

MANATRON INC  
Form 10-Q  
March 13, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended January 31, 2007

**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: **000-15264**

**MANATRON, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Michigan**

(State or Other Jurisdiction of  
Incorporation or Organization)

**38-1983228**

(I.R.S. Employer Identification No.)

**510 E. Milham Avenue**

**Portage, Michigan**

(Address of Principal Executive Offices)

**49002**

(Zip Code)

**(269) 567-2900**

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer (as defined in Exchange Act Rule 12b-2), an accelerated filer (as defined in Exchange Act Rule 12b-2) or a non-accelerated filer.

Large accelerated filer \_\_\_\_\_

Accelerated filer \_\_\_\_\_

Non-accelerated filer \_\_\_\_\_

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes \_\_\_\_\_

No \_\_\_\_\_

On March 13, 2007, there were 5,084,120 shares of the registrant's common stock, no par value, outstanding.



**MANATRON, INC.**

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### ***Forward-Looking Statements***

This Form 10-Q contains statements that are not historical facts. These statements are called "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements involve important known and unknown risks, uncertainties and other factors and can be identified by phrases using "estimate," "anticipate," "believe," "project," "expect," "intend," "predict," "potential," "future," "may," "should" and similar expressions or words. The Company's future results, performance or achievements may differ materially from the results, performance or achievements discussed in the forward-looking statements. There are numerous factors that could cause actual results to differ materially from the results discussed in forward-looking statements, including:

***Fluctuation in our quarterly revenues may adversely affect our operating results.*** In each fiscal quarter our expense levels, operating costs, and hiring plans are based on projections of future revenues and are relatively fixed. If our actual revenues fall below expectations, we could experience a reduction in operating results.

***Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.*** Changing laws, regulations, and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and NASDAQ rules, are creating uncertainty for companies such as ours. The costs required to comply with such evolving laws are difficult to predict. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with evolving standards. This investment may result in an unforeseen increase in general and administrative expenses and a diversion of management time and attention from revenue-generating activities, which may harm our business, financial condition, or results of operations.

***Increases in service revenue as a percentage of total revenues could decrease overall margins and adversely affect our operating results.*** We realize lower margins on software and appraisal service revenues than on license revenue. The majority of our contracts include both software licenses and professional services. Therefore, an increase in the percentage of software service and appraisal service revenue compared to license revenue could have a negative impact on our overall gross margins and could adversely affect operating results.

***Selling products and services into the public sector poses unique challenges.*** We derive substantially all of our revenues from sales of software and services to state and local governments. We expect that sales to state and local governments will continue to account for substantially all of our revenues in the future. We face many risks and challenges associated with contracting with governmental entities.

***Some of our present contracts are on a fixed-priced basis, which can lead to various risks, including:***

The failure to accurately estimate the resources and time required for an engagement;

The failure to effectively manage governmental agencies' and other customers' expectations regarding the scope of services to be delivered for an estimated price; and

The failure to timely complete fixed-price engagements within budget to the customers' satisfaction.

***We face significant competition from other vendors and potential new entrants into our markets.*** We face competition from a variety of software vendors that offer products and services similar to those offered by us, as well as from companies offering to develop custom software. We also face competition from those jurisdictions who decide to develop and maintain their own software.

***We must respond to rapid technological and legislative changes to be competitive.*** The market for our products is characterized by rapid technological and legislative change, evolving industry standards in computer hardware and software technology, changes in customer requirements, and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable.

***Our failure to properly manage growth could adversely affect our business.*** We intend to continue expansion into new markets, including California, in the foreseeable future to pursue existing and potential market opportunities. This growth places a significant demand on management and operational resources.

***We may experience difficulties in executing our acquisition strategy.*** Although we believe our future focus will be on internal growth, we will continue to identify and pursue strategic acquisitions and alliances with suitable candidates. Our future success will depend, in part, on our ability to successfully integrate future acquisitions and other strategic alliances into our operations.

***We may be unable to protect our proprietary rights.*** Many of our product and service offerings incorporate proprietary information, trade secrets, know-how, and other intellectual property rights. We rely on a combination of contracts, copyrights, and trade secret laws to establish and protect our proprietary rights in our technology. We cannot be certain that we have taken all appropriate steps to deter misappropriation of our intellectual property.

***Our products are complex and we run the risk of errors or defects with new product introductions or enhancements.*** Although we have not experienced material adverse effects resulting from defects or errors to date, we cannot assure you that material defects and errors will not be found in the future. We maintain errors and omissions and general liability insurance, and we try to structure our contracts to include limitations on liability. However, we cannot assure you that a successful claim based on errors or defects could not be made or would not have a material adverse effect on our business, financial condition, and results of operations.

***Changes in the insurance markets may affect our ability to win some contract awards and may lead to increased expenses.*** Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds before they will select us as their vendor. The number of qualified, high-rated insurance companies that offer performance bonds has decreased in recent years, while the costs associated with securing these bonds has increased dramatically.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report. However, this list is not intended to be exhaustive; many other factors, including the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended April 30, 2006, could impact our business and it is impossible to predict with any accuracy which factors could adversely affect the Company. Although we believe that the forward-looking statements contained in this report are reasonable, we cannot provide you with any guarantee that the anticipated results will be achieved. All forward-looking statements in this report are expressly qualified in their entirety by the cautionary statements contained in this section and you are cautioned not to place undue reliance on the forward-looking statements contained in this report. In addition to the risks listed above, other risks may arise in the future, and we disclaim any obligation to update information contained in any forward-looking statement.



**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements.****MANATRON, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                                                      | <b>January 31,<br/>2007</b> | <b>April 30,<br/>2006</b> |
|----------------------------------------------------------------------|-----------------------------|---------------------------|
|                                                                      | <b>(Unaudited)</b>          | <b>(Audited)</b>          |
| <b><u>ASSETS</u></b>                                                 |                             |                           |
| <b>CURRENT ASSETS:</b>                                               |                             |                           |
| Cash and equivalents                                                 | \$ 4,504,910                | \$ 4,209,831              |
| Accounts receivable, net                                             | 10,877,516                  | 7,556,313                 |
| Income tax receivable                                                | --                          | 2,182,248                 |
| Revenues earned in excess of billings on long-term contracts         | 5,192,455                   | 6,151,346                 |
| Unbilled retainages on long-term contracts                           | 939,787                     | 1,105,320                 |
| Notes receivable                                                     | 281,435                     | 450,565                   |
| Inventories                                                          | 99,625                      | 146,800                   |
| Deferred tax assets                                                  | 1,153,651                   | 1,153,651                 |
| Other current assets                                                 | 389,293                     | 485,525                   |
|                                                                      | <hr/>                       | <hr/>                     |
| Total current assets                                                 | 23,438,672                  | 23,441,599                |
|                                                                      | <hr/>                       | <hr/>                     |
| <b>NET PROPERTY AND EQUIPMENT</b>                                    | 2,382,758                   | 2,618,588                 |
|                                                                      | <hr/>                       | <hr/>                     |
| <b>OTHER ASSETS:</b>                                                 |                             |                           |
| Notes receivable, less current portions                              | 143,091                     | 272,261                   |
| Computer software development costs, net of accumulated amortization | 3,316,904                   | 2,610,216                 |
| Goodwill                                                             | 12,022,385                  | 12,022,385                |
| Intangible assets, net of accumulated amortization                   | 2,481,306                   | 3,202,935                 |
| Other, net                                                           | 288,465                     | 253,980                   |
|                                                                      | <hr/>                       | <hr/>                     |
| Total other assets                                                   | 18,252,151                  | 18,361,777                |
|                                                                      | <hr/>                       | <hr/>                     |
| Total assets                                                         | \$ 44,073,581               | \$ 44,421,964             |
|                                                                      | <hr/>                       | <hr/>                     |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                   |                             |                           |
| <b>CURRENT LIABILITIES:</b>                                          |                             |                           |
| Accounts payable                                                     | \$ 651,919                  | \$ 898,301                |
| Current portion of notes payable                                     | 818,760                     | 2,700,000                 |

