

EPICOR SOFTWARE CORP  
Form 10-Q  
August 06, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2010

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 No. 000-20740

**EPICOR SOFTWARE CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**33-0277592**  
(IRS Employer  
Identification No.)

**18200 Von Karman Avenue**

**Suite 1000**

**Irvine, California 92612**

(Address of principal executive offices, zip code)

**Registrant's telephone number, including area code: (949) 585-4000**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of August 1, 2010, there were 63,306,979 shares of common stock outstanding.

**Table of Contents**

**FORM 10-Q INDEX**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009</u>	3
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three and Six Months Ended June 30, 2010 and 2009</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2010 and 2009</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	46
Item 4. <u>Controls and Procedures</u>	47
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	48
Item 1A. <u>Risk Factors</u>	48
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	48
Item 6. <u>Exhibits</u>	48
<b><u>SIGNATURE</u></b>	49
<u>Exhibit Index</u>	50

**Table of Contents****Part I****FINANCIAL INFORMATION****Item 1 Financial Statements:****EPICOR SOFTWARE CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands)*

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(Unaudited)</i>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 109,373	\$ 106,861
Accounts receivable, net of allowance for doubtful accounts	85,357	90,011
Deferred income taxes	24,942	11,572
Inventory, net	3,033	1,819
Prepaid expenses and other current assets	18,161	13,976
Total current assets	240,866	224,239
Property and equipment, net	26,878	28,511
Deferred income taxes	21,425	21,867
Intangible assets, net	69,690	84,107
Goodwill	367,826	368,336
Other assets	9,974	10,990
Total assets	\$ 736,659	\$ 738,050
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 16,504	\$ 13,966
Accrued compensation and benefits	15,261	21,790
Other accrued expenses	24,438	24,964
Current portion of long-term debt	214	202
Current portion of accrued restructuring costs	1,631	1,694
Current portion of deferred revenue	99,079	96,040
Total current liabilities	157,127	158,656
Long-term debt, less current portion	254,607	255,535
Accrued restructuring costs	5,035	4,423
Deferred revenue	368	392
Deferred income taxes and other income taxes	14,594	15,172
Other long-term liabilities	3,131	3,785
Total long-term liabilities	277,735	279,307

Commitments and contingencies (Note 12)

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Stockholders' equity:		
Common stock	66	63
Additional paid-in capital	431,346	422,460
Less: treasury stock at cost	(23,298)	(20,670)
Accumulated other comprehensive loss	(8,331)	(4,825)
Accumulated deficit	(97,986)	(96,941)
<b>Total stockholders' equity</b>	<b>301,797</b>	<b>300,087</b>
Total liabilities and stockholders' equity	\$ 736,659	\$ 738,050

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**EPICOR SOFTWARE CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE LOSS**

*(in thousands, except per share amounts)*

*(Unaudited)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenues:</b>				
License	\$ 19,160	\$ 17,533	\$ 35,396	\$ 30,710
Consulting	34,344	32,061	65,433	63,512
Maintenance	47,503	47,340	95,463	94,206
Hardware and other	8,158	3,513	12,154	10,711
<b>Total revenues</b>	<b>109,165</b>	<b>100,447</b>	<b>208,446</b>	<b>199,139</b>
Cost of revenues	51,638	44,009	96,422	90,192
Amortization of intangible assets	7,051	8,221	14,108	16,626
<b>Total cost of revenues</b>	<b>58,689</b>	<b>52,230</b>	<b>110,530</b>	<b>106,818</b>
<b>Gross profit</b>	<b>50,476</b>	<b>48,217</b>	<b>97,916</b>	<b>92,321</b>
<b>Operating expenses:</b>				
Sales and marketing	20,595	18,151	41,729	36,241
Software development	13,656	12,432	27,535	24,838
General and administrative	11,940	14,033	24,155	28,224
Restructuring charges and other	2,626	(204)	2,671	1,207
<b>Total operating expenses</b>	<b>48,817</b>	<b>44,412</b>	<b>96,090</b>	<b>90,510</b>
<b>Income from operations</b>	<b>1,659</b>	<b>3,805</b>	<b>1,826</b>	<b>1,811</b>
Interest expense	(5,003)	(4,877)	(9,960)	(10,870)
Interest and other income (expense), net	14	(65)	(1,292)	(231)
<b>Loss before income taxes</b>	<b>(3,330)</b>	<b>(1,137)</b>	<b>(9,426)</b>	<b>(9,290)</b>
Income tax provision (benefit)	(2,318)	5,543	(8,382)	(982)
<b>Net loss</b>	<b>\$ (1,012)</b>	<b>\$ (6,680)</b>	<b>\$ (1,044)</b>	<b>\$ (8,308)</b>
<b>Comprehensive loss:</b>				
Net loss	\$ (1,012)	\$ (6,680)	\$ (1,044)	\$ (8,308)
Unrealized foreign currency translation gain (loss)	(2,194)	2,154	(3,506)	(508)
Net unrealized gain (loss) on derivative financial instruments, net of tax		94		(15)
Net unrealized loss on defined benefit pension plan liabilities, net of tax		(35)		(48)
<b>Comprehensive loss</b>	<b>\$ (3,206)</b>	<b>\$ (4,467)</b>	<b>\$ (4,550)</b>	<b>\$ (8,879)</b>
<b>Net loss per share:</b>				
Basic	\$ (0.02)	\$ (0.11)	\$ (0.02)	\$ (0.14)

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Diluted	\$ (0.02)	\$ (0.11)	\$ (0.02)	\$ (0.14)
Weighted average common shares outstanding:				
Basic	58,990	59,486	58,813	59,237
Diluted	58,990	59,486	58,813	59,237

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents****EPICOR SOFTWARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(in thousands)**(Unaudited)*

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Net loss	\$ (1,044)	\$ (8,308)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	17,794	20,745
Stock-based compensation expense	7,740	4,062
Provision for doubtful accounts	546	2,102
Provision for excess and obsolete inventory	16	199
Amortization and write-off of debt issuance fees	848	1,861
Amortization of long-term debt discount	4,172	3,882
Change in deferred taxes	(353)	(3,293)
Restructuring charges and other	2,671	1,207
Change in fair value of derivatives	(142)	
Excess tax benefits from share-based payment arrangements	(659)	(2)
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts receivable	2,341	4,886
Inventory	(1,229)	1,799
Prepaid expenses and other current assets	(4,368)	(2,145)
Other assets	(19)	(353)
Income taxes payable	(10,424)	(2,066)
Accounts payable	2,838	(968)
Accrued expenses	(8,534)	(5,620)
Accrued restructuring costs	(1,763)	(3,853)
Deferred revenue	4,348	(630)
Other long-term liabilities	(555)	2,217
<b>Net cash provided by operating activities</b>	<b>14,224</b>	<b>15,722</b>
<b>Investing activities</b>		
Purchases of property and equipment	(2,207)	(2,039)
Cash paid for business combinations	(684)	(953)
<b>Net cash used in investing activities</b>	<b>(2,891)</b>	<b>(2,992)</b>
<b>Financing activities</b>		
Principal payments on long-term debt	(5,104)	(16,065)
Proceeds from exercise of stock options	240	9
Proceeds from employee stock purchase plan	271	244
Excess tax benefits from share-based payment arrangements	659	2
Purchase of treasury stock	(2,628)	(980)
<b>Net cash used in financing activities</b>	<b>(6,562)</b>	<b>(16,790)</b>
<b>Effect of exchange rate changes on cash</b>	<b>(2,259)</b>	<b>332</b>



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Net increase (decrease) in cash and cash equivalents	2,512	(3,728)
Cash and cash equivalents at beginning of period	106,861	89,764
Cash and cash equivalents at end of period	\$ 109,373	\$ 86,036

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2010****Note 1. Basis of Presentation**

The accompanying Unaudited Condensed Consolidated Financial Statements included herein have been prepared by Epicor Software Corporation (the Company) in conformity with accounting principles generally accepted in the United States of America (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial information for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

In the opinion of management, the Unaudited Condensed Consolidated Financial Statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations and cash flows.

The results of operations for the three and six months ended June 30, 2010, are not necessarily indicative of the results of operations that may be reported for any other interim period or for the entire year ending December 31, 2010. The Condensed Consolidated Balance Sheet at December 31, 2009, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements, as permitted by SEC rules and regulations for interim reporting.

Inventory is comprised solely of finished goods. Accounts receivable is net of allowance for doubtful accounts of \$6,794,000 and \$8,557,000 at June 30, 2010 and December 31, 2009, respectively.

**Note 2. Basic and Diluted Net Loss Per Share**

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period, excluding shares of unvested restricted stock. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of common and potential common shares outstanding during the period if their effect is dilutive.

The following table computes basic and diluted net loss per share (*in thousands, except per share amounts*):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net loss applicable to common stockholders	\$ (1,012)	\$ (6,680)	\$ (1,044)	\$ (8,308)
Basic:				
Weighted average common shares outstanding	63,271	62,678	62,953	62,392
Weighted average common shares of unvested restricted stock	(4,281)	(3,192)	(4,140)	(3,155)
Shares used in the computation of basic and diluted net loss per share	58,990	59,486	58,813	59,237
Net loss per share applicable to common stockholders - basic and diluted	\$ (0.02)	\$ (0.11)	\$ (0.02)	\$ (0.14)

Due to net losses for all periods presented, the assumed exercise of stock options, employee stock purchase plan shares and unvested restricted stock had an anti-dilutive effect and therefore these potential common shares were excluded from the computation of diluted loss per share. On May 8, 2007, the Company closed an offering of \$230 million aggregate principal amount of convertible senior notes (Note 7). The notes are only dilutive when the common stock price exceeds the conversion price of approximately \$18.10 per share, therefore, no shares have been



**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

included in the calculation of diluted net loss per share as the conversion value did not exceed the principal amount of the notes.

**Note 3. Goodwill and Intangible Assets**

In acquisitions accounted for using the purchase method, goodwill was recorded for the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net assets acquired. In acquisitions accounted for using the acquisition method, goodwill is recorded as the excess, if any, of the consideration transferred plus the fair value of any non-controlling interest in the acquiree over the fair value of the identifiable net assets acquired. An annual review of goodwill and indefinite-lived intangibles is required for possible impairment. The Company performed its annual impairment review of its recorded goodwill in the fourth quarter of 2009, and determined that no impairment of goodwill existed at that time because the estimated fair value of each reporting unit exceeded its carrying amount. The Company monitors the indicators for goodwill impairment testing between annual tests. Certain adverse business conditions impacting one or more of the Company's reporting units would cause the Company to test goodwill for impairment on an interim basis. No such events occurred during the six months ended June 30, 2010.

The following table represents the balance and changes in goodwill by reporting unit as of and for the six months ended June 30, 2010 (*in thousands*):

	<b>License</b>	<b>Consulting</b>	<b>Maintenance</b>	<b>Total</b>
Balance as of December 31, 2009	\$ 140,234	\$ 70,767	\$ 157,335	\$ 368,336
Scala Africa earn out	76	65	413	554
Foreign currency translation	(271)	(411)	(382)	(1,064)
Balance as of June 30, 2010	\$ 140,039	\$ 70,421	\$ 157,366	\$ 367,826

The average amortization period for intangible assets are as follows:

	<b>Average Amortization Periods</b>
Acquired technology	5 years
Customer base	7 years
Trademark	5 years
Covenants not to compete	1-2 years

The following represents the change in the gross carrying amount of intangible assets recorded during the six months ended June 30, 2010 (*in thousands*):

	<b>Foreign Currency Translation</b>	<b>Other</b>	<b>Total</b>
Acquired technology	\$ (26)	\$	\$ (26)
Customer base	(1,396)	130	(1,266)

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Covenant not to compete	(116)	(116)
Total	\$ (1,538)	\$ 130 \$ (1,408)

Intangible assets are amortized over the estimated economic life of the assets. As of June 30, 2010, the Company has not identified any indicators of impairment associated with intangible assets.

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

The following table summarizes the components of intangible assets (*in thousands*):

	As of June 30, 2010			As of December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Acquired technology	\$ 137,677	\$ 104,085	\$ 33,592	\$ 137,703	\$ 95,400	\$ 42,303
Customer base	74,901	40,876	34,025	76,167	37,076	39,091
Trademark	13,790	11,717	2,073	13,790	11,077	2,713
Covenant not to compete	2,047	2,047		2,163	2,163	
<b>Total</b>	<b>\$ 228,415</b>	<b>\$ 158,725</b>	<b>\$ 69,690</b>	<b>\$ 229,823</b>	<b>\$ 145,716</b>	<b>\$ 84,107</b>

Amortization expense of the Company's intangible assets is included in cost of revenues and for the three months ended June 30, 2010 and 2009, was \$7,051,000 and \$8,221,000, respectively. Amortization expense of the Company's intangible assets is included in cost of revenues and for the six months ended June 30, 2010 and 2009, was \$14,108,000 and \$16,626,000, respectively. Estimated amortization expense for the remainder of 2010, 2011, 2012, 2013, 2014 and thereafter, is approximately \$13,662,000, \$21,501,000, \$20,063,000, \$7,871,000, \$6,016,000 and \$577,000, respectively.

**Note 4. Restructuring Charges and Other**

During the first six months of 2010, the Company recorded restructuring charges of \$2,606,000. These charges represent \$1,351,000 of severance costs associated with cost reductions initiatives taken in the second quarter as well as management severance. The Company also recorded a charge of \$1,255,000 for changes in estimates on subleasing arrangements for facilities located in the United Kingdom. In connection with these restructuring activities, the Company terminated 31 employees or approximately 1% of the Company's workforce during 2010 from across all functions. As of June 30, 2010, all of these terminations had been completed. During the six months ended June 30, 2010, the Company made \$1,763,000 in cash payments or otherwise settled against reserves associated with its restructuring activities. The liability was further decreased by \$294,000 of foreign currency translation. The facilities obligations are expected to be paid through 2016 and the Company believes these obligations will be funded from existing cash reserves and cash generated from continuing operations.

During the first six months of 2009, the Company recorded restructuring charges of \$1,207,000. These charges represent \$1,758,000 of severance related costs associated with the cost reduction initiatives taken in the second quarter, management severance and reductions primarily from the elimination of redundancies in the Company's retail business resulting from the NSB acquisition. The Company also recorded \$693,000 of facilities credits related primarily to changes in estimates on subleasing facilities located in the United Kingdom. The Company also recorded \$142,000 in asset impairments related to leasehold improvements and facilities redundancies in the Company's retail business resulting from the NSB acquisition. In connection with these restructuring activities, the Company terminated 43 employees or approximately 2% of the Company's workforce during 2009 primarily from professional services and sales functions. As of June 30, 2009, all of these terminations had been completed. During the six months ended June 30, 2009, the Company made \$3,875,000 in cash and share-based payments against reserves associated with its restructuring activities. The liability was further increased by \$861,000 of foreign currency translation.

**Note 5. Stock-Based Compensation**

The Company has in effect stock incentive plans under which restricted stock and stock options have been granted to employees and non-employee members of the Board of Directors. The Company also has an employee stock purchase plan for eligible employees. The Company recognizes share-based payments to employees, including grants of employee restricted stock and stock options, in the financial statements based upon their respective grant date fair values.

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The following table sets forth the total stock-based compensation expense resulting from restricted stock awards and stock options included in the Company's Condensed Consolidated Statements of Operations and Comprehensive Loss (*in thousands*):

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Cost of revenues	\$ 538	\$ 345	\$ 1,088	\$ 657
Sales and marketing	737	415	1,565	1,022
Software development	614	171	1,242	348
General and administrative	1,572	713	3,845	2,035
<b>Total stock-based compensation expense</b>	<b>\$ 3,461</b>	<b>\$ 1,644</b>	<b>\$ 7,740</b>	<b>\$ 4,062</b>

In January 2010, the Company's Board of Directors approved extending the Performance Based Restricted Stock Plan ( PBRSP ) to 2011. All existing participants in the PBRSP were granted the same number of shares for the 2010 and 2011 plan years as they had been granted in the 2009 plan year. During the six months ended June 30, 2010, the Company granted 1,553,000 shares of performance-based restricted stock to employees for extension of the PBRSP to 2011, and for annual promotions and new hires for the 2010 and 2011 performance plan years under the terms of the PBRSP. In January 2010, the Company's Board of Directors also approved modifying and replacing the Company's prior cash-based management bonus plan with a performance-based restricted stock Management Incentive Program ( MIP ) for 2010. In creating the equity based MIP, an additional 1,328,000 performance-based restricted shares were granted for the 2010 year. All performance-based restricted shares are subject to a vesting schedule and are subject to the terms of the Company's PBRSP and MIP. The recipients will vest in the restricted stock, or a portion thereof, in two equal, annual installments depending upon achievement of targets with respect to the Company's annual revenue and adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) for 2010 and additionally, for PBRSP participants, for 2011. Unvested restricted stock is held in escrow, and the Company's reacquisition right will not lapse until the shares are fully vested. Upon an employee's termination of service with the Company, shares that have not vested will be forfeited and automatically transferred to and reacquired by the Company. In addition, restricted shares that do not vest as a result of the Company's non-achievement with respect to annual revenue and adjusted EBITDA performance conditions for either performance year will be forfeited and automatically transferred to and reacquired by the Company.

