruments.

Our short-term investments as of June 30, 2007 and December 31, 2006 were \$159.1 million and \$174.8 million, respectively. The day-to-day management of our cash equivalents and short-term investments is performed by two large financial institutions in the U.S., using strict and formal investment guidelines approved by our Board of Directors. Under these guidelines, short-term investments are limited to certain acceptable investments with: (i) a maximum maturity, (ii) a maximum concentration and diversification; and (iii) a minimum acceptable credit quality.

We do not utilize any derivative financial instruments for purposes of managing our market risks related to interest rate risk.



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**Item 4. Controls and Procedures**

***(a) Disclosure Controls and Procedures***

As required by Rule 13a-15(b), our management, including the Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), conducted an evaluation as of the end of the period covered by this report of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e). Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

***(b) Internal Control Over Financial Reporting***

As required by Rule 13a-15(d), our management, including the CEO and CFO, also conducted an evaluation of our internal control over financial reporting, as defined by Rule 13a-15(f), to determine whether any changes occurred during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, the CEO and CFO concluded that there has been no such change during the quarter covered by this report.

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**CSG SYSTEMS INTERNATIONAL, INC.**

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

From time-to-time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not presently a party to any material pending or threatened legal proceedings.

**Item 1A. *Risk Factors***

We or our representatives from time-to-time may make or may have made certain forward-looking statements, whether orally or in writing, including without limitation, any such statements made or to be made in MD&A contained in our various SEC filings or orally in conferences or teleconferences. We wish to ensure that such statements are accompanied by meaningful cautionary statements, so as to ensure, to the fullest extent possible, the protections of the safe harbor established in the Private Securities Litigation Reform Act of 1995.

Accordingly, the forward-looking statements are qualified in their entirety by reference to and are accompanied by the following meaningful cautionary statements identifying certain important risk factors that could cause actual results to differ materially from those in such forward-looking statements. This list of risk factors is likely not exhaustive. We operate in a rapidly changing and evolving market involving the North American communications industry (e.g., bundled multi-channel video, Internet, voice and IP-based services), and new risk factors will likely emerge. Management cannot predict all of the important risk factors, nor can it assess the impact, if any, of such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause actual results to differ materially from those in any forward-looking statements. Accordingly, there can be no assurance that forward-looking statements will be accurate indicators of future actual results, and it is likely that actual results will differ from results projected in forward-looking statements and that such differences may be material.

**We Derive a Significant Portion of Our Revenues From a Limited Number of Clients, and the Loss of the Business of a Significant Client Would Materially Adversely Affect Our Financial Condition and Results of Operations.**

The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a limited number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues are generated from a limited number of clients, with approximately 70% of our revenues being generated from our four largest clients, which are (in order of size) Comcast, EchoStar, Time Warner, and Charter. See our 2006 10-K for a brief summary of our business relationship with each of these clients.

There are inherent risks whenever a large percentage of total revenues are concentrated with a limited number of clients. One such risk is that, should a significant client: (i) terminate or fail to renew their contracts with us, in whole or in part for any reason; (ii) significantly reduce the number of customer accounts processed on our systems, the price paid for our services, or the scope of services that we provide; or (iii) experience significant financial or operating difficulties, it could have a material adverse effect on our financial condition and results of operations (including possible impairment, or significant acceleration of the amortization of intangible assets).

Our industry is highly competitive, and the possibility that a major client may move all or a portion of its customers to a competitor has increased. While our clients may incur some costs in switching to our competitors, they may do so for a variety of reasons, including if we do not maintain favorable relationships, do not provide satisfactory services and products, or for reasons associated with price.

**A Reduction in Demand for Our Key Customer Care and Billing Products and Services Could Have a Material Adverse Effect on Our Financial Condition and Results of Operations.**

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Historically, a substantial percentage of our total revenues have been generated from our core outsourced processing product, ACP and its components, and also related services. These products and services are expected to continue to provide a large percentage of our total revenues in the foreseeable future. Any significant reduction in demand for ACP and related services could have a material adverse effect on our financial condition and results of operations, including possible impairment to intangible assets.

### **We May Not Be Able to Respond to the Rapid Technological Changes in Our Industry.**

The market for customer care and billing systems is characterized by rapid changes in technology and is highly competitive with respect to the need for timely product innovations, new product introductions, and how they are delivered. As a result, we believe that our future success in sustaining and growing our revenues depends upon the continued market acceptance of our products, especially ACP and its components, and our ability to continuously adapt, modify, maintain, and operate our products to address the increasingly complex and evolving needs of our clients, without sacrificing the reliability or quality of the products. In addition, the market is demanding that our products have architectural flexibilities and features, (e.g., service oriented architecture, or SOA), that are more easily integrated with other computer systems, and that we are able to meet the demands for technological advancements to our products and services at a greater pace. Attempts to meet these demands subjects our R&D efforts to greater risks.

