LIGHTBRIDGE INC
Form 10-Q
November 09, 2006

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from to

Commission file number: 000-21319

LIGHTBRIDGE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**04-3065140**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

30 Corporate Drive
Burlington, Massachusetts 01803
(Address of Principal Executive Offices) (Zip Code)
(781) 359-4000
(Registrant s Telephone Number, Including Area Code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of November 7, 2006, there were 27,382,795 shares of the registrant s common stock, $.01 par value, outstanding.

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LIGHTBRIDGE, INC.
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2006
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
LIGHTBRIDGE, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share and per share amounts)

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 104,630	$ 83,120
Short-term investments	1,123	1,688
Accounts receivable, net	8,418	11,911
Other current assets	2,489	3,432
Total current assets	116,660	100,151
Property and equipment, net	5,585	10,804
Other assets, net	561	438
Restricted cash	2,100	2,100
Goodwill	57,628	57,628
Intangible assets, net	16,290	18,414
Total assets	$ 198,824	$ 189,535
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,791	$ 3,448
Accrued compensation and benefits	2,692	5,724
Other accrued liabilities	4,826	5,203
Deferred rent	622	656
Deferred revenues	2,466	2,863
Funds due to merchants	8,525	7,112
Accrued restructuring	877	989
Total current liabilities	23,799	25,995
Deferred rent, less current portion	2,101	2,548
Deferred tax liability	4,468	3,074
Other long-term liabilities	1,461	965
Total liabilities	31,829	32,582

Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized; no shares issued or outstanding at September 30, 2006 and December 31, 2005		
Common stock, $.01 par value; 60,000,000 shares authorized; 30,738,455 and 30,259,882 shares issued and 27,348,732 and 26,820,839 shares outstanding at September 30, 2006 and December 31, 2005, respectively	308	303
Additional paid-in capital	176,855	169,648
Accumulated other comprehensive income	181	110
Retained earnings	10,438	7,679
Less: treasury stock, at cost; 3,439,043 shares	(20,787)	(20,787)
Total stockholders equity	166,995	156,953
Total liabilities and stockholders equity	$ 198,824	$ 189,535

See notes to unaudited condensed consolidated financial statements.

3

Table of Contents

LIGHTBRIDGE, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share amounts)

	Three Months Ended September 30, 2006	2005
Revenues:		
Transaction services	$ 22,620	$ 25,676
Consulting and maintenance services	655	1,556
Total revenues	23,275	27,232
Cost of revenues:		
Transaction services	8,758	11,691
Consulting and maintenance services	263	597
Total cost of revenues	9,021	12,288
Gross profit:		
Transaction services	13,862	13,985
Consulting and maintenance services	392	959
Total gross profit	14,254	14,944
Operating expenses:		
Engineering and development	2,726	3,502
Sales and marketing	4,863	4,461
General and administrative	3,254	4,113
Restructuring charges and related asset impairments	3,187	1,544
Total operating expenses	14,030	13,620
Income from operations	224	1,324
Other income	1,269	489
Income from continuing operations before provision for income taxes	1,493	1,813
Provision for income taxes	1,219	558
Income from continuing operations	274	1,255

Discontinued operations, net of income taxes		(268)
Net income	$ 274	$ 987
Net income (loss)per common shares (basic):		
From continuing operations	$ 0.01	$ 0.05
From discontinued operations		(0.01)
Net income per common share (basic)	$ 0.01	$ 0.04
Net income (loss) per common share (diluted):		
From continuing operations	$ 0.01	$ 0.05
From discontinued operations		(0.01)
Net income per common share (diluted):	$ 0.01	$ 0.04
Basic weighted average shares	27,322	26,678
Diluted weighted average shares	28,364	27,345

See notes to unaudited condensed consolidated financial statements.

4

Table of Contents

LIGHTBRIDGE, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share amounts)

	Nine Months Ended September 30,	
	2006	**2005**
Revenues:		
Transaction services	$ 72,852	$ 76,477
Consulting and maintenance services	2,188	4,492
Total revenues	75,040	80,969
Cost of revenues:		
Transaction services	30,352	35,881
Consulting and maintenance services	1,188	1,919
Total cost of revenues	31,540	37,800
Gross profit:		
Transaction services	42,500	40,596
Consulting and maintenance services	1,000	2,573
Total gross profit	43,500	43,169
Operating expenses:		
Engineering and development	8,909	10,978
Sales and marketing	14,574	13,375
General and administrative	13,794	11,734
Restructuring charges and related asset impairments	5,517	1,920
Total operating expenses	42,794	38,007
Income from operations	706	5,162
Other income	3,378	1,079
Income from continuing operations before provision for income taxes	4,084	6,241
Provision for income taxes	1,793	1,479
Income from continuing operations	2,291	4,762

