OPEN SOLUTIONS INC
Form 10-Q
August 09, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period of___to___

Commission file number 000-02333

Open Solutions Inc.

(Exact name of registrant as specified in its charter)

Delaware	**22-3173050**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

455 Winding Brook Drive, Glastonbury, CT

(Address of principal executive offices)

06033

(Zip Code)

(860) 652-3155

(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 þ Noo

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

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

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

As of August 4, 2006, 20,650,855 shares of common stock, $0.01 par value per share, were outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION
- Item 1. Financial Statements
- Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
- Item 3. Quantitative and Qualitative Disclosure About Market Risk
- Item 4. Controls and Procedures

PART II OTHER INFORMATION
- Item 1. Legal Proceedings
- Item 1A. Risk Factors
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
- Item 3. Defaults Upon Senior Securities
- Item 4. Submission of Matters to a Vote of Security Holders
- Item 5. Other Information
- Item 6. Exhibits

SIGNATURES
EXHIBIT INDEX
EX-10.1 Incentive Stock Option Agreement
EX-10.2 Nonstatutory Stock Option Agreement
EX-31.1 Section 302 Certification of C.E.O.
EX-31.2 Section 302 Certification of C.F.O.
EX-32.1 Section 906 Certification of C.E.O.
EX-32.2 Section 906 Certification of C.F.O.

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2006	December 31, 2005
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,953	$ 174,426
Investments in marketable securities	8,038	
Accounts receivable, net	76,981	36,582
Prepaid expenses and other current assets	18,338	14,353
Deferred tax assets	11,601	13,000
Total current assets	160,911	238,361
Fixed assets, net	38,316	20,779
Intangible assets, net	224,511	46,794
Goodwill	416,098	94,081
Deferred tax assets	1,194	4,283
Other assets	19,253	6,914
Total assets	$ 860,283	$ 411,212
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,682	$ 7,313
Accrued expenses	30,150	24,624
Deferred revenue, current portion	72,279	34,588
Capital lease obligations, current portion	4,668	102
Total current liabilities	112,779	66,627
Convertible notes payable	144,061	144,061
Long-term debt	342,000	
Capital lease obligations, less current portion	3,596	122
Deferred revenue, less current portion	36,892	3,251
Other long-term liabilities	3,216	1,447

Total liabilities	642,544	215,508
Commitments and contingencies (Note 6)		
Stockholders equity;		
Preferred stock, $0.01 par value; 5,000,000 shares authorized; no shares issued and outstanding at June 30, 2006 and December 31, 2005		
Common stock, $0.01 par value; 95,000,000 shares authorized; 20,607,787 and 19,980,262 shares issued and 20,061,653 and 19,434,128 shares outstanding at June 30, 2006 and December 31, 2005, respectively	206	200
Additional paid-in capital	215,676	206,483
Deferred compensation		(127)
Accumulated other comprehensive income, net of tax	6,390	2,469
Retained earnings (accumulated deficit)	5,467	(3,321)
Treasury stock at cost; 546,134 and 546,134 treasury shares at June 30, 2006 and December 31, 2005, respectively	(10,000)	(10,000)
Total stockholders equity	217,739	195,704
Total liabilities and stockholders equity	$ 860,283	$ 411,212

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

2

Table of Contents

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(In thousands, except share and per share data)			
Revenues:				
Software license	$ 9,189	$ 11,349	$ 20,774	$ 19,254
Service, maintenance and hardware	97,945	35,738	153,068	65,559
Total revenues	107,133	47,087	173,842	84,813
Cost of revenues:				
Software license	1,762	1,638	3,859	2,828
Service, maintenance and hardware	55,174	18,741	86,890	33,943
Total cost of revenues	56,936	20,379	90,749	36,771
Gross profit	50,197	26,708	83,093	48,042
Operating expenses:				
Sales and marketing	9,743	6,003	16,611	10,808
Product development	6,883	5,080	12,412	9,105
General and administrative	18,393	9,169	32,817	16,762
Total operating expenses	35,019	20,252	61,840	36,675
Gain on effective settlement of contract (Note 3)			4,252	
Income from operations	15,178	6,456	25,505	11,367
Interest income and other	605	1,170	1,892	2,040
Interest expense	(8,976)	(1,210)	(12,492)	(2,067)
Income before income taxes	6,807	6,416	14,905	11,340
Income tax provision	2,710	2,581	6,114	4,540
Net income	$ 4,097	$ 3,835	$ 8,791	$ 6,800

Net income per common share:				
Basic	$ 0.21	$ 0.20	$ 0.45	$ 0.35
Diluted	0.19	0.18	0.40	0.32
Weighted average common shares used to compute net income per common share:				
Basic	19,797,324	19,372,648	19,667,937	19,412,034
Diluted	25,652,446	25,399,423	25,571,621	24,638,388

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

Table of Contents

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended June 30, 2006	2005
	(In thousands)	
Cash flows from operating activities		
Net income	$ 8,791	$ 6,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,923	3,313
Amortization	10,846	2,029
Gain on effective settlement of contract	(4,252)	
Non-cash interest expense	840	294
Stock based compensation expense	3,938	200
Deferred tax provision	5,547	3,707
Provision for doubtful accounts	680	277
Changes in operating assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(6,377)	(10,955)
Prepaid expenses and other assets	4,783	(1,023)
Accounts payable and accrued expenses	(16,779)	809
Deferred revenue	18,675	3,399
Net cash provided by operating activities	32,613	8,850
Cash flows from investing activities		
Purchases of fixed assets and capitalized software	(10,076)	(3,936)
Purchases of marketable securities	(8,038)	(92,758)
Sales of marketable securities		54,168
Business acquisitions, net of cash received	(476,309)	(41,936)
Net cash used in investing activities	(494,423)	(84,462)
Cash flows from financing activities		
Proceeds from exercise of stock options and issuance of common stock from employee stock purchase plan	4,581	1,441
Repayment of long-term debt from customers		(2,917)
Repayment of capital lease obligation	(1,864)	(479)
Proceeds from issuance of long-term debt	350,000	
Repayment of long-term debt	(8,000)	
Proceeds from convertible notes payable		144,061
Payment of debt issuance costs	(11,806)	(4,915)
Repurchase of common stock		(8,461)

Net cash provided by financing activities	332,911	128,730
Effects of exchange rate on cash and cash equivalents	426	(48)
Net (decrease) increase in cash and cash equivalents	(128,473)	53,070
Cash and cash equivalents, beginning of period	174,426	49,447
Cash and cash equivalents, end of period	$ 45,953	$ 102,517
Supplemental disclosures		
Cash paid for interest	$ 9,728	$ 121
Cash paid for income taxes	$ 818	$ 405

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

4

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. The Company

Open Solutions Inc. (the Company) is a provider of open relational software technologies and services designed to enable financial institutions to better compete and service their customers more effectively. The Company develops, markets, licenses and supports an enterprise-wide suite of software and services that performs a financial institution s core data processing and information management functions. The Company s software applications can be operated either by the financial institution itself, on an outsourced basis in one of the Company s outsourcing centers or through an outsourcing center hosted by one of the Company s resellers.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation. The operating results for the three and six months ended June 30, 2006 may not be indicative of the results expected for any succeeding quarter or for the entire fiscal year ending December 31, 2006.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant accounts, transactions and profits between the consolidated companies have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting for Stock-Based Compensation

The Company has adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), effective January 1, 2006, using the modified prospective application method (MPA). SFAS 123R requires the recognition of the fair value of stock-based compensation in net earnings. Under the MPA, compensation costs recognized in the three and six months ended June 30, 2006 include: (a) compensation costs for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in

accordance with the provisions of SFAS 123R. The results of prior periods have not been restated.