As a result, substantial R&D will be required to maintain the competitiveness of our products and services in the market. Technical problems may arise in developing, maintaining and operating our products and services as the complexities are increased. Development projects can be lengthy and costly, and may be subject to changing requirements, programming difficulties, a shortage of qualified personnel, and/or unforeseen factors which can result in delays. In addition, we may be responsible for the implementation of new products and/or the migration of clients to new products, and depending upon the specific product, we may also be responsible for operations of the product.

There is an inherent risk in the successful development, implementation, migration, and operations of our products and services as the technological complexities, and the pace at which we must deliver these products and services to market, continues to increase. The risk of making an error that causes significant operational disruption to a client increases proportionately with the frequency and complexity of changes to our products and services. There can be no assurance:

of continued market acceptance of our products and services;

that we will be successful in the development of product enhancements or new products that respond to technological advances or changing client needs at the pace the market demands; or

that we will be successful in supporting the implementation, migration and/or operations of product enhancements or new products without causing a significant disruption to our clients' operations.

### **Our Business is Dependent on the North American Communications Industry.**

We generate a significant portion of our revenues by providing products and services to the U.S. and Canadian communication industries. A decrease in the number of customers served by our clients, loss of business due to non-renewal of client contracts, industry and client consolidations, an adverse change in the economic condition of these industries, movement of customers from our systems to a competitor's system as a result of regionalization strategies by our clients, and/or changing consumer demand for services could have a material adverse effect on our results of operations. Additionally, our current clients' distribution methods could be disrupted by new entrants into the communications industry. There can be no assurance that new entrants into the communications market will become our clients. Also, there can be no assurance that communication providers will be successful in expanding into other segments of the converging communications industry. Even if major forays into new markets are successful, we may be unable to meet the special billing and customer care needs of that market.

### **The Consolidation of the North American Communications Industry May Have a Material Adverse Effect on Our Results of Operations.**

The North American communications industry is undergoing significant ownership changes at an accelerated pace. One facet of these changes is that communications service providers are consolidating, decreasing the potential number of buyers for our products and services. Such client consolidations carry with them the inherent risk that the consolidators may choose to move their purchased customers to a competitor's



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system. Should this consolidation result in a concentration of customer accounts being owned by companies with whom we do not have a relationship, or with whom competitors are entrenched, it could negatively affect our ability to maintain or expand our market share, thereby having a material adverse effect on our results of operations. In addition, service providers may choose to use their size and scale to exercise more severe pressure on pricing negotiations.

In addition, it is widely anticipated that communication service providers will continue their aggressive pursuit of providing convergent services. Traditional wireline and wireless telephone providers have recently entered the residential video market, a market dominated by our clients. Should these traditional telephone service providers be successful in their video strategy, it could threaten our clients' market share, and thus our processing revenues, as generally speaking, these companies do not currently use our products and services.

### **We Face Significant Competition in Our Industry.**

The market for our products and services is highly competitive. We directly compete with both independent providers of products and services and in-house systems developed by existing and potential clients. In addition, some independent providers are entering into strategic alliances with other independent providers, resulting in either new competitors, or competitors with greater resources. Many of our current and potential competitors have significantly greater financial, marketing, technical, and other competitive resources than our company, many with significant and well-established domestic and international operations. There can be no assurance that we will be able to compete successfully with our existing competitors or with new competitors.

### **Client Bankruptcies Could Adversely Affect Our Business, and Any Accounting Reserves We Have Established May Not Be Sufficient.**

In the past, certain of our clients have filed for bankruptcy protection. Companies involved in bankruptcy proceedings pose greater financial risks to us, consisting principally of possible claims of preferential payments for certain amounts paid to us prior to the bankruptcy filing date, as well as increased collection risk for accounts receivable, particularly those accounts receivable that relate to periods prior to the bankruptcy filing date. We consider such risks in assessing our revenue recognition and the collection of accounts receivable related to our clients that have filed for bankruptcy protection, and for those clients that are seriously threatened with a possible bankruptcy filing. We establish accounting reserves for our estimated exposure on these items. However, there can be no assurance that our accounting reserves related to this exposure will be adequate. Should any of the factors considered in determining the adequacy of the overall reserves change adversely, an adjustment to the accounting reserves may be necessary. Because of the potential significance of this exposure, such an adjustment could be material.