Discontinued operations, net of income taxes:		
Gain on sale of INS assets		12,689
Discontinued operations	468	(2,352)
Total discontinued operations, net of income taxes	468	10,337
Net income	$ 2,759	$ 15,099
Net income per common shares (basic):		
From continuing operations	$ 0.08	$ 0.18
From discontinued operations	0.02	0.39
Net income per common share (basic)	$ 0.10	$ 0.57
Net income per common share (diluted):		
From continuing operations	$ 0.08	$ 0.18
From discontinued operations	0.02	0.38
Net income per common share (diluted):	$ 0.10	$ 0.56
Basic weighted average shares	27,197	26,631
Diluted weighted average shares	28,158	27,120

See notes to unaudited condensed consolidated financial statements.

Table of Contents

LIGHTBRIDGE, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005 (As Restated, See Note 3)
Cash flows from operating activities:		
Net income	$ 2,759	$ 15,099
Income from discontinued operations	468	10,337
Income from continuing operations	2,291	4,762
Adjustments to reconcile net income to net cash provided by operating activities for continuing operations:		
Depreciation and amortization	5,785	6,831
Asset impairment related to restructuring	3,475	1,920
Loss on disposal of property and equipment		8
Deferred income taxes	1,394	1,316
Stock compensation expense	3,432	414
Changes in assets and liabilities:		
Accounts receivable	3,493	2,209
Other assets	786	(1,301)
Accounts payable and accrued liabilities	(3,183)	(3,248)
Funds due to merchants	1,413	1,361
Deferred rent	(481)	(1,075)
Deferred revenues	(397)	1,454
Other liabilities	496	818
Net cash provided by operating activities of continuing operations	18,504	15,469
Cash flows from investing activities of continuing operations:		
Purchases of property and equipment	(1,789)	(2,232)
Restricted cash		(1,500)
Purchase of short-term investments	(520)	(3,928)
Proceeds from sales and maturities of short-term investments	1,085	13,461
Net cash (used in) provided by investing activities for continuing operations	(1,224)	5,801
Cash flows from financing activities of continuing operations:		

Proceeds from issuance of common stock	3,780	1,028
Net cash provided by financing activities of continuing operations	3,780	1,028
Effects of foreign exchange rate changes on cash and cash equivalents	(18)	289
Net cash provided by (used in) operating activities of discontinued operations	468	(1,267)
Net cash provided by investing activities of discontinued operations		15,017
Net cash financing activities of discontinued operations		
Net increase in cash and cash equivalents	21,510	36,337
Cash and cash equivalents, beginning of period	83,120	39,036
Cash and cash equivalents, end of period	$ 104,630	$ 75,373

See notes to unaudited condensed consolidated financial statements.

6

LIGHTBRIDGE, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of Lightbridge, Inc. and its subsidiaries (collectively, Lightbridge or the Company). Lightbridge believes that the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of Lightbridge s financial position, results of operations and cash flows at the dates and for the periods indicated. Although certain information and disclosures normally included in Lightbridge s annual financial statements have been omitted, Lightbridge believes that the disclosures provided are adequate to make the information presented not misleading. Results of interim periods may not be indicative of results for the full year or any future periods. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in Lightbridge s Annual Report on Form 10-K for the year ended December 31, 2005.

2. EXIT FROM THE TELECOM DECISIONING SERVICES (TDS) BUSINESS

On October 4, 2006, the Company announced plans to exit from the Telecom Decisioning Services (TDS) business segment. The decision was based upon negotiations with Sprint Nextel, which advised the Company that it would not be a significant customer after October 2006. The Company expects to reduce the workforce by approximately 200 employees, or approximately 50 percent of its regular full-time staff and to complete the exit from the business by the end of the second quarter of 2007. The Company s exit from the TDS business may include the sale of all or a part of that business.

With respect to the Company s exit from the TDS business, it recorded all impairment charge to reduce the carrying value of leasehold improvements and other tangible assets to the estimated fair value of $1.1 million. The Company recorded an impairment charge of $2.4 million in the third quarter of 2006 which represented the excess of the carrying amount over the fair value of the TDS long-lived assets. The Company expects to incur pre-tax restructuring charges in the range of $3.5 million to $8.0 million from the fourth quarter 2006 through the second quarter of 2007. These charges are expected to consist of approximately $2.0 to $4.0 million of severance charges with respect to terminated employees; approximately $1.0 to $2.5 million of facilities exit charges, comprised of the net present value of the lease payment obligations for the remaining term of the Company s TDS-related leases in Burlington, Lynn, and Waltham, Massachusetts, net of any estimated sublease income; and approximately $0.5 to $1.5 million of other charges related to the closing of the TDS business. Substantially all of the remaining costs will require the outlay of cash, although the timing of lease payments relating to leased facilities will be unchanged by the restructuring action. The Company began to implement these restructuring efforts in October 2006 with notifications of intended action to certain affected personnel.