The Company has four stock-based compensation plans: the 1994 Stock Option Plan, the 2000 Stock Incentive Plan, the 2003 Stock Incentive Plan (collectively the Plans), and the 2003 Employee Stock Purchase Plan. Under the Plans, restricted stock, stock options and other stock-related awards may be granted to directors, officers, employees and consultants or advisors of the Company. To date, stock-based compensation issued under the Plans consists of incentive and non-qualified stock options and restricted stock. Stock options are granted to employees at exercise prices equal to the fair market value of the Company s stock at the dates of grant. Stock options and restricted stock granted to employees vest over four and five years, respectively from the grant date, and stock options have a term of 10 years. A maximum of 14,482,757 shares of common stock is authorized for issuance under the Plans as of June 30, 2006. Upon exercise of stock options, the Company s policy is to issue new shares and, to date, the Company has not issued shares from treasury stock.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Compensation expense is measured at the grant date, based on the estimated fair value of the award. The Company recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the individual grants, which generally equals the vesting period. Compensation expense related to all equity awards is recorded net of estimated forfeitures. Effective December 1, 2005, the 2003 Employee Stock Purchase Plan was amended to reduce the discount available to 5% and to eliminate the look-back feature. Accordingly, the 2003 Employee Stock Purchase Plan is non-compensatory under SFAS 123R.

Prior to January 1, 2006, the Company accounted for the stock-based compensation plans under the intrinsic value method described in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* (APB No. 25), and related interpretations as permitted by SFAS 123. When applying the intrinsic value method, the Company did not record stock-based compensation cost in net income because the exercise price of the Company s stock options equaled the market price of the underlying stock on the date of grant, except with respect to certain awards granted prior to the Company s initial public offering in November 2003, for which the exercise price of those options was less than the underlying market price. Under the MPA, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. Upon adoption of SFAS 123R, the Company netted against additional paid-in capital approximately $788,000 of deferred compensation related to the awards granted prior to the initial public offering which were granted at less than market value, which had previously been recorded as a liability. Upon adoption, the Company also netted the deferred compensation balance of $127,000 previously recorded within equity against additional paid-in capital.

Consistent with the valuation method it used for the disclosure-only provisions of SFAS 123, the Company is using the Black-Scholes model to value the compensation expense associated with its stock-based awards under SFAS 123R. The key assumptions for this valuation method include the expected term of the options, stock price volatility, risk free interest rate, dividend yield and exercise price. Many of these assumptions require judgments by management and are highly sensitive in the determination of compensation expense. The Company estimates forfeitures when recognizing compensation expense, and will adjust its estimate of forfeitures over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative true-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

The assumptions made by the Company to value the compensation expense associated with its stock-based awards are based (in part) on class of employee.

During the three months ended June 30, 2006 and 2005, the weighted-average fair value of the options granted under Plans was $12.68 and $8.30, respectively. During the six months ended June 30, 2006 and 2005, the weighted-average fair value of the options granted under the Plans was $11.49 and $8.97, respectively, using the following assumptions:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Expected life in years	5	4	5	4
Interest rate	5.47%	3.82%	4.88%	3.82%
Volatility	43.37%	48.63%	38.45%	48.63%
Dividend yield	None	None	None	None

The expected stock price volatility rates are based on historical volatilities of the Company s common stock. The risk-free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. The average expected life represents the weighted average period

of time that options granted are expected to be outstanding giving consideration to vesting schedules and historical patterns.

Certain exercises of stock options resulted in tax deductions in excess of previously recorded benefits based on the option value at the time of grant (windfalls). Although these additional tax windfalls are reflected in net operating tax loss carry-forwards, pursuant to SFAS 123R, the additional tax benefit associated with the windfall is not recognized until the deduction reduces taxes payable. Accordingly, since the tax benefit does not reduce the Company s current taxes payable due to net operating loss carry-forwards, these windfall tax benefits are not reflected in the Company s net operating losses in deferred tax assets at June 30, 2006. Windfalls included in net operating loss carry-forwards but not reflected in deferred tax assets as of June 30, 2006 and 2005 are approximately $6,000,000 and $0, respectively.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In conjunction with the Financial Accounting Standards Board Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for Tax Effective of Share-Based Payment Awards*, the Company elected to adopt the alternative transition method for calculating the tax effective of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee stock-based compensation, and to determine the subsequent effect on the additional paid-in capital pool and the statements of cash flows of the tax effects of employee stock-based compensation awards that were outstanding upon the adoption of SFAS 123R.

SFAS 123R requires the presentation of pro forma information for periods prior to the adoption as if the Company had accounted for all stock-based compensation under the fair value method of SFAS 123. For purposes of pro forma disclosure, the estimated fair value of the options at the date of grant is amortized to expense over the requisite service period, which generally equals the vesting period. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based employee compensation during 2005.

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	$ 3,835,000	$ 6,800,000
Add: Stock-based employee compensation expense included in reported net income, net of tax	86,000	152,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(1,539,000)	(2,827,000)
Pro forma net income	$ 2,382,000	$ 4,125,000
Reported net income per share:		
Basic	$ 0.20	$ 0.35
Diluted	$ 0.18	$ 0.32
Pro forma net income per share:		
Basic	$ 0.12	$ 0.21
Diluted	$ 0.12	$ 0.21

During the six months ended June 30, 2006, the Company recognized stock-based compensation expense of approximately $3,535,000 for stock options and approximately $403,000 for restricted stock. The income tax benefit for stock-based payment recorded in the statement of operations totaled $877,000 for the six months ended June 30, 2006. As a result of adopting SFAS 123R, stock-based compensation charges during the six months ended June 30, 2006 increased by approximately $3,300,000 and net income for the six months ended June 30, 2006 decreased by approximately $2,500,000, or $0.13 per basic share and $0.10 per diluted share.

A summary of the status of the Company s stock options at June 30, 2006 and changes during the six months then ended are as follows:

	Options	Weighted-Average Exercise Price

Options outstanding at December 31, 2005	3,562,047	$	14.99
Options granted	678,550		26.07
Options cancelled	(196,321)		19.51
Options exercised	(431,445)		10.35
Options outstanding at June 30, 2006	3,612,831		17.42
Options exercisable at June 30, 2006	1,706,356		12.29

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Options outstanding at June 30, 2006 had an aggregate intrinsic value of $33,700,000, a weighted-average intrinsic value of $9.33 per share and a weighted average remaining contractual life of 7.49 years. Intrinsic value of options outstanding consists of the amount by which the market price of the Company s stock at the end of the period exceeded the exercise price of the option. Options exercised during the six months ended June 30, 2006 had a weighted-average intrinsic value of $16.96 per share. Intrinsic value of options exercised consists of the amount by which the average market price of the Company s stock during the six months ended June 30, 2006 exceeded the exercise price of the option. The following table presents weighted average information about significant option groups at June 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number**	**Weighted-Average Exercise Price**	**Weighted-Average Contractual Life**	**Number**	**Weighted-Average Exercise Price**
$0.00 2.94	297,459	$ 2.83	6.73	178,217	$ 2.79
$2.95 5.86	270,005	5.70	3.18	270,005	5.70
$5.87 8.81	589,666	7.25	4.97	588,454	7.25
$8.82 17.62	60,594	13.97	7.30	21,801	13.76
$17.63 20.56	549,578	19.39	8.74	150,584	19.37
$20.57 23.49	1,001,382	22.29	8.24	392,721	21.97
$23.50 26.43	511,639	25.67	9.39	28,262	24.37
$26.44 29.37	332,508	28.16	8.93	76,312	27.87
	3,612,831	17.42	7.49	1,706,356	12.29

As of June 30, 2006, there was $19,001,000 of unrecognized compensation expense related to non-vested options granted under the Plans, which is expected to be recognized over a weighted-average period of 1.91 years.

A summary of the status of non-vested restricted stock at June 30, 2006 and changes during the six months then ended are as follows:

	Restricted Stock	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2005		
Granted	213,862	$ 25.87
Vested		
Cancelled		
Non-vested at June 30, 2006	213,862	$ 25.87

As of June 30, 2006, there was $5,233,000 of unrecognized compensation expense related to non-vested restricted stock granted under the Plans, which is expected to be recognized over a weighted-average period of 2.89 years.

Investments in Marketable Securities

The Company s investments in marketable securities at June 30, 2006 consist primarily of short-term time deposits that are held with a major financial institution. The Company s marketable securities are recorded at fair value. At June 30, 2006, there were no unrealized gains or losses on the Company s short term securities.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Segment Reporting

The Company applies the provisions of Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information.* The Company views its operations and manages its business as one reportable segment, the development and marketing of financial services-focused computer software and related services. Factors used to identify the Company s single reportable segment include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company operates primarily in two geographical areas, the United States and Canada. The Company provides the following disclosures of revenues from products and services:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Software license	$ 9,189,000	$ 11,349,000	$ 20,774,000	$ 19,254,000
Installation, training and professional services	11,831,000	6,812,000	19,915,000	12,566,000
Maintenance and support	14,966,000	11,320,000	27,725,000	20,555,000
Data center and payment processing services	68,149,000	15,352,000	100,287,000	28,705,000
Hardware and other	2,999,000	2,254,000	5,141,000	3,733,000
Service, maintenance and hardware	97,945,000	35,738,000	153,068,000	65,559,000
Total revenues	$ 107,134,000	$ 47,087,000	$ 173,842,000	$ 84,813,000

Revenues and tangible long-lived assets by significant geographic region are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues:				
United States	$ 93,744,000	$ 39,076,000	$ 150,391,000	$ 68,761,000
Canada	13,390,000	8,011,000	23,451,000	16,052,000
Total revenues	$ 107,134,000	$ 47,087,000	$ 173,842,000	$ 84,813,000

	As of	
	June 30, 2006	December 31, 2005
Tangible long-lived assets:		

United States	$ 31,988,000	$ 14,773,000
Canada	6,328,000	6,006,000
	$ 38,316,000	$ 20,779,000

Net Income Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income or loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted EPS includes in-the-money stock options using the treasury stock method and also includes the assumed conversion of the Company s convertible debt using the if-converted method. Under the if-converted method, the after-tax interest expense is added to the numerator and the weighted average shares issuable upon conversion of the debt instrument are added to the denominator.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The following table reconciles net income and the weighted average shares outstanding used to calculate basic and diluted income per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income used for basic calculation	$ 4,097,000	$ 3,835,000	$ 8,791,000	$ 6,800,000
Interest expense from convertible debt, net of tax effect	716,000	703,000	1,421,000	1,167,000
Net income used for diluted calculation	$ 4,813,000	$ 4,538,000	$ 10,212,000	$ 7,967,000
Basic net income per share weighted average common shares outstanding	19,797,324	19,372,648	19,667,937	19,412,034
Dilutive effect of stock options, warrants and unvested restricted stock	890,918	1,062,571	939,480	1,139,799
Dilutive effect of convertible debt	4,964,204	4,964,204	4,964,204	4,086,555
Diluted net income per share weighted average common shares outstanding	25,652,446	25,399,423	25,571,621	24,638,388

Weighted average common shares of 299,966 and 259,427 were excluded from the computation of diluted EPS for the three and six months ended June 30, 2006, and 1,477,425 and 1,286,019 were excluded for the three and six months ended June 30, 2005, as their effect would have been anti-dilutive.

Comprehensive Income

The following table summarizes comprehensive income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 4,097,000	$ 3,835,000	$ 8,791,000	$ 6,800,000
Unrealized gain on marketable securities		38,000		54,000
Foreign currency translation adjustment	2,413,000	(452,000)	2,322,000	(945,000)
Unrealized gain on cash flow hedge, net of tax	1,446,000		1,601,000	
Total comprehensive income	$ 7,956,000	$ 3,421,000	$ 12,714,000	$ 5,909,000

Concentration of Credit Risk

Financial instruments that potentially expose the Company to concentrations of credit risk are limited to accounts receivable. No customers accounted for more than 10% of total revenues for the three and six month periods ended June 30, 2006 and 2005. At June 30, 2006 and December 31, 2005, no customer accounted for 10% or more of the total accounts receivable balance. The Company maintains allowances for potential credit risks and otherwise controls

this risk through monitoring procedures.

Derivative Financial Instruments

The Company does not engage in derivative trading, market-making or other speculative activities. The Company enters into agreements to manage certain exposures to fluctuations in interest rates. The Company s interest-rate contracts involve the exchange of fixed and floating rate interest payments without the exchange of the underlying principal. Net amounts paid or received are reflected as adjustments to interest expense (see Note 5).

The Company recognizes all derivative financial instruments, such as interest rate swap agreements, at their fair value regardless of the purpose or intent for holding the instrument. Changes in fair value of derivative financial instruments are either recognized periodically in income or in stockholders equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether if qualifies as a fair value hedge or cash flow hedge. At June 30, 2006, the Company had solely utilized derivative instruments as cash flow hedges. Changes in fair values of derivatives accounted as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income.

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Software Developed for Internal Use

As a result of the acquisition of the Information Services Group of BISYS, Inc. (BISYS), a provider of outsourcing services, the Company has recently began to incur costs for the development of internal-use software. The Company capitalizes the costs of computer software developed or obtained for internal use in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Capitalized computer software costs consist of purchased software licenses, implementation costs, consulting costs and payroll-related costs for certain projects that qualify for capitalization. Costs capitalized under SOP 98-1 are amortized over their estimated useful lives, which range from three to six years.

3. Acquisitions

On March 3, 2006, the Company purchased the outstanding common stock of the Information Services Group of BISYS for total cash consideration of approximately $472,400,000, subject to adjustments set forth in the purchase agreement. In conjunction with this acquisition, the Company has incurred approximately $5,700,000 of acquisition related costs. This acquisition is expected to expand the Company s product offerings, further increase the Company s presence in the financial service marketplace and extend the Company s client base to include insurance, healthcare and other industries. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the assets acquired and liabilities assumed based on estimates of fair value. The fair value of purchased technology was determined based on management s best estimate of future cash flows expected to be generated by such technology. The excess of the purchase price over the fair value of the net assets acquired has been allocated to goodwill. The operating results of this acquisition have been included in the Company s consolidated financial statements from the date of acquisition. The purchased technology related to this acquisition is being amortized over its useful life of 5 years. The other intangible assets, comprised of customer relationships and tradenames, are being amortized over their useful lives of 15 and 5 years, respectively based on the pattern in which economic benefits of the asset are consumed. The Company reclassified approximately $27,950,000 of purchased third party licenses that were recorded within fixed assets on its March 31, 2006 balance sheet to intangible assets as part of the finalization process of the purchase price allocation. Purchase accounting for this acquisition is preliminary and is expected to be finalized during 2006.

The preliminary allocation of purchase price is summarized below:

Tangible assets acquired	$ 59,942,000
Purchased technology	53,899,000
Goodwill	321,150,000
Other intangibles	128,000,000
Liabilities assumed	(82,340,000)
Gain on settlement of contract, net of tax	(2,594,000)
Purchase price	$ 478,057,000

Under the terms of the Company s pre-existing reseller agreement with BISYS, BISYS paid the Company non-refundable minimum license fees related to the achievement of certain minimum sales requirements. The Company agreed not to compete with BISYS for the sale of data processing services using The Complete Banking Solution (TCBS) software on an outsourced basis to banks and thrifts in the United States, except in certain circumstances. In connection with the purchase of the Information Services Group of BISYS, this reseller

agreement with BISYS was terminated. In accordance with Emerging Issued Task Form (EITF) 04-01, *Accounting for Pre-existing Relationships between the Parties to a Business Combination* (EITF 04-01), the Company reviewed the terms of the reseller agreement to determine if this executory contract included terms that were favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, and measured a settlement gain or loss as the lesser of (A) the amount by which the reseller agreement was favorable or unfavorable to market terms or (B) the stated settlement provisions of the reseller agreement available to BISYS to which the reseller agreement is unfavorable. Accordingly, the Company recognized an imputed gain on the effective settlement of the reseller agreement with BISYS of approximately $4,252,000. This gain represents the stated settlement provision available to BISYS.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Pro Forma Financial Information (Unaudited)

The financial information in the table below summarizes the combined results of operations of the Company and its material acquisitions, (the U.S. based services to credit unions business of CGI-AMS Inc. and the Information Services Group of BISYS), on a pro forma basis, as though the companies had been combined at the beginning of each period presented. The pro forma information excludes the effect of Omega Systems of North America LLC, S.O.S. Computer Systems, Inc., Financial Data Systems, Inc. and COWWW Software, Inc., as the results of their operations, individually and in the aggregate, are not significant to the Company. This pro forma financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented below.

	Three Months Ended,	Six Months Ended June 30,	
	June 30, 2005	2006	2005
Pro forma revenues	$ 95,564,000	$214,041,000	$181,970,000
Pro forma net income	$ 3,517,000	8,510,000	7,924,000
Pro forma net income per share basic	$ 0.18	$ 0.43	$ 0.41
Pro forma net income per share diluted	$ 0.17	$ 0.39	$ 0.37

Included in the pro forma results for the six months ended June 30, 2006 and 2005 is a gain of approximately $4,252,000 which represents the effective settlement of the Company s pre-existing reseller agreement with BISYS. In addition, the pro forma results for both periods presented have been adjusted to reflect the impact of the settlement of the pre-existing reseller agreement at the beginning of each period presented, including reductions of revenue and related costs of the Company and the Information Services Group of BISYS related to this agreement.

4. Bank Financing

In connection with the acquisition of the Information Services Group of BISYS, the Company obtained bank financing. The bank financing is in the form of two agreements: a $320,000,000 First Lien Senior Secured Credit Agreement (the First Agreement), which provides for a $290,000,000 term loan (the First Term Facility) and a $30,000,000 revolving line of credit (the Line of Credit), and a $60,000,000 Second Lien Senior Term Loan Agreement (the Second Term Facility).

The First Term Facility, which has a term of 5.5 years and bears interest at LIBOR plus 250 basis points, was originally payable beginning June 30, 2006 in the amount of $725,000 per quarter through March 31, 2011, with balloon payments of $137,750,000 due on June 30, 2011 and September 3, 2011. The Company may prepay the First Term Facility in aggregate principal amounts of $1,000,000 or a multiple of $250,000 in excess thereof during the term of the First Agreement. During the six months, ended June 30, 2006, the Company prepaid an aggregate of $8,000,000 of principal and, as a result, the next principal payment is not due until June 30, 2008. The remaining principal balance of the First Term Facility as of June 30, 2006 was $282,000,000.

The Line of Credit expires on March 3, 2011 and bears interest at LIBOR plus 250 basis points. Borrowings under the Line of Credit are required to be in an aggregate amount of $1,000,000 or a multiple of $250,000 in excess thereof. To date, the Company has not drawn against the Line of Credit.

The Second Term Facility has a term of 6 years and bears interest at LIBOR plus 650 basis points and is payable on November 30, 2011. The remaining principle balance of the Second Term Facility as of June 30, 2006 was

$60,000,000.

The bank financing contains both financial and non-financial covenants including maintaining a senior leverage ratio, as defined, a total leverage ratio, as defined, and a fixed charge ratio, as defined. These financial covenants are designed to measure the Company s ability to repay its outstanding debt as well as to fund the related interest payments. Borrowings under the bank financing are collateralized by substantially all of the Company s assets.

The costs of approximately $8.1 million related to the First and Second Term Facilities have been recorded as deferred financing costs within other assets in the accompanying financial statements. During the six months ended June 30, 2006, the Company recognized approximately $0.5 million of interest expense related to the amortization of these deferred financing costs. The deferred financing costs are being amortized into interest expense using the effective interest rate method over the term of the First Term Facility, which is through September 2011. To the extent the Company prepays all or a portion of the debt, the amortization of the deferred costs may be accelerated.

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

5. Interest Rate Swap Agreements

On March 12, 2006, the Company entered into two separate interest rate swap agreements with a bank. The objective of these derivative instruments is to offset the changes in variable benchmark interest rates and to limit exposure to uncertainty in interest expense and cash flow on the Company s bank financing. The first swap agreement is for $217,500,000 of the Company s $290,000,000 First Term Facility and steps down quarterly in conjunction with the Company s anticipated repayment of the First Term Facility. This swap agreement extends through December 31, 2010. The second swap agreement is for $60,000,000 of the Company s $60,000,000 Second Term Facility. This swap agreement extends through November 30, 2011. The fair value of these derivative instruments at June 30, 2006 was $2.7 million and has been recorded within other assets.

The accounting for changes in the fair value of a derivative or hedging instrument depends upon the intended use of the derivative and the resulting designation. The effective portion of the derivative s gain/loss is initially reported as a component of other comprehensive income and subsequently reclassified to earnings when the forecasted transaction affects earnings. The ineffective portion of gain/loss is reported in earnings immediately. Upon entering into the swap agreements, the Company assessed the effectiveness of the hedging transactions by considering the guidance in the Derivative Implementation Group (DIG) Issue G-7, *Cash Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge under Paragraph 30(b) when the Shortcut Method is Not Applied.* The Company has determined that at inception, the Company s swap agreements are effective hedges and therefore changes in fair value will be recorded as a component of other comprehensive income as long as the hedge remains effective.

6. Commitments and Contingencies

At June 30, 2006, the Company was committed under facility and various other operating leases, which expire at various dates through January 2013. Minimum future lease payments under non-cancelable leases with a remaining term of greater than one year at June 30, 2006 are approximately as follows:

2006	$ 8,020,000
2007	7,499,000
2008	6,852,000
2009	4,586,000
2010	2,751,000
Thereafter	2,777,000
Total minimum obligations	$ 32,485,000

Rent expense under operating leases was approximately $3,740,000 and $2,085,000 for the six months ended June 30, 2006 and 2005, respectively. The Company recognizes rent expense on a straight-line basis for all lease agreements with periods of free rent or escalating payment terms. In connection with the acquisition of the Information Services Group of BISYS, the Company recorded a liability of approximately $1,200,000 for certain facility leases that contain lease payments above fair value as of the acquisition date. The liability will be amortized against rent expense over the term of the leases.

Legal Proceedings

The Company is from time to time a party to legal proceedings which arise in the normal course of business. The Company is not currently involved in any material litigation, the outcome of which would, in management s judgment based on information currently available, have a material effect on the Company s results of operations or financial condition, nor is management aware of any such litigation.

Filing of Internal Revenue Service Tax Forms on Behalf of Certain Customers

In August 2005, the Company became aware that it had not timely filed certain federal tax forms on behalf of certain of its data processing customers with the Internal Revenue Service. Upon discovering this oversight, those filings were promptly made in August 2005. The Internal Revenue Code provides that penalties can be imposed upon the failure to make timely IRS filings on those parties ultimately responsible for filings, which in this case would be the Company s data processing clients. However, Treasury department regulations provide that a filer s established history of timely complying with its filing obligations may, in certain instances, result in a waiver of any penalties. The potential range of penalties is $0 to approximately $2,500,000, but because the imposition of penalties is neither probable nor estimable, no amounts have been accrued in the financial statements as of June 30, 2006 and December 31, 2005.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

7. Recently Issued Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, *Accounting for Income Tax Uncertainties* (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties.

FIN 48 is effective for fiscal years beginning after December 31, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48, and the amounts reported after adoption, will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. Because the guidance was recently issued, management has not yet determined the impact, if any, of adopting the provisions of FIN 48 on the Company s financial position and results of operations.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with, and are derived from, our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions, which could cause actual results to differ materially from management s expectations. Important factors that could cause these differences include those described in Part II, Item 1A. Risk Factors and elsewhere in this Quarterly Report on Form 10-Q.

We use the terms Open Solutions, we, us and our to refer to the business of Open Solutions Inc. and our subsidiarie

All references to years, unless otherwise noted, refer to our fiscal years, which end on December 31.

Overview

Open Solutions is a provider of open relational software technologies and services designed to enable financial institutions to better compete and service their customers more effectively. We develop, market, license and support an enterprise-wide suite of software and services that performs a financial institution s core data processing and information management functions, including account, transaction, deposit, lending, operations, back office, client information and reporting. Our complementary products and services supplement our relational core software to provide our clients with fully-integrated business intelligence, customer relationship management, or CRM, check and document imaging, Internet banking and cash management, general ledger and profitability, loan origination, payment, web services, interactive voice solutions, HSA (health savings accounts) and Check 21 enabled check and item processing solutions. Our software applications can be operated either by the financial institution itself, on an outsourced basis in one of our outsourcing centers or through an outsourcing center hosted by one of our resellers.

Substantially all of our historical revenue has been generated through the licensing of our core software and our complementary products and the provision of related services and maintenance to small and mid-size commercial banks and thrifts and credit unions of all sizes. We also derive revenue from payment processing services. We view our operations and manage our business as one reportable segment, the development and marketing of financial services focused computer software and related services.

We derive revenues from two primary sources:

- sales of licenses for our core software and complementary products, and

- fees from installation, training, maintenance and support services, as well as fees generated from our outsourcing and payment processing centers and the outsourcing centers hosted by our resellers.

Our revenues have grown from approximately $27.3 million in 2001 to approximately $193.8 million in 2005. Our revenues for the six months ended June 30, 2006 were $173.8 million. This growth has resulted from strategic acquisitions and internal expansion, through which we have developed and acquired new products and services and have expanded the number of clients using one or more of our products to approximately 5,400 as of June 30, 2006.

On March 3, 2006, we purchased the outstanding common stock of the Information Services Group of BISYS, Inc. (BISYS) for total cash consideration of approximately $472.4 million, subject to certain adjustments. In connection with this acquisition, we incurred approximately $5.7 million of acquisition related costs. This acquisition expands our product offerings, offers us additional cross selling solutions, further increases our presence in the financial services marketplace and extends our client base for our outsourcing services to include the insurance, healthcare and other industries. We anticipate that this acquisition will increase the recurring portion of our revenues. In addition, in conjunction with this acquisition, our pre-existing reseller agreement with BISYS was terminated, and we recognized a pre-tax gain on the effective settlement of this contract of approximately $4.3 million, which represents the stated settlement provision available to BISYS. We used the net proceeds from a $350.0 million bank financing and $129.1 million of available cash to fund the purchase price. As discussed in greater detail under Liquidity and Capital Resources, this bank financing substantially increased our indebtedness.