The performance conditions for each year are independent of the performance conditions for any other years. Accordingly, the related compensation expense will be recognized separately in each year related only to the shares potentially earned in each year, based on their grant date fair values, assuming that it is considered to be probable that the shares will be earned each year. In addition, the compensation expense for each year is estimated at each reporting period and a cumulative pro rata amount is accrued on a quarterly basis. Quarterly compensation expense may include a cumulative adjustment resulting from changes in the estimated number of shares expected to be earned during that plan year.

On February 12, 2010, the Company's reacquisition right lapsed on 563,000 shares related to the performance-based restricted stock plan for the 2009 performance year. These shares were included in restricted stock at December 31, 2009. The lapse occurred following the Company's determination of its 2009 performance year performance conditions achievement. The compensation expense related to these shares was included in the Consolidated Statements of Operations for the year ended December 31, 2009.

The Company withholds, at the employee's election, a portion of the vested shares as consideration for the Company's payment of applicable employee income taxes. As of June 30, 2010, these repurchased shares are held in treasury and are available for future reissuance. In conjunction with the periodic vesting of the restricted stock and the annual vesting of performance-based restricted stock, during the three and six months ended June 30, 2010, the Company acquired 89,000 and 300,000 shares of common stock at a value of \$869,000 and \$2,628,000, respectively.

At June 30, 2010, the Company had approximately \$12,243,000 of total unrecognized compensation expense related to performance-based restricted stock. This cost is expected to be recognized over a weighted-average period of approximately two years. At June 30, 2010, the Company had approximately \$2,781,000 of total unrecognized compensation expense related to other restricted stock grants. This cost is expected to be recognized over a weighted-average period of approximately two years. The compensation cost related to the performance-based restricted stock depends on the estimated number of shares that will vest, based on the probable outcome of the performance conditions. Therefore, the recognized compensation could vary significantly, depending on the outcome of those conditions. The Company is required at



each reporting date to assess whether achievement of any

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

performance condition is probable. Based on the Company's current assessment, the Company has recorded stock compensation expense related to performance-based restricted stock of \$2,820,000 and \$5,575,000 for the three and six months ended June 30, 2010, respectively.

The fair value of restricted stock that vested during the three months ended June 30, 2010 and 2009, was \$2,090,000 and \$2,448,000, respectively. The fair value of restricted stock that vested during the six months ended June 30, 2010 and 2009, was \$3,022,000 and \$3,989,000, respectively.

The tax benefit recognized in the Condensed Consolidated Statement of Operations and Comprehensive Loss related to stock-based compensation for the three months ended June 30, 2010 and 2009 was \$1,038,000 and \$404,000, respectively. The tax benefit recognized in the Condensed Consolidated Statement of Operations and Comprehensive Loss related to stock-based compensation for the six months ended June 30, 2010 and 2009 was \$2,410,000 and \$1,216,000, respectively. No share-based compensation was capitalized for the three or six months ended June 30, 2010 or 2009.

The Company granted zero stock options during the three months ended June 30, 2010 and 2009. The Company granted zero and 15,000 stock options during the six months ended June 30, 2010 and 2009, respectively. Stock options are granted with an exercise price equal to the market value on the date of grant, generally vest over four years and expire ten years from the date of grant. The weighted-average grant date fair value of options granted in fiscal 2009 was \$1.96. The Company estimates the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the value of traded options that have no vesting restrictions and are fully transferable, while the options issued by the Company are subject to both vesting and restrictions on transfer. In addition, option-pricing models require input of highly subjective assumptions including expected stock price volatility. The Company uses historical volatility data for expected volatility and estimates the expected life of its stock options based on the historical life of the Company's options. The grant date fair value of options granted during the six months ended June 30, 2009 was estimated using the following weighted-average assumptions:

	<b>Six Months Ended June 30, 2009</b>
Expected life (years)	4.0
Risk-free interest rate	1.3%
Volatility	75.5%
Dividend rate	0.0%

There were 10,000 options exercised during the three months ended June 30, 2010 with an intrinsic value of \$72,000. There were 61,000 options exercised during the six months ended June 30, 2010 with an intrinsic value of \$327,000. As of June 30, 2010, there were 1,320,000 options exercisable with a weighted average remaining contractual term, weighted average exercise price and aggregate intrinsic value of 3.3 years, \$7.88 and \$3,437,000, respectively. As of June 30, 2010, there were 1,331,000 options outstanding with a weighted average remaining contractual term, weighted average exercise price and aggregate intrinsic value of 3.3 years, \$7.85 and \$3,483,000, respectively. The Company issues new shares to satisfy stock option exercises and stock purchases under the Company's share-based plans. The aggregate intrinsic value above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the quarter and the exercise price) multiplied by the number of shares that would have been received by the option holders had all option holders exercised their options on June 30, 2010. This amount changes based on the market value of the Company's stock.

**Note 6. Revenue Recognition**

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, specifically, the Company recognizes revenue in accordance with software industry specific GAAP.

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The Company enters into contractual arrangements with end-users of its products to sell software licenses, maintenance services and consulting services, either separately or in various combinations thereof. For each arrangement, revenues are recognized when persuasive evidence of an arrangement exists, the fees to be paid by the customer are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, vendor-specific objective evidence (VSOE) of the fair value of any undelivered elements exists and no other significant obligations on the part of the Company remain.

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

For multiple-element software arrangements, the Company accounts for the software license component using the residual method. The residual method generally requires recognition of software license revenue in a multiple-element arrangement once all software products have been delivered and accepted by the customer and the only undelivered elements are maintenance services and/or consulting services. The fair value of the maintenance services is determined based on VSOE of fair value and is deferred and recorded ratably over the maintenance service period. Fair value for any related consulting services is determined by VSOE of fair value and generally recognized as the services are performed. After any required fair value allocations to the undelivered maintenance and/or consulting services elements, the residual contractual consideration is allocated to the license element associated with the software products sold as part of the transaction. The Company's maintenance services VSOE of fair value is determined by reference to the price the Company's customers are required to pay for the services when sold-separately (i.e. the maintenance service fees paid by the Company's customers upon renewal). VSOE of fair value for consulting services is determined by reference to the price the Company's customers are required to pay for such services when sold-separately, or when sold independent of any of the Company's other product or service offerings.

In certain instances, the Company enters into arrangements that include two or more non-software products or services such as hardware and related services. Such arrangements are divided into separate units of accounting provided that the delivered item has stand-alone value and there is objective and reliable evidence of the fair value of the undelivered items. The total arrangement fee is allocated to the undelivered elements based on their fair values and to the initial delivered elements using the residual method. Revenue is recognized separately, and in accordance with the Company's revenue recognition policy, for each element. Sales taxes collected from customers are recorded on a net basis.

*License Revenues:* Amounts allocated to software license revenues sold directly by the Company are recognized at the time of shipment of the software when fair value for all undelivered elements exists and all the other revenue recognition criteria discussed above have been met.

Revenues on sales made to the Company's resellers are recognized upon shipment of the Company's software to the reseller when the reseller has an identified end-user and all other revenue recognition criteria noted above are met. The Company does not offer a right of return on its products.

*Consulting Service Revenues:* Consulting service revenues are comprised of consulting and implementation services and, to a limited extent, other services such as training, software hosting, applications management and software as a service ( SaaS ). Consulting services are sold on a fixed fee and time-and-materials basis and can include services ranging from software installation to data conversion and building non-complex interfaces to allow the software to operate in integrated environments. Consulting engagements can last anywhere from one day to several months and are based strictly on the customer's requirements and complexities and are independent of the functionality of the Company's software. The Company's software, as delivered, can generally be used by the customer for the customer's purpose upon installation. Further, implementation and integration services provided are generally not essential to the functionality of the software, as delivered, and do not result in any material changes to the underlying software code. Services are generally separable from the other elements under the same arrangement since the performance of the services are not essential to the functionality of the other elements of the transaction, the services are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services, and VSOE of fair value exists for the services based on sold-separately data. For services performed on a time-and-materials basis, revenue is recognized when the services are performed and billed. On occasion, the Company enters into fixed fee arrangements or arrangements in which customer payments are tied to achievement of specific milestones. In fixed fee arrangements, revenue is recognized as services are performed as measured by hours incurred to date, as compared to total estimated hours to be incurred to complete the work. In milestone achievement arrangements, the Company recognizes revenue as the respective milestones are achieved. If, in the services element of the arrangement the Company performs significant production, modification or customization of its software, the Company accounts for the entire arrangement, inclusive of the software license revenue, using contract accounting as the software and services do not meet the criteria for separation. In such instances, the software license revenue is recognized as the services are performed utilizing the same methodology applied to fixed fee arrangements.

Hosting, outsourcing and applications management revenues consist primarily of recurring fees for remote management, monitoring, data processing, updating or administrative support of applications software, servers, operating systems and other automation tools. SaaS revenues are comprised of recurring fees for licensing access to and the use of the Company's application software as a service, on a subscription or on-demand basis over a



**Table of Contents**

**EPICOR SOFTWARE CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**JUNE 30, 2010**

contractual term. Related recurring fees are recognized as the services are provided. Related one time set up fees are recognized on a straight-line basis over the longer of the contractual term or the expected life of the relationship.

The Company has recorded unbilled consulting revenues totaling \$2,820,000 and \$2,602,000 at June 30, 2010 and December 31, 2009, respectively. These unbilled revenues are comprised primarily of consulting services performed on a time and materials basis during the last few business days of the quarter but not billed until the following month, as well as accruals recorded for services provided under certain engagements for which the associated payment has yet to be billed in accordance with the contractual payment terms. Unbilled consulting revenues are recorded in accounts receivable in the accompanying Condensed Consolidated Balance Sheets.

*Maintenance and Support Service Revenues:* Maintenance and support service revenues consist primarily of fees for providing unspecified software upgrades on a when-and-if-available basis and technical support over a specified term, which is typically twelve months. Maintenance revenues are typically paid in advance and are recognized on a straight-line basis over the term of the contract.

*Hardware Revenues:* In some cases, the Company resells third party hardware systems and related peripherals as part of an end-to-end solution requested by its customers. Hardware revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is considered probable. The Company considers delivery to occur when the product is shipped and title and risk of loss have passed to the customer.

*Software License Indemnification:* The Company's standard software license agreements contain an infringement indemnity clause under which the Company agrees to defend, indemnify and hold harmless our customers and business partners against liability and damages arising from third party claims that the Company's products violate or infringe the intellectual property rights of others. These clauses constitute a form of guarantee that is subject to disclosure requirements, but not to initial recognition or measurement provisions. The Company has never lost a third party infringement claim, and, to date, the Company's costs to defend such claims and/or lawsuits have been insignificant. Although it is possible that in the future third parties may claim that the Company's current or future software solutions infringe upon their intellectual property, a maximum obligation arising out of these types of agreements is not explicitly stated and, therefore, the overall maximum amount of these obligations cannot be reasonably estimated.

**Note 7. Credit Facility and Convertible Senior Notes**

***Credit Facility***

In December 2007, the Company entered into a syndicated credit facility (the 2007 credit facility) for up to \$250 million in term loan and revolving facilities, consisting of a \$100 million term loan and a \$150 million revolving loan facility, after giving consideration to an accordion feature which would allow the Company to increase the initial principal loaned under the 2007 credit facility. In December 2008, the Company amended the 2007 credit facility to, among other things, reduce the commitments under the revolving loan facility from \$150 million to \$100 million. The Company pledged all of its assets as collateral, subject to certain exceptions.

On September 30, 2009, the Company amended the 2007 credit facility to, among other things, (i) amend the financial covenants by eliminating the total leverage and fixed charge coverage ratios, lowering the maximum senior secured leverage ratio and adding a minimum EBITDA covenant and a minimum liquidity ratio, (ii) amend the maturity date from February 19, 2013 to September 30, 2012, and (iii) increase the applicable interest rates and commitment fees payable under the facility. In connection with this amendment, the Company also paid the outstanding term loan balance by drawing funds available under the revolving facility. The Company paid amendment fees to the lenders and an arrangement fee to secure the amendment.

As of June 30, 2010, the Company had \$62,500,000 outstanding on the revolving facility and unused borrowing capacity of \$37,500,000 under the revolving facility. During the three months ended June 30, 2010, the Company made a voluntary principal payment of \$5,000,000 against the revolving loan from discretionary funds, bringing the outstanding loan balance to \$62,500,000.

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At June 30, 2010, the Company was in compliance with all covenants included in the terms of the 2007 credit facility, and the weighted average interest rate applicable to the 2007 credit facility was 5.28%. The 2007 credit

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

facility is subject to interest rate swap agreements to convert a portion of the Company's interest rate variability to a fixed rate basis as required under the 2007 credit facility (Note 8).

The Company is not obligated to make mandatory quarterly principal payments under the 2007 credit facility, however periodic interest payments are made, not less often than quarterly. All the outstanding principal and accrued interest on the revolving loan facility is due September 30, 2012, upon expiration of the facility. Accordingly, the outstanding balance of the facility at June 30, 2010 and December 31, 2009 was classified as long-term debt.

***Convertible Senior Notes***

On May 8, 2007, the Company closed an offering of \$230 million aggregate principal amount of 2.375% convertible senior notes due in 2027 (convertible senior notes). The convertible senior notes are unsecured and pay interest semiannually at a rate of 2.375% per annum until May 15, 2027. The convertible senior notes are convertible into cash or, at the Company's option, cash and shares of the Company's common stock, at an initial conversion rate of 55.2608 shares of common stock per \$1,000 principal amount of the convertible senior notes, which is equivalent to an initial conversion price of approximately \$18.10 per share. Pursuant to the terms of the convertible senior notes, the principal amount of the convertible senior notes may be settled in cash and only the amount of conversion value, as defined, in excess of the principal amount of the convertible senior notes may be settled in cash or shares. The initial conversion price represents a 30% premium over the last reported sale price of the Company's common stock prior to the offering that began on May 2, 2007, which was \$13.92 per share.

The Company recorded a \$61,752,000 debt discount as additional paid-in capital, as of the convertible senior notes' issuance date of May 15, 2007. At June 30, 2010 and December 31, 2009, the unamortized debt discount was \$37,970,000 and \$42,143,000, respectively. The Company has \$230,000,000 in principal due under the convertible debt, for a net carrying amount of \$192,030,000 at June 30, 2010. At June 30, 2010, the fair value of the debt was \$205,436,000, as determined based upon quoted market prices.

The Company is amortizing the debt discount through the date at which the Company can begin to redeem the notes, which is May 15, 2014. The effective interest rate used to measure the initial fair value of the debt was 7.35%, which was based on market conditions for nonconvertible debt at the time the debt was entered into. The Company recognized interest expense of \$3,471,000 and \$3,324,000 related to the convertible debt for the three months ended June 30, 2010 and 2009, respectively, of which \$1,366,000 is based on the coupon rate. The Company recognized interest expense of \$6,904,000 and \$6,613,000 related to the convertible debt for the six months ended June 30, 2010 and 2009, respectively, of which \$2,731,000 is based on the coupon rate.

**Note 8. Derivative Instruments**

The Company is exposed to certain risks relating to its ongoing business operations. The Company uses derivative instruments to manage interest rate risk and foreign currency risk. Interest rate swaps are entered into to manage interest rate risk associated with the Company's variable rate borrowings. Foreign currency forward contracts are entered into to manage foreign currency exchange rate risk associated with intercompany receivable and payable balances. The Company does not use derivative instruments for trading purposes.

Interest rate swaps were entered into in connection with the term loan previously outstanding under the 2007 credit facility and were initially designated and qualified as cash flow hedges, whereby the effective portion of the gain or loss on the derivative was reported as a component of other comprehensive income and reclassified into earnings in the same period during which the hedged transaction affected earnings. If the Company had experienced gains or losses on the derivatives representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, they would have been recognized in current earnings.

On September 30, 2009, the Company paid in full the balance outstanding on its term loan by borrowing on the revolving line of credit under the 2007 credit facility (Note 7). Both the term loan and the revolving credit facility incur a variable interest rate. Because the interest rate swaps were designated as hedging the interest rate variability on the term loan, repayment of the term loan resulted in the de-designation of this hedging relationship. Accordingly, subsequent to September 30, 2009, the interest rate swaps are no longer designated in a hedging relationship.



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For the three months ended June 30, 2010, a gain for the change in the fair value of the interest rate swaps of \$138,000 was recognized in interest and other income (expense), net in the accompanying Condensed

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

Consolidated Statements of Operations and Comprehensive Loss. For the six months ended June 30, 2010, a gain for the change in the fair value of the interest rate swaps of \$142,000 was recognized in interest and other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss.

The Company's foreign currency contracts are not designated and do not qualify as hedging instruments, and gains and losses resulting from these transactions are included in interest and other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. As of June 30, 2010, the Company had no open foreign currency forward contracts.

*Interest Rate Swaps*

On April 18, 2008, March 11, 2009 and March 12, 2009, the Company entered into interest rate swap agreements to convert a portion of the Company's interest rate variability to a fixed rate basis as required under the 2007 credit facility. As of June 30, 2010 and December 31, 2009, the fair value of the interest rate swaps is included on the Company's Condensed Consolidated Balance Sheets. The differential to be paid or received on the interest rate swap agreements is accrued and recognized as an adjustment to interest expense as interest rates change. Following is a summary of the interest rate swaps (rates for expired contracts are exclusive of an interest rate margin and rates for active contracts are inclusive of the interest rate margin of 4.00% applicable at June 30, 2010 under the 2007 credit facility):

Contract Date	Notional Amount	Interest Period Covered	Rate
04/18/08	\$20 million	06/30/08 - 03/31/09	3.170%
04/18/08	\$15 million	06/30/08 - 09/30/09	3.195%
04/18/08	\$15 million	06/30/08 - 09/30/09	3.150%
03/11/09	\$20 million	03/31/09 - 03/31/11	5.690%
03/12/09	\$15 million	09/30/09 - 03/31/11	5.890%
03/12/09	\$ 5 million	09/30/09 - 09/30/10	6.050%

At June 30, 2010, the effective interest rate for the notional amounts covered by the swap agreements as of such date was 5.81% (inclusive of 4.00% interest rate margin applicable at March 31, 2010 under the 2007 credit facility).

The Company does not hold or issue interest rate swap agreements for trading purposes. In the event that a counter-party fails to meet the terms of the interest rate swap agreement, the Company's exposure is limited to the interest rate differential. The Company manages the credit risk of counterparties by dealing only with institutions that the Company considers financially sound. The Company considers the risk of non-performance to be remote.

*Foreign Currency Contracts*

The Company uses foreign currency forward contracts to manage its market risk exposure associated with foreign currency exchange rate fluctuations for certain intercompany balances denominated in currencies other than an entity's functional currency. These derivative instruments are not designated and do not qualify as hedging instruments. Accordingly, the gains or losses on these derivative instruments are recognized in interest and other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss and are designed generally to offset the gains and losses resulting from remeasurement of intercompany balances recognized in the same line item. The Company reported a net foreign currency loss of \$316,000 and \$418,000 for the three months ended June 30, 2010 and 2009, respectively, which is inclusive of financial instruments and non-financial assets and liabilities to which the instruments relate. The Company reported a net foreign currency loss of \$1,717,000 and \$742,000 for the six months ended June 30, 2010 and 2009, respectively, which is inclusive of financial instruments and non-financial assets and liabilities to which the instruments relate.



Table of Contents

## EPICOR SOFTWARE CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

JUNE 30, 2010

*Quantitative Disclosures About Derivative Instruments*The fair value of derivative instruments is as follows (*in thousands*):

	Balance Sheet Location	Fair Value of Liability Derivatives as of	
		June 30, 2010	December 31, 2009
Derivatives not designated as hedging instruments:			
Interest rate swaps	Other accrued expenses	\$ 362	\$ 61
Interest rate swaps	Other long-term liabilities		443
Total		\$ 362	\$ 504

The effects of derivative instruments on the Condensed Consolidated Statements of Operations and Comprehensive Loss on a pre-tax basis are as follows (*in thousands*):

	Amounts of Gain (Loss) Reclassified from Accumulated OCI into Income			
	Three Months		Six Months Ended	
	Ended June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Derivatives in cash flow hedging relationship:				
Interest rate swaps	\$	\$ (212)	\$	\$ (426)

The following table represents the amount of derivative instruments not designated as hedges recognized in the Company's Condensed Consolidated Statements of Operations and Comprehensive Loss (*in thousands*):

	Location of gain (loss) recognized in income on derivatives:	Amount of Gain or (Loss) Recognized in Income on Derivatives			
		Three Months		Six Months Ended	
		Ended June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Derivatives not designated as hedging instruments:					
Interest rate swaps	Interest and other income (expense), net	\$ 138	\$	\$ 142	\$
Foreign currency contracts	Interest and other income (expense), net	621	(1,423)	347	(1,392)
Total		\$ 759	\$ (1,423)	\$ 489	\$ (1,392)

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U.S. GAAP requires a three-tier hierarchy for fair value measurements, which prioritizes the inputs used in measuring fair value as follows:

Level 1 observable inputs such as quoted prices for identical instruments in active markets.

Level 2 inputs other than quoted prices in active markets that are observable either directly or indirectly through corroboration with observable market data.

Level 3 unobservable inputs in which there is little or no market data, which would require the Company to develop its own assumptions.

The Company's interest rate swap is required to be measured at fair value on a recurring basis. The fair value of the interest rate swap is determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized the interest rate swap as Level 2. The following tables present the Company's financial liabilities as of June 30, 2010 and December 31, 2009, measured at fair value on a recurring basis (*in thousands*):

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

Interest rate swap liability	Fair value measurements using		
	Level 1	Level 2	Level 3
June 30, 2010	\$	\$ 362	\$
December 31, 2009		504	

**Note 9. Provision (Benefit) for Income Taxes**

The provision (benefit) for income taxes consists of federal, state and foreign income taxes. The Company operates in an international environment with significant operations in various locations outside the U.S. Accordingly, the consolidated income tax rate is a composite rate reflecting earnings in the various locations and the applicable rates.

The Company makes its best estimate of the tax rate expected to be applicable for the full fiscal year. The rate so determined is used to provide for income taxes in an interim period. Absent any material or discrete adjustments, the deferred taxes accounts are adjusted only at year end.

The Company recorded an income tax provision (benefit) of \$(2,318,000) and \$5,543,000 for the three months ended June 30, 2010 and 2009, respectively. The effective income tax rates were (69.6)% and 487.5% for the three months ended June 30, 2010 and 2009, respectively. The Company recorded an income tax benefit of \$8,382,000 and \$982,000 for the six months ended June 30, 2010 and 2009, respectively. The effective income tax rates were (88.9)% and (10.6)% for the six months ended June 30, 2010 and 2009, respectively.

Principal differences between the recorded benefit for income taxes and the amount determined by applying the U.S. federal statutory rate of 35% pertain to earnings in foreign jurisdictions taxed at different rates, state taxes, permanent differences between GAAP pre-tax income and taxable income, and the recognition of uncertain tax benefits. Depending on the levels of consolidated pre-tax earnings, these differences can have a significant impact on the effective tax rate.

The Company has a valuation allowance of \$13,928,000 against certain foreign deferred tax assets, and intends to maintain a valuation allowance until sufficient positive evidence exists to support its reversal. In general, any realization of these deferred tax assets will reduce the Company's effective rate in future periods. Future releases of the valuation allowance related to the Scala and NSB acquisitions will be accounted for as a reduction in income tax expense.

The Company assesses the recoverability of its deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment, the Company is required to consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that some portion, or all, of the net deferred tax assets will be realized in future periods. This analysis includes assessment by jurisdiction of forecasted and historic financial performance and taxable income, performance compared to profit and revenue targets, strength or weakness of revenue generating functions, expense forecasts, and other factors. The valuation allowance will continue to be evaluated over future quarters.

The preparation of consolidated financial statements in conformity with GAAP requires the formulation of estimates and assumptions that affect the reported amount of tax-related assets and liabilities and income tax provisions. This assessment requires significant judgment. In addition, the Company has made estimates involving current and deferred income taxes, tax attributes relating to the interpretation of various tax laws and historical bases of tax attributes associated with certain tangible and intangible assets. Failure to achieve the Company's operating income targets may change its assessment regarding the recoverability of the net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of the deferred tax assets. Any increase in a valuation allowance would result in additional income tax expense, lower stockholders' equity and could have a significant impact on the Company's earnings in future periods.

U.S. income taxes were not provided for on unremitted earnings from non-U.S. subsidiaries. Those unremitted earnings are considered to be indefinitely reinvested.

At June 30, 2010 and December 31, 2009, the Company had \$16,791,000 and \$17,503,000, respectively, of non-current gross unrecognized tax benefits, of which \$12,459,000 and \$12,910,000, respectively, would reduce the effective tax rate if recognized. The change in gross

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unrecognized tax benefits during the quarter is primarily due to the lapse in statutes in foreign jurisdictions and foreign exchange gains and losses.

The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. During the three months ended June 30, 2010, the Company increased its liability for interest of \$5,000

**Table of Contents****EPICOR SOFTWARE CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****JUNE 30, 2010**

related to unrecognized tax benefits. The Company had a recorded liability for interest and potential penalties totaling \$1,064,000 at June 30, 2010.

The tax years 2003 to 2009 remain open to examination by the Federal, state and foreign jurisdictions to which we are subject. The Federal statute of limitations for tax years 1997 to 2003 remains open for purposes of adjusting the amounts of net operating losses carried forward from those years. The Company is currently under examination in various foreign locations. The Company anticipates effectively settling the uncertain tax positions relating to certain foreign jurisdictions in the next twelve months. The Company does not believe the amount settled will materially differ from the unrecognized tax benefit as of June 30, 2010.

The Company believes it has adequately provided for income tax issues not yet resolved with federal, state and foreign tax authorities. Although not probable, the most adverse resolution of these issues could result in additional charges to earnings in future periods.

**Note 10. Segment Information**

The Company has prepared operating segment information to report components that are evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company's reportable operating segments include software licenses, consulting, maintenance and hardware and other. Currently, the Company does not separately allocate amortization of intangible assets or operating expenses to these segments, nor does it allocate specific assets to these segments. Therefore, the segment information reported includes only revenues, cost of segment revenues and segment gross profit. Excluded from the table below is amortization of intangible assets for the three months ended June 30, 2010 and 2009, of \$7,051,000 and \$8,221,000, respectively, and amortization of intangible assets for the six months ended June 30, 2010 and 2009, of \$14,108,000 and \$16,626,000, respectively.

Operating segment data for the three and six months ended June 30, 2010 and 2009 is as follows (*in thousands*):

	<b>Licenses</b>	<b>Consulting</b>	<b>Maintenance</b>	<b>Hardware and Other</b>	<b>Total</b>
<b>Three months ended June 30, 2010:</b>					
Revenues	\$ 19,160	\$ 34,344	\$ 47,503	\$ 8,158	\$ 109,165
Cost of revenues	4,718	27,874	11,876	7,170	51,638
Gross profit	\$ 14,442	\$ 6,470	\$ 35,627	\$ 988	\$ 57,527
<b>Three months ended June 30, 2009:</b>					
Revenues	\$ 17,533	\$ 32,061	\$ 47,340	\$ 3,513	\$ 100,447
Cost of revenues	3,850	26,079	11,023	3,057	44,009
Gross profit	\$ 13,683	\$ 5,982	\$ 36,317	\$ 456	\$ 56,438
<b>Six months ended June 30, 2010:</b>					
Revenues	\$ 35,396	\$ 65,433	\$ 95,463	\$ 12,154	\$ 208,446
Cost of revenues	8,252	53,675	23,816	10,679	96,422



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Gross profit	\$ 27,144	\$ 11,758	\$ 71,647	\$ 1,475	\$ 112,024
<b>Six months ended June 30, 2009:</b>					
Revenues	\$ 30,710	\$ 63,512	\$ 94,206	\$ 10,711	\$ 199,139
Cost of revenues	6,279	52,493	21,989	9,431	90,192
Gross profit	\$ 24,431	\$ 11,019	\$ 72,217	\$ 1,280	\$ 108,947

**Note 11. Venezuela Currency Devaluation**

The Company conducts limited operations in Venezuela (revenue derived from Venezuelan operations represented less than 0.01% of the Company's consolidated revenue for the six months ended June 30, 2010). In January 2010, the government of Venezuela devalued its bolivar currency from 2.15 to 4.30 bolivares per United States dollar. As a result of the devaluation, the Company reduced its cash and working capital balances by and incurred a foreign currency charge of \$1,315,000 due to the revaluing of its bolivar-based net assets. This charge is included in

**Table of Contents**

**EPICOR SOFTWARE CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**JUNE 30, 2010**

interest and other income (expense), net in the Condensed Consolidated Statements of Operations and Comprehensive Loss.

**Note 12. Commitments and Contingencies**

*Litigation*

The Company is subject to legal proceedings and claims in the normal course of business. The Company is currently defending these proceedings and claims, and anticipates that it will be able to resolve these matters in a manner that will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

*Guarantees*

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. These contracts primarily relate to: (i) divestiture and acquisition agreements, under which the Company may provide customary indemnifications to either (a) purchasers of the Company's businesses or assets; or (b) entities from whom the Company is acquiring assets or businesses; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities and other claims arising from the Company's use of the applicable premises; (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their relationship with the Company; (iv) Company license and consulting agreements with its customers, under which the Company may be required to indemnify such customers for intellectual property infringement claims and other claims arising from the Company's provision of services to such customers and (v) Company distribution agreements with its distributors and resellers, under which the Company may be required to indemnify such distributors or resellers against property infringement claims.

**Note 13. New Accounting Pronouncements**

In January 2010, the FASB issued an update to existing accounting standards to improve disclosures regarding fair value measurements and, thus, increase the transparency in financial reporting. The update provides that a reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and in the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, the update clarifies the requirements of the existing disclosures as follows: (1) For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements (for measurements in Level 2 and Level 3). The update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted the provisions that were in effect as of December 15, 2009, and the adoption did not have an impact on the consolidated financial statements. The Company will adopt the remaining provisions as they become effective. The Company does not expect adoption to have a material impact on the consolidated financial statements.

In October 2009, the FASB issued new accounting guidance for revenue recognition for multiple-deliverable revenue arrangements. The objective of this guidance is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit as well as eliminate the use of the residual method for use in allocating contractual consideration and replace it with the relative selling price method. Vendors often provide multiple products or services to their customers. Those deliverables often are provided at different points in time or over different time periods. This update provides amendments to the criteria in Accounting Standards Codification (ASC) Subtopic 605-25 for allocating consideration in multiple-deliverable arrangements. The amendments in this update establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not

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available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The amendments in this update also will replace the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than

**Table of Contents**

**EPICOR SOFTWARE CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**JUNE 30, 2010**

assumptions of a marketplace participant. Additionally, the new guidance is only applicable to non-software related deliverables sold as part of a multiple-deliverable arrangement. In an arrangement that includes software deliverables as well as non-software related deliverables, the provisions of ASC Topic 985 would apply to the software deliverables. This update is effective for fiscal years beginning on or after June 15, 2010; however, early adoption is permitted. The Company is currently evaluating the impact, if any, of this new accounting update on its consolidated financial statements.

**Table of Contents****Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations:****Forward Looking Statements – Safe Harbor**

Certain statements in this Quarterly Report on Form 10-Q are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, that involve risks and uncertainties. Any statements contained herein (including without limitation statements to the effect that the Company or Management estimates, expects, anticipates, plans, believes, projects, continues, should, may, or will or statements concerning potential or opportunity or variability or comparable terminology or the negative thereof) that are not statements of historical fact should be construed as forward-looking statements including statements about (i) the Company's future financial results, (ii) the impact of new accounting pronouncements, (iii) the Company's product development plans, (iv) the Company's capital spending, (v) the Company's future cash flow from operations, (vi) sufficient sources of financing to continue operations for next twelve months and to satisfy contractual obligations and commercial commitments, (vii) the effect of current legal proceedings, (viii) payment of obligations related to the Company's restructurings, (ix) the future use of forward or other hedging contracts, (x) the future impact of recent acquisitions on the Company, (xi) future investments in product development, (xii) schedule of amortization of intangible assets, (xiii) future impact of valuation allowance review and (xiv) future expense levels. Actual results could differ materially and adversely from those anticipated in such forward looking statements as a result of certain factors, including the factors listed at pages 36 to 44. Because these factors may affect the Company's operating results, past performance should not be considered an indicator of future performance and investors should not use historical results to anticipate results or trends in future periods. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements. Investors should carefully review the risk factors described below and in other documents the Company files from time to time with the Securities and Exchange Commission, including the Company's Annual Report on Form 10-K.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

***Overview***

Epicor Software Corporation (Epicor or the Company) designs, develops, markets and supports enterprise application software solutions and services primarily for use by mid-sized companies and the divisions and subsidiaries of Global 1000 enterprises, which generally consist of companies with annual revenues between \$25 million and \$1 billion, and emerging enterprises, which generally consist of rapidly growing businesses with annual revenues under \$25 million. Epicor's solutions are designed to help companies focus on their customers, suppliers, partners and employees through enterprise-wide management of resources and information. This collaborative focus distinguishes the Company from conventional enterprise resource planning (ERP) vendors, whose primary focus is improving internal business processes and efficiencies. The Company believes that by automating and integrating information and critical business processes across their entire value chain, enterprises can improve, not just their bottom line, but also their top line, allowing them to compete more effectively in today's increasingly global economy.

Epicor generates its revenues through three principal lines of business: i) the sale of software licenses, ii) the sale of consulting services primarily to implement the software it sells for its customers; and iii) the sale of maintenance services to support the ongoing use of the Company's software by its customers. In addition, Epicor sells a small amount of hardware, which consists primarily of servers and point-of-sales systems for customers who would like the Company's software pre-loaded prior to shipping.

One of the most important aspects of the Company's business is the sale of software licenses to new name customers, as most of the other revenues generated by the Company including the sale of consulting services and maintenance services, as well as the sale of additional software licenses are dependent on the initial sale of software to a new customer. Following the release of Epicor 9 in December of 2008, sales to new name customers have been relatively strong. Epicor 9 has expanded the scope of the Company's addressable markets by providing additional features and functionality that enable Epicor to meet the ERP software requirements of significantly more companies throughout the world. As such, despite the fact that none of the markets or vertical industries the Company has traditionally served have resumed spending levels anywhere close to the levels of 2007 or 2008, Epicor is seeing relatively strong sales of software licenses to new name customers as its total addressable market has expanded. Sales to new name customers have been particularly strong in the Americas, as well as in Europe, the Middle East, and Asia. Epicor continues to invest in additional features, functionality, languages and localizations

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**Table of Contents**

for Epicor 9 to further expand its addressable markets. Research and development and sales and marketing expenses have increased in the first half of 2010 when compared to the first half of 2009 as a result of these investments, as well as a result of additional compensation expense. While the Company believes it will continue to see relatively strong sales of license revenues into new name customer throughout the world, further economic deterioration in the Americas or internationally could have a significant impact on the Company's ability to generate revenue from new name software license sales.

Epicor also generates software license revenue from its existing base of customers. Historically, sales of software licenses into its base of existing customers consist primarily of existing customers purchasing new features and functionality or additional user software licenses, as well as upgrades to another of the Company's software products, particularly when the Company has recently released a new product such as Epicor 9. As economies throughout the world continue to face uncertain times, sales of software licenses into the Company's base of existing customers has been more difficult as the Company's existing customers are more reluctant to add new features and functionality, nor are they inclined to upgrade to a new product. The Company is also selling fewer additional seat licenses as most of the Company's existing customers are not growing and are not engaged in merger and acquisition activity. As economies throughout the world improve, Epicor believes spending by its existing base of customers will gradually increase and that revenue contribution from this group of customers will get better.

Toward the end of 2009 and in 2010, the Company began to see some signs of improvement in the markets it targets, which is beginning to be reflected primarily in higher software license revenues when compared to the year earlier period, particularly as the Company has expanded its addressable markets for the sale of Epicor 9 into new name customers. Specifically, all revenue lines for the 2010 second quarter and year to date each exceeded the 2009 second quarter and year to date revenues. While there are increasing signs of economic recovery throughout the world, which the Company believes may benefit its future revenue streams, the Company continues to monitor the economic situation, the business environment and the Company's outlook.

Total revenues for the three months ended June 30, 2010, increased 8.8% to \$109.3 million, compared to \$100.4 million for the three months ended June 30, 2009. Net license revenue increased by 9.3% to \$19.2 million for the three months ended June 30, 2010, when compared to net license revenue of \$17.5 million for the three months ended June 30, 2009. Consulting revenue was \$34.4 million for the three months ended June 30, 2010, an increase of 7.1% compared to consulting revenue of \$32.1 million for the three months ended June 30, 2009. Maintenance revenue for the three months ended June 30, 2010 was \$47.5 million, an increase of 0.3% compared to maintenance revenue of \$47.3 million for the three months ended June 30, 2009. Hardware and other revenue for the three months ended June 30, 2010 was \$8.2 million, an increase of 132.2% compared to hardware and other revenue of \$3.5 million for the three months ended June 30, 2009. See discussion in Results of Operations for more detailed information.

Total revenues for the six months ended June 30, 2010, increased 4.7% to \$208.4 million, compared to \$199.1 million for the six months ended June 30, 2009. Net license revenue increased by 15.3% to \$35.4 million for the six months ended June 30, 2010, when compared to net license revenue of \$30.7 million for the six months ended June 30, 2009. Consulting revenue was \$65.4 million for the six months ended June 30, 2010, an increase of 3.0% compared to consulting revenue of \$63.5 million for the six months ended June 30, 2009. Maintenance revenue for the six months ended June 30, 2010 was \$95.5 million, an increase of 1.3% compared to maintenance revenue of \$94.2 million for the six months ended June 30, 2009. Hardware and other revenue for the six months ended June 30, 2010 was \$12.1 million, an increase of 13.5% compared to hardware and other revenue of \$10.7 million for the six months ended June 30, 2009. See discussion in Results of Operations for more detailed information.

Overall gross margin was 46.2% for the three months ended June 30, 2010, compared to 48.0% during the same period in 2009. The decrease is primarily due to increased third-party royalty costs. Overall gross margin was 47.0% for the six months ended June 30, 2010, compared to 46.4% during the same period in 2009, up primarily due to decreased cost of sales, primarily in consulting as a result of cost cutting efforts made by the Company.

Cash flows from operations were \$14.2 million for the six months ended June 30, 2010, compared to 2009 cash flows from operations of \$15.7 million. Cash flows from operating activities decreased due primarily to an increase in inventory balances for expected customer roll outs and a decrease in other accrued liabilities due to payment of prior year bonuses, and changing the current year's bonus plan to a stock-based, noncash, bonus plan.

The Company reported a net loss of \$1.0 million, or a loss of \$0.02 per diluted share, for the three months ended June 30, 2010, compared to a net loss of \$6.7 million, or a loss of \$0.11 per diluted share, for the three months ended

**Table of Contents**

June 30, 2009. Net loss for the three months ended June 30, 2010 and 2009, included significant non-cash charges primarily consisting of amortization of intangible assets of \$7.1 million and \$8.2 million, stock-based compensation expense of \$3.5 million and \$1.6 million, and amortization of long-term debt discount of \$2.1 million and \$2.0 million, respectively. Net loss for the three months ended June 30, 2010 and 2009 also includes restructuring and other charges of \$2.6 million and a credit of \$0.2 million, respectively, and a gain on the change in the fair value of our interest rate swaps of \$0.1 million and \$0, respectively.

The Company reported a net loss of \$1.0 million, or a loss of \$0.02 per diluted share, for the six months ended June 30, 2010, compared to a net loss of \$8.3 million, or a loss of \$0.14 per diluted share, for the six months ended June 30, 2009. Net loss for the six months ended June 30, 2010 and 2009, included significant non-cash charges primarily consisting of amortization of intangible assets of \$14.1 million and \$16.6 million, stock-based compensation expense of \$7.7 million and \$4.1 million, amortization of long-term debt discount of \$4.2 million and \$3.9 million, Venezuela currency devaluation of \$1.3 million and \$0, and the write-off of debt issuance fees of \$0 and \$0.9 million, respectively. Net loss for the six months ended June 30, 2010 and 2009 also includes restructuring and other charges of \$2.7 million and \$1.2 million, respectively, and a gain on the change in fair value of our interest rate swaps of \$0.1 million and \$0, respectively. The net loss for the six months ended June 30, 2009 excludes approximately \$0.4 million of revenues that would have been recorded if NSB's deferred revenues had not been adjusted to fair value in purchase accounting.

**Foreign Currency**

The Company has operations in foreign countries around the world and these operations generate revenue and incur expenses in currencies other than the U.S. dollar, particularly the Australian dollar, Canadian dollar, euro, British pound, Mexican peso, Malaysian ringgit and Japanese yen. For revenue and expenses denominated in a currency other than the U.S. dollar, the Company calculates constant currency comparisons by converting current period financials at the average monthly exchange rates applicable to prior periods. The following table summarizes the changes, in both U.S. dollar and percentages, due to currency fluctuations for the three and six months ended June 30, 2010, compared to the same periods of 2009 (*in thousands except percentages*):

2010 vs. 2009	Three months ended June 30,		Six months ended June 30,	
	Change \$	Change %	Change \$	Change %
Total revenues	\$ 143	0.1%	\$ 3,201	1.6%
Cost of revenues (including amortization)	\$ 1,071	1.9%	3,642	3.4%
Operating expenses	\$ 633	1.3%	2,651	2.8%

For the three and six months ended June 30, 2010, the average foreign currency exchange rates for the U.S. dollar weakened against the group of foreign currencies (taken as a whole) in which the Company conducts business as compared to the average exchange rates for the similar periods last year. As a result, the weakening U.S. dollar increased the Company's reported revenues, cost of revenues and operating expenses compared to what would have been reported in the corresponding periods of last year.

**Critical Accounting Policies**

The consolidated financial statements are prepared in conformity with United States of America generally accepted accounting principles (GAAP). As such, management is required to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant accounting policies which are most critical to aid in fully understanding and evaluating reported financial results include the following:

**Revenue Recognition**

The Company enters into contractual arrangements with end-users that may include licensing of the Company's software products, product support and maintenance services, consulting services, resale of third-party hardware or various combinations thereof, including the sale of such products or services separately. The Company's accounting

## **Table of Contents**

policies regarding the recognition of revenue for these contractual arrangements is fully described in Note 6 of Notes to Condensed Consolidated Financial Statements.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

The actual contractual terms, such as payment terms, delivery dates and pricing of the various product and service elements of a contract;

Availability of products to be delivered;

Time period over which services are to be performed;

Creditworthiness of the customer;

The complexity of customizations and integrations to the Company's software required by service contracts;

The sales channel through which the sale is made (direct, value added reseller (VAR), distributor, etc.);

Discounts given for each element of a contract;

Any commitments made as to installation or implementation go live dates; and

Whether vendor specific objective evidence of the fair value of undelivered elements exists.

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse effect on the Company's future revenues and operating results.

### *Allowance for Doubtful Accounts*

The Company's accounts receivable go through a collection process that is based on the age of the invoice and requires attempted contacts with customers at specified intervals and assistance from other personnel within the Company who have a relationship with the customer. The Company writes off accounts to its allowance when the Company has determined that collection is not likely. The Company believes no significant concentrations of credit risk existed at June 30, 2010. Receivables from customers are generally unsecured.

The Company maintains an allowance for doubtful accounts based on historical collections performance and specific collection issues. If actual bad debts differ from the reserves calculated, the Company records an adjustment to bad debt expense in the period in which the difference occurs. Such adjustment could result in additional charges to the Company's results of operations.

### *Intangible Assets*



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The Company's intangible assets were recorded as a result of the Company's acquisitions and represent acquired technology, customer base and trademarks. These intangible assets are amortized over the estimated economic life of the asset. The Company periodically evaluates the recoverability of the intangible assets and considers any events or changes in circumstances that would indicate that the carrying amount of an asset may not be recoverable. Any material changes in circumstances, such as large decreases in revenue or the discontinuation of a particular product line, could require future write-downs of the Company's intangible assets and could have a material adverse impact on the Company's operating results for the periods in which such write-downs occur.

### *Goodwill*

Goodwill was recorded as a result of the Company's acquisitions. The Company has recorded these acquisitions using the acquisition method and purchase method of accounting. The Company annually performs an impairment review of its recorded goodwill, and in 2009 determined that no impairment of goodwill existed because the estimated fair value of each reporting unit exceeded its carrying amount. The Company tests its recorded goodwill for impairment on an annual basis, or more often if indicators of potential impairment exist, by determining if the carrying value of each reporting unit exceeds its estimated fair value. Factors that could trigger an interim impairment test include, but are not limited to, underperformance relative to historical or projected future operating

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**Table of Contents**

results, significant changes in the manner of use of the acquired assets or the Company's overall business, significant negative industry or economic trends and a sustained period where market capitalization, plus an appropriate control premium, is less than stockholders equity. Future impairment reviews may require write-downs of the Company's goodwill and could have a material adverse impact on the Company's operating results for the periods in which such write-downs occur.

*Stock-Based Compensation*

Under the fair value recognition provisions of GAAP, stock-based compensation expense is measured at the grant date and is expensed ratably over the vesting period. Determining the fair value of stock options at the grant date requires judgment, including estimating expected dividends, volatility, terms and estimating the amount of share-based awards that are expected to be forfeited. If actual forfeiture rates differ significantly from the estimate, stock-based compensation expense and the Company's results of operations could be materially impacted. Beginning in 2006, the Company changed its previous practice of predominantly granting stock options to employees, and began granting primarily performance-based and time-based restricted stock as an alternative. Compensation expense for restricted stock is based on the fair market value of the restricted stock on its grant date, and is expensed ratably over the vesting period.

Performance-based restricted stock vests upon the attainment of specific performance targets. The measurement date of restricted stock containing performance-based vesting criteria is the date the restricted stock grant is authorized and the specific performance goals are communicated. Compensation expense is recognized based on the probability that the performance criteria will be met. The recognition of compensation expense associated with performance-based vesting requires judgment in assessing the probability of meeting the performance goals, as well as defined criteria for assessing achievement of the performance-related goals. The continued assessment of probability may result in additional expense recognition or expense reversal depending on the level of achievement of the performance goals.

*Income Taxes*

The Company provides for income taxes based on the estimated effective income tax rate for the complete fiscal year. The income tax provision (benefit) is computed on the pre-tax income (loss) of the consolidated entities located within each taxing jurisdiction based on current tax law. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company regularly reviews the deferred tax assets for recoverability and has established a valuation allowance when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. The Company assesses the recoverability of the deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment, the Company is required to consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that some portion, or all, of the net deferred assets will be realized in future periods.

The Company is subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. The Company applies a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

Although the Company believes it has adequately reserved for its uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes

**Table of Contents**

includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, the Company recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite the Company's belief that its tax return positions are supportable, the Company believes that certain positions may not be fully sustained upon review by tax authorities. The Company believes that its accruals for tax liabilities are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

U.S. income taxes were not provided for on unremitted earnings from non-U.S. subsidiaries. Those unremitted earnings are considered to be indefinitely reinvested.

**New Accounting Pronouncements**

For new accounting pronouncements see Note 13 in Notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****Results of Operations**

The following table summarizes certain aspects of the Company's results of operations for the three and six months ended June 30, 2010, compared to the three and six months ended June 30, 2009 (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2010	2009	Change \$	Change %	2010	2009	Change \$	Change %
<b>Revenues</b>								
License	\$ 19.2	\$ 17.5	\$ 1.7	9.3%	\$ 35.4	\$ 30.7	\$ 4.7	15.3%
Consulting	34.3	32.1	2.2	7.1%	65.4	63.5	1.9	3.0%
Maintenance	47.5	47.3	0.2	0.3%	95.5	94.2	1.3	1.3%
Hardware and other	8.2	3.5	4.7	132.2%	12.1	10.7	1.4	13.5%
<b>Total revenues</b>	<b>109.2</b>	<b>100.4</b>	<b>8.8</b>	<b>8.7%</b>	<b>208.4</b>	<b>199.1</b>	<b>9.3</b>	<b>4.7%</b>
<b>Gross profit % excluding amortization</b>								
License	75.4%	78.0%			76.7%	79.6%		
Consulting	18.8%	18.7%			18.0%	17.3%		
Maintenance	75.0%	76.7%			75.1%	76.7%		
Hardware and other	12.1%	13.0%			12.1%	12.0%		
Amortization of intangible assets	\$ 7.1	\$ 8.2	\$ (1.1)	(14.2)%	\$ 14.1	\$ 16.6	\$ (2.5)	(15.1)%
% of revenues	6.5%	8.2%			6.8%	8.3%		
Gross profit	\$ 50.5	\$ 48.2	\$ 2.3	4.7%	\$ 97.9	\$ 92.3	\$ 5.6	6.1%
% of revenues	46.2%	48.0%			47.0%	46.4%		
Sales and marketing	\$ 20.6	\$ 18.2	\$ 2.4	13.5%	\$ 41.7	\$ 36.2	\$ 5.5	15.1%
% of revenues	18.9%	18.1%			20.0%	18.2%		
Software development	\$ 13.7	\$ 12.4	\$ 1.3	9.8%	\$ 27.5	\$ 24.8	\$ 2.7	10.9%
% of revenues	12.5%	12.4%			13.2%	12.5%		
General and administrative	\$ 11.9	\$ 14.0	\$ (2.1)	(14.9)%	\$ 24.2	\$ 28.2	\$ (4.0)	(14.4)%
% of revenues	10.9%	14.0%			11.6%	14.2%		
Restructuring charges and other	\$ 2.6	\$ (0.2)	\$ 2.8	1387.3%	\$ 2.7	\$ 1.2	\$ 1.5	121.3%
% of revenues	2.4%	(0.2)%			1.3%	0.6%		
Interest expense	\$ 5.0	\$ 4.9	\$ 0.1	2.6%	\$ 10.0	\$ 10.9	\$ (0.9)	(8.4)%
% of revenues	4.6%	4.9%			4.8%	5.5%		
Interest and other income (expense), net	\$	\$ (0.1)	\$ 0.1	(121.5)%	\$ (1.3)	\$ (0.2)	\$ (1.1)	459.3%
% of revenues	0.0%	(0.1)%			(0.6)%	(0.1)%		
Income tax provision (benefit)	\$ (2.3)	\$ 5.5	\$ (7.8)	(141.8)%	\$ (8.4)	\$ (1.0)	\$ (7.4)	753.6%
Effective tax rate	(69.6)%	487.5%			(88.9)%	(10.6)%		
Net loss	\$ (1.0)	\$ (6.7)	\$ 5.7	(84.8)%	\$ (1.0)	\$ (8.3)	\$ 7.3	(87.4)%
% of revenues	(0.9)%	(6.7)%			(0.5)%	(4.2)%		

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**Table of Contents**

*Revenue*

The increase in license revenues for the three and six months ended June 30, 2010, compared to the same periods in 2009, is due primarily to increased sales of the Company's software solutions driven by sales of the Epicor 9 product, primarily to new customers. License revenues for the three and six months ended June 30, 2010, had no sales greater than \$1.0 million. License revenues for the three months ended June 30, 2009, included one sale greater than \$1.0 million. License revenues for the six months ended June 30, 2009, included two sales greater than \$1.0 million.

Consulting revenues for the three and six months ended June 30, 2010, increased compared to the same periods in 2009. Consulting revenue is derived from license sales, and as such, the increase in license sales has resulted in higher consulting revenue in the current periods.

Maintenance revenues for the three and six months ended June 30, 2010, were relatively flat compared to the same periods in 2009. The Company continues to see high renewal rates in its customer base, and continues to have new license sales and related maintenance contracts sold with new licenses. There is also a continued focus on re-signing customers whose maintenance agreements had previously lapsed, but who have now renewed their maintenance agreements.

Hardware and other revenues consist primarily of the resale of third-party hardware. The increase in hardware and other revenue for the three and six months ended June 30, 2010, as compared to the same periods in 2009, is due to the timing and/or amount of customer hardware orders, which vary based on the customers' hardware roll-out schedules, resulting in a high degree of variability in the Company's hardware revenues.

International revenues were \$33.2 million and \$31.7 million for the three months ended June 30, 2010 and 2009, respectively, representing 30.4% and 31.6%, respectively, of total revenues. International revenues were \$66.1 million and \$62.2 million for the six months ended June 30, 2010 and 2009, respectively, representing 31.7% and 31.2%, respectively, of total revenues. The increase in international revenues in absolute dollars and as a percentage of total revenues was primarily due to the increased international reach of Epicor 9, which is enabling the Company to win deals in international geographies in which it did not as effectively compete previously, including Latin America. Foreign currency exchange rate fluctuations resulted in foreign currency-based revenues during the three months ended June 30, 2010 being \$0.1 million higher, or 0.1%, than these revenues would have been if they had been translated at 2009 foreign currency exchange rates. Foreign currency exchange rate fluctuations resulted in foreign currency-based revenues during the six months ended June 30, 2010 being \$3.2 million higher, or 1.6%, than these revenues would have been if they had been translated at 2009 foreign currency exchange rates.

*Cost of Revenues and Gross Profit*

Cost of license revenues consists primarily of software royalties paid for third-party software incorporated into the

Company's products, referral fees paid to Value Added Resellers (VARs), costs associated with product packaging and documentation and software duplication. For the three and six months ended June 30, 2010, compared to the same periods in 2009, gross profit on license revenue decreased due to higher costs primarily due to a higher mix of third-party software sales.

Cost of consulting revenues consists primarily of salaries, benefits, commissions, bonuses, stock-based compensation, other headcount-related expenses and travel for the Company's consulting organization, as well as outside contractor costs. These costs increased in absolute dollars during the three and six months ended June 30, 2010, compared to the same periods in 2009, due primarily to an increase in outside contractor expenses incurred to support increased demand for the Company's consulting services. Consulting services margins increased for the three and six months ended June 30, 2010, compared to the same periods in 2009, due primarily to increased revenue.

Cost of maintenance revenues consists primarily of salaries, benefits and other personnel-related expenses for the Company's support organization as well as maintenance royalties on third-party software incorporated into the Company's products and referral fees paid to VARs. For the three and six months ended June 30, 2010, compared to the same periods in 2009, cost of maintenance revenues increased in absolute dollars due primarily to increased referral fees paid to VARs. Maintenance gross profit decreased for the three and six months ended June 30, 2010, compared to the same periods in 2009, due to the increase in maintenance costs against flat maintenance revenues.

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**Table of Contents**

Cost of hardware and other revenues increased in absolute dollars in the three and six months ended June 30, 2010, compared to the same periods in 2009, due to the timing of customer hardware orders, which vary based on the customers' hardware roll-out schedules and can result in a high degree of variability in our hardware gross profit margins. Gross profit margin for hardware and other revenues also varies depending on the volume of the hardware sales. Historically, higher-volume hardware sales transactions have yielded lower hardware margins.

*Amortization of Intangible Assets*

Amortization of intangible assets consists of amortization of capitalized acquired technology, customer base and trademarks that were recorded as a result of acquisitions. The Company's intangible assets are amortized over the estimated economic lives of the assets. For the three months ended June 30, 2010 and 2009, the Company recorded amortization expense, included in cost of revenues, related to intangible assets of \$7.1 million and \$8.2 million, respectively. For the six months ended June 30, 2010 and 2009, the Company recorded amortization expense, included in cost of revenues, related to intangible assets of \$14.1 million and \$16.6 million, respectively. The decrease in amortization expense for the three and six months ended June 30, 2010, as compared to 2009, is due to intangible assets that became fully amortized during the period. Amortization of acquired technology, customer base and trademarks will be complete in 2015. See Note 3 in Notes to Unaudited Condensed Consolidated Financial Statements for expected future amortization expense.

*Sales and Marketing*

Sales and marketing expenses consist primarily of salaries, benefits, commissions, stock-based compensation, travel, advertising and promotional expenses. These costs increased in absolute dollars for the three and six months ended June 30, 2010, compared to the same periods in 2009 due primarily to an increase in compensation costs of \$1.6 million and \$3.7 million and an increase in travel expenses related to continued expansion of the Company's products worldwide of \$0.6 million and \$1.0 million, respectively. The Company continues to make additional investments in sales and marketing programs to generate leads, including hiring additional business development representatives, and further supporting and developing its channel strategy.

*Software Development*

Software development costs consist primarily of compensation of development personnel, related overhead incurred to develop new products and upgrade and enhance the Company's current products and fees paid to outside consultants. The majority of these expenses are being incurred by the Company in the United States, Canada, Mexico, Eastern Europe, Malaysia, Australia and Russia, where the Company operates development centers.

Software development expenses increased in absolute dollars and as a percentage of revenue for the three and six months ended June 30, 2010, compared to the same periods in 2009, due primarily to an increase in compensation costs related to continued investment in Epicor 9, particularly in adding additional languages and localizations and additional features and functionality to further expand the Company's addressable markets, additional investment in the development of products to replace some of the third-party software solutions the company currently resells.

*General and Administrative Expense*

General and administrative expenses consist primarily of costs associated with the Company's executive, financial, legal, human resources and information systems functions. General and administrative expenses decreased in absolute dollars and as a percentage of total revenues during the three and six months ended June 30, 2010, compared to the same periods in 2009. This decrease for the three months ended June 30, 2010 is primarily attributable to a lower provision for doubtful accounts of \$1.1 million with the remaining decrease primarily attributable to overall cost reductions as a result of a continued focus on expense management. The decrease for the six months ended June 30, 2010 compared to the same period in 2009 is due primarily to lower legal fees of \$1.6 million, a lower provision for doubtful accounts of \$1.6 million with the remaining decrease primarily related to overall cost reductions as a result of a continued focus on expense management.

*Stock-Based Compensation Expense*

Stock-based compensation expense includes compensation expense from restricted stock issued and stock options granted by the Company. For the three months ended June 30, 2010 and 2009, stock-based compensation expense was \$3.5 million and \$1.6 million, respectively. For the six months ended June 30, 2010 and 2009, stock-based



**Table of Contents**

compensation expense was \$7.7 million and \$4.1 million, respectively. Stock-based compensation expense increased due primarily to the expansion of the Company's performance-based restricted stock program and elimination of the Company's cash-based bonus program.

At June 30, 2010, there was approximately \$12.2 million and \$2.8 million of unrecognized compensation expense related to performance-based restricted stock and other restricted stock grants, respectively. These costs are expected to be recognized over weighted-average periods of approximately two years.

In January 2010, the Company's Board of Directors expanded the Company's performance-based restricted stock program for 2010 and eliminated the Company's prior cash-based management bonus plan for 2010. The compensation cost related to the additional performance-based restricted stock depends on the estimated number of shares that will vest based on the probable outcome of the performance conditions, similar to the existing performance-based restricted stock. Because the additional performance-based restricted stock replaces the Company's management cash bonus program, overall compensation expense for the Company as a result of the plan is not expected to increase significantly.

The compensation cost related to performance-based restricted stock depends on the estimated number of shares that will vest based on the probable outcome of the performance conditions. Therefore, the recognized compensation could vary significantly depending on the outcome of those conditions. The Company is required at each reporting date to assess whether achievement of any performance condition is probable. Quarterly compensation expense may include a cumulative adjustment resulting from changes in the estimated number of shares expected to be earned during that plan year. Based on the Company's current estimate of performance conditions applicable to the 2010 performance year, the Company has recorded compensation expense of \$2.8 million and \$5.6 million related to performance-based restricted stock for the three and six months ended June 30, 2010, respectively.

The following table sets forth the total stock-based compensation expense resulting from restricted stock awards and stock options included in the Company's Condensed Consolidated Statements of Operations and Comprehensive Loss (*in thousands*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Cost of revenues	\$ 538	\$ 345	\$ 1,088	\$ 657
Sales and marketing	737	415	1,565	1,022
Software development	614	171	1,242	348
General and administrative	1,572	713	3,845	2,035
<b>Total stock-based compensation expense</b>	<b>\$ 3,461</b>	<b>\$ 1,644</b>	<b>\$ 7,740</b>	<b>\$ 4,062</b>

*Restructuring Charges and Other*

During the six months ended June 30, 2010, the Company recorded restructuring and other charges of \$2.7 million. These charges represent \$1.4 million of severance related costs associated with cost reduction initiatives taken and management severance. The Company also recorded \$1.3 million of facilities charges primarily related to changes in estimates on subleasing facilities located in the United Kingdom. For the six months ended June 30, 2009, the Company recorded \$1.2 million in restructuring and other charges, primarily related to management severance.

*Interest Expense*

Interest expense is comprised of interest on the Company's convertible debt and credit facility, debt discount amortization, debt issuance fees amortization and debt issuance fees write-offs. Interest expense was flat for the three months ended June 30, 2010, compared to the same period in 2009. Interest expense decreased for the six months ended June 30, 2010, compared to the same period in 2009 due to a lower credit facility balance and lower amortization of capitalized debt issuance costs related to the reduction in borrowing capacity on the credit facility. See Note 7 in Notes to Unaudited Condensed Consolidated Financial Statements for additional information.



**Table of Contents**

*Interest and Other Income (Expense), Net*

Interest and other income (expense), net, was flat for the three months ended June 30, 2010, compared to the same period in 2009. Interest and other income (expense), net, increased for the six months ended June 30, 2010, compared to the same period in 2009, due primarily to a foreign currency charge due to the Venezuela currency devaluation. See Note 11 in Notes to Unaudited Condensed Consolidated Financial Statements for additional information.

*Income Tax Provision (Benefit)*

The income tax provision (benefit) consists of federal, state and foreign income taxes. The Company operates in an international environment with significant operations in various locations outside the U.S. Accordingly, the consolidated income tax rate is a composite rate reflecting earnings in the various locations and the applicable rates.

The Company recorded an income tax provision (benefit) of \$(2.3) million and \$5.5 million for the three months ended June 30, 2010 and 2009, respectively. The effective income tax rates were (69.6)% and 487.5% for the three months ended June 30, 2010 and 2009, respectively. The Company recorded an income tax benefit of \$8.4 million and \$1.0 million for the six months ended June 30, 2010 and 2009, respectively. The effective income tax rates were (88.9)% and (10.6)% for the six months ended June 30, 2010 and 2009, respectively.

The 2010 effective tax rate differs from the statutory U.S. federal income tax rate of 35% due to earnings in foreign jurisdictions taxed at different rates, state taxes, permanent differences between GAAP pre-tax income and taxable income, and the recognition of uncertain tax benefits.

The 2009 effective tax rate differs from the statutory U.S. federal income tax rate of 35% due to earnings in foreign jurisdictions taxed at different rates, state taxes, permanent differences between GAAP pre-tax income and taxable income, and releases of reserves for uncertain tax positions primarily related to statute closures and expected audit settlements in foreign jurisdictions.

The Company regularly reviews its deferred tax assets for recoverability and has established a valuation allowance when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. The Company assesses the recoverability of the deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment, the Company is required to consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that some portion, or all, of the net deferred assets will be realized in future periods. Given the increased global scope of our operations, and the complexity of global tax and transfer pricing regulations, it has become increasingly difficult to estimate earnings within each tax jurisdiction. If actual earnings within a tax jurisdiction differ materially from our estimates, an adjustment to income would occur if we determine that we are able to realize a different amount of our deferred tax assets than currently expected.

**Table of Contents****Liquidity and Capital Resources**

The following table summarizes the Company's cash and cash equivalents, working capital and long-term debt as of June 30, 2010 and December 31, 2009 as well as cash flows for the six months ended June 30, 2010 and 2009 (*in millions*):

	As of June 30, 2010	As of December 31, 2009
Cash and cash equivalents	\$ 109.4	\$ 106.9
Working capital	83.7	65.6
Long-term debt, less current portion, exclusive of debt discount	254.6	255.5

  

	Six Months Ended June 30,	
	2010	2009
Net cash provided by operating activities	\$ 14.2	\$ 15.7
Net cash (used in) investing activities	(2.9)	(3.0)
Net cash (used in) financing activities	(6.6)	(16.8)

**Overview**

As of June 30, 2010, the Company had cash and cash equivalents of \$109.4 million and \$83.7 million in net working capital (current assets in excess of current liabilities) compared to \$106.9 million and \$65.6 million at December 31, 2009. The Company's primary sources of operating cash are customers' payments for license fees, consulting services and maintenance contracts. The Company's primary use of operating cash is for employee costs, third-party software royalties, and facilities. The Company's working capital excluding deferred revenue at June 30, 2010 and December 31, 2009, was \$182.8 million and \$161.6 million, respectively. The Company believes this is a relevant measurement of working capital since deferred revenue is an obligation for services rather than for cash. The cost of providing these services is generally fixed in nature and ranges from 22% to 27% of the related revenues.

The Company's cash balances are held in numerous locations throughout the world, including substantial amounts held outside the United States. Most of the amounts held outside of the United States could be repatriated to the United States, but under current law, would be subject to U.S. federal income taxes, less applicable foreign tax credits. In some countries, repatriation of certain foreign balances is restricted by local laws. The Company utilizes a variety of tax planning and financing strategies with the objective of having its worldwide cash available in the location where it is needed.

The Company's days sales outstanding (DSO) for the last six quarters are set forth in the following table:

<b>Quarter Ended:</b>	<b>2009</b>
March 31	72
June 30	78
September 30	74
December 31	74
	<b>2010</b>
March 31	76
June 30	71

Days sales outstanding have ranged from 71 to 78 for the last six quarters and are expected to remain in this range for the third quarter of 2010.

As of June 30, 2010, the Company had \$6.7 million in cash obligations for severance costs, lease terminations and other costs related to the Company's restructurings. These obligations are expected to be paid through 2016 and the Company believes these obligations will be funded from existing cash reserves and cash generated from continuing operations.



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**Table of Contents**

Considering current cash reserves, funds from future operations and availability of funds under the Company's 2007 credit facility, management believes that the Company will have sufficient liquidity to fund its operations through at least the next twelve months. However, the Company may require additional sources of liquidity to fund any future acquisitions and its future growth. There can be no assurance that the Company will not seek to raise additional capital through the incurrence of debt or issuance of equity securities in the future.

The Company is dependent upon its ability to generate cash flows from license and other operating revenues, providing services to its customers and on collection of its accounts receivable to maintain current liquidity levels. If the Company is not successful in achieving targeted revenues and expenses or positive cash flows from operations, the Company may be required to take further cost-cutting measures and restructuring actions or seek alternative sources of funding.

As of June 30, 2010, the Company had \$37.5 million in borrowing capacity available under its 2007 credit facility. Borrowing capacity under the 2007 credit facility may be reduced or otherwise limited as a result of the Company's obligation to comply with certain financial covenants. However, the Company is currently in compliance with these covenants (as described below). The Company increased its leverage to finance its acquisitions of CRS (2005) and NSB (2008). As described below, as of June 30, 2010, the Company had \$230 million outstanding convertible senior notes and \$62.5 million outstanding under its 2007 credit facility. This indebtedness may reduce the Company's flexibility to respond to changing business and economic conditions or fund capital expenditures or working capital needs because the Company may require additional sources of liquidity to fund any future acquisitions and its future growth. While the Company currently expects that additional capital will be available to it through the incurrence of debt or issuance of equity securities, these alternative sources of funding may not be available on terms favorable to the Company or at all, in which case, the Company's business, financial condition or results of operations may be adversely affected.

***Operating Activities***

The Company's operations provided \$14.2 million in cash during the six months ended June 30, 2010. Cash flows from operating activities were generated even though the Company reported a net loss of \$1.0 million. Cash flows from operating activities differed from the net loss partially because of non-cash charges primarily consisting of \$17.8 million of depreciation and amortization, \$7.7 million of stock-based compensation expense, \$0.5 million of provision for doubtful accounts, \$0.9 million of debt issuance fee amortization, \$4.2 million of debt discount amortization, and \$2.7 million of restructuring charges and other. Net working capital changes decreased overall cash provided from operations by \$6.3 million. The working capital changes relate primarily to a decrease in other current assets of \$4.4 million, a decrease in inventory of \$1.3 million, a decrease in other accrued liabilities of \$8.5 million, and a decrease in accrued restructuring costs of \$1.8 million for payments made in connection with the Company's restructuring activities in 2010 offset by \$2.3 million from cash collections of accounts receivable.

The Company's operations provided \$15.7 million in cash during the six months ended June 30, 2009. Cash flows from operating activities were generated even though the Company reported a net loss of \$8.3 million. Net loss was reduced by non-cash charges primarily consisting of \$20.7 million of depreciation and amortization, \$4.1 million of stock-based compensation expense, \$2.1 million of provision for doubtful accounts, \$1.9 million of debt issuance fee amortization, \$3.9 million of debt discount amortization and \$1.2 million of restructuring charges. Net working capital changes decreased overall cash provided from operations by \$6.5 million. The working capital changes relate primarily to a decrease in accounts receivable of \$4.9 million offset by \$3.9 million in payments made in connection with the Company's restructuring activities in 2009, as well as a decrease in accounts payable and accrued expenses of \$6.5 million.

***Investing Activities***

The Company's principal investing activities for the six months ended June 30, 2010, included \$2.2 million for capital expenditures and \$0.7 million in business combination costs.

The Company's principal investing activities for the six months ended June 30, 2009, included \$2.0 million for capital expenditures and \$1.0 million in additional business combination costs.

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**Table of Contents*****Financing Activities***

Financing activities for the six months ended June 30, 2010, included \$5.1 million of payments on the 2007 credit facility and capital leases and \$2.6 million for the purchase of treasury stock. The Company repurchases a portion of employees' vested shares to satisfy employee income tax withholding requirements and expects such treasury stock activity to recur due to the various vesting schedules of restricted stock. Cash provided by financing activities included proceeds from the issuance of stock under the employee stock purchase plan and proceeds from the exercise of employee stock options of \$0.5 million.

Financing activities for the six months ended June 30, 2009, included \$16.1 million in payments on the 2007 credit facility and \$1.0 million for the purchase of treasury stock. Cash provided by financing activities included proceeds from the issuance of stock under the employee stock purchase plan and proceeds from the exercise of employee stock options of \$0.2 million.

***2007 Credit Facility***

On December 16, 2007, the Company entered into a syndicated credit facility (the 2007 credit facility) for up to \$250 million in term loan and revolving facilities, consisting of \$100 million term loan and \$150 million in revolving loan facility (after giving effect to an accordion feature). Funds from the 2007 credit facility were allowed to be used to finance the NSB acquisition and to pay certain fees and expenses incurred in connection with the NSB acquisition; and following such acquisition, to provide ongoing working capital and to be used for other general corporate purposes. The Company pledged all of its assets as collateral, subject to certain exceptions. The terms of the 2007 credit facility requires compliance with various covenants, described below. Amounts repaid under the term loan may not be re-borrowed. On December 30, 2008, the Company amended the 2007 credit facility to, among other things, (i) amend the total leverage ratio to add back up to \$4 million in restructuring charges to consolidated EBITDA in connection with certain restructuring activities undertaken by the Company during the quarter ending December 31, 2008, (ii) repurchase up to \$25 million of the Company's convertible senior notes, and (iii) to reduce the revolving credit facility from \$150 million to \$100 million, which reduced the lenders' aggregate commitment to the Company and allowed the Company to reduce the commitment fees it paid on the unused capacity.

On September 30, 2009, the Company amended the 2007 credit facility to, among other things, (i) amend the financial covenants by eliminating the total leverage and fixed charge coverage ratios, lowering the maximum senior secured leverage ratio and adding a minimum EBITDA covenant and a minimum liquidity ratio, (ii) amend the maturity date from February 19, 2013 to September 30, 2012, and (iii) increase the applicable interest rates and commitment fees payable under the facility. Upon entering into the amendment, the Company was required to repay in full the outstanding term loan facility, which had an outstanding principal balance of \$79 million. On September 30, 2009, the Company paid the outstanding term loan balance by drawing \$72.5 million under the revolving facility and paying \$6.5 million from discretionary funds.

As a result of the September 30, 2009 amendment to the 2007 credit facility, the Company is required to comply with the following financial covenants from September 30, 2009 through the remainder of the term of the 2007 credit facility: (i) maximum senior leverage ratio, (ii) minimum EBITDA ratio, and (iii) minimum liquidity ratio; all measured on a consolidated basis. EBITDA, for purposes of these ratios, consists of net income, plus the following to the extent deducted in calculating net income for a given period: (a) interest expense; (b) the provision for taxes payable; (c) the amount of depreciation and amortization expense (including impairment of goodwill); (d) restructuring charges incurred during the fiscal quarter ended December 31, 2008, in an aggregate amount up to \$4 million; (e) cash restructuring charges incurred after June 30, 2009, in an aggregate amount up to \$5 million; and (f) non-cash charges.

Under the senior leverage ratio covenant, the Company's senior leverage, consisting of amounts outstanding under the 2007 credit facility and any other secured borrowings, may not exceed two times the EBITDA for the preceding 12-month period, as measured at the end of each fiscal quarter.

Under the minimum EBITDA ratio, the Company's EBITDA for the preceding 12-month period, as measured at the end of each fiscal quarter, must be at least \$50 million.

Under the minimum liquidity ratio, the ratio of (a) the sum of (i) unrestricted cash and (ii) accounts receivable to (b) the sum of (i) current liabilities (exclusive of amounts outstanding under the 2007 credit facility), plus (ii) amounts outstanding under the 2007 credit facility, minus (iii) deferred revenue, minus (iv) accounts payable for inventory held for resale; may be no less than (aa) 1.15 to 1 for fiscal quarters ended September 30 and December 31, 2009,

**Table of Contents**

(bb) 1.25 to 1 for fiscal quarters ending March 31 and June 30, 2010, (cc) 1.40 to 1 for the fiscal quarter ending September 30, 2010, and (dd) 1.50 to 1 for the fiscal quarters ending on or after December 31, 2010.

Interest under the 2007 credit facility is variable, and at June 30, 2010, the effective weighted average interest rate was 5.28%. At June 30, 2010, the Company was in compliance with all covenants included in the terms of the 2007 credit facility.

On April 28, 2010, the Company made a voluntary principal payment of \$5.0 million against the revolving loan from discretionary funds, bringing the outstanding loan balance to \$62.5 million and unused borrowing capacity of \$37.5 million under the revolver at June 30, 2010. On July 29, 2010, the Company made a voluntary principal payment of \$5.0 million against the revolving loan from discretionary funds, bringing the outstanding loan balance to \$57.5 million.

On April 18, 2008, March 11, 2009 and March 12, 2009, the Company entered into interest rate swap agreements to convert a portion of the Company's interest rate variability to a fixed rate basis as required under the 2007 credit facility in connection with the term loan thereunder. The interest rate swaps qualified for hedge accounting treatment at the time. The agreements effectively convert the Company's floating-rate debt to fixed-rate debt. This reduces the risk of higher interest costs in periods of rising interest rates and increases our risk of paying higher interest costs in periods of decreasing interest rates.

Following is a summary of the interest rate swaps (rates for expired contracts are exclusive of an interest rate margin and active contracts are inclusive of the interest rate margin of 4.00% applicable at June 30, 2010, under the 2007 credit facility):

Contract Date	Notional Amount	Interest Period Covered	Rate
04/18/08	\$20 million	06/30/08 03/31/09	3.170%
04/18/08	\$15 million	06/30/08 09/30/09	3.195%
04/18/08	\$15 million	06/30/08 09/30/09	3.150%
03/11/09	\$20 million	03/31/09 03/31/11	5.690%
03/12/09	\$15 million	09/30/09 03/31/11	5.890%
03/12/09	\$ 5 million	09/30/09 09/30/10	6.050%

At June 30, 2010, the effective interest rate for the notional amounts covered by the swap agreements as of such date was 5.81% (inclusive of 4.00% interest rate margin applicable at June 30, 2010, under the 2007 credit facility). As of September 30, 2009, as a result of repayment of the term loan facility, the interest rate swaps were de-designated and no longer qualify for hedge accounting treatment. The interest rate swaps are recorded as a net liability of \$0.4 million in accrued expenses as of June 30, 2010, and a gain for the change in the fair value of the interest rate swaps of \$0.1 million is included in interest and other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss for both the three and six months ended June 30, 2010.

**Convertible Senior Notes**

On May 8, 2007, the Company closed an offering of \$230 million aggregate principal amount of 2.375% convertible senior notes due in 2027 (the convertible senior notes). The convertible senior notes are unsecured and pay interest semiannually at a rate of 2.375% per annum until May 15, 2027. The convertible senior notes are convertible into cash or, at the Company's option, cash and shares of the Company's common stock. Pursuant to the terms of the notes, the principal amount of the convertible senior notes is settleable in cash and only the amount of conversion value, as defined, in excess of the principal amount of the notes is settleable in cash or shares. The convertible senior notes do not contain any restrictive financial covenants.

On or after May 15, 2014, the Company may from time to time at its option redeem the convertible senior notes, in whole or in part, for cash, at a redemption price equal to 100% of the principal amount of the convertible senior notes we redeem, plus any accrued and unpaid interest to, but excluding, the redemption date. On May 15, 2014, May 15, 2017 and May 15, 2022, holders may require the Company to purchase all or a portion of their convertible

**Table of Contents**

senior notes at a purchase price equal to 100% of the principal amount of the convertible senior notes to be purchased, plus any accrued and unpaid interest to, but excluding, the purchase date.

At June 30, 2010 and December 31, 2009, the debt discount was \$38.0 million and \$42.1 million, respectively. At both June 30, 2010 and December 31, 2009, the Company has \$230 million in principal due under the convertible debt. The net carrying amount was \$192.0 million and \$187.9 million as of June 30, 2010 and December 31, 2009, respectively. The Company is amortizing the debt discount through the date at which the Company can begin to redeem the convertible senior notes, which is May 15, 2014. The effective interest rate used to measure the initial fair value of the debt was 7.35%, which was based on market conditions for nonconvertible debt at the time the debt was entered into. The Company recognized interest expense of \$3.5 million and \$3.3 million related to the convertible debt for the three months ended June 30, 2010 and 2009, respectively, of which \$1.4 million in each year is based on the coupon rate. The Company recognized interest expense of \$6.9 million and \$6.6 million related to the convertible debt for the six months ended June 30, 2010 and 2009, respectively, of which \$2.7 million in each year is based on the coupon rate.

*Foreign Currency Risk*

The Company has operations in foreign locations around the world. These operations incur revenue and expenses in various foreign currencies. Revenues and expenses denominated in currencies other than the United States dollar expose the Company to foreign currency exchange rate risk. Unfavorable movements in foreign currency exchange rates between the United States dollar and other foreign currencies may have an adverse impact on the Company's operations. These foreign currency exchange rate movements could create a foreign currency gain or loss that could be realized or unrealized for the Company. The foreign currencies for which we currently have the most significant exposure are the Australian dollar, Canadian dollar, euro, British pound, Mexican peso, Malaysian ringgit and Japanese yen. The Company's Board of Directors has approved a foreign currency risk policy that allows the Company to enter into forward contracts and purchase option agreements to hedge foreign currency risks. The Company has an ongoing program to evaluate its foreign currency risk and to minimize these risks whenever possible through leading and lagging accounts payables and accounts receivables, centralized cash management and other forms of natural hedging. The Company also uses forward contracts or purchase options to hedge some of its foreign currency transaction exposure. Gains and losses resulting from these transactions are included in interest and other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. As of June 30, 2010, the Company had no open forward contracts or purchase options.

The Company conducts limited operations in Venezuela (i.e., revenue derived from Venezuelan operations represented less than 0.01% of the Company's consolidated revenue for the three and six months ended June 30, 2010). In January 2010, the government of Venezuela devalued its bolivar currency from 2.15 to 4.30 bolivares per United States dollar. As a result of the devaluation, the Company reduced its cash and working capital balances by and incurred a foreign currency charge of \$1.3 million due to the revaluing of its bolivar-based assets.

*Off-Balance Sheet Arrangements*

Through June 30, 2010, the Company has not entered into any off-balance sheet arrangements or transactions with unconsolidated entities or other persons.

*Contractual Obligations*

There are no material changes to the Company's contractual obligations from its December 31, 2009 Annual Report on Form 10-K.

## **Table of Contents**

### ***Certain Factors That May Affect Future Results***

#### **Economic conditions could materially adversely affect the Company.**

The Company's operations and performance vary significantly in relation to worldwide economic conditions. Uncertainty about current global economic conditions poses a risk as consumers and businesses may continue to postpone spending in response to tighter credit markets, unemployment, negative financial news and/or declines in income or asset values, which could have a material negative effect on demand for the Company's products and services. These and other economic factors could materially adversely affect demand for the Company's products and services and the Company's financial condition and operating results. All of these factors could also increase the volatility of the Company's stock price.

#### **Our future results could be harmed by economic, political, geographic, regulatory and other specific risks associated with our international operations.**

The Company believes that any future growth of the Company will be dependent, in part, upon the Company's ability to maintain and increase revenues in its existing and emerging international markets, including Asia and Latin America. During the three months ended June 30, 2010 and 2009, 30.4% and 31.6%, respectively, of total Company revenues were generated by the Company's international operations. During the six months ended June 30, 2010 and 2009, 31.7% and 31.2%, respectively, of total Company revenues were generated by the Company's international operations. There can be no assurance that the Company will be able to maintain or expand its international sales. In addition, if the revenues that the Company generates from foreign activities are inadequate to offset the expense of maintaining foreign offices and activities, the Company's business, financial condition and results of operations could be materially and adversely affected. The international reach of the Company's businesses could also subject the Company and its results of operations to unexpected, uncontrollable and rapidly changing economic and political conditions. Specifically, our international sales and operations are subject to inherent risks, including:

Differing intellectual property and labor laws;

Lack of experience in a particular geographic market;

Different and changing regulatory requirements;

Tariffs and other barriers, including import and export requirements and taxes on subsidiary operations;

Fluctuating exchange rates, currency devaluation and currency controls;

Difficulties in staffing and managing foreign sales and support operations;

Longer accounts receivable payment cycles;

Potentially adverse tax consequences, including repatriation of earnings;

Development and support of localized and translated products;



Lack of acceptance of localized products or the Company in foreign countries;

Shortage of skilled personnel required for local operations; and

Perceived health risks natural disasters or terrorist risks which impact a geographic region and business operations therein. Any one of these factors or a combination of them could materially and adversely affect the Company's future international sales and, consequently, the Company's business, operating results, cash flows and financial condition. A portion of the Company's revenues from sales to foreign entities, including foreign governments, has been in the form of foreign currencies. While the Company does enter into hedges and other similar foreign currency contracts from time to time, there can be no assurance that such activities will effectively minimize the impact that fluctuations in the value of foreign currencies may have on the Company. Specifically, during the three and six months ended June 30, 2010, foreign currency transaction losses totaled \$0.3 million and \$1.7 million, respectively. Fluctuations in the value of foreign currencies have in the past and could continue to adversely impact the profitability of the Company's foreign operations.

## **Table of Contents**

### **We have a significant amount of debt outstanding under our convertible senior notes and our 2007 credit facility which could have various adverse effects on our business and financial conditions.**

As of June 30, 2010, we had approximately \$230 million of outstanding debt under our convertible senior notes. In addition, in February 2008, we borrowed \$160 million under our 2007 credit facility, of which \$62.5 million is outstanding at June 30, 2010, to finance the acquisition of NSB and to pay certain fees and expenses incurred in connection with the acquisition. Our substantial indebtedness could adversely affect our business, financial condition and results of operations and our ability to meet our payment obligations under our outstanding liabilities.

This level of debt could have significant consequences on our future operations, including:

Making it more difficult for us to meet our payment and other obligations under our outstanding debt;

Resulting in an event of default if we fail to comply with the financial and other restrictive covenants contained in our 2007 credit facility, which event of default could result in all of our debt becoming immediately due and payable and, in the case of an event of default under our secured debt, such as our 2007 credit facility, could permit the lenders to foreclose on our assets securing that debt. For example, we failed to meet the total leverage ratio covenant in our credit agreement during the second quarter of 2008 and were required to seek and obtain a waiver by paying a penalty to prevent an event of default. Although we amended the financial covenants in September 2009 in a manner favorable to us, if we are unable to satisfy these amended financial covenants in the future, amendments or waivers to the credit agreement may not be available on reasonable terms or at all, which may result in an event of default and acceleration of the debt, which we may be unable to pay;

Reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes;

Subjecting us to the risk of increased sensitivity to interest rate increases on any indebtedness with variable interest rates;

Limiting our flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business, the industry in which we operate and the general economy; and

Placing us at a competitive disadvantage compared to our competitors that have less debt or are less leveraged because of the above-listed factors.

Any of the above-listed factors could have an adverse effect on our business, financial condition and results of operations and our ability to meet our payment obligations under our outstanding liabilities.

### **Fluctuations in foreign currency exchange rates may negatively impact the financial results of the Company.**

The results of operations or financial condition of the Company may be negatively impacted by fluctuations in foreign currency exchange rates. The Company operates throughout the world through international sales subsidiaries, networks of exclusive third party distributors, and non-exclusive value added resellers (VARs). As a result, certain sales and related expenses are denominated in currencies other than the United States dollar. The Company's results of operations may fluctuate due to exchange rate fluctuation between the United States dollar and other currencies because our financial results are reported on a consolidated basis in United States dollars and through the use of foreign currency denominated loans available under the Company's 2007 credit facility. In an effort to minimize operation fluctuations due to currency movements, we may attempt to limit foreign exchange exposure through operational strategies (e.g. natural hedges, netting, leading and lagging of accounts payables and account receivables) to offset the effects of exchange rate changes. In addition, the Company may enter into forward currency contracts and purchase options contracts to mitigate unfavorable impacts to our non-operating income. However, we can provide no assurance that any of these strategies will be effective.

**The continued future success of our *Epicor* product could materially impact our ability to successfully grow our business.**

**Table of Contents**

*Epicor*, our next generation ERP software product, became generally available during the fourth quarter of 2008. If we are not able to continue to successfully market and license *Epicor* in the future, it may have an adverse effect on our financial condition and results of operations. In addition, we operate in a highly competitive segment of the software industry and if our competitors develop more successful products or services, our revenue and profitability will most likely decline.

**If the emerging and current technologies and platforms of Microsoft Corporation and others upon which the Company builds its products do not gain or retain broad market acceptance, or if we fail to develop and introduce in a timely manner new products and services compatible with such emerging technologies, we may not be able to compete effectively and our ability to generate revenues will suffer.**

The Company's software products are built and depend upon several underlying and evolving relational database management system ( RDBMS ) platforms such as Microsoft SQL Server, Progress Open Edge and Rock@U2 . To date, the standards and technologies that the Company has chosen to develop its products upon have proven to be popular and have gained broad industry acceptance. However, the market for the Company's software products is subject to ongoing rapid technological developments, quickly evolving industry standards and rapid changes in customer requirements, and there may be existing or future technologies and platforms that achieve industry standard status, which are not compatible with our products. Additionally, because the Company's products rely significantly upon popular existing user interfaces to third party business applications, the Company must forecast which user interfaces will be or will remain popular in the future. For example, the Company believes the Internet has and continues to transform the way businesses operate and the software requirements of customers, who are increasingly shifting towards Web-based applications and away from server-based applications. Specifically, the Company believes that customers desire business software applications that enable a customer to engage in commerce or service over the Internet. The Company is proceeding on its previously announced determination to continue with development of several of its primary product lines upon the Microsoft .NET technology. If the Company cannot continue to develop such .NET compatible products in time to effectively bring them to market, or if .NET does not continue to be a widely accepted industry standard, or if customers adopt competitors' products when they shift to Web-based applications, the ability of the Company's products to interface with popular third party applications will be negatively impacted and the Company's competitive position, operating results and revenues could be adversely affected.

**New software technologies could cause us to alter our business model resulting in adverse effects on our operating results.**

Development of new technologies may also cause the Company to change how it licenses or prices its products, which may adversely impact the Company's revenues and operating results. Developing licensing models include Software as a Service (SaaS), hosting and subscription-based licensing, in which the licensee essentially rents software for a defined period of time, as opposed to the current perpetual license model. While the Company currently offers a hosted model as well as a SaaS model to its NSB retail customers, and to a limited extent, its enterprise customers, it has to date chosen not to offer a subscription-based model. The Company's future business, operating results and financial condition will depend on its ability to effectively train its sales force to sell an integrated comprehensive set of business software products and recognize and implement emerging industry standards and models, including new pricing and licensing models.

If the Company fails to respond to emerging industry standards, including licensing models and end-user requirements, the Company's competitive position and revenues could be adversely affected.

**A significant portion of our future revenue is dependent upon our existing installed base of customers continuing to license additional products, as well as purchasing consulting services and renewing their annual maintenance and support contracts. If our existing customers fail to renew their maintenance and support agreements or fail to purchase new user licenses or product enhancements or additional services from the Company at historical levels, the Company's revenues and results of operations could be materially impacted.**

Historically, approximately 50% to 60% of the Company's license revenues, 90% of the Company's maintenance revenues and a substantial portion of the Company's consulting revenues are generated from

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## **Table of Contents**

the Company's installed base of customers. Maintenance and support agreements with these customers are traditionally renewed on an annual basis at the customer's discretion, and there is normally no requirement that a customer renew or that a customer pay new license or service fees to the Company following the initial purchase. For example, as a result of the recent economic downturn, some customers have not renewed their maintenance and support agreements. If the Company's existing customers do not renew their maintenance and support agreements or fail to purchase new user licenses or product enhancements or additional services at historical levels, our revenues and results of operations could be materially impacted.

**We have recorded a large amount of goodwill and other acquired intangible assets that we will be required to write down and record an expense if they become impaired.**

In connection with our acquisitions, as of June 30, 2010, we have goodwill of \$367.8 million and \$69.7 million of amortizing acquired intangible assets on our balance sheet. Although the goodwill is not amortized, we are required to test the goodwill for impairment at least yearly and any time there is an indication an impairment may have occurred. For example, a significant decline in stock price, like the one that occurred for our common stock following December 31, 2008, may require us to test our goodwill for impairment. If we determine that the carrying value of the goodwill or other acquired intangible assets is in excess of its fair value, we will be required to write down a portion or all of the goodwill or other acquired intangible assets, which would adversely impact our results of operations and our ability to satisfy financial covenants in our credit agreement.

**Our increasingly complex software products may contain errors or defects, which could result in the rejection of our products and damage to our reputation as well as cause lost revenue, delays in collecting accounts receivable, diverted development resources and increased service costs and warranty claims.**

The Company's software products are made up of increasingly complex computer programs. Software products are complex and products offered by the Company often contain undetected errors or failures (commonly referred to as bugs) when first introduced to the market or as new updates or upgrades of such products are released to the market. Despite testing by the Company, and by current and potential customers, prior to general release to the market, the Company's products may still contain material errors after their initial commercial shipment. Such material errors may result in loss of or delay in market acceptance of the Company's products, damage to the Company's reputation and increased service and warranty costs. Ultimately, such errors could lead to a decline in the Company's revenues. The Company has from time to time been notified by some of its customers of errors in its various software products. Although it has not occurred to date, if the Company is unable to correct such errors in a timely manner it could have a material adverse effect on the Company's results of operations and its cash flows. In addition, if material technical problems with the current release of the various database and technology platforms, on which the Company's products operate, including offerings by Progress Software Corporation, Rocket Software and Microsoft Corporation (i.e., SQL and .NET), occur, such difficulties could also negatively impact sales of these products, which could in turn have a material adverse effect on the Company's results of operations.

**The market for new development tools, application products and consulting and education services continues to emerge, which could negatively affect our client/server and Web-based products, and, if the Company fails to respond effectively to evolving requirements of these markets, the Company's business, financial condition, results of operations and cash flows could be materially and adversely affected.**

The Company's development tools, application products and consulting and education services generally help organizations build, customize or deploy solutions that operate in both client/server-computing and Web-based environments. The Company believes that the environment for application software is continuing to change from client/server to a Web-based environment to facilitate commerce on the Internet. There can be no assurance that the market for client/server computing will continue to grow, or will not decrease, or that the Company will be able to continue to respond effectively to the evolving requirements of Web-based markets. Lack of growth in the client/server market or our failure to respond effectively to the needs of Web-based markets could harm our ability to compete or grow our business which would adversely affect our financial condition and results of operations.

**The market for our software products and services is highly competitive. If we are unable to compete effectively with existing or new competitors our business could be negatively impacted.**

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**Table of Contents**

The business information systems industry in general and the manufacturing, distribution, retail, customer relationship management (CRM) and financial computer software industry specifically, in which the Company competes are very competitive and subject to rapid technological change, evolving standards, frequent product enhancements and introductions and changing customer requirements. Many of the Company's current and potential competitors have (i) longer operating histories, (ii) significantly greater financial, technical and marketing resources, (iii) greater name recognition, (iv) larger technical staffs and/or (v) a larger installed customer base than the Company. In addition, as the Company continues to sell to larger companies outside the mid-market, it faces more competition from large well-established competitors such as SAP AG and Oracle Corporation. A number of companies offer products that are similar to the Company's products and target the same markets. In addition, any of these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements (such as commerce on the Internet and Web-based application software), and to devote greater resources to the development, promotion and sale of their products than the Company. Furthermore, because there are relatively low barriers to entry in the software industry, the Company expects additional competition from other established and emerging companies. Such competitors may develop products and services that compete with those offered by the Company or may acquire companies, businesses and product lines that compete with the Company. It also is possible that competitors may create alliances and rapidly acquire significant market share, including in new and emerging markets. Accordingly, there can be no assurance that the Company's current or potential competitors will not develop or acquire products or services comparable or superior to those that the Company develops, combine or merge to form significant competitors or adapt more quickly than the Company to new technologies, evolving industry trends and changing customer requirements. Competition could cause price reductions, reduced margins or loss of market share for the Company's products and services, any of which could materially and adversely affect the Company's business, operating results and financial condition. There can be no assurance that the Company will be able to compete successfully against current and future competitors or that the competitive pressures that the Company may face will not materially adversely affect its business, operating results, cash flows and financial condition.

**If we were to lose and not be able to replace the services of the members of our senior management team, we may not be able to execute our business strategy.**

Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, our executive officers and other senior members of our management team such as our chief marketing officer and executive and senior vice presidents are critical to the overall management of the Company as well as the development of our technology, our operations and our strategic direction. All of our executive officers and key employees are at-will employees, and we do not maintain any key-person life insurance policies. The transition of key executives, such as at the CEO level over the last year, as well as the loss of other key members of our executive management team could adversely affect our ability to compete effectively and seriously harm our business if the management team is unable to lead the Company during such times of transition or attract qualified replacements in a timely manner.

**We may not be able to maintain and expand our product offerings or business if we are not able to retain, hire and integrate sufficiently qualified personnel.**

The Company's success depends in large part on the continued service of key management personnel that are not subject to employment agreements, including, but not limited to, several of the key personnel employed as a result of the Company's recent acquisitions. In addition, the Company needs to expand its workforce to continue its growth, and the competition to attract, retain and motivate qualified technical, sales and software development personnel is intense. Additionally, the sudden unexpected loss of such technical personnel, such as developers can have a negative impact on the Company's ability to develop and introduce new products in a timely and effective manner. There is no assurance that the Company will retain its key personnel, including those who came to the Company as part of acquisitions, or attract sufficient numbers of qualified key personnel in the future. The failure to retain or attract such persons could have a material adverse effect on the Company's business, operating results, cash flows and financial condition.

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**Table of Contents**

**Our software products incorporate and rely upon third party software products for certain key functionality and our revenues, as well as our ability to develop and introduce new products, could be adversely affected by our inability to control or replace these third party products and operations.**

The Company's products incorporate and rely upon software products developed by several other third party entities such as Microsoft Corporation, Progress Software Corporation, and Rocket Software, Inc. Specifically, the Company's software products are built and depend upon several underlying and evolving relational database management system platforms including Microsoft SQL Server, Progress OpenEdge and Rocket® U2, and also are integrated with several other third party provider products for the purpose of providing or enhancing necessary functionality. In the event that these third party products were to become unavailable to the Company or to our customers, either directly from the third party manufacturers or through other resellers of such products, the Company could not readily replace these products with substitute products. The Company cannot provide assurance that these third parties will:

Remain in business;

Continue to support the Company's product lines;

Maintain viable product lines;

Make their product lines available to the Company on commercially acceptable terms; and

Not make their products available to the Company's competitors on more favorable terms.

Any interruption in the short term could have a significant detrimental effect on the Company's ability to continue to market and sell those of its products relying on these specific third party products and could have a material adverse effect on the Company's business, results of operations, cash flows and financial condition.

**We may pursue strategic acquisitions, investments and relationships and may not be able to successfully manage our operations if we fail to successfully integrate such acquired businesses and technologies, which could adversely affect our operating results.**

As part of its business strategy, the Company may continue to expand its product offerings to include application software products and services that are complementary to its existing software applications, particularly in the areas of electronic commerce or commerce over the Internet, or may gain access to established customer bases into which the Company can sell its current products. The Company's acquisitions of Scala in 2004, CRS in 2005 and NSB in 2008 are typical of this ongoing strategy. However, in connection with acquisitions, investments in other businesses that offer complementary products, joint development agreements or technology licensing agreements, we commonly encounter the following risks:

Difficulty in effectively integrating any acquired technologies or software products into our current products and technologies;

Difficulty in predicting and responding to issues related to product transition such as development, distribution and customer support;

The possible adverse impact of such acquisitions on existing relationships with third party partners and suppliers of technologies and services;

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The possibility that customers of the acquired company might not accept new ownership and may transition to different technologies or attempt to renegotiate contract terms or relationships, including maintenance or support agreements;

The possibility that the due diligence process in any such acquisition may not completely identify material issues associated with product quality, product architecture, product development, intellectual property issues, key personnel issues or legal and financial contingencies;

Difficulty in integrating acquired operations, including incorporating internal control structures, due to geographical distance, and language and cultural differences; and

Difficulty in retaining employees of the acquired company.

A failure to successfully integrate acquired businesses or technology for any of these reasons could have a material adverse effect on the Company's results of operations.



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**Table of Contents**

**We rely, in part, on third parties to sell our products. Disruptions to these channels would adversely affect our ability to generate revenues from the sale of our products.**

The Company distributes products through a direct sales force as well as through an indirect distribution channel, which includes VARs and other distributors and authorized consultants, consisting primarily of professional firms. If the Company's VARs, distributors or authorized consultants cease distributing or recommending the Company's products or emphasize competing products, the Company's results of operations could be materially and adversely affected. The success of the Company's VARs, distributors and authorized consultants depends in part upon their ability to attract and maintain qualified sales and consulting personnel. Additionally, the Company's VARs, distributors and authorized consultants may generally terminate their agreements with the Company upon as little as 30 days' notice. Almost all partners though may effectively terminate their agreements at any time by ceasing to promote or sell our products. If our VARs or other distributors are unable to maintain such qualified personnel or if several of the Company's VARs or other distributors were to cease doing business or terminate their agreements and the Company is unable to replace them in a timely fashion, such factors could negatively impact the Company's results of operations. Further, there can be no assurance that having both a direct sales force and a distribution channel for the Company's products will not lead to conflicts between those two sales forces that could adversely impact the Company's ability to close sales transactions or could have a negative impact upon average selling prices, any of which may negatively impact the Company's operating revenues and results of operations. Finally, many VARs, distributors and authorized consultants operate on narrow operating margins and have been negatively affected by the past by weak economic conditions. The Company's financial condition and operating results could be materially adversely affected if the financial condition of these VARs, distributors or authorized consultants weakens.