3. RESTATEMENT OF FINANCIAL STATEMENTS FOR DISCONTINUED OPERATIONS

Subsequent to the issuance of the Company s interim condensed consolidated financial statements for the period ended September 30, 2005, the Company concluded that it was necessary to restate the statement of cash flows for the nine months ended September 30, 2005 previously filed by the Company on Form 10-Q/A, to correct the error as set forth below in reporting the gain on the sale of the Company s INS (as defined in Note 5) business. The gain on the sale of the INS business of $12.7 million and the net proceeds from the sale of the INS business of $15.0 million were previously improperly presented in net cash provided by (used in) operating activities of continuing operations and net cash provided by investing activities of continuing operations, respectively and are now properly classified as cash provided by and used in discontinuing operations.

The following table summarizes the amounts as previously reported and as restated in the Statements of Cash Flows for the nine months ended September 30, 2005. The amounts have been adjusted to reflect discontinued operations (see Note 5) (dollars in thousands):

	Nine months ended September 30, 2005	
	As previously	As

	reported	restated
Net cash provided by operating activities of continuing operations	$ 2,780	$15,469
Net cash provided by investing activities of continuing operations	$20,818	$ 5,801
Net cash provided by (used in) operating activities of discontinued operations	$11,422	$ (1,267)
Net cash provided by investing activities of discontinued operations	$	$15,017

Table of Contents

4. SHARE-BASED COMPENSATION

Stock Option Plans

Stock Incentive Plans (active) The Company awards stock options and restricted share awards under the 2004 Stock Incentive Plan (2004 Plan). No further grants can be made under the 1996 Incentive and Nonqualified Stock Option Plan (the 1996 Plan) and the 1998 Non-Statutory Stock Option Plan (the 1998 Plan). Also, the Company does not plan to make any further grants under the 1997 Stock Incentive Plan and Restricted Stock Purchase Plan.

In April and June 2004, respectively, the Board authorized and the stockholders approved the adoption of the 2004 Plan which provides for the issuance of options and other stock-based awards to purchase up to 2,500,000 shares of the Company s common stock, plus the number of shares then remaining available for future grants under the Company s 1996 Plan and the 1998 Plan, plus the number of shares subject to any stock option granted pursuant to the 1996 Plan or the 1998 Plan that expires, is cancelled or otherwise terminates (other than by exercise) after the effective date of the 2004 Plan. Options are granted with an exercise price of no less than the common stock s market value at the date of grant. Options generally have a four-year graded vesting and have 10-year contractual terms. Certain option and plan awards provide for accelerated vesting based on stock price performance or if there is a change in control (as defined in the 2004 Plan). At September 30, 2006, 3,160,016 shares were available for grant under the 2004 Plan.

Employees Stock Purchase Plan On June 14, 1996, the Board authorized and the stockholders approved the adoption of the 1996 Employee Stock Purchase Plan (ESPP Plan). The ESPP Plan provided for the sale of up to 600,000 shares of the Company s common stock to employees. Employees may have up to 6% of their base salary withheld through payroll deductions to purchase common stock during semi-annual offering periods. The purchase price of the stock is the lower of 85% of (i) the fair market value of the common stock on the enrollment date (the first day of the offering period), or (ii) the fair market value on the exercise date (the last day of each offering period). Offering period means approximately six-month periods commencing (a) on the first trading day on or after February 1 and terminating on the last trading day in the following July, and (b) on the first trading day on or after August 1 and terminating on the last trading day in the following January.

During the nine months ended September 30, 2006, and 2005, the Company issued approximately 20,000 and 74,000 shares, respectively, under the ESPP Plan. The ESPP Plan was terminated upon expiration of the offering period on January 31, 2006.

Stock Option Valuation and Expense Information under SFAS 123(R)

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R) (SFAS No. 123(R)), *Share-Based Payment,* which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS No. 123(R), share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity grant). Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. The Company also followed the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure.* The Company elected to adopt the modified prospective transition method as provided by SFAS No. 123(R) and, accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of expensing share-based compensation.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (the FSP). The FSP provides that companies may elect to use a specified short-cut method to calculate the historical pool of windfall tax benefits upon adoption of SFAS No. 123(R). The Company elected to use the short-cut method when SFAS No. 123(R) was adopted by the Company on January 1, 2006.