Software license revenue includes fees received from the licensing of application software. We license our proprietary software products under standard agreements which typically provide our clients with the perpetual, non-exclusive, non-transferable right to use the software for a single financial institution upon payment of a license fee. We also license certain third-party software to clients.

Table of Contents

We generate service and maintenance fees by converting clients to our core software suite, installing our software, assisting our clients in operating the applications, modifying and updating the software and providing outsourcing and payment processing services. Our software license agreements typically provide for five years of support and maintenance, with automatic annual renewals.

We perform outsourcing services through our outsourcing centers and our check, item and payment processing centers. Revenues from outsourcing services, payment processing services and the check and item processing services are derived from monthly and transaction based fees, typically under three to five-year service contracts.

We derive other revenues from hardware sales and client reimbursement of out-of-pocket and telecommunication costs. We have entered into agreements with several hardware manufacturers under which we sell computer hardware and related services. Client reimbursements represent direct costs paid to third parties primarily for data communication, postage and travel.

We expect that our revenues from installation, training, support and maintenance, our outsourcing centers and the outsourcing centers hosted by our resellers will continue to expand as our base of clients expands. Our maintenance and outsourcing revenues are the largest of these revenue components, and we expect that these revenues, due to their recurring nature, will continue to be a significant portion of our total revenue as our client base grows. In addition, as a result of our acquisition of the Information Services Group of BISYS, we expect the revenue from outsourcing services to increase as a percentage of total revenue.

Application of Critical Accounting Policies

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which require that management make numerous estimates and assumptions. Actual results could differ from those estimates and assumptions, impacting our reported results of operations and financial position. The application of our critical accounting policies is described in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities Exchange Commission. These critical accounting policies include:

- Revenue Recognition
- Allowance for Doubtful Accounts
- Software Development Costs
- Accounting for Purchase Business Combinations
- Long-Lived Assets, Intangible Assets and Goodwill
- Income Taxes

The following material changes to the application of our critical accounting policies for the six months ended June 30, 2006 were as follows:

Stock Compensation

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), effective January 1, 2006. We utilize the Black-Scholes option pricing model to estimate the fair value of employee stock based compensation at the date of grant, which requires the input of highly subjective assumptions, including expected volatility and expected term. Further, as required under SFAS 123R, we now estimate forfeitures for options granted which are not expected to vest. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. We adopted the provisions of SFAS 123R on January 1, 2006 using the modified prospective application method (MPA), which provides for certain changes to the method for valuing share-based compensation. Under the MPA, prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new awards and to the modification and cancellation of awards that are outstanding on the effective date.

Upon the adoption of SFAS 123R, we recognized compensation expense associated with awards granted after January 1, 2006 and the unvested portion of previously granted awards that remain outstanding as of January 1, 2006 in our condensed consolidated statement of income for the six months ended June 30, 2006. During the six months ended June 30, 2006, we recognized compensation expense of $3.5 million for stock options and $0.4 million for restricted stock in our condensed consolidated statement of operations. Upon the adoption of SFAS 123R, we also netted against additional paid-in capital the deferred compensation balance previously recorded in liabilities of $0.8 million. We also netted the deferred compensation balance of $0.1 million previously recorded in equity against additional paid-in capital.

Derivative Financial Instruments

We recognize all derivative financial instruments, such as our interest rate swap agreements, at their fair value regardless of the purpose or intent for holding the instrument. Changes in fair value of derivative financial instruments are either recognized periodically in income or in stockholders equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risk. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income.

Software Developed for Internal Use

As a result of the acquisition of the Information Services Group of BISYS, a provider of outsourcing services, we have recently began to incur material costs for the development of internal-use software. We capitalize the costs of computer software developed or obtained for internal use in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Capitalized computer software costs consist of purchase software licenses, implementation costs, consulting costs and payroll-related costs for certain projects that qualify for capitalization. Costs capitalized under SOP 98-1 are amortized over their estimated useful lives, which range from three to six years.

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, *Accounting for Income Tax Uncertainties* (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties.

FIN 48 is effective for fiscal years beginning after December 31, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48, and the amounts reported after adoption, will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. Because the guidance was recently issued, we have not yet determined the impact, if any, of adopting the provisions of FIN 48 on our financial position and results of operations.

Results of Operations

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
As a Percentage of Revenues:				
Revenues:				
Software license	8.6%	24.1%	12.0%	22.7%
Service, maintenance and hardware	91.4	75.9	88.0	77.3
Total revenues	100.0	100.0	100.0	100.0

Cost of revenues:				
Software license	1.6	3.5	2.2	3.3
Service, maintenance and hardware	51.5	39.8	50.0	40.1
Total cost of revenues	53.1	43.3	52.2	43.4
Operating expenses:				
Sales and marketing	9.1	12.8	9.6	12.7
Product development	6.4	10.8	7.1	10.7
General and administrative	17.2	19.5	18.9	19.8
Total operating expenses	32.7	43.1	35.6	43.2
Gain on effective settlement of contract			2.4	
Income from operations	14.2	13.6	14.6	13.4
Interest expense, net	(7.8)	(0.1)	(6.0)	
Income before income taxes	6.4	13.5	8.6	13.4
Income tax provision	(2.5)	(5.5)	(3.5)	(5.4)
Net income	3.9%	8.0%	5.1%	8.0%

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Revenues.

We generate revenues from licensing the rights to use our software products and certain third-party software products to clients. We also generate revenues from installation, training, maintenance and support services provided to clients, from outsourcing services and from hardware sales related to the licensing of our software and other third party software products. Revenues increased 127.5% from $47.1 million for the three months ended June 30, 2005 to $107.1 million for the three months ended June 30, 2006.

Software Licenses.

Software license revenues decreased 19.0% from $11.3 million for the three months ended June 30, 2005 to $9.2 million for the three months ended June 30, 2006. This decrease was primarily as a result of no longer recognizing license revenues related to our reseller arrangement with BISYS after that arrangement was settled upon our acquisition of the Information Services Group of BISYS in March 2006. The license fees from this reseller arrangement accounted for approximately zero and $2.9 million of our license revenues for the three months ended June 30, 2006 and 2005, respectively. This decrease was partially offset by an increase of $0.7 million due to sales of products that we acquired in the recent acquisition of the Information Services Group of BISYS and COWWW Software, Inc. Software license revenues will vary depending on the timing, size and nature of our license transactions.

Maintenance.

Maintenance revenues increased 32.2% from $11.3 million for the three months ended June 30, 2005 to $15.0 million for the three months ended June 30, 2006. The increase was primarily due to our recent acquisitions, which contributed $3.3 million, and an increase in our core processing maintenance, which contributed $0.4 million. Additionally, we will not be recognizing maintenance revenues related to our reseller agreement with BISYS in the future as this arrangement was settled upon our acquisition of the Information Services Group of BISYS. The maintenance fees under the BISYS reseller agreement accounted for approximately zero and $1.0 million for the three months ended June 30, 2006 and 2005, respectively. We typically provide maintenance services under five-year contracts with automatic renewals that provide for an annual increase in fees, generally tied to the change in the consumer price index. Future maintenance revenue growth is dependent on new license sales and retention of existing clients and additional product sales to existing clients.

Implementation and Other Professional Services.

Implementation and other professional services revenues increased 73.7% from $6.8 million for the three months ended June 30, 2005 to $11.8 million for the three months ended June 30, 2006. The increase in implementation and other professional services is directly related to the increase in recent sales of licenses to new clients over the past few quarters and sales of additional products to existing clients. The increase was also due to our recent acquisitions, which contributed $2.1 million, and an increase in our core service revenues, which contributed $3.0 million. Our overall software license revenue levels and market demand for implementation and other professional services will continue to affect our implementation and other professional services revenues.

Outsourcing.

Outsourcing revenues increased 343.9% from $15.4 million for the three months ended June 30, 2005 to $68.1 million for the three months ended June 30, 2006. The increase in outsourcing revenues was primarily due to the acquisitions completed after June 30, 2005 of the Information Services Group of BISYS, Financial Data Solutions, Inc. and COWWW Software, Inc., which contributed $51.6 million, combined with the addition of new clients in our pre-existing outsourcing centers. Future outsourcing revenue growth is dependent on our ability to retain existing clients, add new clients and increase average outsourcing fees.

Cost of Revenues.

Cost of revenues includes third party license fees and the direct expenses associated with providing our services, such as systems operations, customer support, installations, professional services and other related expenses. Cost of revenues increased 179.4% from $20.4 million for the three months ended June 30, 2005 to $56.9 million for the three months ended June 30, 2006. Gross margin decreased from 56.7% for the three months ended June 30, 2005 to 47.1% for the three months ended June 30, 2006. The decrease in gross margin is primarily attributable to our acquisition of

the Information Services Group of BISYS, which generates gross margins lower than our historical gross margins, as the acquired business primarily consists of outsourcing services. Additionally, as a result of the BISYS acquisition, the mix of revenue generated from third party license sales has increased, which has also resulted in a decrease in our gross margins.

Table of Contents

Cost of Software Licenses Revenues.
Cost of software license revenues consists primarily of amortization expense of purchased technology, royalties, third-party software, and the costs of product media, packaging and documentation. Cost of license revenues increased 7.6% from $1.6 million for the three months ended June 30, 2005 to $1.8 million for the three months ended June 30, 2006. The increase in cost of software license revenues was primarily due to increased third-party software licenses sold in connection with our core and complementary products as well as increases in amortization of purchased technology related to our recent acquisitions.
Cost of Service, Maintenance and Hardware Revenues.
Cost of service, maintenance and hardware revenues consists primarily of personnel utilized to provide implementation, conversion and training services to our software licensees; technical client support and related costs; personnel, facility, telecommunication, depreciation of capital assets and amortization of developed technology utilized in servicing our outsourcing clients; and third party hardware costs. Cost of service, maintenance and hardware revenues increased 194.4% from $18.7 million for the three months ended June 30, 2005 to $55.2 million for the three months ended June 30, 2006. The increase in cost of service, outsourcing and hardware revenues was due primarily to a $30.6 million increase in costs associated with the growth of our outsourcing and payment processing business, $30.1 million of which is from the recently acquired businesses. There was also a $4.2 million increase in costs associated with implementation and other professional services, $2.1 million of which is from acquired businesses and the remainder of which is primarily related to an increased investment in our professional services organization to support the services related to increased license sales and potential future acquisitions. Maintenance costs increased $1.0 million, which primarily related to the acquired business. Gross margin decreased from 47.6% for the three months ended June 30, 2005 to 43.9% for the three months ended June 30, 2006. The decrease in gross margin is primarily due to our acquisition of the Information Services Group of BISYS, as the acquired outsourcing business generates lower margins than our other service, maintenance and hardware revenue sources. This lower margin of the Information Services Group outsourcing business is primarily a result of a greater mix of revenue from third party vendors which generates lower margins.
Operating Expenses
Sales and Marketing.
Sales and marketing expenses include salaries and commissions paid to sales and marketing personnel and other costs incurred in marketing our products and services. Sales and marketing expenses increased 62.3% from $6.0 million for the three months ended June 30, 2005 to $9.7 million for the three months ended June 30, 2006. This increase was due primarily to increases in commissions from higher revenues of approximately $0.3 million, stock compensation costs of $0.5 million and $2.7 million of sales and marketing costs as a result of our recent acquisitions. Sales and marketing expenses represented 12.8% of revenues for the three months ended June 30, 2005 as opposed to 9.1% of revenues for the three months ended June 30, 2006. Sales and marketing expenses as a percentage of revenues decreased primarily because of the increase in recurring service revenues which require lower selling costs than new sales.
Product Development.
Product development expenses include salaries of personnel in our product development department, consulting fees and other related expenses. Product development expenses increased 35.5% from $5.1 million for the three months ended June 30, 2005 to $6.9 million for the three months ended June 30, 2006. This increase was due primarily to a $2.0 million increase in product development expenses from the acquired businesses. Product development expenses represented 10.8% of revenues for the three months ended June 30, 2005 as opposed to 6.4% of revenues for the three months ended June 30, 2006. Product development expenses as a percentage of revenues decreased primarily because product development expenses did not increase proportionally to our revenue growth.
General and Administrative.
General and administrative expenses consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance and depreciation. General and administrative expenses increased 100.6% from $9.2 million for the three months ended June 30, 2005 to $18.4 million for the three months ended June 30, 2006. The increase was due primarily to $5.6 million of expenses from the acquired

businesses, an increase in stock compensation costs of $1.1 million, an increase in legal, audit and audit related services of approximately $0.3 million, an increase in consulting expenses of approximately $0.5 million, and investments in our infrastructure, including increases in depreciation expense of $0.4 million primarily related to the development of our new accounting systems and leasehold improvements at our facilities. General and administrative expenses represented 19.5% of revenues for the three months ended June 30, 2005 as opposed to 16.9% of revenues for the three months ended June 30, 2006.

Interest and Other Income

Interest and other income decreased 48.4% from $1.2 million for the three months ended June 30, 2005 to $0.6 million for the three months ended June 30, 2006. The decrease was primarily due to lower cash balances available for investment in 2006.

Interest Expense

Interest expense increased from $1.2 million for the three months ended June 30, 2005 to $9.0 million for the three months ended June 30, 2006. The increase in interest expense was due to interest from our March 2006 bank financing used to acquire the Information Services Group of BISYS.

Income Tax Provision.

Income tax provision increased from $2.6 million for the three months ended June 30, 2005 to $2.7 million for the three months ended June 30, 2006. Our effective tax rate decreased from 40.2% to 39.8% for the three months ended June 30, 2005 and 2006, respectively, primarily as a result of certain changes in Canadian tax laws which increased long-term deferred tax assets, partially offset by the adoption of SFAS 123R and the effect of stock-based compensation expense recorded for incentive stock options. An incentive stock option does not ordinarily result in a tax benefit for us unless there is a disqualifying disposition of stock. Accordingly, no deferred tax asset or benefit has been recognized by us for compensation expense recorded for incentive stock options. We expect to record a higher tax rate in the near term than has been recorded historically as incentive stock options continue to vest. Additional factors that may impact our expected rate would include changes in the magnitude and location of taxable income among taxing jurisdictions, including the blended state tax rate based on the mix of states we do business in, any non-deductible expenses and any tax credits we may receive.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Revenues.

Revenues increased 105.0% from $84.8 million for the six months ended June 30, 2005 to $173.8 million for the six months ended June 30, 2006.

Software Licenses.

Software license revenues increased 7.9% from $19.3 million for the six months ended June 30, 2005 to $20.8 million for the six months ended June 30, 2006. Licensing of our core and complementary products increased due to an increase in the number of software license agreements in the six months ended June 30, 2006 as compared to the six months ended June 30, 2005, as well as an increase of $1.5 million due to sales of products that we acquired in the recent acquisitions of the Information Services Group of BISYS and COWWW Software, Inc. These increases were partially offset by reduced license revenues from our reseller arrangement with BISYS as this arrangement was settled upon our acquisition of the Information Services Group of BISYS in March 2006. The license fees from BISYS accounted for approximately $3.6 million and $5.9 million of our license revenue for the six months ended June 30, 2006 and 2005, respectively. Software license revenues will vary depending on the timing, size and nature of our license transactions.

Maintenance.

Maintenance revenues increased 34.9% from $20.6 million for the six months ended June 30, 2005 to $27.7 million for the six months ended June 30, 2006. The increase was due to our recent acquisitions, which contributed $7.1 million, and an increase in our core processing maintenance, which contributed $2.1 million. Additionally, we will not be recognizing maintenance revenues related to our reseller agreement with BISYS in the future as this arrangement was settled upon our acquisition of the Information Services Group of BISYS. The maintenance fees under the BISYS reseller agreement accounted for approximately $0.9 million and $2.6 million for the six months ended June 30, 2006 and 2005, respectively. We typically provide maintenance services under five-year contracts with automatic renewals that provide for an annual increase in fees, generally tied to the change in the consumer price index. Future maintenance revenue growth is dependent on new license sales, retention of existing clients and additional product sales to existing clients.

Implementation and Other Professional Services.

Implementation and other professional services revenues increased 58.5% from $12.6 million for the six months ended June 30, 2005 to $19.9 million for the six months ended June 30, 2006. The increase in implementation and

other professional services is directly related to the increase in recent sales of licenses to new clients over the past few quarters and sales of additional products to existing clients. The increase in professional services revenues was also due to our recent acquisitions, which contributed $3.6 million. Our overall software license revenue levels and market demand for implementation and other professional services will continue to affect our implementation and other professional services revenues.

Outsourcing.

Outsourcing revenues increased 249.4% from $28.7 million for the six months ended June 30, 2005 to $100.3 million for the six months ended June 30, 2006. The increase in outsourcing revenues was primarily due to the acquisitions completed after June 30, 2005 of the Information Services Group of BISYS and COWWW Software, Inc., which contributed $63.8 million, combined with the addition of new clients in our pre-existing outsourcing centers. Future outsourcing revenue growth is dependent on our ability to retain existing clients, add new clients and increase average outsourcing fees.

Cost of Revenues.

Cost of revenues increased 146.8% from $36.8 million for the six months ended June 30, 2005 to $90.7 million for the six months ended June 30, 2006. Gross margin decreased from 56.6% for the six months ended June 30, 2005 to 47.8% for the six months ended June 30, 2006. The decrease in gross margin is primarily attributable to our acquisition of the Information Services Group of BISYS, which generates gross margins lower than our historical gross margins, as the acquired business primarily consists of outsourcing services. Additionally, as a result of the BISYS acquisition, the mix of revenue generated from third party license sales has increased, which has also resulted in a decrease in our gross margins.

Cost of Software License Revenues.

Cost of license revenues increased 36.5% from $2.8 million for the six months ended June 30, 2005 to $3.9 million for the six months ended June 30, 2006. The increase in cost of software license revenues was primarily due to increased third-party software licenses sold in connection with our core and complementary products as well as increases in amortization of purchased technology related to our recent acquisitions.

Cost of Service, Maintenance and Hardware Revenues.

Cost of service, maintenance and hardware revenues increased 155.4% from $33.9 million for the six months ended June 30, 2005 to $86.9 million for the six months ended June 30, 2006. The increase in cost of service, outsourcing and hardware revenues was due primarily to a $42.9 million increase in costs associated with the growth of our outsourcing and payment processing business, $41.3 million of which is from the recently acquired businesses. There was also a $7.1 million increase in costs associated with implementation and other professional services, $3.2 million of which is from acquired businesses and the remainder of which is primarily related to an increased investment in our professional services organization to support the services related to the recent increase in license sales and potential future acquisitions. Maintenance costs increased $2.1 million, which primarily related to the acquired business. Gross margin decreased from 48.2% for the six months ended June 30, 2005 to 43.2% for the six months ended June 30, 2006. The decrease in gross margin is primarily due to our acquisition of the Information Services Group of BISYS, as the acquired outsourcing business generates lower margins than our other service, maintenance and hardware revenue sources. This lower margin of the Information Services Group outsourcing business is primarily a result of a greater mix of revenue from third party vendors which generate lower margins.

Operating Expenses

Sales and Marketing.

Sales and marketing expenses increased 53.7% from $10.8 million for the six months ended June 30, 2005 to $16.6 million for the six months ended June 30, 2006. This increase was due primarily to increases in commissions from higher revenues of approximately $0.6 million, stock compensation costs of $0.8 million and $4.0 million of sales and marketing costs as a result of our recent acquisitions. Sales and marketing expenses represented 12.7% of revenues for the six months ended June 30, 2005 as opposed to 9.6% of revenues for the six months ended June 30, 2006. Sales and marketing expenses as a percentage of revenues decreased primarily because of the increase in recurring service revenues which generate lower selling costs over the course of the recurring revenue stream.

Product Development.

Product development expenses increased 36.3% from $9.1 million for the six months ended June 30, 2005 to $12.4 million for t