**If third parties infringe upon our intellectual property, we may expend significant resources enforcing our rights or suffer competitive injury, which could adversely affect our operating results. In addition, we may be subject to claims that we infringe upon the intellectual property of others.**

The Company considers its proprietary software and the related intellectual property rights in such products to be among its most valuable assets. The Company relies on a combination of copyright, trademark and trade secret laws (domestically and internationally), employee and third party nondisclosure agreements and other industry standard methods for protecting ownership of its proprietary software. However, the Company cannot provide assurance that, in spite of these precautions, an unauthorized third party will not copy or reverse-engineer certain portions of the Company's products or obtain and use information that the Company regards as proprietary. From time to time, the Company has in the past taken legal action against third parties whom the Company believed were infringing upon the Company's intellectual property rights. However, there is no assurance that the mechanisms that the Company uses to protect its intellectual property will be adequate or that the Company's competitors will not independently develop products that are substantially equivalent or superior to the Company's products.

Moreover, the Company from time to time receives claims from third parties that the Company's software products infringe upon the intellectual property rights of others. The Company expects that as the number of software products in the United States and worldwide increases and the functionality of these products further overlaps, the number of these types of claims will increase. This risk is potentially heightened in such diverse international markets as Eastern Europe, Asia and the Middle East. Although it has not yet occurred to date, any such claim, with or without merit, could result in costly litigation and require the Company to enter into royalty or licensing arrangements or result in an injunction against the Company. The terms of such royalty or license arrangements, if required, may not be favorable to the Company.

In addition, in certain cases, the Company provides the source code for some of its application software under licenses to its customers to enable them to customize the software to meet their particular requirements and to distributors or other third party developers to translate or localize the products for resale in foreign countries. Although the source code licenses contain confidentiality and nondisclosure provisions, the Company cannot be certain that such customers, distributors or third-party developers will take or have taken adequate precautions to protect the Company's source code or other confidential information. Moreover, regardless of contractual arrangements, the laws of some countries in which the Company does business or distributes its products do not offer the same level of protection to intellectual property, as do the laws of the United States.

## Table of Contents

### **Our quarterly operating results are difficult to predict and subject to substantial fluctuation.**

The Company's quarterly operating results have fluctuated significantly in the past. For example, from the first quarter of 2008 through the second quarter of 2010, quarterly operating results have ranged from a net loss of \$8.0 million to net income of \$6.7 million. The Company's operating results may continue to fluctuate in the future as a result of many specific factors that include:

Continued turmoil in the global economy;

The demand for the Company's products, including reduced demand related to changes in marketing focus for certain products, software market conditions or general economic conditions as they pertain to information technology (IT) spending;

Fluctuations in the length of the Company's sales cycles, which may vary depending on the complexity of our products as well as the complexity of the customer's specific software and service needs;

The size and timing of orders for the Company's software products and services, which, because many orders are completed in the final days of each quarter, may be delayed to future quarters;

The number, timing and significance of new software product announcements, both by the Company and its competitors;

Customers' unexpected postponement or termination of expected system upgrades or replacement due to a variety of factors including economic conditions, credit availability, changes in IT strategies or management changes;

Changes in accounting standards, including software revenue recognition standards;

Currency fluctuations and devaluation; and

Fluctuations in number of customers renewing maintenance and support.

In addition, the Company has historically realized a significant portion of its software license revenues in the final month of any quarter, with a concentration of such revenues recorded in the final ten business days of that month. Further, the Company generally realizes a significant portion of its annual software license revenues in the final quarter of the fiscal year.

Due to the above factors, among others, the Company's revenues are difficult to forecast. The Company, however, bases its expense levels, including operating expenses and hiring plans, in significant part, on its expectations of future revenue. As a result, the Company expects its expense levels to be relatively fixed in the short term. The Company's failure to meet revenue expectations could adversely affect operating results. Further, an unanticipated decline in revenue for a particular quarter may disproportionately affect the Company's operating results in that quarter because the majority of the Company's expenses will be fixed in the short term. As a result, the Company believes that period-to-period comparisons of the Company's results of operations are not, and will not, necessarily be meaningful, and you should not rely upon them as an indication of future performance. Due to the foregoing factors, it is likely that, as in past quarters, in some future quarters the Company's operating results will be below the expectations of public market analysts and investors. As in those past quarters, such an event would likely have an adverse effect upon the price of the Company's outstanding securities.

**Our operating cash flows are subject to fluctuation, primarily related to our ability to timely collect accounts receivable and to achieve anticipated revenues and expenses. Negative fluctuations in operating cash flows may require us to seek additional cash sources to fund our working capital requirements. If additional cash sources are not available on terms acceptable to the Company, our operations**

**could be adversely affected.**

From the first quarter of 2008 through the second quarter of 2010, the Company's quarterly operating cash flows have ranged from \$0.1 million provided by operating activities to \$34.8 million provided by operating activities. The Company's cash and cash equivalents have increased from \$89.8 million at December 31, 2008 to \$109.4 million at June 30, 2010. However, the Company has at times experienced decreasing revenues and, prior to the first quarter of 2003, continued operating losses. If the Company is not successful in achieving its anticipated revenues and expenses or maintaining a positive cash flow, the

**Table of Contents**

Company may not have sufficient resources for planned growth and may be required to take actions to reduce its operating expenses, such as reductions in work force and/or seek additional sources of funding. Historically, the Company has also experienced fluctuations in the proportion of accounts receivable over 90 days old and days sales outstanding. These fluctuations have been due to various issues, including product and service quality, deteriorating financial condition of customers during the recent recession and lack of effectiveness of the Company's collection processes. During the past two years, our days sales outstanding have fluctuated from lows of 65 to highs of 78, due to a variety of factors. Given the recent economic turmoil, if the Company cannot successfully collect a significant portion of its net accounts receivable, the Company may be required to seek alternative financing sources. Further, without sufficient cash flows, the Company may not be able to service its debt or it may not be able to comply with certain covenants under its 2007 credit facility. As of June 30, 2010, the Company had a \$230.0 million obligation to holders of the Company's convertible senior notes and \$62.5 million in debt outstanding under the 2007 credit facility.

**The market for our stock is volatile and fluctuations in operating results, changes in the Company's guidance on revenues and earnings estimates and other factors could negatively impact our stock's price.**

During the three-year period ended June 30, 2010, the closing price of the Company's common stock ranged from a low of \$2.36 to a high of \$10.75. For the six months ended June 30, 2010, the price of the Company's common stock ranged from a low of \$7.26 to a high of \$10.75. The market prices for securities of technology companies, including the Company's, have historically been quite volatile. Quarter to quarter variations in operating results, changes in the Company's guidance on revenues and earnings estimates, announcements of technological innovations or new products by the Company or its competitors, announcements of major contract awards, announcements of industry acquisitions by us or our competitors, changes in accounting standards or regulatory requirements as promulgated by the FASB, SEC, NASDAQ or other regulatory entities, changes in management and other events or factors may have a significant impact on the market price of the Company's Common Stock. In addition, the securities of many technology companies have experienced extreme price and volume fluctuations, which have often been related more to changes in recommendations or financial estimates by securities analysts than to the companies' actual operating performance. Any of these conditions may adversely affect the market price of the Company's Common Stock.

## **Table of Contents**

### **Unplanned or unforeseeable business interruptions could adversely affect our business.**

A number of particular types of business interruptions with respect to which we have no control could greatly interfere with our ability to conduct business. For example, a substantial portion of our facilities, including our corporate headquarters and other critical business operations, are located near major earthquake faults. We do not carry earthquake insurance and do not reserve for earthquake-related losses. In addition, our computer systems are susceptible to damage from fire, floods, earthquakes, power loss, telecommunications failures, and similar events. The Company continues to consider and implement its options and develop contingency plans to avoid and/or minimize potential disruptions to its telecommunication services. However, any force majeure or act of god as described above could cause severe disruptions in our business.

### **If open source software expands into enterprise software applications, our software license revenues may decline.**

Open source software includes a broad range of software applications and operating environments produced by companies, development organizations and individual software developers and typically licensed for use, distribution and modification at a nominal cost or often, free of charge. A notable example of open source software is the Linux operating system, which continues to gain in popularity. To the extent that the open source software models expand and non-commercial companies and software developers create and contribute competitive enterprise software applications to the open source community, we may have to adjust our pricing, maintenance and distribution strategies and models, which could adversely affect our revenue and operating margins.

### **Future acquisitions of technologies or companies, which are paid for partially, or entirely through the issuance of stock or stock rights could prove dilutive to existing shareholders.**

Consistent with past experience, the Company expects that the consideration it might pay for any future acquisitions of companies or technologies could include stock, rights to purchase stock, cash or some combination of the foregoing. For example, the Company's Scala acquisition in 2004 involved the issuance of approximately 4.25 million shares of the Company's Common Stock. If the Company issues stock or rights to purchase stock in connection with future acquisitions, earnings (loss) per share and then-existing holders of the Company's Common Stock may experience dilution.

### **Our preferred share rights plan, blank check preferred stock and Delaware law contain provisions that may inhibit potential acquisition bids, which may harm our stock price or discourage potential acquirers.**

We have in place a preferred share rights plan and our Board of Directors also has the authority to issue preferred stock and to determine the rights, preferences, privileges and restrictions, including voting rights, of the shares without any further vote or action by our stockholders. If we issue any of these shares of preferred stock in the future, the rights of holders of our common stock may be negatively affected. Although we have no current plans to issue shares of preferred stock, if we issue preferred stock, a change of control of our company could be delayed, deferred or prevented. Furthermore, Section 203 of the Delaware General Corporation Law restricts certain business combinations with any interested stockholder as defined by that statute. In the past, we have been the target of unsolicited takeover bids and an unsolicited tender offer. The preferred share rights plan and these other provisions are designed to encourage potential acquirers to negotiate with our Board of Directors and give our Board an opportunity to consider various alternatives to increase stockholder value. The preferred share rights plan and other provisions are also intended to discourage certain tactics that may be used in proxy contests. However, the operation of the preferred share rights plan, the potential issuance of preferred stock or the restrictions in Section 203 of the Delaware General Corporation Law could discourage potential acquisition proposals and could delay or prevent a change in control, which may adversely affect the market price of our stock.

**Table of Contents****Item 3 Quantitative and Qualitative Disclosures About Market Risk:***Interest Rate Risk*

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's cash and cash equivalents and outstanding debt. At June 30, 2010, the Company had \$109.4 million in cash and cash equivalents. Based on the investment interest rate and the balance as of June 30, 2010, a hypothetical 1% decrease in interest rates would decrease interest income by approximately \$1.1 million on an annual basis (to the extent the Company's returns exceed 1%), as well as a corresponding decrease in the Company's net income and a decrease in cash flows from operations. The Company places its investments with high credit quality issuers and, by policy, limits the amount of credit exposure to any one issuer. Deposits with its United States issuers may exceed the amounts of federal deposit insurance provided on such deposits, and deposits held outside the United States are not afforded such protection. The Company has approximately 74.1% of its cash and cash equivalents outside the United States. The Company is averse to principal loss and ensures the safety and preservation of its invested funds by limiting default, market and reinvestment risk. The Company mitigates default risk by investing in only the safest and highest credit quality securities and by constantly positioning its portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The Company has not experienced any losses on deposits of cash or cash equivalents.

The Company cannot predict market fluctuations in interest rates and their impact on its variable rate debt, nor can there be any assurance that fixed rate long-term debt will be available to the Company at favorable rates, if at all. Consequently, future results may differ materially from the estimated adverse changes discussed above. Changes in interest rates do not affect the amount of interest we pay on our fixed rate senior convertible notes, but do affect the fair value of the debt.

Interest under the Company's 2007 credit facility is computed on a floating rate basis. The 2007 credit facility required the Company to enter into interest rate swap agreements to protect against fluctuations in the floating rate for a portion of the outstanding term loan balance for a period of time. On April 18, 2008, March 11, 2009 and March 12, 2009 the Company entered into interest rate swap arrangements that convert a portion of its floating rate interest rate exposure under the 2007 credit facility to a fixed rate basis. At the time the Company entered into the interest rate swaps, they qualified for hedge accounting treatment. The changes in the fair value of the interest rate swaps are reflected in the carrying value of the interest rate swaps on the balance sheet. As of September 30, 2009, the Company de-designated the swaps as a result of its repayment of the term loan under the 2007 credit facility, and the fair value changes are now recorded in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. The differential to be paid or received on the interest rate swap agreements is accrued and recognized as an adjustment to interest expense as interest rates change. At June 30, 2010, the interest rates swap arrangements hedged the floating rate interest risk on \$40.0 million of the \$62.5 million balance then outstanding under the 2007 credit facility. Accordingly, at June 30, 2010, a hypothetical 1% increase in interest rates would increase interest expense by approximately \$0.2 million (on the un-hedged principal amount) on an annual basis, as well as decrease the Company's net income and decrease cash flows from operations.

*Foreign Currency Risk*

The Company did not have any foreign currency forward or option contracts or other material foreign currency denominated financial instruments open as of June 30, 2010. International revenues represented 30.4% of the Company's total revenues for the three months ended June 30, 2010, and 23.5% of revenues were denominated in foreign currencies. International revenues represented 31.7% of the Company's total revenues for the six months ended June 30, 2010, and 24.3% of revenues were denominated in foreign currencies. The Company had an unrealized and realized transactional foreign currency loss for the three and six months ended June 30, 2010 of \$0.3 million and \$1.7 million, respectively. For the three months ended June 30, 2010 the transactional gains and losses were primarily due to the settlement of inter-company balances and changes in value of certain cash and other net assets denominated in currencies other than the functional currencies. For the six months ended June 30, 2010 the transactional gains and losses were primarily due to the devaluation of the Venezuela bolivar, Venezuela becoming highly inflationary, settlement of inter-company balances and changes in value of certain cash and other net assets denominated in currencies other than the functional currencies. The foreign currencies for which we currently have the most significant exposure are the Australian dollar, Canadian dollar, euro, British pound, Mexican peso, Malaysian ringgit and Japanese yen.

**Table of Contents**

**Item 4 Controls and Procedures:**

*Evaluation of disclosure controls and procedures*

The Company's management evaluated, with the participation of the Chief Executive Officer (the principal executive officer) and the Chief Financial Officer (the principal financial officer), the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, the Company's principal executive officer and principal financial officer have concluded, as of the end of the period covered by this Quarterly Report on Form 10-Q, that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) (the Exchange Act) were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in internal controls over financial reporting*

There was no change in the Company's internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II****OTHER INFORMATION****Item 1 Legal Proceedings:**

The Company is subject to legal proceedings and claims in the normal course of business. The Company is currently defending such proceedings and claims, and, although the outcome of legal proceedings is inherently uncertain presently, the Company anticipates that it will be able to resolve these matters in a manner that will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**Item 1A Risk Factors:**

A description of the risk factors associated with our business is included under "Certain Factors That May Affect Future Results" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," contained in Item 2 of Part I of this report.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds:***Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

<b>Dates</b>	<b>Total Number of Shares Purchased (a)</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may Yet Be Purchased Under the Plans or Programs</b>
April 1, 2010 to April 30, 2010	109	\$ 9.75		N/A
May 1, 2010 to May 31, 2010	88,952	\$ 9.76		N/A
June 1, 2010 to June 30, 2010		\$		N/A
<b>Total</b>	<b>89,061</b>	<b>\$ 9.76(1)</b>		

(1) Represents the weighted average price per share purchased during the quarter.

All shares of the Company's common stock purchased listed in column (a) were purchased through a plan or program not publicly announced and are shares repurchased under the Company's restricted stock programs as consideration for the payment of the required withholding taxes.

**Item 6 Exhibits**

(a) Index to Exhibits.

The list of exhibits contained in the accompanying Index to Exhibits is herein incorporated by reference.

Items 3, 4 and 5 of Part II are not applicable and have been omitted.





**Table of Contents**

**SIGNATURE**

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.

EPICOR SOFTWARE CORPORATION  
(Registrant)

Date: August 6, 2010

/s/ **MICHAEL PIETRINI**  
**Michael Pietrini**  
**Chief Financial Officer, Executive Vice**  
**President Finance and Administration**  
**(Principal Financial Officer)**

**Table of Contents**

**Exhibits Index**

<b>Exhibit No.</b>	<b>Description</b>
10.1	Amendment to Management Retention Agreement dated June 21, 2010 by and between L. George Klaus and the Company (incorporated by reference to the Company's Current Report on Form 8-K filed on June 23, 2010).
31.1	Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.