### **We May Incur Additional Material Restructuring Charges in the Future.**

Since the third quarter of 2002, we have recorded restructuring charges related to involuntary employee terminations, various facility abandonments, and various other restructuring activities. The accounting for facility abandonments requires highly subjective judgments in determining the proper accounting treatment for such matters. We continually evaluate our assumptions, and adjust the related restructuring reserves based on the revised assumptions at that time. Moreover, we continually evaluate ways to reduce our operating expenses through new restructuring opportunities, including more effective utilization of our assets, workforce and operating facilities. As a result, there is a reasonable likelihood that we may incur additional material restructuring charges in the future.

### **Failure to Attract and Retain Our Key Management and Other Highly Skilled Personnel Could Have a Material Adverse Effect on Our Business.**

Our future success depends in large part on the continued service of our key management, sales, product development, and operational personnel. We believe that our future success also depends on our ability to attract and retain highly skilled technical, managerial, operational, and marketing personnel, including, in particular, personnel in the areas of R&D and technical support. Competition for qualified personnel at times can be intense, particularly in the areas of R&D, conversions, software implementations, and technical support, especially now that market conditions are improved and the demand for such talent has increased. For these reasons, we may not be successful in attracting and retaining the personnel we require, which could have a material adverse effect on our ability to meet our commitments and new product delivery objectives.

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### **We May Not Be Successful in the Integration of Our Acquisitions.**

As part of our growth strategy, we have recently acquired and expect to continue to acquire assets, technology, and businesses which will provide the technology and technical personnel to expedite our product development efforts, provide complementary products or services, or provide access to new markets and clients.

Acquisitions involve a number of risks and difficulties, including: (i) expansion into new markets and business ventures; (ii) the requirement to understand local business practices; (iii) the diversion of management's attention to the assimilation of acquired operations and personnel; (iv) the desired retention of key personnel of the acquired business; and (v) potential adverse effects on a company's operating results for various reasons, including, but not limited to, the following items: (a) the inability to achieve revenue targets; (b) the inability to achieve certain operating synergies; (c) charges related to purchased in-process R&D projects; (d) costs incurred to exit current or acquired contracts or activities; (e) costs incurred to service any acquisition debt; and (f) the amortization or impairment of intangible assets.

Due to the multiple risks and difficulties associated with any acquisition, there can be no assurance that we will be successful in achieving our expected strategic, operating, and financial goals for any such acquisition.

### **Failure to Protect Our Proprietary Intellectual Property Rights Could Have a Material Adverse Effect on Our Financial Condition and Results of Operations.**

We rely on a combination of trade secret and copyright laws, nondisclosure agreements, and other contractual and technical measures to protect our proprietary rights in our products. We also hold a limited number of patents on some of our newer products, but do not rely upon patents as a primary means of protecting our rights in our intellectual property. There can be no assurance that these provisions will be adequate to protect our proprietary rights. Although we believe that our intellectual property rights do not infringe upon the proprietary rights of third parties, there can be no assurance that third parties will not assert infringement claims against us or our clients.

We continually assess whether there are any risks to our intellectual property rights. Should these risks be improperly assessed or if for any reason should our right to develop, produce and distribute our products be successfully challenged or be significantly curtailed, it could have a material adverse effect on our financial condition and results of operations.

### **The Delivery of Our Products and Services is Dependent on a Variety of Computing Environments and Communications Networks, Which May Not Be Available or May Be Subject to Security Attacks.**

Our products and services are generally delivered through a variety of computing environments operated by us, which are collectively referred to herein as Systems. We provide such computing environments through both out-sourced arrangements, such as our data processing arrangement with FDC, as well as internally operating numerous distributed servers in geographically dispersed environments. The end users are connected to our Systems through a variety of public and private communications networks, which are collectively referred to herein as Networks. Our products and services are generally considered to be mission critical customer management systems by our clients. As a result, our clients are highly dependent upon the continuous availability and uncompromised security of our Networks and Systems to conduct their business operations.

Our Networks and Systems are subject to the risk of an extended interruption or outage due to many factors such as: (i) planned changes to our Systems and Networks for such things as scheduled maintenance and technology upgrades, or migrations to other technologies, service providers, or physical location of hardware; (ii) human and machine error; (iii) acts of nature; and (iv) intentional, unauthorized attacks from computer hackers. In addition, we continue to expand our use of the Internet with our product offerings thereby permitting, for example, our clients' customers to use the Internet to review account balances, order services or execute similar account management functions. Allowing access to our Networks and Systems via the Internet increases their vulnerability to unauthorized access and corruption, as well as increasing the dependency of our Systems' reliability on the availability and performance of the Internet's infrastructure.