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|                                                              |               |               |
|--------------------------------------------------------------|---------------|---------------|
| Billings in excess of revenues earned on long-term contracts | 1,287,093     | 3,373,271     |
| Billings for future services                                 | 12,162,832    | 8,369,114     |
| Accrued liabilities                                          | 3,147,845     | 3,419,286     |
|                                                              | <hr/>         | <hr/>         |
| Total current liabilities                                    | 18,068,449    | 18,759,972    |
|                                                              | <hr/>         | <hr/>         |
| <b>DEFERRED INCOME TAXES</b>                                 | 284,963       | 284,963       |
| <b>LONG-TERM PORTION OF NOTES PAYABLE</b>                    | 1,849,416     | 2,334,228     |
| <b>SHAREHOLDERS' EQUITY:</b>                                 |               |               |
| Common stock                                                 | 16,748,215    | 16,538,483    |
| Retained earnings                                            | 7,122,538     | 6,504,318     |
|                                                              | <hr/>         | <hr/>         |
| Total shareholders' equity                                   | 23,870,753    | 23,042,801    |
|                                                              | <hr/>         | <hr/>         |
| Total liabilities and shareholders' equity                   | \$ 44,073,581 | \$ 44,421,964 |
|                                                              | <hr/>         | <hr/>         |

See accompanying notes to condensed consolidated financial statements.



**MANATRON, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

|                                                             | Three Months Ended<br>January 31, |                | Nine Months Ended<br>January 31, |                |
|-------------------------------------------------------------|-----------------------------------|----------------|----------------------------------|----------------|
|                                                             | 2007                              | 2006           | 2007                             | 2006           |
| <b>NET REVENUES</b>                                         | \$ 10,324,099                     | \$ 8,024,451   | \$ 31,715,423                    | \$ 26,414,813  |
| <b>COST OF REVENUES</b>                                     | 4,997,650                         | 5,858,868      | 16,638,237                       | 18,398,909     |
| Gross profit                                                | 5,326,449                         | 2,165,583      | 15,077,186                       | 8,015,904      |
| <b>SELLING, GENERAL AND<br/>ADMINISTRATIVE EXPENSES</b>     | 4,737,403                         | 4,368,023      | 14,176,467                       | 12,638,649     |
| Income (loss) from operations                               | 589,046                           | (2,202,440)    | 900,719                          | (4,622,745)    |
| <b>OTHER INCOME, NET</b>                                    | 40,616                            | 54,213         | 90,101                           | 207,078        |
| Income (loss) before provision (credit) for<br>income taxes | 629,662                           | (2,148,227)    | 990,820                          | (4,415,667)    |
| <b>PROVISION (CREDIT) FOR INCOME<br/>TAXES</b>              | 236,000                           | (816,000)      | 372,600                          | (1,677,440)    |
| <b>NET INCOME (LOSS)</b>                                    | \$ 393,662                        | \$ (1,332,227) | \$ 618,220                       | \$ (2,738,227) |
| <b>BASIC EARNINGS (LOSS) PER SHARE</b>                      | \$ .08                            | \$ (.31)       | \$ .13                           | \$ (.64)       |
| <b>DILUTED EARNINGS (LOSS) PER SHARE</b>                    | \$ .08                            | \$ (.31)       | \$ .12                           | \$ (.64)       |
| <b>BASIC WEIGHTED AVERAGE<br/>SHARES OUTSTANDING</b>        | 4,909,756                         | 4,322,363      | 4,897,821                        | 4,297,453      |
| <b>DILUTED WEIGHTED AVERAGE<br/>SHARES OUTSTANDING</b>      | 5,088,126                         | 4,322,363      | 4,968,896                        | 4,297,453      |

See accompanying notes to condensed consolidated financial statements.



**MANATRON, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|                                                                                                                     | <b>Nine Months Ended<br/>January 31,</b> |                |
|---------------------------------------------------------------------------------------------------------------------|------------------------------------------|----------------|
|                                                                                                                     | <b>2007</b>                              | <b>2006</b>    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                                        |                                          |                |
| Net income (loss)                                                                                                   | \$ 618,220                               | \$ (2,738,227) |
| Adjustments to reconcile net income (loss) to net cash and equivalents provided by (used for) operating activities: |                                          |                |
| Depreciation expense                                                                                                | 602,887                                  | 610,993        |
| Amortization expense                                                                                                | 1,628,058                                | 1,737,906      |
| Stock compensation expense                                                                                          | 509,728                                  | 318,258        |
| Decrease (increase) in current assets:                                                                              |                                          |                |
| Accounts and notes receivables, net                                                                                 | (3,022,903)                              | (3,958,638)    |
| Income tax receivable                                                                                               | 2,182,248                                | (1,091,439)    |
| Revenues earned in excess of billings and retainages on long-term contracts                                         | 1,124,424                                | 383,689        |
| Inventories                                                                                                         | 47,175                                   | 24,149         |
| Other current assets                                                                                                | 96,232                                   | 303,616        |
| Increase (decrease) in current liabilities:                                                                         |                                          |                |
| Accounts payable and accrued liabilities                                                                            | (517,823)                                | (524,513)      |
| Billings in excess of revenues earned on long-term contracts                                                        | (2,086,178)                              | (193,274)      |
| Billings for future services                                                                                        | 3,793,718                                | 2,787,766      |
|                                                                                                                     | 4,975,786                                | (1,953,166)    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                                        |                                          |                |
| Net additions to property and equipment                                                                             | (367,056)                                | (412,438)      |
| Investments in computer software                                                                                    | (1,613,117)                              | (1,208,610)    |
| Other, net                                                                                                          | (19,297)                                 | (221,548)      |
|                                                                                                                     | (1,999,470)                              | (2,442,596)    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                                        |                                          |                |
| Issuance of common stock, net                                                                                       | 136,023                                  | 333,510        |
| Repurchases of common stock                                                                                         | (436,020)                                | (268,490)      |
| Payments on notes payable                                                                                           | (2,381,240)                              | (300,000)      |

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|                                                        |             |           |
|--------------------------------------------------------|-------------|-----------|
| Net cash and equivalents used for financing activities | (2,681,237) | (234,980) |
|--------------------------------------------------------|-------------|-----------|

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**CASH AND EQUIVALENTS:**

|                                             |           |             |
|---------------------------------------------|-----------|-------------|
| Increase (decrease) in cash and equivalents | 295,079   | (4,630,742) |
| Balance at beginning of period              | 4,209,831 | 8,444,195   |

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|                          |              |              |
|--------------------------|--------------|--------------|
| Balance at end of period | \$ 4,504,910 | \$ 3,813,453 |
|--------------------------|--------------|--------------|

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|                                                        |              |           |
|--------------------------------------------------------|--------------|-----------|
| Cash received from income tax refunds, net of payments | \$ 1,972,691 | \$ 80,000 |
|--------------------------------------------------------|--------------|-----------|

|                                                              |            |       |
|--------------------------------------------------------------|------------|-------|
| Cash paid for interest associated with seller financed notes | \$ 164,705 | \$ -- |
|--------------------------------------------------------------|------------|-------|

See accompanying notes to condensed consolidated financial statements.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**(1) GENERAL INFORMATION**

The condensed consolidated financial statements included in this Form 10-Q have been prepared by Manatron, Inc. ("Manatron" or the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended April 30, 2006, as filed with the Securities and Exchange Commission on July 24, 2006.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of only a normal and recurring nature, necessary to present fairly (a) the financial position of the Company as of January 31, 2007, (b) the results of its operations for the three and nine months ended January 31, 2007 and 2006, and (c) the cash flows for the nine months ended January 31, 2007 and 2006. The balance sheet as of April 30, 2006 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

Revenue Recognition

The Company enters into contracts with customers to license or sell application software; third party software; hardware, forms and supplies; and professional services, such as installation, training, data conversions, post-contract support and maintenance ("PCS") services, consulting and various appraisal services.

The Company recognizes revenue for contracts with multiple element software arrangements in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended. The Company allocates the total arrangement fee among each deliverable based on the relative fair value of each of the deliverables, determined based on vendor-specific objective evidence ("VSOE"). When discounts are offered in a software arrangement, the Company utilizes the residual method, as defined in SOP 97-2, and allocates revenue to the undelivered elements based on VSOE. The discount and remaining revenue are allocated to the delivered elements, which typically encompass the software and hardware components of the contract.

Certain of the Company's software arrangements involve "off-the-shelf" software and services that are not considered essential to the functionality of the software. For these arrangements, software revenue is recognized when the installation has occurred, customer acceptance is reasonably assured, the sales price represents an enforceable claim and is probable of collection, and the remaining services such as training and installation are considered nominal. Fees

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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**(1) GENERAL INFORMATION (continued)**

allocable to services under these arrangements are recognized as revenue as the services are performed. It is not the Company's practice and not typical for the Company to offer price concessions. On the contrary, the Company collects under the original terms of its contracts in substantially all cases. Therefore, the Company believes its fees are fixed and determinable.

Revenue related to sales of computer hardware and supplies is recognized when title passes, which is normally the shipping or installation date.

PCS includes telephone support, bug fixes, enhancements and rights to upgrades on a when-and-if available basis. These support and maintenance fees are typically billed in advance on a monthly, quarterly or annual basis and are recognized as revenue ratably over the related contract periods.

Billings for future services, as reflected in the accompanying condensed consolidated balance sheets, includes PCS and other services that have been billed to the customer in advance of performance. It also includes customer deposits on new contracts and other progress billings for software and hardware that have not been completely installed.

For arrangements that include significant customization or modification of the software, or where software services are otherwise considered essential, or for software that is not generally available, revenue is recognized using contract accounting. Revenue from these arrangements is recognized using the percentage-of-completion method with progress-to-completion measured based primarily upon labor hours incurred or units completed. Revenue earned is based on the progress-to-completion percentage after giving effect to the most recent estimates of total cost. Changes to total estimated contract costs, if any, are recognized in the period they are determined. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. The reserves for contract losses, as well as billed retainages outstanding associated with revenue that has been recognized, were approximately \$411,000 and \$683,000 at January 31, 2007 and 2006, respectively.

For its real estate appraisal projects, the Company recognizes revenue using the proportional performance method because the Company believes each of its projects result in one ultimate deliverable - the appraised values of all properties defined within a given contract, as well as the fact that many of these projects are implemented over a one-to three-year period and consist of various activities. Under this method of revenue recognition, the Company identifies each activity for the appraisal project with a typical project generally calling for planning, data collection, data verification, data input, project management, abstracts and hearings. The costs for these activities are estimated and the total contract value is then allocated to each activity based on the proportion of the budgeted cost for a given activity divided by the total budgeted cost for a project. Revenue recognition occurs for each activity based upon the proportional performance method, driven primarily by output measures such as parcels or hearings complete. Actual costs are expensed in the period in which they occur.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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**(1) GENERAL INFORMATION (continued)**

Since the timing of billings does not always coincide with revenue recognition, the Company reflects Revenues Earned in Excess of Billings and Retainages, as well as Billings in Excess of Revenues for contracts in process at the end of the reporting period, as reflected in the accompanying condensed consolidated balance sheets.

Due to the appropriation requirements of governmental units, the Company will very seldom have a collection issue due to a shortage or lack of funds, such as bankruptcy. As a result, the Company's past due receivables primarily revolve around issues in which the customer does not feel that the software operates to its expectations. In the majority of these cases there is a gap between what the customer expects and what the Company is obligated to deliver per its contract. Accordingly, reserves against Accounts Receivable and reserves against Revenues Earned in Excess of Billings and Retainages are established based on the Company's collection history and other known risks associated with the related contracts. These reserves contain a provision of 2% as well as a specific provision for accounts the Company believes will not be collected.

The Company's contracts do not typically contain a right of return or cancellation. Accordingly, as of January 31, 2007 and 2006, the reserve for returns was not material.

Notes receivable result from certain software contracts in which customers pay for the application software, hardware or related services over an extended period of time, generally three to five years. Interest on these notes range from 8% to 10%. The Company recognizes revenue for these contracts when the related elements are delivered, as the contract terms are fixed and determinable and the Company has a longstanding history of collecting on the notes under the original payment terms without providing concessions. Certain of the Company's contracts with customers include lease terms that meet the criteria of sales type leases as defined by Statement of Financial Accounting Standards ("SFAS") No. 13, "Accounting for Leases." However, the Company's leasing activities are not a material part of its business activities and, accordingly, are not broken out separately in the condensed consolidated financial statements.

Changes in Accounting Estimates

Effective May 1, 2006, the Company extended the useful life of its capitalized GRM® software development from three years to five years. Since GRM® is a national product, which will be implemented in many states and all of the clients will be using the same and single thread of code, the Company believes that its useful life is greater than the historic state specific software that did not cross state boundaries. The change has resulted in a reduction of amortization expense and an increase in income before provision of income taxes for the three and nine months ended January 31, 2007 of \$350,000, and an increase in net income of \$219,000 or \$0.04 per diluted share after tax.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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**(1) GENERAL INFORMATION (continued)**

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. Under FIN 48, the tax effects of a position should be recognized only if it is "more likely than not" to be sustained solely on its technical merits as of the reporting date. FIN 48 also requires significant new annual disclosures in the notes to the financial statements. The effects of adjustments at adoption should be recorded directly to beginning retained earnings in the period of adoption and reported as a change in accounting principle. Retroactive application is prohibited under FIN 48. The guidance in FIN 48 is required to be applied in fiscal years beginning after December 15, 2006. As such the Company is required to adopt FIN 48 effective May 1, 2007. The Company is currently evaluating the impact of FIN 48 on its consolidated financial statements.

**(2) STOCK-BASED COMPENSATION**

Effective May 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment* ("SFAS 123(R)") using the modified-prospective-transition method. Under SFAS 123(R), a public entity is generally required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award, with such cost recognized over the applicable vesting period. In addition, SFAS 123(R) requires an entity to provide certain disclosures in order to assist in understanding the nature of share-based payment transactions and the effects of those transactions on the financial statements. As a result of this adoption, the Company incurred approximately \$64,000 and \$93,000 of compensation expense for the three and nine months ended January 31, 2007, respectively.

The Company has a number of stock plans that include restricted stock or stock options that were developed to assist the Company in attracting, rewarding, and retaining well-qualified directors, executive personnel, and other key employees. The Compensation Committee, a sub-committee of the Board of Directors, has the authority to approve restricted stock grants as well as the vesting schedule. Shares of restricted stock granted to employees typically vest over a three- to five-year period. When shares were granted, the related unrecognized expense was previously reflected as deferred compensation in shareholders' equity in the accompanying condensed consolidated balance sheets. However, with the implementation of SFAS 123(R) these amounts, which totaled approximately \$1.1 million at January 31, 2007, were reclassified and are now included within the common stock caption in the accompanying condensed consolidated balance sheets. The related compensation expense is still being amortized to expense over the applicable vesting periods.



**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

**(2) STOCK-BASED COMPENSATION (Continued)**

Effective October 5, 2006, the date on which the Manatron, Inc. 2006 Executive Stock Incentive Plan was approved by the Company's shareholders, the Company issued 430,000 options to various members of its Executive Leadership Team, which will vest over a five-year period for financial reporting purposes and will result in approximately \$60,000 of quarterly compensation expense to the Company. The fair value of each option granted, which was \$2.78, was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

|                         |         |
|-------------------------|---------|
| Risk Free Interest Rate | 4.55%   |
| Expected Life           | 5 years |
| Expected Volatility     | 37.79%  |
| Expected Dividend Yield | 0%      |

**Stock Options**

The following activity occurred under the Company's option plans for the three and nine months ended January 31, 2007:

|                         | Stock<br>Under<br>Option | Weighted<br>Average<br>Exercise Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value (1) |
|-------------------------|--------------------------|----------------------------------------------------|---------------------------------------------------------|-------------------------------------|
| <b>May 1, 2006</b>      | 443,200                  | \$ 5.89                                            | 4.87 years                                              | \$ 518,222                          |
| Granted                 | --                       | --                                                 |                                                         |                                     |
| Exercised               | (7,700)                  | 3.36                                               |                                                         |                                     |
| Forfeited or expired    | (7,000)                  | 6.17                                               |                                                         |                                     |
| <b>July 31, 2006</b>    | 428,500                  | \$ 5.93                                            | 4.65 years                                              | \$ 384,899                          |
| Granted                 | 430,000                  | 6.86                                               |                                                         |                                     |
| Exercised               | (5,000)                  | 3.13                                               |                                                         |                                     |
| Forfeited or expired    | (6,000)                  | 6.81                                               |                                                         |                                     |
| <b>October 31, 2006</b> | 847,500                  | \$ 5.95                                            | 6.72 years                                              | \$ 517,402                          |
| Granted                 | --                       | --                                                 |                                                         |                                     |
| Exercised               | (13,500)                 | 1.70                                               |                                                         |                                     |
| Forfeited or expired    | --                       | --                                                 |                                                         |                                     |
| <b>January 31, 2007</b> | 834,000                  | \$ 6.49                                            | 6.57 years                                              | \$ 1,971,471                        |

**Exercisable at**

**January 31, 2007**

|                |           |             |                   |                     |
|----------------|-----------|-------------|-------------------|---------------------|
| <u>404,000</u> | <u>\$</u> | <u>6.09</u> | <u>4.32 years</u> | <u>\$ 1,115,771</u> |
|----------------|-----------|-------------|-------------------|---------------------|

(1) The aggregate intrinsic value of options outstanding is calculated as the difference between the exercise price of the underlying options and the market price of the Company's common stock for options that were in-the-money as of that date. Options that were not in-the-money as of that date, and therefore have a negative intrinsic value, have been excluded from this figure. The total intrinsic value of options exercised during the three and nine months ended January 31, 2007 was \$81,300 and \$122,300, respectively.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

**(2) STOCK-BASED COMPENSATION (Continued)**

Cash received from option exercises and share issuances under the Stock Purchase Plan was \$45,000 and \$136,000 for the three and nine months ended January 31, 2007, respectively.

The following table provides pro forma net losses and related per share amounts had the Company applied the fair value method of SFAS 123(R) for the three and nine months ended January 31, 2006:

|                         | Three Months<br>Ended<br><u>January 31, 2006</u> | Nine Months<br>Ended<br><u>January 31, 2006</u> |
|-------------------------|--------------------------------------------------|-------------------------------------------------|
| Net loss as reported    | \$ (1,332,227)                                   | \$ (2,738,227)                                  |
| Compensation expense    | (2,837)                                          | (46,274)                                        |
| Pro forma net loss      | <u>\$ (1,335,064)</u>                            | <u>\$ (2,784,501)</u>                           |
| Basic loss per share:   |                                                  |                                                 |
| As reported             | <u>\$ (.31)</u>                                  | <u>\$ (.64)</u>                                 |
| Pro forma               | <u>\$ (.31)</u>                                  | <u>\$ (.65)</u>                                 |
| Diluted loss per share: |                                                  |                                                 |
| As reported             | <u>\$ (.31)</u>                                  | <u>\$ (.64)</u>                                 |
| Pro forma               | <u>\$ (.31)</u>                                  | <u>\$ (.65)</u>                                 |

**Restricted Stock Awards**

Activity under the Company's Restricted Stock Plan for the nine month period ended January 31, 2007 was as follows:

|                                      | Shares         | Weighted Average<br>Grant Date<br>Fair Value |
|--------------------------------------|----------------|----------------------------------------------|
| Unvested balance at May 1, 2006      | 233,975        | \$7.74                                       |
| Granted                              | 17,300         | 6.75                                         |
| Vested                               | (62,175)       | (7.30)                                       |
| Unvested balance at January 31, 2007 | <u>189,100</u> | <u>\$7.74</u>                                |

As of January 31, 2007, there was \$1,095,149 of unrecognized compensation cost related to nonvested share-based compensation arrangements granted under restricted stock award plans. That cost is expected to be recognized over a weighted-average period of 2.5 years. The total fair value of shares vested during the nine months ended January 31,

2007 was \$344,000.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

**(2) STOCK-BASED COMPENSATION (Continued)**

**Share-Based Compensation Expense**

Total share-based compensation expense recognized in the Statement of Operations for the three and nine months ended January 31, 2007 was as follows:

|                                        | Three Months<br>Ended<br>January 31, 2007 | Nine Months<br>Ended<br>January 31, 2007 |
|----------------------------------------|-------------------------------------------|------------------------------------------|
| Stock options                          | \$ 59,769                                 | \$ 79,692                                |
| Restricted stock                       | 122,480                                   | 417,446                                  |
| Employee stock purchase plan           | 3,945                                     | 12,590                                   |
| Total share-based compensation expense | <u>\$ 186,194</u>                         | <u>\$ 509,728</u>                        |

**(3) EARNINGS (LOSS) PER SHARE**

The following table reconciles the numerators and denominators used in the calculation of basic and diluted earnings (loss) per share for each of the periods presented:

|                                                                                          | Three Months Ended<br>January 31, |                       | Nine Months Ended<br>January 31, |                      |
|------------------------------------------------------------------------------------------|-----------------------------------|-----------------------|----------------------------------|----------------------|
|                                                                                          | <u>2007</u>                       | <u>2006</u>           | <u>2007</u>                      | <u>2006</u>          |
| Numerators:                                                                              |                                   |                       |                                  |                      |
| Net income (loss)                                                                        | <u>\$ 393,662</u>                 | <u>\$ (1,332,227)</u> | <u>\$ 618,220</u>                | <u>\$(2,738,227)</u> |
| Denominators:                                                                            |                                   |                       |                                  |                      |
| Denominator for basic earnings per share, weighted average outstanding common shares (1) | 4,909,756                         | 4,322,363             | 4,897,821                        | 4,297,453            |
| Potential dilutive shares                                                                | 178,370(2)                        | --(3)                 | 71,075(2)                        | --(3)                |

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|                                            |                             |                             |                             |                             |
|--------------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Denominator for diluted earnings per share | 5,088,126                   | 4,322,363                   | 4,968,896                   | 4,297,453                   |
|                                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Earnings (Loss) Per Share:                 |                             |                             |                             |                             |
| Basic                                      | \$ .08                      | \$ (.31)                    | \$ .13                      | \$ (.64)                    |
|                                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Diluted                                    | \$ .08                      | \$ (.31)                    | \$ .12                      | \$ (.64)                    |
|                                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |

(1) These amounts exclude unvested restricted stock, which amounted to 189,100 shares as of January 31, 2007 and 206,575 shares as of January 31, 2006.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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**(3) EARNINGS (LOSS) PER SHARE (Continued)**

- (2) Options to purchase 70,000 shares of common stock at prices ranging from \$8.11 to \$8.33 per share that were outstanding for the three months and 102,000 shares at prices ranging from \$7.00 to \$8.33 for the nine months ended January 31, 2007, have been excluded from the computation of diluted earnings per share because the exercise prices are greater than the average market price of the common stock for these periods.
- (3) Due to the loss reported for the three- and nine-month periods, there are no potential diluted shares included in the calculations. However, had income been reported there would have been an additional 173,806 and 229,609 of potential dilutive shares for the three and nine months ended January 31, 2006, respectively.

**(4) ACQUISITIONS**

Effective February 1, 2006, the Company acquired all of the outstanding stock of ASIX Inc. ("ASIX"). The purchase price for ASIX was approximately \$11 million consisting of \$4.2 million in cash, 436,500 shares of Manatron common stock and \$3.8 million in promissory notes bearing interest at 5% with \$2.2 million, \$1.2 million, \$200,000 and \$200,000 due on February 1, 2007, 2008, 2009 and 2010, respectively. The stock purchase agreement also contains an earn-out provision of up to \$1 million if certain revenue thresholds are met in the California market from February 1, 2006 through January 31, 2012, which would be recorded as additional goodwill, if paid.

The excess of the purchase price over the net book value of assets acquired of \$8.6 million was allocated to goodwill and intangible assets. Specifically, \$1,224,000 was allocated to customer relationships, \$683,000 was allocated to purchased technology and \$131,000 to trademarks, all of which will be amortized over a five-year period. The remaining \$6.6 million has been allocated to goodwill.

Founded in 1991, ASIX designed, developed and marketed Ascend®, a comprehensive client/server-based assessment administration and property tax billing and collection system that is currently installed in 16 counties in Colorado, Illinois, Minnesota, Missouri, Nevada, Oregon and Washington. ASIX also provided professional services including installation, training, project management, data conversions and on-going support in connection with sales of its property tax software. Finally, ASIX provided requirements definition and requests for proposal development to a number of larger jurisdictions seeking a new property tax system.

ASIX was a sub-contractor to BearingPoint, Inc. to provide technical services and subject matter expertise in connection with a \$31 million project to develop a state-of-the-art property tax and assessment system for San Diego County. In connection with this project, ASIX and BearingPoint entered into an exclusive joint marketing agreement to provide the developed solution to other California counties.

**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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**(4) ACQUISITIONS (Continued)**

This acquisition has been accounted for under the purchase method of accounting. The operating results of ASIX have been included in the Company's results of operations from the date of acquisition.

Effective November 1, 2005, the Company acquired substantially all of the assets of the Plexis Group, LLC ("Plexis") and assumed the support and maintenance obligations of its software contracts for approximately \$1 million. The cash outlay for this transaction included an initial payment of \$600,000 which was paid on November 1, 2005 and two additional payments of \$200,000 which were due on November 1, 2006 and 2007, respectively. The Company prepaid this \$400,000 during the first quarter of fiscal 2007. The excess of the purchase price over the net book value of assets acquired of \$1,080,000 was allocated to intangible assets. Specifically, \$525,000 was allocated to customer relationships, which will be amortized over a five-year period. The remaining \$555,000 has been allocated to goodwill.

Formed in 2000 as a subsidiary of Beam, Longest & Neff, LLC, a 50-year-old engineering company, Plexis was an Indiana-based company that had long standing relationships with 20 Indiana counties, 13 of whom were current Computer Assisted Mass Appraisal (CAMA) software clients. Plexis also provided property tax and Geographic Information Systems (GIS) software and related services.

Historical annual revenues from the Plexis client base acquired ranged from \$1.5 million to \$1.8 million, of which \$550,000 was recurring from ongoing software support and map hosting contracts.

This acquisition has been accounted for under the purchase method of accounting. The operating results of Plexis have been included in the Company's results of operations from the date of acquisition.

**(5) RESTRUCTURING CHARGE**

In response to the Company's unsatisfactory financial results for fiscal year 2006, effective April 26, 2006, the Company made strategic workforce reductions. As a result, sixty-two positions were eliminated. In connection with the reorganization, the Company recorded charges that were primarily associated with employee severance costs and related fringe benefits of approximately \$532,000 before income taxes, all of which was accrued and expensed as of April 30, 2006. Approximately \$512,000 of this amount has been paid during the nine months ended January 31, 2007. The remaining accrual of \$20,000 relates to accrued medical costs and is expected to be paid out over the next nine months as claims are incurred.



**MANATRON, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

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(6) CONTINGENT LIABILITIES AND GUARANTEES

The Company is periodically a party, both as plaintiff and defendant, to lawsuits and claims arising out of the normal course of business. The Company does not believe that the liabilities resulting from these proceedings, if any, would be material to the Company's financial position or results of operations.

The Company may provide its customers up to a one-year warranty on its internally developed application software; however, warranty expenses are not and have not been significant.

The Company is periodically required to obtain bid and performance bonds to provide certain assurances to current and prospective customers regarding its ability to fulfill contractual obligations. The Company has agreed to indemnify the surety for any and all claims made against the bonds. Historically, the Company has not had any claims for indemnity from its surety. As of January 31, 2007, the Company had approximately \$34.0 million in outstanding performance bonds, which are anticipated to expire at various times over the next three years.

The Company utilizes subcontractors at times to help complete contractual obligations; however, the Company is still ultimately responsible for the performance of the subcontractors.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**  
***Critical Accounting Policies and Estimates***

Management's discussion and analysis of its financial condition and results of operations is based upon the Company's condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States for interim periods. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to receivable allowances, long-term service contracts, intangible assets, contingencies and litigation. As these are condensed consolidated financial statements, reference should be made to the Company's Form 10-K Annual Report for the year ended April 30, 2006, for expanded information about the Company's critical accounting policies and estimates.

***Results of Operations***

The Company's business is primarily focused on providing software and services to enable state and local governments in North America to completely, fairly and efficiently assess real and

personal property, and to bill and collect the related property taxes from its citizens. The Company's software manages the entire property life cycle, which includes deed recording, mapping (GIS), assessment, tax billing and collection, tax sales and e-government.

The Company's revenues are primarily generated from software license fees, software maintenance fees, professional services and sales of hardware, forms and supplies. Professional services consist of data conversions, installation, training, project management, hardware maintenance, forms processing and printing, consulting and appraisal services.

For simplicity purposes, many of the numbers described below are rounded; however, the percentage variations are based upon the actual amounts.

Total net revenues of \$10.3 million and \$31.7 million for the three and nine months ended January 31, 2007 increased by \$2.3 million or 28.7% and \$5.3 million or 20.1%, respectively, in comparison to the \$8.0 million and \$26.4 million of net revenues that were reported for the three and nine months ended January 31, 2006. These increases were primarily due to increases in the Company's license fees, recurring software maintenance and professional services revenues.

Software license fees increased by \$846,000 to \$1.3 million for the three months ended January 31, 2007 versus the \$466,000 of software license fees that were recognized for the three months ended January 31, 2006. In addition, software license fees increased by \$1.8 million or 82.5% from \$2.2 million to \$4.0 million for the nine months ended January 31, 2007. These increases were driven by several property tax implementations in the Company's core markets of Florida, Indiana and Ohio during the first nine months of fiscal year 2007, as well as the continued execution of the Company's GRM® implementations in Minnesota, Nevada, South Carolina, Tennessee and Virginia.

Recurring software maintenance fees increased by \$1.0 million or 26.3% to \$4.6 million for the three months ended January 31, 2007 and by \$2.9 million or 28.3% from \$10.4 million to \$13.3 million for the nine months ended January 31, 2007 over the prior year comparable periods. These increases are due to three factors. First, the acquisitions of Plexis on November 1, 2005 and ASIX on February 1, 2006 contributed \$600,000 and \$2.0 million of new maintenance revenues for the three and nine months ended January 31, 2007, respectively. Second, annual price increases on the Company's software maintenance contracts initiated in the prior year are starting to take effect. Finally, new software maintenance has been initiated on completed implementations, including Kenai, Alaska; Gwinnett County, Georgia; Payette County, Idaho; DuVal County, Florida; Davidson County, Tennessee and the CAMA portion of the City of Virginia Beach contract.

Professional services revenues increased by \$392,000 or 11.4% to \$3.8 million for the three months ended January 31, 2007 versus \$3.4 million of professional services revenues for the third quarter in the prior fiscal year. For the nine months ended January 31, 2007, these revenues increased by \$621,000 or 5.0% from \$12.4 million to \$13.0 million. These increases were primarily driven by the additional consulting services that the Company acquired as a result of the ASIX acquisition in February of 2006 offset by appraisal service revenue decreases of \$558,000 and \$976,000 for the three and nine months ended January 31, 2007, respectively.

Software license fees and professional services revenues can vary significantly from quarter to quarter or year to year, as they are primarily driven by the Company's backlog, new sales, the timing of the related software implementations and the cyclical nature of certain markets. In addition, many of the larger and more complex jurisdictions, which the Company is now able to pursue due to its new product and business strategy, often take more than a year to fully implement and a number of these contracts are accounted for using the percentage of completion method, which results in the license revenues being recognized over the implementation period.

As of January 31, 2007, the Company's backlog was \$18.3 million compared to \$16.1 million at January 31, 2006. However, the amounts for both periods include \$2.8 million related primarily with the second phase of the project with the City of Baltimore that the Company believes may not be realized in the future. This increase is primarily due to a higher level of sales in the current fiscal year than in the prior period. Signed contracts for the nine months ended January 31, 2007 totaled \$13.3 million versus \$13.0 million for the nine months ended January 31, 2006. The majority of the increase is due to new name accounts recently signed such as Clay County, Missouri; Clinton County, Pennsylvania; Vigo County, Indiana; four counties in Oregon and a number of upgrades in the Company's core markets of Florida, Indiana and Ohio. These backlog amounts are exclusive of the Company's recurring revenue from software maintenance, hardware maintenance and printing and processing contracts, which is currently approximately \$22 million on an annualized basis.

The GRM® suite of software is a web-based, feature-rich, fully-integrated enterprise-level solution that has enabled Gwinnett County, Georgia; Kenai, Alaska; and several counties in Idaho to not only replace their legacy systems, but to realize significant efficiencies and cost savings, provide more and modern services to their constituents and, in most cases, to collect additional tax revenues, which will help to offset the cost of the GRM® system. The rollout of this new, next generation national product has been a key pillar in the Company's growth strategy. It is providing a competitive edge in the market as few, if any, other companies currently have a similar product suite. Historically, the Company had unique tax products for each state that it did business in. This required separate sales, marketing, development, and support initiatives. The Company expects to realize significant cost savings and economies of scale as it continues to market and implement GRM®.

Despite the \$2.3 million increase in revenues, cost of revenues decreased by \$861,000 or 14.7% from \$5.9 million to \$5.0 million for the three months ended January 31, 2007 compared to the three months ended January 31, 2006. Cost of revenues also decreased by \$1.8 million or 9.6% from \$18.4 million to \$16.6 million for the nine months ended January 31, 2007 even though revenues were \$5.3 million greater than the revenues posted for the prior year comparable period.

These decreases in cost of revenues were driven by three factors: First, the Company completed a restructuring effective April 26, 2006 (see Note 5 of Notes to the Condensed Consolidated Financial Statements), which has resulted in lower labor costs. Second, outsourced labor has decreased by \$280,000 and \$715,000 for the three and nine months ended January 31, 2007, respectively, versus the prior year comparable periods, primarily because the prior year amounts included significant contracted labor expense related to the City of Baltimore implementation.

As noted in prior filings, the City of Baltimore had delayed its "go live" date several times and in June of 2006 made the decision to delay once more until January 2007. This project evolved into a custom build solution versus the Commercial-Off-The-Shelf (COTS) product initially purchased. As a result, the Company has continued its negotiations with Unisys (the prime contractor) to address how the Company will be compensated for out-of-scope work performed since March 1, 2006. The Company released all subcontractors associated with the project and will not resume work until an agreement is in place to compensate the Company for prior work and any additional work to be performed in the future. The Company incurred no internal or external labor expense on this project during the second or third quarter of the current fiscal year, but did incur \$352,000 of outsourced labor with no associated revenue during the first quarter ended July 31, 2006.

Third, effective May 1, 2006 the Company extended the useful life of its capitalized GRM® software development from three years to five years. Since GRM® is a national product, which will be implemented in many states and all of the clients will be using the same and single thread of code, the Company believes that its useful life is greater than the historic state-specific software that did not cross state boundaries. This change in accounting estimate has resulted in a reduction of software amortization expense during the current fiscal year of \$350,000, which is one of the components of the Company's cost of revenues.

As a result of the increases in revenues and decreases in cost of sales noted previously, gross margins have increased to 51.6% for the three months ended January 31, 2007 compared to 27.0% for the prior year third quarter. For the nine months ended January 31, 2007, gross margins have increased to 47.5% from 30.3%, versus the prior year. The margin improvements are primarily due to the increase in revenues as the majority of the Company's costs of revenue are fixed. In addition, a favorable change in the mix of revenues has resulted in gross margin improvements. The Company typically generates higher gross margins on software license fees than service revenues and software license fees are up substantially for both the three and nine month periods versus the prior year. Finally, the Company's efforts to reduce costs in connection with its restructuring last April has also led to margin improvement.

Selling, general and administrative expenses increased 8.5% to \$4.7 million for the three months ended January 31, 2007 and by 12.2% to \$14.2 million for the nine months ended January 31, 2007 versus the respective periods in the prior fiscal year. However, for the third quarter, selling, general and administrative expenses are relatively flat or slightly lower than those incurred for the first and second quarters of the current fiscal year. The increases over the prior year comparable periods are primarily due to three factors. First, the amortization expense associated with the intangible assets acquired in connection with the acquisitions of VisiCraft, Plexis and ASIX. Intangible asset amortization increased by \$5,000 and \$261,000 for the three and nine months ended January 31, 2007 over the prior year comparable periods. Second, commission expense has increased by \$18,000 and \$352,000 for the three and nine months ended January 31, 2007 over the prior year comparable periods because of the increase in signed contracts noted previously. The remaining increase in selling, general and administrative expenses is due to the addition of key sales, marketing and development personnel associated with the Plexis and ASIX acquisitions, offset by the decline attributable to the restructuring discussed in Note 5 to the Condensed Consolidated Financial Statements.

As a result of the factors noted above, the Company's operating income increased by \$2.8 million to \$589,000 for the three months ended January 31, 2007 from an operating loss of \$2.2 million for the third quarter in the prior fiscal year. In addition, operating income increased by \$5.5 million to \$901,000 for the nine months ended January 31, 2007 from an operating loss of \$4.6 million for the comparable prior year period.

Net other income decreased by \$14,000 and \$117,000 for the three and nine months ended January 31, 2007 to \$41,000 and \$90,000, respectively. These amounts primarily consist of interest earned on the Company's cash balances and rental income on a portion of the Company's office space offset by interest expense. The decreases from the prior year are due to increased interest expense associated with seller financed notes on the Company's acquisitions that occurred in November 2005 and February 2006.

The Company's provision or credit for income taxes generally fluctuates with the level of pretax income or loss. The effective tax rate was approximately 38% for the three and nine month periods ended January 31, 2007 and 2006, which is comprised of 34% for federal taxes and 4% for various state taxes. The Company anticipates that the effective rate for the balance of fiscal year 2007 will remain at approximately 38%.

The Company reported net income of \$394,000 or \$0.08 per diluted share for the three months ended January 31, 2007 versus a net loss of \$1.3 million or \$0.31 per diluted share for the third quarter of the prior fiscal year. Net income was \$618,000 or \$0.12 per diluted share for the nine months ended January 31, 2007 versus a net loss of \$2.7 million or \$0.64 per diluted share for the comparable prior year period. Net income for the three and nine months ended January 31, 2007 was positively impacted by \$219,000 or \$0.04 per diluted share due to the change in the estimated useful life of the Company's GRM® software, as noted previously, from three to five years.

Diluted weighted average outstanding common shares increased by approximately 766,000 shares for the three months ended January 31, 2007 and by 671,000 shares for the nine months ended January 31, 2007 over the prior year comparable periods. These increases were primarily due to the issuance of 436,500 shares in connection with the acquisition of ASIX effective February 1, 2006, as well as the inclusion of the dilutive impact of stock options issued during the current three and nine month periods. These amounts were excluded from the prior year comparable periods due to the losses reported for those periods.

### ***Financial Condition and Liquidity***

At January 31, 2007, the Company had working capital of \$5.4 million compared to \$4.7 million at April 30, 2006. These levels reflect current ratios of 1.30 and 1.25, respectively. The improvement in working capital is directly related to the Company's improved operating results.

Shareholders' equity at January 31, 2007 increased by \$828,000 to \$23.9 million from the balance reported at April 30, 2006 as a result of \$618,000 of net income for the nine months ended January 31, 2007 as well as \$136,000 of employee stock purchases and recognition of \$510,000 of stock compensation expense. These increases were slightly offset by \$53,000 of Company stock that was repurchased from certain executives to cover the tax consequences of

restricted stock vesting, as well as the repurchase of \$383,000 of Company stock under the Company's Stock Repurchase Plan. Book value per share has increased to \$4.69 as of January 31, 2007 from \$4.53 at April 30, 2006. Book value per share is calculated by dividing total shareholders' equity by total shares outstanding at the end of each respective period.

Net capital expenditures decreased by 11.0% to \$367,000 for the nine months ended January 31, 2007. This decrease was primarily due to the restructuring that occurred during the Company's fourth quarter of fiscal year 2006, which resulted in the redeployment of fixed assets throughout the organization and reduced the purchasing requirements of computers and related software during the first six months of fiscal 2007. Current and prior year capital expenditures primarily relate to purchases or upgrades of computer hardware and software used by the Company's development and support personnel.

The Company has continued to invest significantly in its new GRM® software suite, as well as software products in its core markets of Indiana, Ohio and Florida. Total research and development costs included in expense were \$2.1 million for the three months ended January 31, 2007 compared to \$2.3 million for the three months ended January 31, 2006. These investments were \$6.0 million for the nine months ended January 31, 2007 compared to \$6.5 million for the nine months ended January 31, 2006. These amounts include \$89,000 and \$426,000 of software amortization expense for the three months ended January 31, 2007 and 2006, respectively, and \$906,000 and \$1.3 million for the nine months ended January 31, 2007 and 2006, respectively. As noted previously, the Company's results for the three months ended January 31, 2007 have been positively impacted by \$350,000 before tax and \$219,000 or \$0.04 per diluted share after tax due to the change in estimated life of its GRM® software suite from three years to five years. Software amortization expense is included in cost of revenues. In addition, the Company capitalized approximately \$523,000 of software costs in accordance with FASB Statement No. 86 for the three months ended January 31, 2007 compared to \$351,000 for the three months ended January 31, 2006 and \$1.6 million for the nine months ended January 31, 2007 compared to \$1.2 million for the nine months ended January 31, 2006.

The Company has applied for patents on its iFramework tool, which provides a shared technical platform for all Manatron software in the suite and is being built on Microsoft's .NET framework. A major goal is to produce a feature-rich suite of software that can be deployed across the Company's entire client-base and into new geography. The Company has proven that this can be done with its CAMA software as it is running in approximately 300 jurisdictions in over 20 states. Manatron's GRM® system is currently live in Gwinnett County, Georgia; Payette County, Idaho and Kenai, Alaska and in process of implementation in the States of Minnesota, Nevada, South Carolina, Tennessee and Virginia. The iFramework toolset will allow the software to be more easily modified to include additional states as the Company enters new markets.

Since the Company's revenues are generated from contracts with local governmental entities, it is not uncommon for certain of its accounts receivable to remain outstanding for approximately three to four months, thereby having a negative impact upon cash flow.

On January 14, 2005, the Company entered into a Revolving Credit Loan Agreement (the "Credit Agreement") with Comerica Bank, which superseded and replaced the Company's previous

credit agreement with the bank dated May 17, 2002. Under the Credit Agreement, Comerica Bank provided the Company with a \$6 million revolving line of credit. The Company's borrowing limit was no longer limited based on the ratio of the Company's funded debt to EBITDA, as was the case under the previous credit agreement. Any principal outstanding under the Credit Agreement would bear interest at a rate equal to the bank's prime rate less 0.5%. The Credit Agreement was unsecured and scheduled to terminate on August 1, 2007, the date on which payment of any amounts owing under it were due. The Credit Agreement contained standard events of default and affirmative and negative covenants, which included the maintenance of financial ratios based on the Company's tangible-net-worth and debt, as well as on its current assets and liabilities.

Effective June 29, 2006, the Company amended the Credit Agreement with Comerica Bank. The amendment allows the Company to borrow up to \$10 million through April 1, 2007, after which point the amount available shall be reduced to \$8 million. In addition, the Company's debt covenants have been revised to account for its financial structure subsequent to the ASIX acquisition. As of January 31, 2007, the Company had no borrowings outstanding under this credit agreement.

The Company anticipates that its line of credit, together with its existing cash of approximately \$4.5 million and cash generated from future operations will be sufficient for the Company to meet its working capital requirements for at least the next 12 months.

The third quarter of fiscal year 2007 was the Company's 22<sup>nd</sup> consecutive quarter with no bank debt. However, the Company has executed several seller financed notes payable in connection with its recent acquisitions with the following maturities outstanding at January 31, 2007:

|                            | Fiscal 2007                 | Fiscal 2008                 | Fiscal 2009                 | Fiscal 2010                 |
|----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| VisiCraft Systems,<br>Inc. | \$           --             | \$    300,000               | \$    245,638               | \$           --             |
| ASIX Inc.                  | 518,760                     | 1,200,000                   | 200,000                     | 200,000                     |
|                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Total                      | \$   518,760                | \$   1,500,000              | \$    445,638               | \$    200,000               |
|                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |

Effective July 31, 2006, the Company paid the remaining \$400,000 outstanding under the note payable associated with the Plexis acquisition. The Company did this because the note accrued interest at prime plus 2% and the Company can borrow at prime less 0.5%. The interest rates on the remaining notes associated with the VisiCraft and ASIX acquisitions are favorable to the Company. In addition, the Company paid the fiscal 2007 VisiCraft payment due November 1, 2006, effective October 31, 2006 and \$1,681,240 of the ASIX payment due February 1, 2007, effective January 31, 2007.

During the second quarter of fiscal 2006, the Company received approximately \$2 million in state and federal tax refunds generated from the losses the Company reported for fiscal 2006.





On October 5, 2006, the Board of Directors authorized the Company to repurchase up to \$1 million of the Company's common stock over the subsequent 12 months. The Company repurchased 46,299 shares under this program during the nine months ended January 31, 2007 at an average price of \$8.27 per share totaling \$382,739. The Company repurchased 20,000 shares under a prior repurchase program, which expired on September 6, 2006, during the second quarter of fiscal 2006 at an average price of \$8.31 per share, totaling \$166,200.

The Company cannot precisely determine the effect of inflation on its business. The Company continues, however, to experience relatively stable costs for its inventory as the computer hardware market is very competitive. Inflationary price increases related to labor and overhead will have a negative effect on the Company's cash flow and net income to the extent that they cannot be offset through improved productivity and price increases.

### **Off-Balance Sheet Arrangements**

The Company does not have any significant off-balance sheet arrangements that are reasonably likely to have a current or future effect on its financial condition, results of operations, liquidity, capital expenditures or capital resources.

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

The Company's primary market risk exposure is a potential change in interest rates in connection with its outstanding line of credit. As of January 31, 2007, there were no borrowings outstanding under this line of credit. However, the Company does have the ability to draw on this line of credit, which could result in a potential interest rate risk. Based on the Company's historical borrowings, a change of 1% in interest rates would not have a material adverse effect on the Company's financial position. The Company does not enter into market risk sensitive instruments for trading purposes.

The Company does not believe that there has been a material change in the nature or categories of the primary market risk exposures, or the particular markets that present the primary risk of loss to the Company. As of the date of this report, the Company does not know of or expect any material changes in the general nature of its primary market risk exposure in the near term. In this discussion, "near term" means a period of one year following the date of the most recent balance sheet contained in this report.

Prevailing interest rates and interest rate relationships are primarily determined by market factors that are beyond the Company's control. All information provided in response to this item consists of forward-looking statements. Reference is made to the section captioned "Forward-Looking Statements" before Part I of this report for a discussion of the limitations on the registrant's responsibility for such statements.

**Item 4. Controls and Procedures.**  
**Evaluation of Disclosure Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by the Company in its filings under the Securities Exchange Act of 1934, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls and procedures include controls and procedures designed to ensure that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on such evaluation, the Company's management, including the Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

**Changes in Internal Control Over Financial Reporting**

There was no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended January 31, 2007 that has materially affected, or that is reasonably likely to materially affect the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The Company is not a party to any material pending legal proceedings other than routine litigation incidental to its business. In the opinion of management, the liabilities resulting from these proceedings, if any, would not be material to the Company's financial position or results of operations.

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

A summary of the Company's purchases of its common stock during the third quarter of fiscal year 2007 is as follows:

| Period                                   | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced Plans or<br>Programs | Approximate Dollar<br>Value of Shares that<br>May Yet Be Purchased<br>Under the Plans or<br>Programs(1) |
|------------------------------------------|-------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| November 1, 2006 to<br>November 31, 2006 | --                                        | --                                 | --                                                                                           | \$1,000,000                                                                                             |
| December 1, 2006 to<br>December 31, 2006 | 7,500                                     | \$ 8.62                            | --                                                                                           | \$935,375                                                                                               |
| January 1, 2007 to<br>January 31, 2007   | 27,601                                    | \$ 8.73                            | --                                                                                           | \$694,376                                                                                               |
| <b>Total</b>                             | <b>35,101</b>                             | <b>\$ 8.71</b>                     | <b>--</b>                                                                                    | <b>\$694,376</b>                                                                                        |

- On October 5, 2006, the Board of Directors authorized the Company to repurchase up to \$1 million of the Company's common stock over the subsequent 12 months.

**Item 6. Exhibits.**

The following documents are filed as exhibits to this report on Form 10-Q:

| <u>Exhibit<br/>Number</u> | <u>Document</u>                                                                                                                                                                             |
|---------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                       | Restated Articles of Incorporation. Previously filed as an exhibit to the Company's Form 10-K Annual Report for the fiscal year ended April 30, 2004, and incorporated herein by reference. |
| 3.2                       | Bylaws. Previously filed as an exhibit to the Company's Form 10-K Annual Report for the fiscal year ended April 30, 2004, and incorporated herein by reference.                             |
| 31.1                      | Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                               |
| 31.2                      | Certification of President and Chief Operating Officer under Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                 |
| 31.3                      | Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                               |
| 32.1                      | Certification pursuant to 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                            |

**SIGNATURES**

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

MANATRON, INC.

Date: March 13, 2007

By

/s/ Paul R. Sylvester

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Paul R. Sylvester  
Co-Chairman, Chief Executive Officer and  
Director (Principal Executive Officer, and  
duly authorized signatory for the Registrant)

Date: March 13, 2007

By

/s/ G. William McKinzie

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G. William McKinzie  
President and Chief Operating Officer

Date: March 13, 2007

By

/s/ Krista L. Inosencio

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Krista L. Inosencio  
Chief Financial Officer  
(Principal Finance and Accounting Officer)

**EXHIBIT INDEX**

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