Share-based compensation expense recognized in the condensed consolidated statement of operations for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest, and has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based partially on historical experience. In the Company s pro forma information required under SFAS No. 123 for the periods prior to January 1, 2006, the Company did not established estimates for forfeitures.

The following table summarizes the share-based compensation expense included in operating expense captions that the Company recorded within the accompanying condensed consolidated statements of income (amounts in thousands):

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Cost of revenues	$ 52	$ 197
Engineering and development	73	360
Sales and marketing	27	96
General and administrative	514	2,779
Share-based compensation expense	$ 666	$ 3,432

Except as noted below, the Company estimates the fair value of options granted using the Black-Scholes option valuation model. It estimates the volatility of the Company s common stock at the date of grant based on its historical volatility rate, consistent with Staff Accounting Bulletin No. 107 (SAB 107). The Company s decision to use historical volatility was based upon the absence of actively traded options on its common stock and its assessment that historical volatility is more representative of future stock price trends than implied volatility. Lightbridge estimates the expected term to be consistent with the simplified method identified in SAB 107 for share-based awards granted during the nine months ended September 30, 2006. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award. The dividend yield assumption is based on historical and expected dividend payouts. The risk-free interest rate assumption is based on observed interest rates appropriate for the term of the Company s employee options. The Company uses historical data to estimate pre-vesting option forfeitures and records share-based compensation expense only for those awards that are expected to vest. For options granted, the Company amortizes the fair value on a straight-line basis over the vesting period of the options.

Lightbridge used the following assumptions to estimate the fair value of share-based payment awards:

	Nine Months Ended September 30, 2006	
	Stock Options	Employee Stock Purchase Plan (1)
Expected term (years)	6.25	0.50
Expected volatility	57% - 62%	38%
Risk-free interest rate (range)	4.3 5.2%	4.6%
Expected dividend yield	0.0%	0.0%

Upon adoption of SFAS 123R, the Company recognized a benefit of $0.2 million as a cumulative effect of a change in accounting principle resulting from the requirement to estimate forfeitures on the Company s share-based awards at the date of grant under SFAS 123R rather than recognizing forfeitures as incurred under APB 25. The cumulative benefit, net of tax, was immaterial for separate presentation in the unaudited condensed consolidated statement of operations.

(1) The 1996 Employee Stock Purchase Plan

was terminated upon expiration of the offering period ended January 31, 2006.

During 2004 and 2005, the Company granted stock options to certain executive officers that provide for vesting of the options upon the achievement of stock price performance. During the three months ended March 31, 2006, 125,000 of these options vested because the average closing price of the Company s common stock reached $10.00 for over 20 consecutive days. During the three months ended June 30, 2006, 50,000 of these options vested because the average closing price of the Company s common stock reached $12.50 for over 20 consecutive days. Additional vesting of 50,000, and 50,000 shares under such stock options could occur if the average closing price of the Company s common stock over 20 consecutive days reaches $15.00, and $17.50, respectively. The estimated fair value of these options was calculated using a Monte Carlo simulation model that estimated (i) the probability that the performance goal will be achieved, and (ii) the length of time required to attain the target market price. The Company recognized approximately $0.1 million and $1.2 million of shared-based compensation expense related to these options during the three and nine months ended September 30, 2006, respectively. Stock-based compensation of $0.4 million was recorded in the quarter ended September 30, 2005 related to the performance based vesting of certain executive s stock options. The compensation charge was in accordance with the achievement of certain stock price milestones determined in the option grants of the executives.

Table of Contents

Share Awards

The value of restricted share awards is determined by their intrinsic value (as if the underlying shares were vested and issued) on the grant date. The following table summarizes the Company s time-based non-vested share activity for the nine months ended September 30, 2006:

The following table summarizes the status of the Company s non-vested restricted shares:

	Number of Shares	Weighted Average Fair Value
Non-vested at December 31, 2005		$
Granted	30,000	13.17
Vested	1,875	13.17
Forfeited		
Non-vested at September 30, 2006	28,125	$ 13.17

Stock Option Pro Forma Information under SFAS 123

The Company did not recognize compensation expense for employee share-based awards for the three and nine months ended September 30, 2005, when the exercise price of the Company s employee stock awards equaled the market price of the underlying stock on the date of grant. The Company had previously adopted the provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation,* (SFAS 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure,* through disclosure only. The following table illustrates the effects on net income and earnings per share for the three and nine months ended September 30, 2005, as if the Company had applied the fair value recognition provisions of SFAS 123 to share-based employee awards.

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Income from continuing operations as reported	$ 1,255	$ 4,762
Add: Stock-based compensation included in income	414	414
Deduct: Total stock-based employee compensation expense determined under fair value method	(634)	(1,590)
Pro forma income from continuing operations	$ 1,035	$ 3,586
Income from continuing operations per common share basic and diluted as reported	$ 0.05	$ 0.18
Income from continuing operations per common share basic and diluted pro forma	$ 0.04	$ 0.13

Net income as reported	$ 987	$ 15,099
Add: Stock-based compensation included in (loss) income	414	414
Deduct: Total stock-based employee compensation expense determined under fair value method	(645)	(1,780)
Pro forma net income	$ 756	$ 13,733
Net income per common share basic as reported	$ 0.04	$ 0.57
Net income per common share diluted as reported	$ 0.04	$ 0.56
Net income per common share basic pro forma	$ 0.03	$ 0.52
Net income per common share diluted pro forma	$ 0.03	$ 0.51

Table of Contents

The fair value of options on their grant date was measured using the Black-Scholes Option Pricing Model. Key assumptions used to apply this pricing model are as follows:

	Nine Months Ended September 30, 2005
Risk-free interest rate	2.8%
Expected life of options grants	1- 5years
Expected volatility of underlying stock	60%
Expected dividend payment rate, as a percentage of the stock price on the date of grant	0.0%

The following table presents activity under all stock option plans:

	Shares (In thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2005	3,821	$ 7.23	7.55	
Granted	762	11.41		
Exercised	(507)	7.21		
Forfeited or expired	(773)	10.46		
Outstanding at September 30, 2006	3,303	$ 7.46	8.02	$ 15,050
Options exercisable at September 30, 2006	1,648	$ 7.09	7.42	$ 8,303

The following table sets forth information regarding options outstanding at September 30, 2006:

Number of Options (In thousands)	Range of Exercise Prices	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Currently Exercisable (In thousands)	Weighted Average Exercise Price for Currently Exercisable
615	$ 3.75 - $4.67	$ 4.20	7.90	436	$ 4.03
353	4.82 5.87	5.44	7.63	195	5.46
197	5.88 6.10	5.91	7.83	122	5.91
400	6.11	6.11	8.27	144	6.11
358	6.16	6.16	8.30	128	6.16
344	6.17 7.70	6.82	7.66	196	6.88
450	7.72 9.78	9.40	8.13	184	9.05
470	9.81 13.17	12.24	8.65	140	11.77

115	13.37	28.25	16.97	6.59	102	17.36
1	37.32		37.32	3.68	1	37.32
3,303			$ 7.46	8.02	1,648	$ 7.09

The weighted average grant date fair value of options granted during the nine months ended September 30, 2006 was $6.98. The aggregate intrinsic value of outstanding options as of September 30, 2006 was $15.0 million. The intrinsic value of options exercised during the period was $1.7 million.

As of September 30, 2006, there was $6.4 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company s stock plans including non-vested restricted share awards. That cost is expected to be recognized over a weighted-average period of 2.98 years.

The Company received $3.8 million in cash from option exercises and issuances of stock under the ESPP Plan for the nine months ended September 30, 2006. The excess tax benefits of $0.7 million attributable to these option exercises are reflected on a with-and-without method and will be recognized when the benefit is realized.

Table of Contents

5. DISCONTINUED OPERATIONS

Recent Accounting Pronouncements

In accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets,* (SFAS 144), the Company reports discontinued operations in the period that a business segment has been disposed of or is classified as held for sale. On October 4, 2006, the Company announced plans to exit from the Telecom Decisioning Services (TDS) business (see Note 2). The TDS business was not disposed of or classified as held for sale as of September 30, 2006. Accordingly, the TDS business will continue to be reported as a continuing operation until the period in which it has been disposed of or is classified as held for sale.

Intelligent Network Solutions (INS) Business

On April 25, 2005, the Company announced that it had entered into an asset purchase agreement for the sale of its INS business, which included its PrePay IN product and related services, to VeriSign, Inc. The sale was completed on June 14, 2005 for $17.45 million in cash plus assumption of certain contractual liabilities. Of the sale price, $1.745 million is being held in escrow, $1.495 million is being held by VeriSign, and $0.25 million is being held by the Company. The Company will record the amounts in escrow as a gain upon the expiration of certain representations and as warranties expire after an 18-month period after closing and will be recorded as a gain, net of possible indemnity claims at that time.

In addition, a liability of $0.45 million has been established in accordance with FASB Interpretation No. 45 (FIN 45), *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* based on the estimated cost if the Company were to purchase an insurance policy to cover up to $5 million of indemnification obligations for certain potential breaches of its intellectual property representations and warranties in the asset purchase agreement with VeriSign. Such representations and warranties extend for a period of two years and expire on June 14, 2007. The operating results and financial condition of this former INS segment have been reported as discontinued operations in the accompanying consolidated financial statements in accordance with SFAS No. 144, as the sale was completed during the second quarter of 2005. All comparative prior period amounts have been restated in a similar manner.

Included in the amounts reported for net income from discontinued operations for the nine months ended September 30, 2005 is the gain on the sale of the INS business of $12.7 million (net of income tax provision of $0.1 million) and a $1.4 million settlement received by the Company from a lawsuit between Lucent Technologies, Inc. and the Company that was finalized in the second quarter of 2005.

Instant Conferencing Business

In the first quarter of 2005, the Company made the decision to no longer actively market or sell its GroupTalk product and took actions to outsource the continuing operations of its Instant Conferencing business. On August 17, 2005, the Company and America Online, Inc. mutually agreed to terminate the master services agreement under which the Company provided our GroupTalk instant conferencing services to America Online, Inc. The Company subsequently terminated all of the outsourcing agreements for its GroupTalk services and ceased operations of the Instant Conferencing business in the third quarter of 2005.

Table of Contents

In accordance with SFAS 144, the operating results of the former INS and Instant Conferencing segments have been included as part of the financial results from discontinued operations in the accompanying consolidated financial statements. The components of losses from operations of discontinued operations previously classified as operating activities are as follows (amounts in thousands):

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005
Results of operations:		
Total Gross Profit (Loss)	$	$ (134)
Total Operating Expenses		134
Total discontinued operations, net of income taxes	$	$ (268)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Results of operations:		
Total Gross Profit	$ 468	$ 4,324
Total Operating Expenses		6,676
Discontinued operations	468	(2,352)
Gain on sale of INS		12,689
Total discontinued operations, net of income taxes	$ 468	$ 10,337

The Company recorded net loss from discontinued operations of $0 and $0.3 million for the three months ended September 30, 2006 and 2005, respectively, and the Company recorded net income from discontinued operations of $0.5 million and $10.3 million for the nine months ended September 30, 2006 and 2005, respectively. The net income from discontinued operations in 2006 represents a refund received for telecommunications costs previously paid which related to the Instant Conferencing segment. The net income from discontinued operations for the nine months ended September 30, 2005 includes a gain on sale of the INS business of $12.7 million and the operating results of the INS and Instant Conferencing segments.

6. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION

Based upon the way financial information is provided to the Company s Chief Executive Officer for use in evaluating allocation of resources and assessing performance of the business, the Company reports its operations in two distinct operating segments, described as follows:

Payment Processing Services (Payment Processing) This segment provides a transaction processing system under the Authorize.Net® brand that allows businesses to authorize, settle and manage credit card, electronic check and other electronic payment transactions online.

Telecom Decisioning Services (TDS) This segment provides wireless subscriber qualification, risk assessment, fraud screening, consulting services and contact center services to telecommunications and other companies. See Note 2, Exit From The Telecom Decisioning Services (TDS) Business, for additional information about this business.

In the Company s Quarterly Report on Form 10-Q, as amended, for the three and nine months ended September 30, 2005, the Company reported segment information for the Instant Conferencing Services (Instant Conferencing) business as a separate segment. The operating results and financial condition of the Instant Conferencing segments have been included as part of the financial results from discontinued operations in the accompanying condensed consolidated financial statements and, accordingly, the Company s segment information has been restated. All prior period segment financial information has been restated to conform with the current presentation. See Note 5, Discontinued Operations, for additional information about these businesses.

Within segments, performance is measured based on revenue, gross profit and operating income (loss) realized from each segment. There are no transactions between segments. The Company generally does not allocate share-based compensation, corporate or centralized marketing and general and administrative expenses to its business unit segments, because these activities are managed separately from the business units. Also, the Company does not allocate restructuring expenses and other non-recurring gains or charges to its business unit segments because the Company s Chief Executive Officer evaluates the segment results exclusive of these items. Asset information by operating segment is not reported to or reviewed by the Company s Chief Executive Officer, and therefore the Company has not disclosed asset information for each operating segment.

Table of Contents

Financial information for each reportable segment from continuing operations as restated for the three and nine months ended September 30, 2006, and 2005 were as follows (amounts in thousands):

Three Months Ended September 30, 2006	TDS	Payment Processing	Sub-total Reportable Segments	Reconciling Items	Consolidated Total
Revenues	$8,801	$14,474	$23,275	$	$23,275
Gross profit	2,881	11,425	14,306	(52)(1)	14,254
Operating income	1,255	4,587	5,842	(5,618)(2)	224
Depreciation and amortization	606	1,110	1,716	161(3)	1,877

Three Months Ended September 30, 2005	TDS	Payment Processing	Sub-total Reportable Segments	Reconciling Items	Consolidated Total
Revenues	$15,518	$11,714	$27,232	$	$27,232
Gross profit	5,776	9,168	14,944		14,944
Operating income	2,859	3,255	6,114	(4,790)(2)	1,324
Depreciation and amortization	992	1,035	2,027	166(3)	2,193

Nine Months Ended September 30, 2006	TDS	Payment Processing	Sub-total Reportable Segments	Reconciling Items	Consolidated Total
Revenues	$33,195	$41,845	$75,040	$	$75,040
Gross profit	10,643	33,054	43,697	(197)(1)	43,500
Operating income	4,908	12,948	17,856	(17,150)(2)	706
Depreciation and amortization	1,991	3,319	5,310	475(3)	5,785

Nine Months Ended September 30, 2005	TDS	Payment Processing	Sub-total Reportable Segments	Reconciling Items	Consolidated Total
Revenues	$48,408	$32,561	$80,969	$	$80,969
Gross profit	17,727	25,442	43,169		43,169
Operating income	8,538	7,805	16,343	(11,181)(2)	5,162
Depreciation and amortization	3,123	3,121	6,244	587(3)	6,831

(1) Represents share-based compensation included in the unallocated gross profit.

(2) Reconciling items from segment operating income to consolidated operating

income include the following (amounts in thousands).

(3) Represents depreciation and amortization included in the unallocated corporate or centralized marketing, general and administrative expenses.

Table of Contents

	Three Months Ended September 30,	
	2006	2005
Restructuring charges & related asset impairments	$ 3,187	$ 1,544
Unallocated corporate and centralized marketing, general and administrative expenses	1,765	2,832
Unallocated share-based compensation	666	414
Total	$ 5,618	$ 4,790

	Nine Months Ended September 30,	
	2006	2005
Restructuring charges & related asset impairments	$ 5,517	$ 1,920
Litigation settlement, net	1,500	
Unallocated corporate and centralized marketing, general and administrative expenses	6,701	8,847
Unallocated share-based compensation	3,432	414
Total	$ 17,150	$ 11,181

7. GOODWILL AND INTANGIBLE ASSETS

Goodwill

The Company s goodwill balance of $57.6 million is related to the acquisition of Authorize.Net. There were no adjustments to goodwill during the nine months ended September 30, 2006.

In accordance with Statement of Financial Accounting Standard No. 142 (SFAS 142), *Goodwill and Other Intangible Assets,* the Company is required to analyze the carrying value of goodwill and other intangible assets against the estimated fair value of those assets for possible impairment on an annual basis. If impairment has occurred, the Company will record a charge in the amount by which the carrying value of the assets exceeds their estimated fair value. Estimated fair value will generally be determined based on discounted cash flows. On March 31, 2006, the Company performed the annual impairment test for the goodwill balance of $57.6 million related to the acquisition of Authorize.Net. The Company used the discounted cash flow and market methodologies to determine the fair value of the reporting unit related to these intangible assets. The discounted cash flow methodology is based upon converting expected cash flows to present value. A comparison of the resulting fair value of the reporting unit to its carrying amount, including goodwill, indicated that the goodwill balance was not impaired as of March 31, 2006. There have been no events since March 31, 2006 that would require us to perform an additional assessment of goodwill.

Intangible Assets

Acquired intangible assets related to the acquisition of Authorize.Net include outside sales partner network, merchant customer base, existing technology, processor relationships and trademarks. The outside sales partner network and the processor relationships will be amortized over twelve years. The merchant customer base and the existing technology will be amortized over five years. Trademarks are not amortized.

The components of acquired intangible assets are as follows (dollars in thousands):

	September 30, 2006			December 31, 2005		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Amortizable intangible assets:						
Outside sales partner network	$ 9,300	($1,937)	$ 7,363	$ 9,300	($1,356)	$ 7,944
Merchant customer base	7,000	(3,500)	3,500	7,000	(2,450)	4,550
Existing technology	3,162	(1,572)	1,590	3,162	(1,098)	2,064
Processor relationships	300	(63)	237	300	(44)	256
Unamortized intangible assets:						
Trademarks	3,600		3,600	3,600		3,600
	$ 23,362	($7,072)	$ 16,290	$ 23,362	($4,948)	$ 18,414

Amortization expense for intangible assets totaled $708,000 for the three months ended September 30, 2006 and 2005. Amortization expense for intangible assets totaled $2.1 million for the nine months ended September 30, 2006 and 2005.

As of September 30, 2006, expected future intangible asset amortization was as follows (in thousands):

Fiscal Years:	
2006 (remaining three months)	$ 708
2007	2,832
2008	2,832
2009	1,318
2010	800
Thereafter	4,200
	$ 12,690

8. COMMITMENTS AND CONTINGENCIES

Merchant Funds

At September 30, 2006, the Company was holding funds in the amount of $8.5 million due to merchants comprised of $7.3 million held for Authorize.Net s eCheck.Net® product, and $1.2 million held for Authorize.Net s Integrated Payment Solution (IPS) product. The funds are included in cash and cash equivalents and funds due to merchants on the Company s consolidated balance sheet. Authorize.Net typically holds eCheck.Net funds for approximately seven business days; the actual number of days depends on the contractual terms with each merchant. The $1.2 million held for IPS includes funds from processing both credit card and Automated Clearing House (ACH) transactions. IPS credit card funds are held for approximately two business days; IPS ACH funds are held for approximately four business days, according to the requirements of the IPS product and the contract between Authorize.Net and the financial institution through which the transactions are processed.

In addition, the Company has $0.5 million on deposit with a financial institution to cover any deficit account balance that could occur if the amount of eCheck.Net transactions returned or charged back exceeds the balance on deposit with the financial institution. To date, the deposit has not been applied to offset any deficit balance, and management believes that the likelihood of incurring a deficit balance with the financial institution due to the amount of transactions returned or charged back is remote. The deposit will be held continuously for as long as Authorize.Net utilizes the ACH processing services of the financial institution, and the amount of the deposit may increase as processing volume increases.

Legal Proceedings

Litigation Settlement

In May 2006, the Company entered into a settlement agreement with respect to certain litigation involving NetMoneyIN, Inc. Pursuant to the agreement, the Company agreed to pay NetMoneyIN, Inc. a lump sum payment of $1.75 million in exchange for a release and covenant not to sue. The cost of the settlement to the Company was $1.5 million net of $0.25 million received from another party named in the litigation. The Company recorded this cost in its general and administrative expenses in the second quarter of 2006.

The Company had incurred legal expenses of approximately $0.6 million and $1.1 million for the nine months ended September 30, 2006 and for the year ended December 31, 2005, respectively, in connection with the defense of this lawsuit following the Company s acquisition of Authorize.Net. The Company has not and does not expect to incur any further litigation costs related to this lawsuit after the second quarter of 2006.

The Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. On a quarterly basis, the Company reviews its commitments and contingencies to reflect the effect of ongoing negotiations, settlements, rulings, advice of counsel, and other information and events pertaining to a particular matter.

Leases

As of September 30, 2006, the Company s primary contractual obligations and commercial commitments are under its operating leases and a letter of credit. The Company maintains a letter of credit in the amount of $1.6 million, as required for security under the operating lease for its corporate headquarters.

The Company has non-cancelable operating lease agreements for office space and certain equipment. These lease agreements expire at various dates through 2011 and certain of them contain provisions for extension on substantially the same terms as are currently in effect. Rent expense for operating leases (excluding sublease income) was approximately $1.5 million and $2.1 million for the nine months ended September 30, 2006 and 2005, respectively.

Future minimum payments under operating leases, including facilities affected by restructurings and the Company s headquarters lease, consisted of the following at September 30, 2006 (amounts in thousands):

	Operating Leases
Remainder of 2006	$ 845
2007	3,444
2008	2,844
2009	2,405
2010	2,075
Thereafter	1,686
Total minimum lease payments	$ 13,299

9. RESTRICTED CASH

As of September 30, 2006, the Company has provided $1.6 million of cash as collateral for a letter of credit, which is required for security under an operating lease for its corporate headquarters. The Company is required to maintain this letter of credit throughout the term of the lease, which expires in 2011. In addition, as described in Note 8, Commitments and Contingencies, the Company has $0.5 million on deposit with a financial institution to cover any deficit account balance that could occur if the amount of transactions returned or charged back exceeds the balance on deposit with the financial institution.

10. EARNINGS PER SHARE (EPS)

Basic EPS is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock.

16

Table of Contents

A reconciliation of the shares used to compute basic income per share from continuing operations to those used for diluted income per share from continuing operations is as follows (in thousands):

	Three Months Ended September 30,	
	2006	**2005**
Shares for basic computation	27,322	26,678
Options and warrants (treasury stock method)	1,042	667
Shares for diluted computation	28,364	27,345

	Nine Months Ended September 30,	
	2006	**2005**
Shares for basic computation	27,197	26,631
Options and warrants (treasury stock method)	961	489