BLACKBAUD INC
Form 10-K
February 28, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

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

     For the Fiscal Year ended December 31, 2006
OR

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

     For the Transition period from   to

Commission File Number: 000-50600
Blackbaud, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**11-2617163**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

2000 Daniel Island Drive
Charleston, South Carolina 29492
(Address of principal executive offices, including zip code)
(843) 216-6200
(Registrant s telephone number, including area code)
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on which Registered**
Common Stock, $0.001 Par Value	**The NASDAQ Stock Market LLC (NASDAQ Global Select Market)**

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   YES þ   NO o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.   YES o   NO þ

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   NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.   o
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 þ   Accelerated filer o   Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO þ
The aggregate market value of the registrant   s common stock held by non-affiliates of the registrant on June 30, 2006 (based on the closing sale price of $22.70 on that date), was approximately $981,483,804. Common stock held by each officer and director and by each person known to the registrant who owned 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.
The number of shares of the registrant   s common stock outstanding at February 20, 2007 was 44,328,585.
DOCUMENTS INCORPORATED BY REFERENCE
Portions of the registrant   s definitive Proxy Statement for the 2007 Annual Meeting of Stockholders currently scheduled to be held June 13, 2007 are incorporated by reference into Part III hereof.

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Cautionary Statement Regarding Forward Looking Statements

This Annual Report on Form 10-K contains certain statements that may be deemed to be forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements in this report not dealing with historical results or current facts are forward-looking and are based on estimates, assumptions and projections. Statements which include the words believes, seeks, expects, may, should, intends, likely, ta anticipates, estimates or the negative version of those words and similar statements of a future or forward-looking nature identify forward-looking statements.

Although Blackbaud attempts to be accurate in making these forward-looking statements, it is possible that future circumstances might differ from the assumptions on which such statements are based. In addition, other important factors that could cause results to differ materially include those set forth under Item 1A. Risk factors and elsewhere in this report and in our other SEC filings. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

Item 1. *Business*

Overview

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage their finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982, and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. At the end of 2006, we had approximately 15,500 customers, of which 97%, or almost 15,000, paid annual maintenance and support fees. Our customers operate in multiple verticals within the nonprofit market including religion, education, foundations, health and human services, arts and cultural, public and societal benefits, environment and animal welfare, and international and foreign affairs.

Industry background

The nonprofit industry is large and growing

Nonprofit organizations are a large part of the U.S. economy a 2006 study by the Johns Hopkins Nonprofit Employment Data Project shows that nonprofits employ 7.2% of the work force, a figure that increases to 10.5% when volunteer labor is included. There were greater than 1.5 million U.S. nonprofit organizations registered with the Internal Revenue Service in 2005. In addition, there are greater than 1.7 million nonprofit organizations outside the United States.

Donations to nonprofit organizations in the United States were $260 billion in 2005, having increased almost every year since 1962. The compound annual growth rate over the past ten years was 7.5%, according to Giving USA. In addition, these organizations receive fees of approximately $850 billion annually for services they provide. Worldwide, nonprofit organizations employ more than 25 million people and account for $1.3 trillion in total annual expenditures, according to the Johns Hopkins Nonprofit Employment Data Project.

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Traditional methods of fundraising are costly and inefficient

Many nonprofit organizations manage fundraising programs using manual methods or stand-alone software applications not specifically designed to meet the needs of nonprofit organizations. These fundraising methods are often costly and inefficient, largely because of the difficulties in effectively collecting, sharing and using information to maximize donations and minimize related costs. Based on our market research, an average of $0.24 of each dollar donated is used by nonprofit organizations for their direct fundraising expenses alone. These expenses do not include additional administrative expenses associated with fundraising. Some nonprofit organizations have developed proprietary software, but doing so can be expensive, requiring these organizations to hire technical personnel for development, implementation and maintenance functions. General purpose software and Internet applications typically offer stand-alone solutions with limited functionality that might not efficiently integrate multiple databases.

The nonprofit industry faces particular operational challenges

Nonprofit organizations face distinct operational challenges. For example, nonprofit organizations generally must efficiently:

solicit small cash contributions from numerous contributors to fund operations;

manage complex relationships with the large numbers of constituents that support their organizations;

comply with complex accounting, tax and reporting issues that differ from traditional businesses;

solicit cash and in-kind contributions from businesses to help raise money or deliver products or services;

provide a wide array of programs and services to individual constituents; and

improve the data collection and sharing capabilities of their employees, volunteers and donors by creating and providing distributed access to centralized databases.

Because of these challenges, we believe nonprofit organizations can benefit from software applications specifically designed to serve their particular needs.

The Blackbaud solution

Our suite of products and services addresses the fundraising costs and operational challenges facing nonprofit organizations by providing them with software tools and services that help them increase donations, reduce the overall cost of managing their business and the fundraising process and improve communications with their constituents. We provide an operational platform through our three core software applications: The Raiser s Edge, The Financial Edge and The Education Edge. In addition, we offer over 40 extended applications providing distinct, add-on functionality tailored to meet the specific needs of our diverse customer base. To complement our operational platform, we offer a suite of analytical tools and related services that enable nonprofit organizations to extract, aggregate and analyze vast quantities of data to help them make better-informed operational decisions. We also help our customers increase the return on their technology investment by providing a broad array of complementary professional services, including implementation, business process improvement, education services, as well as maintenance and technical support.

Nonprofit organizations use our products and services to increase donations

Over 12,000 of our active customers currently subscribe to our annual maintenance and support for The Raiser s Edge. These customers use The Raiser s Edge to help them with their fundraising and donor management efforts. The complexity of managing constituent relationships and nonprofits reliance on charitable contributions make managing the fundraising process the critical business function for nonprofits. The Raiser s Edge allows nonprofit organizations to establish, maintain and develop their relationships with current and prospective donors. Our fundraising products and services enable nonprofit organizations to use a centralized database, as well as the Internet and an array of analytical tools to

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facilitate and expand their fundraising efforts. We believe our products and services help nonprofit organizations increase donations by enabling them to:

facilitate the management of complex personal relationships with constituents;

enable the solicitation of large numbers of potential donors using automated and efficient methods;

deliver personalized messages that help inform and drive constituent action;

provide an easy-to-use system that allows the sharing and use of critical fundraising information;

allow organizations to receive online donations through our NetSolutions product, which integrates with an organization s website;

utilize our Internet-based offerings and tools to support online volunteer and events management; and

simplify and automate business processes to allow nonprofits to more effectively pursue their missions.
In addition, our array of predictive donor modeling and wealth identification products and services, including ProspectPoint and WealthPoint, integrate important third-party data, including financial, geographic and demographic information, together with sophisticated analytical techniques to assist nonprofits in their efforts to more effectively identify and target willing and able donors. The result is that organizations are able to lower fundraising costs while at the same time increase donations.

We help nonprofit organizations operate more effectively and efficiently
Our products and services combine a comprehensive suite of software and analytical tools with a centralized database to help employees more effectively and efficiently manage the key aspects of their nonprofit organization s operations. Our products automate nonprofit business processes to create efficiencies for our customers, which helps to reduce the overall costs of operating their organizations. For example, The Raiser s Edge and our other core products automate data collection processes, which eliminate cumbersome and inaccurate manual processes. In addition, nonprofits use The Financial Edge, which integrates with The Raiser s Edge, to eliminate duplicate entry of gift data and streamline processes for posting the results of fundraising activities to the organization s general ledger. Nonprofit constituents can use The Financial Edge to view information in a single, integrated dashboard view that illustrates key performance metrics and detailed information on specific campaigns, funds and programs. These efficient communications are often critical to a nonprofit s ability to effectively strengthen relationships with important supporters, while making effective use of valuable internal resources. We provide solutions that address many of the technological and business process needs of our customers, including:
donor relationship management;

financial management and reporting;

cost accounting information for projects and grants;

integration of financial data and donor information under a centralized system;

student information systems designed for the K-12 market;

data analysis and reporting tools and services;

management of complex volunteer networks; and

results tracking for multiple campaigns.

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Our strategy

Our objective is to maintain and leverage our position as the leading provider of software and related services designed specifically for nonprofit organizations. Key elements of our strategy to achieve this objective are to:

Grow our customer base

We intend to expand our industry-leading customer base and enhance our market position. While we have established a strong presence in the nonprofit industry, we believe that the fragmented nature of the industry presents an opportunity for us to continue to increase our market penetration. We plan to achieve this objective by leveraging our experience in the nonprofit sector, our existing customer base and our strong brand recognition. We also intend to expand our overall sales efforts, especially national accounts and enterprise-focused sales teams.

Maintain and expand existing customer relationships

We have historically had success selling maintenance renewal and additional products and services to existing customers. In each of the past three years, an average of over 95% of our customers has renewed their maintenance and support plans for our products. We plan to continue to pursue opportunities to better serve our existing customer base by increasing both the number of our products and services they use and the frequency with which they use them. As part of this strategy, we have established a dedicated sales team to focus exclusively on selling products and services to our existing customers.

Introduce additional products and services

We intend to leverage our expertise and experience in developing leading products for the nonprofit industry to introduce additional products and related services, to continue to build stronger relationships with existing customers and to attract new customer relationships. We believe that our existing proprietary software and services can form the foundation for an even wider range of products and services for nonprofit organizations. Our current product offerings share approximately one-third of our proprietary code, and we anticipate that future product offerings will also share this backbone. We believe that this shared code allows us to more cost efficiently expedite the development and rollout of new products.

Leverage the Internet as a means of additional growth

We intend to continue to enhance our existing products and develop new products and services to allow our customers to more fully utilize the Internet to effectively achieve their missions. Although online fundraising currently comprises an estimated 1-2% of all charitable contributions, we believe online donations will continue to grow as a percentage of total contributions and that nonprofits will continue to benefit from the trend of increased online donations. As such, we have web-enabled our core applications and currently offer a variety of Internet applications and consulting services that allow nonprofit organizations to utilize our fundraising, accounting and administration products to leverage the Internet for online fundraising, e-marketing, alumni and membership directories, newsletters, event management and volunteer coordination.

Expand international presence

We believe that the United Kingdom, Canada and Australia as well as other international markets represent growing market opportunities. We currently have international operations in Glasgow, Scotland; London, England; Toronto, Canada and Sydney, Australia. We believe the overall market of international nonprofit organizations is changing as donations to nonprofit organizations are increasing in response to reductions in governmental funding of certain activities and expansion of U.S.-based nonprofit organizations into international locations. We believe these markets are currently underserved, and we intend to increase our presence in international markets by expanding our sales and marketing efforts,

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leveraging our installed base of customers to sell complementary products and services and continuing to offer and develop new products tailored to these international markets.

Pursue strategic acquisitions and alliances

We intend to continue to selectively pursue acquisitions and alliances in the future with companies that provide us with complementary technology, customers, personnel with significant relevant experience, increase access to additional geographic and specific vertical markets. We have completed eight acquisitions in the past five years, including the acquisition of Target Software, Inc. and Target Analysis Group, Inc., or the Target Companies, in January 2007. We are also currently involved in a number of strategic relationships. We believe that our size and our history of leadership in the nonprofit sector make us an attractive acquirer or partner for others in the industry.

Products and services

We license software and provide various services to our customers. We generate revenue in six reportable segments and in four geographic regions, as described in more detail in Note 14 of our consolidated financial statements. These revenue segments are license fees, maintenance fees and subscription fees for our software products, consulting and education services, analytic services, and other. In 2006, 2005 and 2004, revenue from the sale of The Raiser s Edge and related services represented approximately 60%, 66% and 70%, respectively, of our total revenue.

Software products

The Raiser s Edge

The Raiser s Edge is the leading software application specifically designed to manage a nonprofit organization s fundraising activity. The Raiser s Edge enables nonprofit organizations to communicate with their constituents, manage fundraising activities, expand their development efforts and make better-informed decisions through its powerful segmentation, analysis, and reporting capabilities. The functionality included in our current version of The Raiser s Edge is the result of over 20 years of improvement incorporating the suggestions of our customers and innovations in technology. The Raiser s Edge provides a comprehensive dashboard view that shows users important performance indicators for campaigns, appeals, funds, events, proposals and membership drives. The Raiser s Edge is highly configurable allowing a nonprofit organization to create numerous custom views of constituent records and automate a variety of business processes. The Raiser s Edge contains a robust data management and storage system to help fundraisers use their data more effectively. Among other things, The Raiser s Edge allows an organization to access extensive biographical and demographic information about donors and prospects, process gifts, monitor solicitation activity, analyze data and publish reports. The Raiser s Edge improves the efficiency and effectiveness of a nonprofit organization by reducing overall mailing costs, offering faster data entry and gift processing, supporting major donor cultivation, using the Internet to send email appeals and accept online donations and providing instant access to better information. The Raiser s Edge also integrates with Microsoft Office® to enable users to take advantage of additional functionality.

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In addition to the standard functionality of The Raiser s Edge, we have built a number of extended applications that may be enabled directly within The Raiser s Edge and address the specific needs of various vertical markets, examples of which are described below.

Module Name	Key Features/Benefits
Event	helps plan, organize and manage all aspects of fundraising events
Volunteer	coordinates an organization s volunteer work force
Member	tracks the identity of members and the date they joined, as well as recording renewals, upgrades, downgrades and lapsed and dropped members
Recurring Gifts	enables easy management and processing of monthly giving
Search	enables an organization to manage prospective planned and major gift donors (individuals, corporations and foundations) from identification and profiling to the cultivation and solicitation of major gifts
Alum	includes additional information and reporting capabilities that help an organization reach, solicit and better manage its alumni constituency
Tribute	tracks all gifts made in honor or memory of an individual or individuals and facilitates properly acknowledging the donor and honoree
Electronic Funds Transfer	allows an organization to easily process gifts made by credit card or by direct debit from donors bank accounts

The Financial Edge
The Financial Edge is an accounting application designed to address the specific accounting needs of nonprofit organizations. As with our other core applications, The Financial Edge integrates with The Raiser s Edge to simplify gift entry processing, relate information from both systems in an informative manner and eliminate redundant tasks. The Financial Edge improves the transparency and accountability of organizations by allowing them to track and report from multiple views, measure the effectiveness of programs and other initiatives, use budgets as monitoring and strategic planning tools, and supervise cash flow to allocate resources efficiently. As a result, The Financial Edge provides nonprofit organizations with the means to help manage fiscal and fiduciary responsibility, enabling them to be more accountable to their constituents. In addition, The Financial Edge is designed specifically to meet governmental accounting and financial reporting requirements prescribed by the Financial Accounting Standards Board and Governmental Accounting Standards Board. We employ certified public accountants who work with our product development, professional services and customer support teams and who can apply their specialized training and background to assist our customers using The Financial Edge to help them comply with these accounting and reporting requirements.

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As with The Raiser s Edge, we have built extended applications that may be enabled directly within The Financial Edge to address the specific functional needs of our customers. We currently offer many extended applications to accompany The Financial Edge, examples of which are described below.

Module Name	Key Features/Benefits
Purchase Orders	provides a variety of options for recording purchases and generating invoices
eRequisitions	automates the requisition and purchase order process by enabling multiple departments, sites and budget managers to make purchasing requests electronically
Electronic Funds Transfer	allows an organization to make electronic payments
Cash Management	provides on online register enabling an organization to manage and reconcile multiple bank and cash accounts in a centralized repository
Cash Receipts	provides flexible receipt-entry enabling an organization to identify where cash amounts originate, produce a detailed profile of each transaction and print a deposit ticket
Payroll	automates in-house payroll processing
Fixed Assets	stores the information required to properly track and manage property, plant and equipment and the costs associated with them
Student Billing	provides independent schools the ability to perform billing functions and process payments
School Store Manager	integrated point-of-sale solution to manage sales, inventory control, discounts, mailings, pricing, purchasing, receivables, reporting and suppliers for bookstores, snack bars, cafeterias and athletic stores
Accounting Forms	integrates with our accounting products, enabling an organization to print business forms cost effectively

The Education Edge
The Education Edge is a comprehensive student information management system designed principally to organize an independent school s admissions and registrar processes, including capturing detailed student information, creating schedules, managing feedback and grading processes, producing demographic, statistic and analytical reports and printing report cards and transcripts. With The Education Edge, an organization can keep biographical and address information for students, parents and constituents consistent across all of its Blackbaud software products. This integrated system allows an independent school to reduce data-entry time and ensure that information is current and accurate throughout the school.
The Patron Edge
The Patron Edge, which we launched in June 2004, is a comprehensive ticketing management solution specifically designed to help large or small performing arts organizations, museums, zoos and aquariums boost attendance and increase revenue. The Patron Edge can be used in conjunction with The Raiser s Edge to allow for comprehensive

marketing based on donor profiles or as a standalone ticketing and subscription sales management tool. The Patron Edge offers a variety of ticketing methods and allows customers to save time by streamlining ticketing, staffing, scheduling, event and membership management, and other administrative tasks. The Patron Edge decreases costs incurred by customers by reducing box office expenses and eliminating the transaction fees common to other online ticketing solutions.

The Information Edge

The Information Edge is an open and scalable business intelligence solution designed specifically to meet the needs of nonprofit organizations. We launched The Information Edge in August 2003. The Information Edge is an analysis and reporting tool that allows an organization to extract data from multiple highly

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indexed transactional databases, including The Raiser s Edge, and integrate that data into a data warehouse that allows high-speed queries, complex analysis and reporting across the organization including remote locations, and thereby, identify opportunities to increase revenue. The Information Edge is optimized to assist an organization with its direct marketing and fundraising programs, including donor segmentation and campaign strategy.

Blackbaud Internet applications

We provide a variety of applications that allow our customers to use our fundraising, accounting and administration products via the Internet. For example, our NetSolutions products enables a nonprofit to conduct online fundraising, e-marketing, event management and volunteer coordination. We launched NetSolutions in August 2000. Through December 31, 2006, we had almost 1,450 active NetSolutions customers. We also offer our NetCommunity product as a complement to The Raiser s Edge, which allows our Raiser s Edge customers to establish an online community that offers interaction among constituents, email marketing and online-giving tools. NetCommunity integrates with The Raiser s Edge, allowing nonprofits to leverage a single donor database.

In addition, we have web-enabled most of our applications to allow nonprofit organizations of all sizes to easily and efficiently interact with wider audiences through dynamic content and email campaigns securely from anywhere in the world. These solutions provide a wide variety of web-based online services including the ability for constituents to register for events, update demographic information, support an organization by volunteering and make donations. We provide real-time integration between our Internet and core applications, which significantly enhances the effectiveness of our solutions by tying all information directly to the back-office, which provides an organization with a single, comprehensive view of its constituents and volunteers.

Consulting services

Our consultants provide installation and implementation services for each of our software products. These services include:

system installation and implementation, including assistance installing the software, setting up security, tables, attributes, field options, default sets, business rules, reports, queries, exports and user options, and explanation of data entry and processing procedures;

management of the data conversion process to ensure data is a reliable and powerful source of information for an organization;

system analysis and application customization to ensure that the organization s Raiser s Edge system is properly aligned with an organization s processes and objectives; and

removal of duplicative records, database merging, and information cleansing and consolidation.

In addition to these services, we apply our industry knowledge and experience, combined with our service offering expertise and expert knowledge of our products, to evaluate an organization s needs and provide operational efficiency and business process improvement consulting for our customers. This work is performed by our staff of consultants who have extensive and relevant domain experience in fundraising, non-profit accounting, project management and IT services. This experience and knowledge allows us to make recommendations and implement solutions that ensure efficient and effective use of our products. In addition, we offer software customization services to organizations that do not have the time or in-house resources to create customized solutions using our core products. We believe that no other software company provides as broad a range of consulting and technology services and solutions dedicated to the nonprofit industry as we do.

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Education services

We provide a variety of classroom, onsite, distance-learning and self-paced training services to our customers relating to the use of our software products and application of best practices. Our software instructors have extensive training in the use of our software and present course material that is designed to include hands-on lab exercises as well as course materials with examples and problems to solve. The education services segment has historically shown some seasonality, as our customers generally attend more training sessions during the second and third quarters of the year. Key aspects of our education services include:

Education Services	Description
Blackbaud University	training facility based in our headquarters with 6 dedicated classrooms, each outfitted with computer workstations for each attendee to view and participate in step-by-step demonstrations of our software
Regional Training	offered year-round for our clients at more than 70 regional locations throughout the United States and Canada. These regional sites include fully equipped classrooms and individual student workstations for hands-on learning
Onsite Training	provided at a customer s location, typically for customers that have a larger group of employees requiring more specialized training
Distance-Learning and Self-Paced Training	includes computer-based training, online courses and our new eLearning Library. The eLearning Library is a subscription service consisting of a collection of more than 130 online software lessons
Training Pass	unlimited product-specific training covering a specified contract period, typically one year, which is sold for a fixed fee

Analytic services

We provide custom modeling and analytical services, including ProspectPoint and WealthPoint, to help nonprofit organizations maximize their fundraising results.

ProspectPoint, which we introduced in February 2001, is a custom modeling service designed specifically for nonprofits. ProspectPoint employs patent-pending modeling techniques to identify and rank the best donor prospects in an organization s database and capture the distinct characteristics that define an organization and its constituencies, providing a better opportunity to maximize gift revenue. We use these proprietary statistical models to help our customers identify an individual s propensity to make any of a number of different types of gifts, including annual fund gifts, major gifts and planned gifts. Our consultants use the ProspectPoint results to prepare customized fundraising plans, which are delivered to our clients with a series of implementation recommendations for increasing the yield of their fundraising efforts.

We released WealthPoint in July 2003 as our wealth identification and information service. It provides a nonprofit organization with financial, biographical and demographic data on the individuals in its database, enabling the organization to identify its wealthiest donors and to plan the most effective donor cultivation strategies. We match donor and prospect names recorded in The Raiser s Edge or any other database against sources of publicly available information about an individual s assets or activities. After the names are matched against the public sources, we then return the data to the clients in a software application that allows them to query, report on, and manipulate the data.

In addition to these modeling and identification services, we offer services that enrich the quality of the data in our customers databases. These include a service that finds outdated address files in the database and makes corrections based on the requirements and certifications of the United States Postal Service and a service that uses known fields in

an organization s constituent records to search and find lost donors and prospects. In addition to these services, we offer services that append to a prospect record important additional information, such as phone, email, age, gender, deceased record, county, and congressional district.

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Maintenance and subscriptions

The vast majority of our customers choose to receive annual maintenance and support from us under one of our tiered maintenance and support programs. In each of the past three years, an average of more than 95% of our customers have renewed their annual maintenance and support contracts for our products. For an annual fee, our customers receive regular upgrades and enhancements to our software and unlimited phone and email support, with extended hours for upgraded maintenance customers. Our maintenance and support customers also receive around-the-clock access to our extensive online support resources, including our self-help knowledge management system, the FAQ section of our Web site, and weekly technical bulletins. Subscriptions cover hosted solutions, data enrichment services and training programs purchased on a subscription basis.

Customers

We have customers in each of the principal vertical markets within the nonprofit industry. At the end of 2006, we had approximately 15,500 customers, of which 97% or almost 15,000 paid annual maintenance and support fees. These organizations range from small, local charities to health care and higher education organizations to the largest national health and human services organizations. No one customer accounts for more than 2% of our annual revenue.

Sales and marketing

We sell all of our software and related services through our direct sales force, which is complemented by our team of account development representatives responsible for sales lead generation and qualification. As of December 31, 2006, we had approximately 300 sales and marketing employees. These sales and marketing professionals are located at our headquarters in Charleston and in metropolitan areas throughout the United States, the United Kingdom, Canada and Australia. We plan to continue expanding our direct sales force in the Americas, Europe and Asia. Our sales force is divided into two main areas of responsibility:

  selling products and services to existing customers; and

  acquiring new customers.

In addition, we have a dedicated portion of our outside sales team focused exclusively on large, enterprise-wide accounts and a group of sales engineers who support both new and existing customers. In general each sales representative is assigned responsibility for handling just one product line in a designated geographic area, except for sales representatives for the K-12 education market and the arts and cultural market who are responsible for selling all of our software products in that market. We generally begin a customer relationship with the sale of one of our primary products, such as The Raiser s Edge, then sell the customer additional products and services, such as vertical-specific software applications and related implementation and technical services.

We conduct a variety of marketing programs that are designed to create brand recognition and market awareness for our products and services. Our marketing efforts include participation at tradeshows, technical conferences and technology seminars, publication of technical and educational articles in industry journals and preparation of competitive analyses. Our customers and strategic partners provide references and recommendations that we often feature in our advertising and promotional activities.

We believe relationships with third parties can enhance our sales and marketing efforts. We have, and intend to seek to establish additional, relationships with companies that provide services to the nonprofit industry, such as consultants, educators, publishers, financial service providers, complementary technology providers and data providers. These companies promote or complement our nonprofit solutions and provide us access to new customers. We believe that active participation in charitable activities is good for the community and helps us build relationships with our clients and enhances our employees awareness of their activities. We have

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established a number of employee volunteer activities and are actively involved with a number of local and regional charities and nonprofit organizations, further demonstrating our dedication to assisting these organizations.

Competition

The market for software and related services for nonprofit organizations is fragmented, competitive and rapidly evolving, and there are limited barriers to entry for some aspects of this market. We expect to encounter new and evolving competition as this market consolidates and matures and as nonprofit organizations become more aware of the advantages and efficiencies that can be attained from the use of specialized software and other technology solutions. A number of diversified software enterprises have made acquisitions or developed products for the market, including Sage and SunGard. Other companies that have greater marketing resources and generate greater revenues and market recognition than we do, such as Microsoft, Salesforce.com and Oracle, offer products that are not designed specifically for nonprofits but still provide some of the functionality of our products and could be considered competitors. In addition, these larger companies could decide to enter the market directly, including through acquisitions of smaller current competitors.

We mainly face competition from four sources:

 software developers offering specialized products designed to address specific needs of nonprofit organizations;

 providers of traditional, less automated fundraising services;

 custom-developed solutions; and

 software developers offering general products not designed to address specific needs of nonprofit organizations.

We compete with several software developers that provide on-demand software specifically designed for nonprofit use. In addition, we compete with custom-developed solutions created either internally by the nonprofit organization or outside custom service providers. However, building a custom solution often requires extensive financial and technical resources that may not be available or cost-effective for the nonprofit organization. In addition, in many cases the customer s legacy database and software system were not designed to support the increasingly complex and advanced needs of today s growing community of nonprofit organizations.

We also compete with providers of traditional, less automated fundraising services, including parties providing services in support of traditional direct mail campaigns, special events fundraising, telemarketing and personal solicitations. Although there are numerous general software developers marketing products that have some application in the nonprofit market, these competitors have generally neglected to focus specifically on the nonprofit market and typically lack the domain expertise to cost effectively build or implement integrated solutions for the needs of the nonprofit market. We believe we compete successfully against these traditional fundraising services, primarily because our products and services are more automated, robust and efficient than the traditional fundraising methods supported by these providers.

Research and development

We have made substantial investments in research and development, and expect to continue to do so as a part of our strategy to introduce additional products and services. As of December 31, 2006, we had approximately 200 employees working on research and development. Our research and development expenses for the years ended December 31, 2006, 2005 and 2004 were $23.1 million, $21.1 million and $17.4 million, respectively.

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Technology and architecture

We utilize a three-tier Component Object Model, or COM-based development model, because it allows our customers to extend and modify the functionality of our applications without requiring them to make any source code or data modifications themselves. This is important for customers that want to customize our applications by incorporating their own business logic into key areas of the applications. The end result is a robust customization platform through which the application can be modified and extended without requiring source code alteration.

The architecture of our COM-based development model ensures our applications are:

Flexible. Our component-based architecture is programmable and easily customized by our customers without requiring modification of the source code, ensuring that the technology can be leveraged and extended to accommodate changing demands of our clients and the market.

Adaptable. The architecture of our applications allows us to easily add features and functionality or to integrate with third party applications in order to adapt to our customers needs or market demands.

Scalable. We combine a scalable architecture with the performance, capacity, and load balancing of industry-standard web servers and databases used by our customers to ensure the applications can scale to the needs of larger organizations.

We have and intend to continue to license technologies from third parties that are integrated into our products. Currently, we believe that the loss of any third party technology integrated into our products would not have a material adverse effect on our business. However, our inability to obtain licenses for third-party technology for future products could delay product development, which could harm our business and operating results.

Intellectual property and other proprietary rights

To protect our intellectual property, we rely on a combination of patent, trademark, copyright and trade secret laws in various jurisdictions, and employee and third-party nondisclosure agreements and confidentiality procedures. We have a number of registered trademarks, including Blackbaud and The Raiser s Edge. We have applied for additional trademarks. We currently have six patents pending on our technology, including functionality in The Financial Edge, The Information Edge and ProspectPoint.

Employees

As of December 31, 2006, we had approximately 1,165 employees, consisting of approximately 300 in sales and marketing, 200 in research and development, 300 in consulting and professional services, 215 in customer support and 150 general and administrative personnel. None of our employees are represented by unions or covered by collective bargaining agreements. We are not involved in any material disputes with any of our employees, and we believe that relations with our employees are satisfactory.

Acquisition of Target Software, Inc. and Target Analysis Group, Inc.

On January 16, 2007, we acquired privately-owned Target Software, Inc. and Target Analysis Group, Inc., affiliated companies based in Cambridge, Massachusetts. As part of the acquisition of the Target Companies we added approximately 400 new customers and 200 additional employees. The Target Companies provide expertise in high-volume direct response marketing through their Team Approach software as well as their analytics offerings, which include donorCentrics.

Where you can find additional information

Our website address is www.blackbaud.com. We make available free of charge through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed

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with or furnished to the SEC. The SEC maintains an Internet site that contains these reports at www.sec.gov.

Executive officers of the registrant

The following table sets forth certain information concerning our executive officers as of February 27, 2007:

Name	Age	
Marc E. Chardon	51	President and Chief Executive Officer
Timothy V. Williams	57	Chief Financial Officer, Senior Vice President, Treasurer and Assistant Secretary
Louis J. Attanasi	45	Senior Vice President of Strategic Technologies
Richard S. Braddock	38	Senior Vice President of Marketing
Charles T. Cumbaa	54	Senior Vice President of Services and Development
Lee W. Gartley	42	Senior Vice President, President of Target Division
Andrew L. Howell	40	Vice President, General Counsel and Corporate Secretary
Charles L. Longfield	50	Chief Scientist
John J. Mistretta	51	Senior Vice President of Human Resources
Heidi H. Strenck	37	Senior Vice President, Controller, Assistant Treasurer and Assistant Secretary
Christopher R. Todd	37	Senior Vice President of Sales
Gerard J. Zink	43	Senior Vice President of Customer Support

Marc E. Chardon joined us in November 2005. Previously, Mr. Chardon served as chief financial officer for the $11 billion Information Worker business group at Microsoft, where he was responsible for the core functions of long-term strategic financial planning and business performance management. He joined Microsoft in August 1998 as general manager of Microsoft France. During his three-year leadership, the subsidiary remained one of the three most admired companies by French professionals and achieved increased customer satisfaction. Prior to joining Microsoft, Mr. Chardon was general manager of Digital France. He joined Digital in 1984, and held a variety of international marketing and business roles within the company. In 1994, Mr. Chardon was named director, office of the president, with responsibility for Digital s corporate strategy development. Mr. Chardon is an American/French dual national. He is an economics honors graduate from Harvard University.

Timothy V. Williams has served as our Chief Financial Officer since January 2001. Mr. Williams is responsible for all of our financial reporting and controls, as well as human resources and legal. From January 1994 to January 2001 he served as Executive Vice President and CFO of Mynd, Inc. (now a subsidiary of Computer Sciences Corporation), a provider of software and services to the insurance industry. Prior to that, Mr. Williams worked at Holiday Inn Worldwide, most recently as Executive Vice President and Chief Financial Officer. Mr. Williams holds a BA from the University of Northern Iowa.

Louis J. Attanasi has led our Strategic Technologies group since 2000. Prior to that, he was our Vice President of Product Development since 1996. He joined us in 1986, and in 1988, he began managing our research and development efforts. From 1988 through 1995, Mr. Attanasi was responsible for our software design. Prior to joining us, he taught mathematics at the State University of New York at Stony Brook and worked as a programming engineer at Environmental Energy Corporation. Mr. Attanasi holds a BS in Mathematics from State University of New York at Stony Brook and a MS in Mathematics from the University of Charleston.

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Richard S. Braddock, our Senior Vice President of Marketing, joined us in July 2003. Prior to joining us, Mr. Braddock was a Marketing/Private Equity Consultant for T.I.F.F., a nonprofit cooperative, from February 2003 until May 2003 and for Deutsche Bank Venture Capital from June 2002 until January 2003. He was with iMediation Inc., a channel management vendor, from August 2000 until February 2002, most recently as Vice President of Marketing and Strategy, and the Vice President of Marketing for Prime Response, Inc., a customer relations management software company from January 1998 until April 2000. Mr. Braddock holds a BA from Dartmouth College and an MBA from Harvard Business School.

Charles T. Cumbaa, our senior Vice President of Services and Development, joined us in May 2001. Prior to joining us, Mr. Cumbaa was an Executive Vice President with Intertech Information Management from December 1998 until October 2000. From 1992 until 1998 he was President and Chief Executive Officer of Cognitech, Inc., a software company he founded. Prior to that, he was employed by McKinsey & Company. Mr. Cumbaa holds a BA from Mississippi State University and an MBA from Harvard Business School.

Lee W. Gartley joined us in January 2007 as a Senior Vice President as part of our acquisition of the Target Companies. Mr. Gartley remains as President of and is responsible for the day-to-day operations of both Target Companies. Prior to joining the Target companies in 1998, Mr. Gartley was a senior marketer with Art Technology Group from 1996 until 1998 where he helped to launch an online commerce platform. From 1992 to 1996 he was a management consultant with Boston Consulting Group working with clients in a variety of industries to develop and implement sound strategy. Mr. Gartley holds a BA in Physics from Bowdoin College and an MBA from the Kellogg Graduate School of Management.

Andrew L. Howell, our Vice President, General Counsel and Corporate Secretary, joined us in July 2002. Prior to joining us, Mr. Howell practiced corporate and technology law, most recently with Sutherland Asbill & Brennan LLP. Mr. Howell received a BA from Washington & Lee University and a JD from Mercer University, where he served as Editor-in-Chief of the Law Review.

Charles L. Longfield became our Chief Scientist in January 2007 as part of our acquisition of the Target Companies, both of which he founded. Mr. Longfield has extensive experience designing and implementing national as well as international constituency databases that address the fundraising information needs at many of the world s largest nonprofit organizations. Mr. Longfield holds a BA in Mathematics and a M.Ed. from Harvard University and has over 25 years of experience helping nonprofits automate their fundraising operations.