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As a means to mitigate certain risks in this area of our business, we have done the following: (i) established policies and procedures related to planned changes to our Systems and Networks; (ii) implemented a business continuity plan, and test certain aspects of this plan on a periodic basis; and (iii) implemented a security and data privacy program (utilizing ISO 17799 as a guideline) designed to mitigate the risk of an unauthorized access to the Networks and Systems primarily through the use of network firewalls, procedural controls, intrusion detection systems and antivirus applications. In addition, we undergo periodic security reviews of certain aspects of our Networks and Systems by independent parties.

The method, manner, cause and timing of an extended interruption or outage in our Networks or Systems are impossible to predict. As a result, there can be no assurances that our Networks and Systems will not fail, or that our business continuity plans will adequately mitigate all damages incurred as a consequence. Should our Networks or Systems: (i) experience an extended interruption or outage; (ii) have their security breached; or (iii) have their data lost, corrupted or otherwise compromised, it would impede our ability to meet product and service delivery obligations, and would likely have an immediate impact to the business operations of our clients. This would most likely result in an immediate loss to us of revenue or an increase in expense, as well as damaging our reputation. Any of these events could have both an immediate, negative impact upon our financial condition and our short-term revenue and profit expectations, as well as our long-term ability to attract and retain new clients.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table presents information with respect to purchases of company common stock made during the three months ended June 30, 2007 by CSG Systems International, Inc. or any affiliated purchaser of CSG Systems International, Inc., as defined in Rule 10b-18(a)(3) under the Exchange Act.

| Period             | Total Number of Shares Purchased <sup>2</sup> | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Programs <sup>1</sup> |
|--------------------|---|------------------------------|--|--|
| April 1 - April 30 | 822,960                                       | \$ 25.50                     | 821,555  | 10,562,111   |
| May 1 - May 31     | 539,639                                       | 27.17                        | 536,515  | 10,025,596   |
| June 1 - June 30   | 454,405                                       | 26.73                        | 447,400  | 9,578,196  |
| Total              | 1,817,004                                     | \$ 26.31                     | 1,805,470  |  |

<sup>1</sup> Our Board of Directors have authorized us to repurchase up to 30 million shares of our common stock under the Stock Repurchase Program. The Stock Repurchase Program does not have an expiration date.

<sup>2</sup> The total number of shares purchased that are not part of the Stock Repurchase Program represents shares purchased and cancelled in connection with stock incentive plans

**Item 3.** None

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

- (a) The 2007 annual meeting of stockholders of CSG Systems International, Inc. (the Annual Meeting ) was held on May 25, 2007.

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(b) The following persons were elected as directors at the Annual Meeting:  
Class I (expiring in 2010)

Edward C. Nafus

Janice I. Obuchowski

Donald B. Reed



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The following directors term of office continued after the Annual Meeting:

Ronald H. Cooper

Bernard W. Reznicek

Donald V. Smith

Frank V. Sica

James A. Unruh

(c) Votes were cast or withheld at the Annual Meeting as follows:

(i) Election of directors:

| Director             | For        | Withheld |
|----------------------|------------|----------|
| Edward C. Nafus      | 39,454,989 | 306,219  |
| Janice I. Obuchowski | 39,454,815 | 306,393  |
| Donald B. Reed       | 39,454,857 | 306,351  |

(ii) Approval of performance bonus program:

| For        | Against | Abstain | Non votes |
|------------|---------|---------|-----------|
| 38,793,946 | 911,053 | 56,209  |           |

(iii) Approval of performance goals for performance-based awards under the 2005 Stock Incentive Plan:

| For        | Against   | Abstain | Non votes |
|------------|-----------|---------|-----------|
| 31,944,517 | 3,235,352 | 70,164  | 4,511,175 |

(iv) Ratification of appointment of independent auditor for 2007:

| For        | Against | Abstain | Non votes |
|------------|---------|---------|-----------|
| 39,664,688 | 45,127  | 51,393  |           |

**Item 5.** None

**Item 6. Exhibits**

The Exhibits filed or incorporated by reference herewith are as specified in the Exhibit Index.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 7, 2007

CSG SYSTEMS INTERNATIONAL, INC.

/s/ Edward C. Nafus  
Edward C. Nafus  
Chief Executive Officer and President

(Principal Executive Officer)

/s/ Randy R. Wiese  
Randy R. Wiese  
Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

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**CSG SYSTEMS INTERNATIONAL, INC.**

**INDEX TO EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 10.80A                    | Forms of Agreement for Equity Compensation   |
| 12.10                     | Statement regarding computation of Ratio of Earnings to Fixed Charges  |
| 31.01                     | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.02                     | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.01                     | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |