

BLACKBAUD INC  
Form 10-Q  
August 07, 2012

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, 2012

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-50600

BLACKBAUD, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)  
2000 Daniel Island Drive  
Charleston, South Carolina 29492  
(Address of principal executive offices, including zip code)  
(843) 216-6200  
(Registrant's telephone number, including area code)

11-2617163  
(I.R.S. Employer  
Identification No.)

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 (Section 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.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant's Common Stock outstanding as of July 25, 2012 was 45,181,811.

BLACKBAUD, INC.  
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Safe Harbor Cautionary Statement

This Quarterly Report on Form 10-Q, including the section titled "Management's discussion and analysis of financial condition and results of operations" in Part I, Item 2, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build and grow our business, our operating results, our ability to successfully integrate acquired businesses and technologies, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the impact of expensing stock based compensation, the sufficiency of our capital resources, our ability to meet our ongoing debt and obligations as they become due, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "aims," "projects," "intends," "plans," "likely," "will," "should," "believes," "estimates," "seeks," variations of such words, and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Factors that could cause actual results to differ materially from our expectations expressed in the report include: general economic risks; lengthy sales and implementation cycles, particularly in larger organizations; uncertainty regarding increased business and renewals from existing customers; continued success in sales growth; management of integration of recently acquired companies and other risks associated with acquisitions; the ability to

attract and retain key personnel, including our new CFO; risk associated with successful implementation of multiple integrated software products; risks related to our dividend policy and stock repurchase program, including potential limitations on our ability to grow and the possibility that we might discontinue payment of dividends; risks relating to restrictions imposed by the credit facility; risks associated with management of growth; technological changes that make our products and services less competitive; and the other risk factors set forth from time to time in our SEC filings. Factors that could cause or contribute to such differences include, but are not limited to, those summarized under Risk Factors in our annual report on

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Form 10-K for the year ended December 31, 2011 and our quarterly reports on Forms 10-Q. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this quarterly report on Form 10-Q. Except as required by law, we do not intend, and undertake no obligation to revise or update these forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

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## PART I- FINANCIAL INFORMATION

## Item 1. Financial Statements

Blackbaud, Inc.

Consolidated balance sheets

(Unaudited)

(in thousands, except share amounts)

	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$21,192	\$52,520
Donor restricted cash	18,314	40,205
Accounts receivable, net of allowance of \$4,208 and \$3,913 at June 30, 2012 and December 31, 2011, respectively	89,208	62,656
Prepaid expenses and other current assets	44,229	31,016
Deferred tax asset, current portion	1,959	1,551
Total current assets	174,902	187,948
Property and equipment, net	43,980	34,397
Deferred tax asset	774	29,376
Goodwill	262,568	90,122
Intangible assets, net	177,747	44,660
Other assets	8,458	6,087
Total assets	\$668,429	\$392,590
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	\$17,594	\$13,464
Accrued expenses and other current liabilities	37,506	32,707
Donations payable	18,314	40,205
Debt, current portion	165,000	—
Deferred revenue, current portion	175,076	153,665
Total current liabilities	413,490	240,041
Long-term debt, net of current portion	94,600	—
Deferred tax liability	1,348	—
Deferred revenue, net of current portion	9,177	9,772
Other liabilities	3,137	2,775
Total liabilities	521,752	252,588
Commitments and contingencies (see Note 9)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, \$0.001 par value; 180,000,000 shares authorized, 54,240,408 and 53,959,532 shares issued at June 30, 2012 and December 31, 2011, respectively	54	54
Additional paid-in capital	194,254	175,401
Treasury stock, at cost; 9,065,862 and 9,019,824 shares at June 30, 2012 and December 31, 2011, respectively	(167,646	) (166,226 )
Accumulated other comprehensive loss	(1,601	) (1,148 )
Retained earnings	121,616	131,921
Total stockholders' equity	146,677	140,002
Total liabilities and stockholders' equity	\$668,429	\$392,590

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



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Blackbaud, Inc.

Consolidated statements of comprehensive income  
(Unaudited)

(in thousands, except share and per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Revenue				
License fees	\$4,521	\$5,097	\$11,689	\$9,648
Subscriptions	37,923	25,885	65,985	49,802
Services	31,790	28,332	55,748	53,311
Maintenance	33,880	32,610	67,446	64,443
Other revenue	2,076	1,858	4,028	3,206
Total revenue	110,190	93,782	204,896	180,410
Cost of revenue				
Cost of license fees	821	1,062	1,434	1,782
Cost of subscriptions	16,561	10,473	29,535	19,635
Cost of services	25,299	20,307	45,341	39,181
Cost of maintenance	6,178	6,035	12,155	12,286
Cost of other revenue	1,646	1,411	3,115	2,545
Total cost of revenue	50,505	39,288	91,580	75,429
Gross profit	59,685	54,494	113,316	104,981
Operating expenses				
Sales and marketing	24,223	19,058	44,600	38,336
Research and development	14,856	11,527	28,160	23,493
General and administrative	21,753	9,176	36,254	18,378
Impairment of cost method investment	200	—	200	—
Amortization	530	246	727	479
Total operating expenses	61,562	40,007	109,941	80,686
Income (loss) from operations	(1,877	) 14,487	3,375	24,295
Interest income	33	45	80	78
Interest expense	(1,462	) (60	) (1,653	) (84
Other income (expense), net	(140	) 216	(448	) 285
Income (loss) before provision for income taxes	(3,446	) 14,688	1,354	24,574
Income tax provision (benefit)	(1,175	) 5,326	866	7,919
Net income (loss)	\$(2,271	) \$9,362	\$488	\$16,655
Earnings (loss) per share				
Basic	\$(0.05	) \$0.22	\$0.01	\$0.38
Diluted	\$(0.05	) \$0.21	\$0.01	\$0.38
Common shares and equivalents outstanding				
Basic weighted average shares	44,112,905	43,447,007	44,023,650	43,399,874
Diluted weighted average shares	44,112,905	44,098,046	44,659,678	44,004,712
Dividends per share	\$0.12	\$0.12	\$0.24	\$0.24
Other comprehensive income (loss)				
Foreign currency translation adjustment	(168	) (87	) 111	169
Unrealized loss on derivative instruments, net of tax	(564	) —	(564	) —
Total other comprehensive income (loss)	(732	) (87	) (453	) 169
Comprehensive income (loss)	\$(3,003	) \$9,275	\$35	\$16,824

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





Blackbaud, Inc.

Consolidated statements of cash flows  
(Unaudited)

(in thousands)	Six months ended June 30,	
	2012	2011
Cash flows from operating activities		
Net income	\$488	\$16,655
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,223	8,170
Provision for doubtful accounts and sales returns	2,511	2,366
Stock-based compensation expense	9,624	7,325
Excess tax benefits from stock-based compensation	(340)	(226)
Deferred taxes	464	3,188
Impairment of cost method investment	200	—
Gain on sale of assets	—	(549)
Other non-cash adjustments	177	(68)
Changes in operating assets and liabilities, net of acquisition of businesses:		
Accounts receivable	(16,135)	(10,580)
Prepaid expenses and other assets	(7,268)	3,602
Trade accounts payable	643	1,355
Accrued expenses and other liabilities	(4,692)	(2,132)
Donor restricted cash	21,868	5,540
Donations payable	(21,868)	(5,540)
Deferred revenue	13,054	9,246
Net cash provided by operating activities	10,949	38,352
Cash flows from investing activities		
Purchase of property and equipment	(11,568)	(7,703)
Purchase of net assets of acquired companies, net of cash acquired	(280,095)	(16,475)
Capitalized software development costs	(235)	(506)
Proceeds from sale of assets	—	719
Net cash used in investing activities	(291,898)	(23,965)
Cash flows from financing activities		
Proceeds from issuance of debt	312,000	—
Payments on debt	(52,400)	—
Payments of deferred financing costs	(2,440)	(767)
Proceeds from exercise of stock options	2,984	1,925
Excess tax benefits from stock-based compensation	340	226
Dividend payments to stockholders	(10,830)	(10,686)
Payments on capital lease obligations	—	(25)
Net cash provided by (used in) financing activities	249,654	(9,327)
Effect of exchange rate on cash and cash equivalents	(33)	363
Net increase (decrease) in cash and cash equivalents	(31,328)	5,423
Cash and cash equivalents, beginning of period	52,520	28,004
Cash and cash equivalents, end of period	\$21,192	\$33,427

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



Blackbaud, Inc.

Consolidated statements of stockholders' equity  
(Unaudited)

(in thousands, except share amounts)	Common stock		Additional paid-in capital	Treasury stock	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
	Shares	Amount					
Balance at December 31, 2010	53,316,280	\$ 53	\$ 158,372	\$(161,186)	\$( 812 )	\$ 120,042	\$ 116,469
Net income	—	—	—	—	—	33,220	33,220
Payment of dividends	—	—	—	—	—	(21,429 )	(21,429 )
Exercise of stock options, stock appreciation rights and restricted stock units	262,428	1	2,040	—	—	—	2,041
Surrender of 176,942 shares upon restricted stock vesting and exercise of stock appreciation rights	—	—	—	(5,040 )	—	—	(5,040 )
Tax impact of exercise of equity-based compensation	—	—	193	—	—	—	193
Stock-based compensation	—	—	14,796	—	—	88	14,884
Restricted stock grants	502,426	—	—	—	—	—	—
Restricted stock cancellations	(121,602 )	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(336 )	—	(336 )
Balance at December 31, 2011	53,959,532	\$ 54	\$ 175,401	\$(166,226)	\$( 1,148 )	\$ 131,921	\$ 140,002
Net income	—	—	—	—	—	488	488
Payment of dividends	—	—	—	—	—	(10,830 )	(10,830 )
Exercise of stock options, stock appreciation rights and restricted stock units	294,570	—	2,984	—	—	—	2,984
Surrender of 46,038 shares upon restricted stock vesting and exercise of stock appreciation rights	—	—	—	(1,420 )	—	—	(1,420 )
Tax impact of exercise of equity-based compensation	—	—	340	—	—	—	340
Stock-based compensation	—	—	9,670	—	—	37	9,707
Equity-based awards assumed in business combination	—	—	5,859	—	—	—	5,859
Restricted stock grants	50,868	—	—	—	—	—	—
Restricted stock cancellations	(64,562 )	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(453 )	—	(453 )
Balance at June 30, 2012	54,240,408	\$ 54	\$ 194,254	\$(167,646)	\$( 1,601 )	\$ 121,616	\$ 146,677

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

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

1. Organization

We provide on-premise and cloud-based software solutions and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage their finances and optimize internal operations. As of June 30, 2012, we had over 27,000 active customers distributed across multiple verticals within the nonprofit market including education, foundations, health and human services, religion, arts and cultural, public and societal benefits, environment and animal welfare and international foreign affairs.

2. Summary of significant accounting policies

Unaudited interim consolidated financial statements

The interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of cash flows and consolidated statements of stockholders' equity for the periods presented in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The consolidated balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date.

Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2012 or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011 and other forms filed with the SEC from time to time.

Basis of consolidation

The consolidated financial statements include the accounts of the Blackbaud, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Areas of the financial statements where estimates may have the most significant effect include revenue recognition, the allowance for sales returns and doubtful accounts, deferred sales commissions and professional services costs, valuation of derivative instruments, long-lived and intangible assets and goodwill, stock-based compensation, the provision for income taxes and valuation of deferred tax assets. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could materially differ from these estimates.

Revenue recognition

Our revenue is primarily generated from the following sources: (1) selling perpetual licenses of our software products; (2) charging for the use of our software products in a hosted environment; (3) providing professional services including implementation, training, consulting, analytic, hosting and other services; and (4) providing software maintenance and support services.



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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

License fees

We recognize revenue from the sale of perpetual software license rights when all of the following conditions are met:

- Persuasive evidence of an arrangement exists;
- The product has been delivered;
- The fee is fixed or determinable; and
- Collection of the resulting receivable is probable.

We deem acceptance of an agreement to be evidence of an arrangement. Delivery occurs when the product is shipped or transmitted, and title and risk of loss have transferred to the customers. Our typical license agreement does not include customer acceptance provisions; however, if acceptance provisions are provided, delivery is deemed to occur upon acceptance. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within our standard payment terms. Payment terms greater than 90 days are considered to be beyond our customary payment terms. Collection is deemed probable if we expect that the customer will be able to pay amounts under the arrangement as they become due. If we determine that collection is not probable, we defer revenue recognition until collection.

We sell software licenses with maintenance, varying levels of professional services and, in certain instances, with hosting services. We allocate revenue to each of the elements in these arrangements using the residual method under which we first allocate revenue to the undelivered elements, typically the non-software license components, based on objective evidence of the fair value of the various elements. We determined the fair value of the various elements using different methods. Fair value for maintenance services associated with software licenses is based upon renewal rates stated in the agreements with customers, which vary according to the level of support service provided under the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis. Any remaining revenue is allocated to the delivered elements which is normally the software license in the arrangement.

When a software license is sold with software customization services, generally the services are to provide customer support for assistance in creating special reports and other enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of the software. However, when software customization services are considered essential to the functionality of the software, we recognize revenue for both the software license and the services on a percent-complete basis.

Subscriptions

We provide hosting services to customers who have purchased perpetual rights to certain of our software products (hosting services). Revenue from hosting services, as well as data enrichment services, data management services and online training programs is recognized ratably over the service period of the contract, which generally ranges from one to three years, upon deployment and use of the service. Any related set-up fees are recognized ratably over the estimated period that the customer benefits from the related fees.

We make certain of our software products available for use in hosted application arrangements without licensing perpetual rights to the software (hosted applications). Revenue from hosted applications is recognized over the subscription service period, which generally ranges from one to three years, upon deployment and use of the hosted application. Any revenue related to upfront activation, set-up or implementation fees is recognized ratably over the estimated period that the customer benefits from the related hosted application. Direct and incremental costs relating to activation, set-up and implementation for hosted applications are capitalized until the hosted application is deployed and in use, and then expensed over the estimated period that the customer benefits from the related hosted application.

For arrangements that have multiple elements and do not include software licenses, we allocate arrangement consideration at the inception of the arrangement to those elements that qualify as separate units of accounting. The arrangement consideration is allocated to the separate units of accounting based on relative selling price method in accordance with the selling price

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

hierarchy, which includes: (i) vendor specific objective evidence (VSOE) if available; (ii) third party evidence (TPE) if VSOE is not available; and (iii) best estimate of selling price if neither VSOE nor TPE is available. In general, we use VSOE to allocate the selling price to subscription and service deliverables.

Revenue from transaction processing fees is recognized when received. Credit card fees directly associated with processing donations for customers are included in subscriptions revenue, net of related transaction costs.

Services

We generally bill consulting, installation and implementation services based on hourly rates plus reimbursable travel-related expenses. Revenue is recognized for these services over the period the services are performed.

We recognize analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery. In arrangements where we provide customers the right to updates to the lists during the contract period, revenue is recognized ratably over the contract period.

We sell training at a fixed rate for each specific class at a per attendee price or at a packaged price for several attendees, and recognize the related revenue only upon the customer attending and completing training. Additionally, we sell fixed-rate programs, which permit customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue is recognized ratably over this contract period.

Maintenance

We recognize revenue from maintenance services ratably over the contract term, typically one year. Maintenance contracts are at rates that vary according to the level of the maintenance program and are generally renewable annually. Maintenance contracts also include the right to unspecified product upgrades on an if-and-when available basis. Certain support services are sold in prepaid units of time and recognized as revenue upon their usage.

Deferred revenue

To the extent that our customers are billed for the above described services in advance of delivery, we record such amounts in deferred revenue.

Fair value measurements

We measure certain financial assets and liabilities at fair value on a recurring basis, including derivative instruments. Fair value is defined as the exchange price that would be received upon purchase of an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. We use a three-tier fair value hierarchy to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets;
- Level 2 - Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

Our financial assets and liabilities are classified in their entirety within the hierarchy based on the lowest level of input that is significant to fair value measurement. Changes to a financial asset's or liability's level within the fair value hierarchy are determined as of the end of a reporting period.



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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

## Derivative instruments

We use derivative instruments to manage interest rate risk. We view derivative instruments as risk management tools and do not use them for trading or speculative purposes. Our policy requires that derivatives used for hedging purposes be designated and effective as a hedge of the identified risk exposure at the inception of the contract.

Accordingly, changes in fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract.

We record all derivative instruments on our consolidated balance sheets at fair value. Gains and losses on derivatives designated as effective hedges are recorded in other comprehensive income and reclassified to earnings in a manner that matches the timing of the earnings impact of the hedged transactions. Gains and losses on ineffective hedges are recognized currently in earnings.

## Goodwill

The change in goodwill for each reportable segment during the six months ended June 30, 2012 consisted of the following:

(in thousands)	ECBU	GMBU	IBU	Target Analytics	Other	Total
Balance at December 31, 2011	\$23,023	\$26,437	\$5,389	\$33,177	\$2,096	\$90,122
Additions related to business combinations	115,563	55,194	1,733	—	—	172,490
Effect of foreign currency translation	—	—	(44)	—	—	(44)
Balance at June 30, 2012	\$138,586	\$81,631	\$7,078	\$33,177	\$2,096	\$262,568

## Amortization expense

Amortization expense related to finite-lived intangible assets acquired in business combinations is allocated to cost of revenue and operating expenses on the consolidated statements of comprehensive income based on the revenue stream to which the asset contributes and the nature of the intangible asset. The following table summarizes amortization expense for the three and six months ended June 30, 2012 and 2011.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Included in cost of revenue:				
Cost of license fees	\$124	\$156	\$247	\$321
Cost of subscriptions	2,706	816	3,688	1,617
Cost of services	468	391	879	778
Cost of maintenance	250	253	494	505
Cost of other revenue	19	20	38	38
Total included in cost of revenue	3,567	1,636	5,346	3,259
Included in operating expenses	530	246	727	479
Total	\$4,097	\$1,882	\$6,073	\$3,738

## Recently adopted accounting pronouncements

Effective January 1, 2012, we adopted ASU 2011-05, Presentation of Comprehensive Income, which (1) eliminates the option to present components of other comprehensive income, or OCI, as part of the statement of changes in stockholders' equity and (2) requires the presentation of each component of net income and each component of OCI either in a single continuous statement or in two separate but consecutive statements. The adoption of ASU 2011-05

did not have a material impact on our consolidated financial statements. We have presented each component of net income and OCI in a single continuous statement.

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

Effective January 1, 2012, we adopted ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards, which amends ASC 820, Fair Value Measurement (ASC 820). ASU 2011-04 provides common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS) and improves the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. ASU 2011-04 is effective for entities prospectively for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material impact on our consolidated financial statements.

## 3. Business combinations

## Convio

In May 2012, we completed our acquisition of Convio, Inc. (Convio), for a total of approximately \$329.4 million in cash consideration and the assumption of unvested equity awards valued at approximately \$5.9 million for a total of \$335.3 million. Convio is a leading provider of on-demand constituent engagement solutions that enable nonprofit organizations to more effectively raise funds, advocate for change and cultivate relationships. The acquisition of Convio expands our subscription and online offerings and accelerates our evolution to a subscription-based revenue model. As a result of the acquisition, Convio has become a wholly-owned subsidiary of ours. The results of operations of Convio are included in our consolidated financial statements from the date of acquisition. Since the date of acquisition through June 30, 2012, total revenue from Convio was \$10.6 million and cost of revenue was \$7.3 million. During the six months ended June 30, 2012, we incurred \$6.4 million of acquisition-related costs associated with the acquisition of Convio, which were recorded in general and administrative expense.

We financed the acquisition of Convio through cash on hand and borrowings of \$312.0 million under our credit facility that we amended in February 2012. In connection with closing the Convio acquisition, we designated Convio as a material domestic subsidiary under our credit facility. As a material domestic subsidiary, Convio guarantees amounts outstanding under the credit facility and pledges certain stock of its subsidiaries.

Management is currently in the process of estimating the purchase price allocation for this transaction. The following table summarizes the preliminary allocation of the purchase price based on the estimated fair value of the assets acquired and the liabilities assumed:

(in thousands)

Net working capital, excluding deferred revenue	\$55,581	
Property and equipment	6,497	
Deferred tax asset and other long term assets	75	
Deferred revenue	(7,917	)
Deferred tax liability	(29,833	)
Intangible assets and liabilities	138,450	
Goodwill	172,481	
	\$335,334	

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The estimated fair value of accounts receivable acquired approximates the contractual value of \$12.8 million. The goodwill recognized is attributable primarily to the assembled workforce of Convio and the opportunities for expected synergies. None of the goodwill arising in the acquisition is deductible for income tax purposes. Goodwill of \$115.6 million, \$55.2 million, and \$1.7 million was assigned to the ECBU, GMBU and IBU reporting segments, respectively. The acquisition resulted in the identification of the following identifiable intangible assets:

	Intangible assets acquired  (in thousands)	Weighted average amortization period (in years)
Customer relationships	\$49,000	15
Marketing assets	7,800	7
Acquired technology	71,000	8
In-process research and development	9,900	Indefinite
Non-compete agreements	1,440	2
Unfavorable leasehold interests	(690	) 7
	\$138,450	

The fair value of the intangible assets was based on the income approach, cost approach, relief of royalty rate method and excess earnings methods. Customer relationships are amortized on an accelerated basis. Marketing assets, acquired technology and non-compete agreements are amortized on a straight-line basis.

The following unaudited pro forma condensed consolidated results of operations are provided for illustrative purposes only and assume that the acquisition of Convio occurred on January 1, 2011. This unaudited pro forma financial information does not reflect any adjustments for anticipated synergies resulting from the acquisition and should not be relied upon as being indicative of the historical results that would have been attained had the transaction been consummated as of January 1, 2011, or of the results that may occur in the future.

(in thousands, except per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Revenue	\$118,789	\$114,434	\$234,364	\$219,325
Net income (loss)	\$(1,914	) \$5,249	\$(5,979	) \$6,953
Basic earnings (loss) per share	\$(0.04	) \$0.12	\$(0.14	) \$0.16
Diluted earnings (loss) per share	\$(0.04	) \$0.12	\$(0.14	) \$0.16
4. Earnings (loss) per share				

We compute basic earnings (loss) per share by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares and dilutive potential common shares then outstanding. Diluted earnings (loss) per share reflect the assumed conversion of all dilutive securities using the treasury stock method. Dilutive potential common shares consist of shares issuable upon the exercise of stock options, settlement of stock appreciation rights and vesting of restricted stock awards and units.

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The following table sets forth the computation of basic and diluted earnings (loss) per share:

(in thousands, except share and per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss), as reported	\$(2,271	) \$9,362	\$488	\$16,655
Denominator:				
Weighted average common shares	44,112,905	43,447,007	44,023,650	43,399,874
Add effect of dilutive securities:				
Employee equity-based compensation	—	651,039	636,028	604,838
Weighted average common shares assuming dilution	44,112,905	44,098,046	44,659,678	44,004,712
Earnings (loss) per share:				
Basic	\$(0.05	) \$0.22	\$0.01	\$0.38
Diluted	\$(0.05	) \$0.21	\$0.01	\$0.38

The following shares and potential shares underlying stock-based awards were not included in diluted earnings (loss) per share because their inclusion would have been anti-dilutive:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Shares excluded from calculations of diluted earnings (loss) per share	753,365	83,975	75,399	380,914

#### 5. Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following as of June 30, 2012 and December 31, 2011:

(in thousands)	June 30, 2012	December 31, 2011
Deferred sales commissions	\$17,511	\$16,452
Prepaid software maintenance and royalties	11,201	7,007
Taxes, prepaid and receivable	4,835	343
Deferred professional services costs	2,930	3,098
Other	7,752	4,116
Total prepaid expenses and other current assets	\$44,229	\$31,016

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## 6. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following as of June 30, 2012 and December 31, 2011:

(in thousands)	June 30, 2012	December 31, 2011
Taxes payable	\$8,579	\$4,384
Accrued commissions and salaries	6,685	6,475
Accrued bonuses	4,794	9,832
Customer credit balances	3,748	3,762
Accrued royalties	2,057	1,418
Accrued health care costs	1,457	996
Accrued accounting, legal and professional fees	1,587	1,490
Other	8,599	4,350
Total accrued expenses and other current liabilities	\$37,506	\$32,707

## 7. Debt

## Credit facility

In February 2012, we amended and restated our credit facility to a \$325.0 million five-year credit facility. The credit facility includes the following facilities: (i) a dollar and a designated currency revolving credit facility with sublimits for letters of credit and swingline loans, and (ii) a delayed draw term loan. The credit facility is secured by the stock and limited liability company interests of certain subsidiaries that were pledged as part of the closing. Amounts outstanding under the credit facility will be guaranteed by our material domestic subsidiaries, if any.

Amounts borrowed under the dollar tranche revolving credit loans and delayed draw term loans under the credit facility bear interest at a rate per annum equal to, at our option, (a) a base rate equal to the highest of (i) the prime rate, (ii) federal funds rate plus 0.50% and (iii) one month LIBOR plus 1% (Base Rate), in addition to a margin of 0.25% to 1.25% (Base Rate Loans), or (b) the LIBOR rate plus a margin of 1.25% to 2.25% (LIBOR Loans). Swingline loans bear interest at a rate per annum equal to the Base Rate plus a margin of 0.25% to 1.25% or such other rate agreed to between the Swingline lender and us. Designated currency tranche revolving credit loans bear interest at a rate per annum equal to the LIBOR rate plus a margin of 1.25% to 2.25%. The exact amount of any margin depends on the nature of the loan and our leverage ratio at the time of the borrowing.

We also pay a quarterly commitment fee on the unused portion of the revolving credit facility from 0.20% to 0.35% per annum, depending on our leverage ratio. At June 30, 2012, the commitment fee was 0.35%.

Under the credit facility, we have the ability to choose either Base Rate Loans or LIBOR Loans. Base Rate borrowings mature in February 2017. LIBOR Loans can be one, two, three or six month maturities (or, if agreed to by the applicable lenders, nine or twelve months), and we have the ability to extend the maturity of these loans by rolling them at their maturity into new loans with the same or longer maturities. We evaluate the classification of our debt based on the maturity of individual borrowings and any roll-over of borrowings subsequent to the balance sheet date, but prior to issuance of the consolidated financial statements.

The credit facility includes covenants related to the consolidated leverage ratio and consolidated interest ratio, as well as restrictions on the maximum amount of annual capital expenditures. At June 30, 2012, we were in compliance with our debt covenants under the credit facility.

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The following table summarizes our debt as of June 30, 2012. We had no borrowings outstanding as of December 31, 2011. The effective interest rate includes our interest cost incurred and the effect of interest rate swap agreements.

(in thousands, except percentages)	Debt balance at June 30, 2012	Effective interest rate at June 30, 2012	
Credit facility:			
Revolving credit loans	\$ 162,100	2.74	%
Term loans	97,500	3.14	%
Total debt	259,600	2.89	%
Less: Current portion of long-term debt	165,000		
Long-term debt	\$94,600		

We believe the carrying amount of our credit facility approximates its fair value at June 30, 2012, due to the variable rate nature of the debt. As LIBOR rates are observable at commonly quoted intervals, it is classified within Level 2 of the fair value hierarchy.

As of June 30, 2012, the required annual maturities related to our credit facility were as follows:

Year ending December 31,

(in thousands)

2012 - remaining	\$ 160,000
2013	10,000
2014	13,750
2015	15,000
2016	15,000
Thereafter	45,850
Total required maturities	\$259,600
Deferred financing costs	

In connection with our credit facility entered into in February 2012, we paid \$2.4 million of financing costs, which is being amortized over the term of the new facility. As of June 30, 2012 and December 31, 2011, deferred financing costs totaling \$2.8 million and \$0.8 million, respectively, are included in other assets on the consolidated balance sheet.

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## 8. Derivative instruments

We use derivative instruments to manage interest rate risk. In May 2012, we entered into two interest rate swap agreements which effectively convert portions of our variable rate debt under our credit facility to a fixed rate for the terms of the swap agreements. The aggregate notional value of the swap agreements was \$150 million with effective dates beginning in May 2012. We designated the swap agreements as cash flow hedges at the inception of the contracts.

The fair values of our derivative instruments as of June 30, 2012 were as follows:

(in thousands)	As of June 30, 2012	
	Liabilities Balance Sheet Location	Fair Value
Derivative instruments designated as hedging instruments:		
Interest rate swaps	Other liabilities	\$925
Total derivative instruments designated as hedging instruments		\$925

We did not have derivative instruments as of December 31, 2011. The fair value of our interest rate swaps was based on model-driven valuations using LIBOR rates, which are observable at commonly quoted intervals. Accordingly, our interest rate swaps are classified within Level 2 of the fair value hierarchy.

The effects of derivative instruments in cash flow hedging relationships for the three and six months ended June 30, 2012 were as follows:

(in thousands)	Loss recognized in accumulated other comprehensive loss	Location of loss reclassified from accumulated other comprehensive loss into income	Loss reclassified from accumulated other comprehensive loss into income	Three months ended June 30, 2012	Six months ended June 30, 2012
	Interest rate swaps	\$(925	) Interest expense	\$(64	)

The tax benefit allocated to the loss recognized in accumulated other comprehensive loss was \$0.4 million for the three and six months ended June 30, 2012. There was no ineffective portion of our interest swaps during the six months ended June 30, 2012.

## 9. Commitments and contingencies

## Leases

We lease our headquarters facility under a 15-year lease agreement which was entered into in October 2008, and has two five-year renewal options. The current annual base rent of the lease is \$4.0 million payable in equal monthly installments. The base rent escalates annually at a rate equal to the change in the consumer price index, as defined in the agreement, but not to exceed 5.5% in any year. In addition, under the terms of the lease, the lessor will reimburse us an aggregate amount of \$4.0 million for leasehold improvements, which will be recorded as a reduction to rent expense ratably over the term of the lease. During each of the three and six month periods ended June 30, 2012 and 2011 rent expense was reduced by \$67,000 and \$134,000, respectively, related to this lease provision. The \$4.0 million leasehold improvement allowance has been included in the table of operating lease commitments below as a reduction in our lease commitments ratably over the then remaining life of the lease from October 2008. The timing of the reimbursements for the actual leasehold improvements may vary from the amount reflected in the table below.



In our acquisition of Convio, we also assumed a lease for office space in Austin, Texas which terminates on September 30, 2023, and has two five-year renewal options. Under the terms of the lease, we will increase our leased space by approximately 20,000 square feet on July 31, 2016. The current annual base rent of the lease is \$2.0 million. The terms of the agreement include a rent holiday during the first year and base rent that escalates annually thereafter between 2% and 4%. The related rent expense is recorded on a straight-line basis over the length of the lease term. In addition, we are entitled to an allowance of approximately \$3.3 million from the lessor for leasehold improvements, allocated among the existing and new expansion

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