

CSG SYSTEMS INTERNATIONAL INC
Form 10-Q
November 08, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2006

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

CSG SYSTEMS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

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

9555 Maroon Circle

Englewood, Colorado 80112

(Address of principal executive offices, including zip code)

(303) 796-2850

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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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 November 6, 2006: 47,168,649

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FORM 10-Q For the Quarter Ended September 30, 2006

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

(in thousands, except share and per share amounts)

	September 30, 2006	December 31, 2005
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 282,665	\$ 346,113
Short-term investments	132,265	46,111
Total cash, cash equivalents and short-term investments	414,930	392,224
Trade accounts receivable-		
Billed, net of allowance of \$1,143 and \$1,324	107,564	104,812
Unbilled and other	5,951	6,660
Deferred income taxes	9,496	9,565
Income taxes receivable		5,032
Other current assets	5,899	17,145
Total current assets	543,840	535,438
Property and equipment, net of depreciation of \$67,824 and \$61,333	19,014	21,143
Software, net of amortization of \$32,676 and \$31,945	8,038	
Goodwill	14,228	623
Client contracts, net of amortization of \$78,533 and \$68,634	35,868	41,661
Deferred income taxes	24,472	33,275
Other assets	7,341	6,236
Total assets	\$ 652,801	\$ 638,376
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Client deposits	\$ 25,418	\$ 19,651
Trade accounts payable	15,616	17,306
Accrued employee compensation	21,392	32,447
Deferred revenue	12,255	9,575
Income taxes payable	3,254	
Other current liabilities	14,269	15,783
Total current liabilities	92,204	94,762
Non-current liabilities:		
Long-term debt	230,000	230,000
Deferred revenue	8,777	8,943
Other non-current liabilities	4,039	6,341
Total non-current liabilities	242,816	245,284
Total liabilities	335,020	340,046
Stockholders equity:		

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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; 47,406,694 and 47,886,480 shares outstanding	614	601
Additional paid-in capital	334,341	316,764
Treasury stock, at cost, 14,019,996 and 12,290,485 shares	(339,744)	(296,976)
Accumulated other comprehensive income:		
Unrealized gain on short-term investments, net of tax	25	71
Accumulated earnings	322,545	277,870
Total stockholders' equity	317,781	298,330
Total liabilities and stockholders' equity	\$ 652,801	\$ 638,376

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)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
	(unaudited)		(unaudited)	
Revenues:				
Processing and related services	\$ 90,272	\$ 87,478	\$ 264,408	\$ 259,390
Software, maintenance and services	8,178	6,614	22,055	24,728
Total revenues	98,450	94,092	286,463	284,118
Cost of revenues:				
Processing and related services	44,867	42,453	129,457	126,127
Software, maintenance and services	5,829	4,601	15,555	14,647
Total cost of revenues	50,696	47,054	145,012	140,774
Gross margin (exclusive of depreciation)	47,754	47,038	141,451	143,344
Operating expenses:				
Research and development	12,097	9,009	32,872	24,865
Selling, general and administrative	10,449	11,467	32,037	41,119
Depreciation	2,600	2,324	7,651	7,416
Restructuring charges	78	3	2,368	9
Total operating expenses	25,224	22,803	74,928	73,409
Operating income	22,530	24,235	66,523	69,935
Other income (expense):				
Interest expense	(1,862)	(1,887)	(5,650)	(5,766)
Interest and investment income, net	6,046	787	15,993	2,158
Other, net		8	(52)	11
Total other	4,184	(1,092)	10,291	(3,597)
Income from continuing operations before income taxes	26,714	23,143	76,814	66,338
Income tax provision	(9,350)	(8,331)	(28,379)	(23,880)
Income from continuing operations	17,364	14,812	48,435	42,458
Discontinued operations:				
Income (loss) from discontinued operations, includes net pretax loss on disposal in 2006 of \$6,000	(6,555)	694	(6,555)	(14,423)
Income tax (provision) benefit	2,795	(2,004)	2,795	2,595
Discontinued operations, net of tax	(3,760)	(1,310)	(3,760)	(11,828)

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Net income	\$ 13,604	\$ 13,502	\$ 44,675	\$ 30,630
Basic earnings (loss) per common share:				
Income from continuing operations	\$ 0.37	\$ 0.32	\$ 1.04	\$ 0.89
Discontinued operations, net of tax	(0.08)	(0.03)	(0.08)	(0.25)
Net income	\$ 0.29	\$ 0.29	\$ 0.96	\$ 0.64
Diluted earnings (loss) per common share:				
Income from continuing operations	\$ 0.37	\$ 0.31	\$ 1.03	\$ 0.87
Discontinued operations, net of tax	(0.08)	(0.03)	(0.08)	(0.24)
Net income	\$ 0.29	\$ 0.28	\$ 0.95	\$ 0.63
Weighted-average shares outstanding:				
Basic	46,549	47,303	46,659	48,166
Diluted	47,154	47,983	47,228	48,816

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)**

	Nine Months Ended	
	September 30, 2006	September 30, 2005
	(unaudited)	
Cash flows from operating activities:		
Net income	\$ 44,675	\$ 30,630
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation	7,651	11,209
Amortization	12,550	21,405
Restructuring charge for abandonment of facilities and impairment of assets	401	3,570
Net pretax loss on disposition of discontinued operations	6,000	
Gain on short-term investments	(567)	(306)
Deferred income taxes	9,740	1,772
Excess tax benefits from stock-based compensation awards	(2,845)	1,138
Stock-based employee compensation	9,114	12,678
Changes in operating assets and liabilities:		
Trade accounts and other receivables, net	(235)	(1,001)
Other current and non-current assets	(1,807)	(1,179)
Income taxes payable/receivable	11,128	5,893
Trade accounts payable and accrued liabilities	(8,103)	3,384
Deferred revenue	1,579	(2,333)
Net cash provided by operating activities	89,281	86,860
Cash flows from investing activities:		
Net payments from the disposition of discontinued operations	(6,436)	
Purchases of property and equipment	(5,198)	(9,356)
Proceeds from sale of aircraft held for sale	7,376	
Purchases of short-term investments	(183,716)	(57,159)
Proceeds from sale/maturity of short-term investments	98,100	40,038
Acquisition of business, net of cash acquired	(21,533)	(487)
Acquisition of and investments in client contracts	(6,549)	(5,508)
Net cash used in investing activities	(117,956)	(32,472)
Cash flows from financing activities:		
Proceeds from issuance of common stock	7,431	3,170
Repurchase of common stock	(44,568)	(61,081)
Payments on acquired equipment financing	(481)	
Excess tax benefits from stock-based compensation awards	2,845	
Payments of deferred financing costs		(87)
Net cash used in financing activities	(34,773)	(57,998)
Effect of exchange rate fluctuations on cash		(2,468)
Net decrease in cash and cash equivalents	(63,448)	(6,078)
Cash and cash equivalents, beginning of period	346,113	133,551

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Cash and cash equivalents, end of period	\$ 282,665	\$ 127,473
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Supplemental disclosures of cash flow information:

Cash paid during the period for-

Interest	\$ 3,195	\$ 3,195
Income taxes	5,265	15,491

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

1. GENERAL

We have prepared the accompanying unaudited condensed consolidated financial statements as of September 30, 2006 and December 31, 2005, and for the three and nine months ended September 30, 2006 and 2005, 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, 2005, filed with the SEC. The results of operations for the three and nine months ended September 30, 2006, are not necessarily indicative of the expected results for the entire year ending December 31, 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 September 30, 2006 and 2005 was \$48.3 million and \$45.4 million, respectively, and for the nine months ended September 30, 2006 and 2005 was \$144.5 million and \$135.9 million, respectively.

Stock-Based Compensation Expense. Effective January 1, 2006, we adopted Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R) and related amendments and interpretations, using the modified prospective transition method. SFAS 123R is a revision of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), which we adopted in 2003, and supersedes Accounting Principles Board No. 25, Accounting for Stock Issued to Employees (APB 25) and its related implementation guidance. Prior to adopting SFAS 123R, we accounted for stock-based awards granted or modified after January 1, 2003 and prior to January 1, 2006 in accordance with SFAS 123, and for all other stock-based awards granted prior to January 1, 2003 (and not subsequently modified after January 1, 2003) in accordance with APB 25.

SFAS 123R establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Under the modified prospective transition method, SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Compensation cost for unvested awards as of January 1, 2006 previously accounted for in accordance with SFAS 123 and APB 25, for which the requisite service has not been rendered, is recognized as the requisite service is rendered on or after January 1, 2006 based upon the grant-date fair value and attribution method applied in accordance with the original provisions of SFAS 123. SFAS 123R also requires us to estimate the amount of expected forfeitures in calculating compensation costs for all outstanding awards. Previously, we accounted for the impact of forfeitures when they occurred.

Since we had adopted SFAS 123 effective January 1, 2003, the adoption of SFAS 123R did not have a significant impact on our financial statements. SFAS 123R requires the benefit of tax deductions in excess of recognized

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compensation expense be reported as a financing cash inflow rather than as an operating cash inflow. As a result, we have separately classified \$2.8 million of excess tax benefits from stock-based compensation arrangements as a financing cash inflow and as an operating cash outflow in our Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2006. In accordance with the modified prospective transition method of adopting SFAS 123R, our financial statements for prior periods have not been restated for this matter.

Because we continued to follow the intrinsic value based method under APB 25 for all stock-based awards granted prior to January 1, 2003 (and not subsequently modified after January 1, 2003) until the effective date of our adoption of SFAS 123R, compensation expense for the three and nine months ended September 30, 2005 is less than what would have been recognized if the fair value based method under SFAS 123 had been applied to all awards for all periods. Had compensation expense for our stock-based compensation plans been based on fair value at the grant dates for awards under those plans for the three and nine months ended September 30, 2005, consistent with the methodology of SFAS 123, our net income and net income per share for the three and nine months ended September 30, 2005, would approximate the pro forma amounts as follows (in thousands, except per share amounts):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	\$ 13,502	\$ 30,630
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	2,509	7,890
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(2,813)	(9,721)
Net income, pro forma	\$ 13,198	\$ 28,799
Net income per share:		
Basic as reported	\$ 0.29	\$ 0.64
Basic pro forma	0.28	0.60
Diluted as reported	0.28	0.63
Diluted pro forma	0.28	0.59

Short-term Investments and Other Financial Instruments. Our financial instruments as of September 30, 2006 and December 31, 2005 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 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 September 30, 2006 and December 31, 2005, the fair value of our long-term debt, based upon quoted market prices, was approximately \$262 million and \$227 million, respectively. As of September 30, 2006 and December 31, 2005, the fair value of the contingent interest feature of our long-term debt, considered an embedded derivative, was \$0.3 million and \$0.1 million, respectively. We do not utilize any derivative financial instruments for purposes of managing the market risks related to our financial instruments.

Accounting Pronouncement Issued But Not Yet Effective. In June 2006, the Financial Accounting Standards Board (FASB) issued 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. The new guidance will be effective for us on January 1, 2007, with any adjustments necessary upon adoption recorded directly to our beginning accumulated earnings balance. We are

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currently in the process of analyzing the impact of adopting FIN 48, 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. ("Comverse"); 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 reflected the results of operations for the GSS Business and plaNet Business 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.

During the third quarter of 2006, we made a \$6 million payment to Comverse related to the settlement of a dispute over a joint tax election associated with the sale of the GSS Business. This payment to Comverse is considered a reduction in the purchase price previously paid by Comverse, and thus is reflected as part of the loss from discontinued operations for the three and nine months ended September 30, 2006. This settlement payment had not been anticipated by us, and we do not expect any similar purchase price adjustments in future periods.

4. EQUITY COMPENSATION PLANS

The discussions below for our equity compensation plans include both continuing and discontinued operations.

Stock Incentive Plans

Background. Beginning in 2002, we implemented changes in our stock-based compensation programs designed to continue to attract and retain employees. In 2003, we allowed employees to exchange stock options, with exercise prices significantly above our then-current stock price, for restricted stock awards. In addition, in 2003, we began primarily granting restricted stock awards instead of stock options to employees. Restricted stock awards offer employees the opportunity to earn shares of our common stock over time, rather than stock options in which employees earn the right to purchase shares of our common stock at a set price over time. Restricted stock awards are generally granted at no cost to the recipient. Because of the greater intrinsic value of the restricted stock at the grant date when compared to stock options, the number of equity awards granted under this compensation methodology is less than the number of equity awards granted when the primary equity awards were stock options.

Summary of Stock Incentive Plans. As of September 30, 2006, we have four stock incentive plans, as summarized below:

Plan	Shares Reserved For Issuance	Shares Available For Issuance
1996 Plan (1)		
1997 Director Plan (2)	450,000	49,233
2005 Plan (1)	12,400,000	11,848,000
Total stockholder approved	12,850,000	11,897,233
2001 Plan (3)	3,000,000	85,603
Total	15,850,000	11,982,836

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- (1) The 2005 Stock Incentive Plan (the 2005 Plan) was adopted upon stockholder approval. The 2005 Plan replaces one of our previously existing stock incentive plans, the 1996 Stock Incentive Plan (the 1996 Plan). No further grants may be made under the 1996 Plan, but any stock awards which are outstanding under the 1996 Plan will remain in effect in accordance with their respective terms. The shares available under the 2005 Plan have been reserved for issuance to officers and other key employees of our company and its subsidiaries and to non-employee directors of our company in the form of stock options, stock appreciation rights, performance unit awards, restricted stock awards, or stock bonus awards. Shares granted under the 2005 Plan in the form of a performance unit award, restricted stock award or stock bonus award are counted toward the aggregate number of shares of common stock available for issuance under the 2005 Plan as two shares for every one share granted or issued in payment of such award.

- (2) The Stock Option Plan for Non-Employee Directors (the 1997 Director Plan) was adopted upon stockholder approval. The shares available under the 1997 Director Plan have been reserved for issuance to non-employee directors of our company in the form of stock options.

- (3) The 2001 Stock Incentive Plan (the 2001 Plan) was adopted without stockholder approval. The shares available under the 2001 Plan have been reserved for issuance to eligible employees of our company in the form of stock options, stock appreciation rights, performance unit awards, restricted stock awards, or stock bonus awards. Shares available under the 2001 Plan may be granted to key employees of our company or its subsidiaries who are not: (i) officers or directors; (ii) covered employees for purposes of Section 162(m) of the Internal Revenue Code; or (iii) persons subject to Section 16 of the Securities Exchange Act of 1934.

Modifications to Stock-Based Awards. During the first quarter of 2005, we modified the terms of approximately 70,000 shares of unvested restricted stock held by two executive officers, and 75,000 unvested stock options held by one executive officer. The terms of the restricted stock awards were modified to include a provision which allows for full vesting of any unvested restricted stock upon an involuntary termination of employment without cause. Unless such an event occurs, the restricted stock will continue to vest as set forth in the original terms of the agreements. The terms of the stock option awards were modified to accelerate vesting of such awards to January 1, 2006 upon continuous employment with our company through such date.

Restricted Stock. Our restricted stock shares typically vest annually over three to four years. Unvested restricted stock shares are typically forfeited and cancelled upon termination of employment with our company. Certain shares of the 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 or termination of employment. There are no restrictions on these shares other than the passage of time (i.e., the shares are released upon calendar vesting with no further restrictions). We generally issue new shares (versus treasury shares) to fulfill restricted stock award grants.

The fair value of each restricted stock award is determined by using the closing market price of our common stock on the grant date of the award and is charged to expense on a straight-line basis over the service period during which the award is deemed to be earned.

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A summary of our unvested restricted stock activity during the nine months ended September 30, 2006, is as follows:

	Nine Months Ended September 30, 2006	
	Shares	Weighted- Average Grant Date Fair Value
Unvested awards at January 1, 2006	838,888	\$ 19.04
Awards granted	728,000	22.97
Awards forfeited/cancelled	(37,037)	20.53
Awards vested	(240,249)	17.59
Unvested awards at September 30, 2006	1,289,602	\$ 21.49

The total market value of restricted stock shares vesting during the nine months ended September 30, 2006 and 2005 was \$5.6 million and \$8.9 million, respectively.

Stock Options. Stock option awards are granted with an exercise price equal to the fair value of our common stock as of the date of the grant. Stock option awards typically vest over four years and have a maximum term of ten years. As discussed above, during 2003, we began primarily granting restricted stock awards instead of stock options to employees. No stock options were awarded during the nine months ended September 30, 2006. All stock options awarded in 2005 were granted to certain GSS Business employees and were subsequently forfeited in 2005 upon the closing of the sale of the GSS Business (see Note 3) as the GSS Business employees were considered terminated.

For purposes of the pro forma disclosure and compensation cost recorded under SFAS 123/SFAS 123R, the fair value of each stock option award was estimated on the date of grant using the Black-Scholes option-pricing model and was charged to expense on a straight-line basis over the service period during which the award was deemed to have been earned.

A summary of our stock option activity during the nine months ended September 30, 2006, is as follows:

	Nine Months Ended September 30, 2006		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(1)
	Shares	Exercise Price		
Outstanding at January 1, 2006	1,455,963	\$ 19.47		
Granted				
Exercised	(620,738)	11.53		
Forfeited	(1,568)	15.30		
Expired	(71,277)	26.96		
Outstanding at September 30, 2006	762,380	\$ 25.24	3.6 Years	\$ 4,911,565
Options exercisable at September 30, 2006	717,271	\$ 26.02	3.5 Years	\$ 4,304,870

- (1) The aggregate intrinsic value represents stock options that were in-the-money as of September 30, 2006, and is calculated as the difference between the exercise price of the underlying awards and the closing market price of our common stock as of September 30, 2006.

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The aggregate intrinsic value of stock options exercised, determined as of the date of option exercise, during the nine months ended September 30, 2006 and 2005 was \$8.0 million and \$1.9 million, respectively. Cash received from stock option exercises during the nine months ended September 30, 2006 and 2005 was \$6.8 million and \$2.3 million, respectively.

1996 Employee Stock Purchase Plan

As of September 30, 2006, we had an employee stock purchase plan whereby 958,043 shares of the Company's common stock have been reserved for sale to our employees through payroll deductions. The price for shares purchased under the plan is 85% of market value on the last day of the purchase period. During the nine months ended September 30, 2006 and 2005, 29,796 and 54,563 shares, respectively, were purchased under the plan for \$0.6 million and \$0.9 million, respectively. As of September 30, 2006, 393,290 shares remain eligible for purchase under the plan.

Table of Contents**Stock-Based Compensation Expense**

The Company recorded stock-based compensation expense as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Continuing operations	\$ 3,085	\$ 3,129	\$ 9,114	\$ 9,853
Discontinued operations		899		2,825
Total stock-based compensation	\$ 3,085	\$ 4,028	\$ 9,114	\$ 12,678

As of September 30, 2006, there was \$19.2 million of total compensation cost related to unvested awards not yet recognized. That cost, excluding the impact of forfeitures, is expected to be recognized over a weighted-average period of 2.8 years.

We recorded a deferred income tax benefit related to stock-based compensation expense during the nine months ended September 30, 2006 and 2005, of \$3.4 million and \$4.8 million, respectively. The actual tax benefit realized for the tax deductions from stock option exercises and vesting of restricted stock for the nine months ended September 30, 2006 and 2005 totaled \$4.6 million and \$3.8 million, respectively.

5. STOCKHOLDERS EQUITY

Stock Repurchase Program. Since August 1999, we have had a stock repurchase program, approved by our Board of Directors, authorizing us to repurchase shares of our common stock from time-to-time as market and business conditions warrant (the "Stock Repurchase Program"). In July 2006, our Board of Directors approved a 10 million share increase in the number of shares authorized for repurchase under the Stock Repurchase Program, bringing the total number of shares authorized to 30 million.

A summary of the shares repurchased during the three and nine months ended September 30, 2006 and 2005 under the Stock Repurchase Program is as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Shares repurchased	820	796	1,729	3,163
Total amount paid	\$ 21,884	\$ 14,999	\$ 42,768	\$ 57,969
Weighted-average price per share	\$ 26.69	\$ 18.84	\$ 24.73	\$ 18.33

As of September 30, 2006, the total shares repurchased under the Stock Repurchase Program since its inception in August 1999 is 14.9 million shares, at a total repurchase price of \$368.3 million (a weighted-average price of \$24.79 per share). As of September 30, 2006, the remaining number of shares authorized for repurchase under the Stock Repurchase Program is 15.1 million shares.

The shares repurchased under the Stock Repurchase Program are being held as treasury shares. The Stock Repurchase Program does not have an expiration date.

Rule 10b5-1 Plans. To facilitate the repurchase of our common stock under the Stock Repurchase Program, we have from time-to-time established formal plans with financial institutions that comply with the provisions of Rule 10b5-1 under the Securities Exchange Act of 1934 ("Rule 10b5-1 Plan"). Any shares repurchased under a Rule 10b5-1 Plan are counted towards the 30 million share limit authorized under the Stock Repurchase Program. A Rule 10b5-1 Plan supplements any stock repurchases made under the existing terms of our

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Stock Repurchase Program. In effect, a Rule 10b5-1 Plan allows us to achieve our stock buyback objectives more readily by permitting the execution of trades during periods that would otherwise be prohibited by internal trading policies.

In April 2005, we established a Rule 10b5-1 Plan to repurchase on the open market up to a maximum of 3 million shares of our common stock. In May 2006, we reached the 3 million share maximum established under the Rule 10b5-1 Plan, and therefore, this Rule 10b5-1 Plan has expired.

In August 2006, we established a new Rule 10b5-1 Plan to facilitate the repurchase of \$350 million of our common stock under our Stock Repurchase Program.

6. 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 nine months ended September 30, 2006 and 2005, 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 September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Basic common shares outstanding	46,549	47,303	46,659	48,166
Dilutive effect of stock options	191	303	253	287
Dilutive effect of unvested restricted stock	414	377	316	363
Dilutive effect of Convertible Debt Securities				
Diluted common shares outstanding	47,154	47,983	47,228	48,816

Potentially dilutive common shares related to stock options and unvested shares of restricted stock of 0.3 million and 0.8 million for the three months ended September 30, 2006 and 2005, respectively, and 0.3 million and 1.1 million during the nine months ended September 30, 2006 and 2005, respectively, were excluded from the computation of diluted EPS as their effect was antidilutive.

We calculate the potential dilutive effect of our Convertible Debt Securities using the treasury stock method. Under the treasury stock method, we have experienced no dilution related to the Convertible Debt Securities since their issuance in June 2004, as our quarterly average stock price has not exceeded the current effective conversion price of \$26.77 per share during any period. In future periods, the Convertible Debt Securities will impact our diluted earnings per share calculation only in those quarterly periods in which our average stock price exceeds the then current effective conversion price.

Table of Contents**7. COMPREHENSIVE INCOME**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	\$ 13,604	\$ 13,502	\$ 44,675	\$ 30,630
Other comprehensive income (loss), net of tax, if any:				
Foreign currency translation adjustments		(748)		(2,668)
Unrealized gain (loss) on short-term investments	(10)	13	(46)	9
Comprehensive income	\$ 13,594	\$ 12,767	\$ 44,629	\$ 27,971

8. ACQUISITION

Description of the Acquisition. On March 1, 2006, we acquired 100% of the voting equity interests of Telution, Inc. (Telution) for \$20.4 million in cash (net of \$1.6 million in acquired cash), plus \$0.4 million in acquisition costs. Telution is a Chicago-based provider of operations support system (OSS) technologies that enable communications companies to bring bundled, advanced services to market quickly and effectively. We acquired Telution and its COMX solution to expand our ability to support communication providers as they deliver advanced and IP-based services.

Purchase Price. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands), and the estimated lives of the acquired intangible assets. Amortization expense related to the acquired intangible assets is recognized on a straight-line basis, which approximates the pattern in which the economic benefits of the acquired intangible assets are expected to be received.

	Amount	Weighted-Average Estimated Lives (months)
Current assets (includes cash and cash equivalents of \$1,618)	\$ 3,566	
Fixed assets	570	
Acquired software	8,769	84
Acquired client contracts and other	504	14
Acquired customer relationships	2,134	60
Goodwill	13,605	
Non-current deferred income tax asset	5,168	
Other non-current assets	2	
Total assets acquired	34,318	
Current liabilities	(2,607)	
Non-current deferred income tax liability	(4,317)	
Total liabilities assumed	(6,924)	
Net assets acquired	\$ 27,394	

As of June 30, 2006, we had received the necessary information to substantially complete our Telution purchase accounting. During the second quarter of 2006, the Telution goodwill amount was adjusted downward by \$1.2 million, due primarily to the finalization of the value of certain Federal and state net operating loss (NOL) carryforwards.

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In addition to the cash paid at closing, the Telution stock purchase agreement includes provisions for: (i) additional purchase price payments of up to \$5 million, contingent upon the achievement of various milestones related to the integration of Telution's COMX solution with our ACP product during 2006 and 2007 (the Integration Earn

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Outs); and (ii) additional purchase price payments of up to \$3 million, contingent upon the signing of certain revenue arrangements with certain clients (the Revenue Earn Outs).

In previous periods, the Integration Earn Outs were not reflected as part of the Telution purchase price as the events related to the contingencies had not yet been resolved, nor had the outcome of the contingencies been determined beyond a reasonable doubt. In August 2006, we made an \$0.8 million Integration Earn Outs payment as the first integration milestone was met. In addition, effective September 30, 2006, we amended the Telution stock purchase agreement to remove the milestone contingencies related to the remaining Integration Earn Outs. As a result of this amendment, we have recorded a liability in our September 30, 2006 condensed consolidated balance sheet for the remaining \$4.2 million of Integration Earn Outs. The \$0.8 million Integration Earn Outs payment in August 2006 and the \$4.2 million Integration Earn Outs liability, which will be paid out in equal installments through December 31, 2007, have been reflected as additional Telution purchase price as of September 30, 2006, with a corresponding \$5 million increase in goodwill attributable to the Telution acquisition.

The right to contingent purchase price payments related to the Revenue Earn Outs expires December 31, 2008. As of September 30, 2006, the additional purchase price payments related to the Revenue Earn Outs have not been reflected in the Telution purchase price. The contingent payments related to revenue will be recorded as additional purchase price if and when the events associated with the contingencies are resolved or the outcome of the contingencies are determined beyond a reasonable doubt.

Goodwill represents the excess of the cost of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. The Telution goodwill and acquired intangible assets are not deductible for income tax purposes. In accordance with SFAS No. 109, Accounting for Income Taxes , we have recognized a deferred tax liability of \$4.3 million for the difference between the assigned book value and the tax basis of the acquired intangible assets, but have not recognized a deferred tax liability for the difference between the assigned book value and the tax basis of goodwill. Included in the net assets acquired are: (i) a \$4.4 million deferred income tax asset related to a Federal NOL carryforward of \$12.4 million which we believe is more likely than not to be realized over 5 years; and (ii) a \$0.6 million deferred income tax asset related to a state NOL carryforward of \$8.1 million which is expected to be utilized within the 20-year carryforward period. The Telution Federal NOL carryforward begins to expire in 2020.

The results of operations of Telution are included in the accompanying Condensed Consolidated Statements of Income for the period subsequent to the acquisition date. Pro forma information on our historical results of operations to reflect the acquisition of Telution is not presented as Telution s results of operations during prior periods are not material to our results of operations.

9. DEBT

Our long-term debt as of September 30, 2006 and December 31, 2005 consists of the Convertible Debt Securities. As of September 30, 2006: (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 in compliance with the provisions of the bond indenture related to the Convertible Debt Securities.

As of September 30, 2006, and as it relates to our \$100 million 2004 Revolving Credit Facility, we: (i) have made no borrowings; (ii) are in compliance with the financial ratios and other covenants; and (iii) have the entire \$100 million available to us.

10. LONG-LIVED ASSETS

Goodwill. The change in the carrying amount of goodwill for the nine months ended September 30, 2006, relating to goodwill resulting from the Telution acquisition (see Note 8), was as follows (in thousands):

January 1, 2006, balance	\$ 623
Goodwill acquired during period	13,605
September 30, 2006, balance	\$ 14,228

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Other Intangible Assets. Our intangible assets subject to ongoing amortization consist primarily of client contracts and software. As of September 30, 2006 and December 31, 2005, the carrying values of these assets were as follows (in thousands):

	September 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Client contracts and other	\$ 114,401	\$ (78,533)	\$ 35,868	\$ 110,295	\$ (68,634)	\$ 41,661
Software	40,714	(32,676)	8,038	31,945	(31,945)	
Total	\$ 155,115	\$ (111,209)	\$ 43,906	\$ 142,240	\$ (100,579)	\$ 41,661

The increase in the gross carrying amount of the software intangible assets during the nine months ended September 30, 2006 is the result of the Telution acquisition (see Note 8).

The total amortization expense related to intangible assets for the three months ended September 30, 2006 and 2005 was \$4.1 million and \$3.5 million, respectively, and for the nine months ended September 30, 2006 and 2005 was \$11.6 million and \$10.2 million, respectively. Of the net client contracts asset amount as of September 30, 2006, approximately \$26 million relates to the Comcast Contract. Based on the September 30, 2006 net carrying value of our intangible assets, the estimated total amortization expense for each of the five succeeding fiscal years ending December 31 are: 2006 \$15.6 million; 2007 \$16.2 million; 2008 \$14.6 million; 2009 \$2.7 million; and 2010 \$2.4 million.

11. RESTRUCTURING CHARGES

During the three and nine months ended September 30, 2006, we recorded restructuring charges of \$0.1 million and \$2.4 million, respectively. Restructuring charges in the three and nine months ended September 30, 2005 were minimal. The restructuring charges have been reflected as a separate line item in the accompanying Condensed Consolidated Statements of Income. The components of the restructuring charges are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Involuntary employee terminations	\$ 56	\$	\$ 1,668	\$
Facility abandonments	21	3	744	9
Other	1		(44)	
	\$ 78	\$ 3	\$ 2,368	\$ 9

The activity in the business restructuring reserves related to continuing operations during the nine months ended September 30, 2006 is as follows (in thousands):

	Termination Benefits	Facility Abandonments	Other	Total
	January 1, 2006, balance	\$ 1,904	\$ 257	\$ 5,427
Charged to expense during the period	1,668	744	(44)	2,368
Cash payments	(3,452)	(682)	(4,429)	(8,563)
Other	237	(222)	46	61
September 30, 2006, balance	\$ 357	\$ 97	\$ 1,000	\$ 1,454

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As of September 30, 2006, primarily all of the \$1.5 million business restructuring reserve balance was included in current liabilities. The large cash payments reflected in other in the above table represent: (i) \$3.0 million in contract termination fees paid to FairPoint Communications, Inc. (FairPoint) related to amendments executed in November 2005 to terminate its long-term processing agreement; and (ii) the payment of incentive bonuses to certain members of our management team involved in the sale of the GSS Business (see Note 3). As of September 30, 2006, we have one remaining \$1.0 million payment to FairPoint, which is included in the restructuring reserve balance shown above.

12. COMMITMENTS, GUARANTEES AND CONTINGENCIES

Executive Retirement Benefits. In December 2004, we announced that our then Chairman of the Board of Directors (the Chairman) and Chief Executive Officer (CEO) would retire on June 30, 2005. In consideration for certain changes to the Chairman and CEO s employment agreement and for post-termination consulting services to be provided, we agreed to pay the Chairman and CEO a total of \$9.6 million, of which \$5.6 million was paid on January 2, 2006, \$2.0 million was paid on June 30, 2006, and \$2.0 million is scheduled to be paid on January 2, 2007. During the three months ended September 30, 2006 and 2005, expense recognized related to his retirement package was approximately \$39,000 and \$181,000, respectively, and during the nine months ended September 30, 2006 and 2005 was \$0.2 million and \$8.7 million, respectively.

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 Indemnifications. Our software arrangements generally include a product indemnification provision that will indemnify and defend a client in actions brought against the client that claim our products infringe upon a copyright, trade secret, or valid patent. Historically, we have not incurred any significant costs related to product 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 September 30, 2006, 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 (see Note 3), 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 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.

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Following the guidelines of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others - An Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34, 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. The indemnification liability as of September 30, 2006 and December 31, 2005 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 September 30, 2006. 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.

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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, 2005 (our 2005 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 improving financial condition of service providers, are resulting in a more positive outlook for the demand for scalable, flexible and cost efficient customer care and billing solutions, which we believe will provide 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 market share and processing revenues in this area, as generally speaking, these companies do not currently use our products and services.

Sale of GSS and plaNet Businesses

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. (Comverse); 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 reflected the results of operations for the GSS Business and plaNet Business 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.

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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 unique 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.

A summary of our results of operations for the third quarter of 2006 is as follows:

Our revenues for the third quarter of 2006 were \$98.5 million, up 4.6% when compared to \$94.1 million for the same period in 2005, and up 3.6% when compared to \$95.0 million for the second quarter of 2006.

Our operating expenses for the third quarter of 2006 were \$75.9 million, up 8.7% when compared to \$69.9 million for the same period in 2005, and up 3.6% when compared to \$73.3 million for the second quarter of 2006.

The year-over-year increase in operating expenses relates primarily to: (i) the impact of the acquisition of Telution, Inc. (Telution) in March 2006; and (ii) an increase in employee-related costs, primarily as a result of an increase in staff levels between periods and merit-wage increases that went into effect in August 2006.

The increase in operating expenses between the second and third quarters of 2006 is primarily due to an increase in employee-related costs, largely as a result of merit-wage increases that went into effect in August 2006.

Income from continuing operations (net of tax) for the third quarter of 2006 was \$17.4 million, or \$0.37 per diluted share, an increase of 17.2% when compared to \$14.8 million, or \$0.31 per diluted share, for the same period in 2005, and an increase of 11.3% when compared to \$15.6 million, or \$0.33 per diluted share for the second quarter of 2006. The increase in income from continuing operations (net of tax) between sequential quarters is primarily due to an increase in revenues between periods.

Additionally, income from continuing operations (net of tax) for the second and third quarters of 2006 included \$5.3 million and \$6.0 million, respectively, of interest and investment income, which is significantly greater than the amount in the third quarter of 2005. The increase in interest and investment income in 2006 is a result of a significant increase in our cash and short-term investment balances between years, which is primarily the result of the cash proceeds received from the sale of the GSS Business in December 2005.

During the third quarter of 2006, we made a \$6.0 million payment to Comverse related to the settlement of a dispute over a joint tax election associated with the sale of our GSS Business to Comverse in December 2005. This payment to Comverse was considered a reduction in the purchase price previously paid by Comverse, and thus is reflected as part of discontinued operations. As a result, we have a loss from discontinued operations (net of tax) for the third quarter of 2006 of \$3.8 million, or \$0.08 per diluted share.

Net income (which includes the results of discontinued operations, as applicable) for the third quarter of 2006 was \$13.6 million, or \$0.29 per diluted share, an increase of 0.8% when compared to \$13.5 million, or \$0.28 per diluted share, for the same period in 2005, and a decrease of 12.8% when compared to the second quarter of 2006 net income of \$15.6 million, or \$0.33 per diluted share. The decrease in net income between sequential quarters relates to the loss from discontinued operations in the third quarter of 2006, as discussed above.

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Net income for the third quarter of 2006 includes stock-based compensation expense of \$3.1 million, depreciation expense of \$2.6 million, and amortization of intangible assets of \$4.1 million. These non-cash charges totaled \$9.8 million (pretax impact), or \$0.14 per diluted share. Income from continuing operations for the third quarter of 2005 included stock-based compensation expense of \$3.1 million, depreciation expense of \$2.3 million, and amortization of intangible assets of \$3.5 million. These non-cash charges totaled \$8.9 million (pretax impact), or \$0.12 per diluted share.

We continue to generate strong cash flows from our operations. As of September 30, 2006, we had cash, cash equivalents, and short-term investments of \$414.9 million, as compared to \$414.3 million as of June 30, 2006, and \$392.2 million as of December 31, 2005.

Cash flows from operating activities for the third quarter of 2006 were \$28.6 million, compared to \$24.7 million for the third quarter of 2005, and \$38.7 million for the second quarter of 2006, with the fluctuation between periods related primarily to changes in trade account receivables. 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 September 30, 2006 were 44.8 million, relatively unchanged from 44.7 million as of September 30, 2005 and 44.9 million as of June 30, 2006. The annualized revenue per processing unit ([ARPU](#)) for the third quarter of 2006 was \$8.08, compared to \$7.86 for the third quarter of 2005, and \$7.79 for the second quarter of 2006. The third quarter 2006 ARPU includes \$0.10 related to the higher revenues from Adelpia, discussed in further detail in the [Significant Client Relationships](#) section below.

To date, over three-fourths of the cable customer accounts processed on our systems have been migrated to our ACP platform. We expect to migrate the remaining cable customer accounts to the ACP platform by the end of 2007. See the [Business](#) section of our 2005 10-K for additional discussion of this effort.

In August 2006, we implemented our \$350 million Rule 10b5-1 stock repurchase plan. During the quarter, we repurchased 0.8 million shares of our common stock for \$21.9 million (weighted-average price of \$26.69 per share), leaving \$328.1 million of share repurchases still authorized under our Rule 10b5-1 stock repurchase plan as of September 30, 2006.

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 historical revenues have been generated from a limited number of clients, with over 70% of our revenues being generated from our largest clients, which include Comcast Corporation ([Comcast](#)), EchoStar Communications Corporation ([EchoStar](#)), Time Warner Inc. ([Time Warner](#)), Charter Communications ([Charter](#)), and Adelpia Communications ([Adelpia](#)). Revenues from these clients represented the following percentages of our total revenues for the three months ended September 30, 2006, June 30, 2006, and September 30, 2005:

	September 30,	Three Months Ended	
	2006	June 30,	September 30,
	2006	2006	2005
Comcast	23%	24%	22%
EchoStar	20%	19%	21%
Time Warner (1)	13%	10%	10%
Charter	11%	11%	10%
Adelpia (1)	6%	8%	9%

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- (1) The increase in our percentage of revenues generated from Time Warner and related decrease in our percentage of revenues generated from Adelphia for the three months ended September 30, 2006 is due to the sale of Adelphia's broadband business to Comcast and Time Warner on July 31, 2006, as discussed below.

As of September 30, 2006, December 31, 2005, and September 30, 2005, the percentages of net billed accounts receivable balances attributable to our largest clients were as follows:

	September 30, 2006	As of December 31, 2005	September 30, 2005
Comcast (2)	24%	21%	25%
EchoStar	28%	29%	24%
Time Warner (2)	13%	9%	11%
Charter	10%	11%	11%
Adelphia (2)	0%	6%	7%

- (2) The shift in accounts receivable from Adelphia to Comcast and Time Warner for the three months ended September 30, 2006 is due to the sale of Adelphia's broadband business to Comcast and Time Warner on July 31, 2006, as discussed below.

See our 2005 10-K for additional discussion of our business relationships with the above mentioned significant clients.

Sale of Adelphia Assets. As discussed in our 2005 10-K and previously filed 2006 Form 10-Qs, as expected, Adelphia completed the sale of its broadband assets to Comcast and Time Warner on July 31, 2006. Prior to the closing of this transaction, we processed approximately three million Adelphia domestic broadband customer accounts (the Acquired Customer Accounts) on our systems under a contract that ran through March 2009. Upon closing of this transaction, the Acquired Customer Accounts we processed remained on our systems and were transferred to the respective Comcast and Time Warner contracts. This transaction had the following impacts to our business for the third quarter of 2006:

In August 2006, we recognized \$2.8 million of one-time, non-recurring revenues related to the Adelphia contract when the Acquired Customer Accounts were transferred under our Comcast and Time Warner contracts. These revenues included items such as upfront payments for services that were previously deferred and were being recognized ratably over the remaining term of the Adelphia contract.

Our monthly processing revenues related to the Acquired Customer Accounts were approximately \$1.8 million lower in the third quarter of 2006 when compared to the second quarter of 2006 due to the Comcast and Time Warner contracts having lower per unit pricing than the Adelphia contract (due to the relative size of Comcast and Time Warner when compared to Adelphia). The \$1.8 million reflects two months of invoices in the third quarter at the lower per unit pricing for these Acquired Customer Accounts. These two items combined resulted in a net increase in processing revenues of approximately \$1 million for the third quarter of 2006, when compared to that of the second quarter of 2006.

Although there was some movement of customer accounts between Comcast and Time Warner as the result of this transaction, it had minimal impact on the overall number of customer accounts processed on our systems as of the end of the third quarter of 2006.

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The revenues in the fourth quarter of 2006 related to the Acquired Customer Accounts are expected to be approximately \$3.5 million lower than the corresponding revenue in the third quarter of 2006. The decrease is due to: (i) the \$2.8 million of one-time, non-recurring revenues recognized in the third quarter; and (ii) the Comcast and Time Warner lower per unit pricing being applicable to three months in the fourth quarter as compared to only two months in the third quarter. Although there is expected to be some additional movement of customer accounts between Comcast and Time Warner as the final terms of the transaction are worked out, we expect this to have minimal impact on the overall number of customer accounts processed on our systems.

Risk of Client Concentration. Going forward, 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 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 third quarter of 2006, we repurchased 820,000 shares of our stock, at a total price of \$21.9 million, or approximately \$26.69 per share under our Stock Repurchase Program. As a result, as of September 30, 2006, the remaining number of shares authorized for repurchase under the Stock Repurchase Program is 15.1 million shares.

In August 2006, we established a new Rule 10b5-1 Plan to facilitate the repurchase of \$350 million of our common stock under our Stock Repurchase Program. Any shares repurchased under this Rule 10b5-1 Plan are counted towards the 30 million share limit authorized under the Stock Repurchase Program.

The number of shares repurchased under our new Rule 10b5-1 Plan is based upon predetermined factors that were established when we implemented the plan in August 2006. Over time, there will likely be some variability around the share repurchases based upon changing market conditions, as well as the trading volume of our stock. We remain committed to completing the repurchase of \$350 million of our outstanding common stock, but the time period may extend beyond our original estimate of 12-15 months due to various market factors that may impact the pace at which we buy back our common stock.

See Note 5 to our Financial Statements for further discussion of our Stock Repurchase Program.

Table of Contents**Stock-Based Compensation Expense**

Stock-based compensation expense is included in the following income statement captions in the accompanying Financial Statements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Continuing Operations:				
Cost of processing and related services	\$ 1,097	\$ 818	\$ 3,301	\$ 2,420
Cost of software, maintenance and services	176	215	530	544
Research and development	436	311	1,120	829
Selling, general and administrative	1,377	1,785	4,163	6,060
Total continuing operations (1)	3,085	3,129	9,114	9,853
Discontinued operations		899		2,825
Total stock-based compensation expense	\$ 3,085	\$ 4,028	\$ 9,114	\$ 12,678

- (1) The decrease in stock-based compensation expense for continuing operations between periods is due primarily to certain equity awards held by key members of our management team having a change of control provision that was triggered upon the closing of the sale of the GSS Business in the fourth quarter of 2005, which resulted in accelerated vesting for the equity awards impacted. This decrease is offset to a certain degree by additional stock-based compensation for equity awards granted in 2006.

See Notes 2 and 4 to our Financial Statements for further discussion of our stock-based compensation expense.

Critical Accounting Policies

The preparation of our Financial Statements in conformity with accounting principles generally accepted in the U.S. 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 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 2005 10-K.

Results of Operations

Total Revenues. Total revenues for the: (i) three months ended September 30, 2006 increased 4.6% to \$98.5 million, from \$94.1 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased 0.8% to \$286.5 million, from \$284.1 million for the nine months ended September 30, 2005. 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 September 30, 2006 increased \$2.8 million or 3.2% to \$90.3 million, from \$87.5 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased \$5.0 million or 1.9% to \$264.4 million, from \$259.4 million for the nine months ended September 30, 2005.

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The increase in processing and related services revenues between the three months ended September 30, 2006 and 2005 is primarily due to: (i) higher usage of marketing services and various ancillary customer care solutions by our clients, which include things such as professional services, system interfaces, and reporting tools; and (ii) the net \$1 million increase in revenues from the Adelpia Acquired Customer Accounts, as discussed above. These increases are offset to a certain degree by the lower processing revenues from EchoStar in 2006 due to new contract pricing that became effective November 1, 2005.

The increase in processing and related services revenues between the nine months ended September 30, 2006 and 2005 is primarily due to: (i) an increase in the number of customer accounts processed on our systems between periods; (ii) higher revenues related to marketing services and various customer care solutions in 2006; and (iii) the net \$1 million increase in revenues from the Adelpia Acquired Customer Accounts, as discussed above. These increases are offset to a certain degree by: (i) lower processing

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revenues in 2006 from EchoStar due to new contract pricing becoming effective November 1, 2005; and (ii) \$2.3 million related to contract termination and bankruptcy settlements recorded in 2005, with no comparable amount in 2006.

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 September 30, 2006 and 2005 was \$3.3 million and \$3.2 million, respectively; and (ii) nine months ended September 30, 2006 and 2005 was \$9.9 million and \$9.5 million, respectively.

Total customer accounts processed on our systems as of September 30, 2006 were 44.8 million, up slightly when compared to 44.7 million as of September 30, 2005. Total customer accounts processed on our systems as of June 30, 2006 were 44.9 million. As noted above, the impact of the closing of the Adelpia transaction had minimal impact on the overall number of customer accounts processed on our systems as of the end of the third quarter of 2006.

The ARPU for the third quarter of 2006 was \$8.08, compared to \$7.86 for the third quarter of 2005 and \$7.79 for the second quarter of 2006. ARPU for the third quarter of 2006 includes an approximate \$0.10 impact from the net \$1 million increase in revenues from the Adelpia Acquired Customer Accounts, as discussed above. The remaining portion of the sequential ARPU increase is due to continued high usage of marketing services and various ancillary customer care solutions by our clients, which includes such things as professional services, system interfaces, and reporting tools.

As noted above, we expect the revenues related to the Adelpia Acquired Customer Accounts to be approximately \$3.5 million lower in the fourth quarter of 2006, when compared to the third quarter of 2006. This will have the affect of lowering our ARPU by approximately \$0.30 in the fourth quarter when compared to the third quarter.

Software, Maintenance and Services Revenues. Software, maintenance and services revenues for the: (i) three months ended September 30, 2006 increased \$1.6 million or 23.6% to \$8.2 million, from \$6.6 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 decreased \$2.6 million or 10.8% to \$22.1 million, from \$24.7 million for the nine months ended September 30, 2005.

The \$1.6 million increase in software, maintenance and services revenues between the three months ended September 30, 2006 and 2005 is primarily due to revenues generated as a result of the Telution acquisition.

The \$2.6 million decrease in software, maintenance and services revenues between the nine months ended September 30, 2006 and 2005 is due primarily to several large software transactions in 2005 (primarily during the first and second quarters) for our workforce automation and call center products, with no comparable amounts in 2006. This decrease is offset to a certain degree by the revenues generated as a result of the Telution acquisition.

Cost of Revenues. See our 2005 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 September 30, 2006 increased \$2.4 million or 5.7% to \$44.9 million, from \$42.5 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased \$3.3 million or 2.6% to \$129.4 million, from \$126.1 million, for the nine months ended September 30, 2005. The increases between periods are primarily due to an increase in employee-related costs, primarily as a result of an increase in staff levels and merit wage increases. The gross margin percentage for processing and related services was: (i) 50.3% for the three months ended September 30, 2006 compared to 51.5% for the three months ended September 30, 2005; and (ii) 51.0% for the nine months ended September 30, 2006 compared to 51.4% for the nine months ended September 30, 2005.

Cost of Software, Maintenance and Services. The cost of software, maintenance and services for the: (i) three months ended September 30, 2006 increased 26.7% to \$5.8 million, from \$4.6 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased 6.2% to \$15.6 million, from \$14.6 million for the nine

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months ended September 30, 2005. The increases between periods is due primarily to the acquisition of Telution in March 2006, to include the amortization of the Telution acquired intangible assets. The year-to-date increase is offset to a certain degree by a decrease in third party software costs due to lower software revenues in the 2006, as compared to 2005.

The gross margin percentage for software, maintenance and services was: (i) 28.7% for the three months ended September 30, 2006, as compared to 30.4% for the three months ended September 30, 2005; and (ii) 29.5% for the nine months ended September 30, 2006, as compared to 40.8% for the nine months ended September 30, 2005. The decrease in the year-to-date gross margin percentages is attributed primarily to lower revenues in the first nine months of 2006 as compared to the first nine months of 2005, as noted above.

Gross Margin (Exclusive of Depreciation). The overall gross margin percentage (exclusive of depreciation) for the: (i) three months ended September 30, 2006 was 48.5%, compared to 50.0% for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 was 49.4%, compared to 50.5% for the nine months ended September 30, 2005. 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 September 30, 2006 increased 34.3% to \$12.1 million, from \$9.0 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased 32.2% to \$32.9 million, from \$24.9 million for the nine months ended September 30, 2005. The increase between periods is primarily due to an increase in employees, to include the development personnel that came over in the acquisition of Telution. As a percentage of total revenues, R&D expense was: (i) 12.3% for the three months ended September 30, 2006, compared to 9.6% for the three months ended September 30, 2005; and (ii) 11.5% for the nine months ended September 30, 2006, compared to 8.8% for the nine months ended September 30, 2005. We did not capitalize any internal software development costs during the three and nine months ended September 30, 2006 and 2005.

During the first nine months of 2006, we focused our development and enhancement efforts on various R&D projects, consisting principally of enhancements to ACP and related software products, to include the integration of the Telution COMX product with ACP, targeted to increase the functionalities and features of our products, including those necessary to service new and expanded product offerings (e.g., VoIP, commercial services, etc.). At this time, we expect our future R&D efforts to continue to focus on similar tasks as noted above, and we expect our investment in R&D to approximate our historical investment rate of 10-12% of total revenues. However, in the near term, we expect this percentage to be at the top end of this range.

Selling, General and Administrative (SG&A) Expense. SG&A expense for the: (i) three months ended September 30, 2006 decreased 8.9% to \$10.4 million, from \$11.5 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2005, decreased 22.1% to \$32.0 million, from \$41.1 million for the nine months ended September 30, 2005. The nine month year-over-year decrease in SG&A expense relates primarily to the accrual of retirement benefits for our former CEO of \$0.2 million and \$8.7 million, respectively, for the nine months ended September 30, 2006 and 2005.

Depreciation Expense. Depreciation expense for the: (i) three months ended September 30, 2006 increased 11.9% to \$2.6 million, compared to the \$2.3 million for the three months ended September 30, 2005; and (ii) nine months ended September 30, 2006 increased 3.2% to \$7.7 million, from \$7.4 million for the nine months ended September 30, 2005. The capital expenditures during the three and nine months ended September 30, 2006 consisted principally of: (i) computer hardware and related equipment; and (ii) internal infrastructure items. Depreciation expense for all property and equipment is reflected separately in the aggregate and is not included in the cost of