John J. Mistretta, our Senior Vice President of Human Resources, joined us in August 2005. Prior to joining us, Mr. Mistretta was an Executive Vice President of Human Resources and Alternative Businesses at National Commerce Financial Corporation from 1998 to 2005. Earlier in his career, Mr. Mistretta held various senior Human Resources positions over a thirteen year period at Citicorp. Mr. Mistretta holds a Masters of Science in Counseling and a BA in Psychology from the State University of New York at Oswego.

Heidi H. Strenck has served as our Senior Vice President and Controller since January 2007. From October 2002 until January 2007, Ms. Strenck served as our Vice President and Controller. Ms. Strenck joined us in September 1996 and held key management roles as Accounting Manager from 1996 until 1997 and as Controller until 2002. Prior to joining us, she served as a Senior Associate with Coopers & Lybrand and as Internal Auditor for The Raymond Corporation. Ms. Strenck serves on the board of directors of the Trident Area Salvation Army. Ms. Strenck holds a BA from Hartwick College.

Christopher R. Todd, our Senior Vice President of Sales, joined us in July 2000. From June 2005 until January 2007, Mr. Todd served as our Vice President of Sales, and from July 2000 until June 2005, he headed our business development efforts and led our analytics division. Prior to joining us, Mr. Todd served as the Director of Business Development and Legal Affairs for NetGen Inc. from July 1999 until July 2000 and as an Associate with McKinsey & Co. from July 1997 until July 1999. Mr. Todd holds a BA from Harvard College and a JD from Yale Law School.

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Gerard J. Zink has served as our Senior Vice President of Customer Support since January 2007 and Vice President of Customer Support since June 1996. Mr. Zink is responsible for all of our customer support, as well as information technology and administrative services. He joined us in November 1987, and served as a Customer Support Analyst and Manager of Customer Support before assuming his current position. Prior to joining us, Mr. Zink was employed as a computer consultant by the Diocese of Rockville Center in New York.

Item 1A. *Risk factors*

Our business operations face a number of risks. These risks should be read and considered with other information provided in this report.

A substantial majority of our revenue is derived from The Raiser s Edge and a decline in sales or renewals of this product and related services could harm our business.

We derive a substantial majority of our revenue from the sale of The Raiser s Edge and related services, and revenue from this product and related services is expected to continue to account for a substantial majority of our total revenue for the foreseeable future. For example, revenue from the sale of The Raiser s Edge and related services represented approximately 60%, 66% and 70% of our total revenue in 2006, 2005 and 2004, respectively. Because we generally sell licenses to our products on a perpetual basis and deliver new versions and enhancements to customers who purchase annual maintenance and support, our future license, services and maintenance revenue are substantially dependent on sales to new customers. In addition, we frequently sell The Raiser s Edge to new customers and then attempt to generate incremental revenue from the sale of additional products and services. If demand for The Raiser s Edge declines significantly, our business would suffer.

If our customers do not renew their annual maintenance and support agreements or subscriptions for our products or if they do not renew them on terms that are favorable to us, our business might suffer.

Most of our maintenance agreements and subscriptions are for a term of one year. As the end of the annual period approaches, we pursue the renewal of the agreement with the customer. Historically, maintenance and subscriptions renewals have represented a significant portion of our total revenue, including approximately 38%, 36% and 40% of our total revenue in 2006, 2005 and 2004, respectively. Because of this characteristic of our business, if our customers choose not to renew their maintenance and support agreements or subscriptions with us on beneficial terms, our business, operating results and financial condition could be harmed.

We might not generate increased business from our current customers, which could limit our revenue in the future.

Our business model is highly dependent on the success of our efforts to increase sales to our existing customers. Many of our customers initially make a purchase of only one or a limited number of our products or only for a single department within their organization. These customers might choose not to expand their use of or make additional purchases of our products and services. If we fail to generate additional business from our current customers, our revenue could grow at a slower rate or even decrease. In addition, as we deploy new applications and features for our existing products or introduce new products and services, our current customers could choose not to purchase these new offerings.

The market for software and services for nonprofit organizations might not grow, and nonprofit organizations might not continue to adopt our products and services.

Many nonprofit organizations have not traditionally used integrated and comprehensive software and services for their nonprofit-specific needs. We cannot be certain that the market for such products and services will continue to develop and grow or that nonprofit organizations will elect to adopt our products and services rather than continue to use traditional, less automated methods, attempt to develop software

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internally, rely upon legacy software systems, or use generalized software solutions not specifically designed for the nonprofit market. Nonprofit organizations that have already invested substantial resources in other fundraising methods or other non-integrated software solutions might be reluctant to adopt our products and services to supplement or replace their existing systems or methods. In addition, the implementation of one or more of our core software products can involve significant time and capital commitments by our customers, which they may be unwilling or unable to make. If demand for and market acceptance of our products and services does not increase, we might not grow our business as we expect.

> ***Our services revenue produces substantially lower gross margins than our license revenue, and an increase in services revenue relative to license revenue would harm our overall gross margins.***

Our services revenue, which includes fees for consulting, implementation, training, data and technical services and analytics, was approximately 32% of our revenue in both 2006 and 2005 and 31% of our revenue for 2004. Our services revenue has substantially lower gross margins than our product license revenue. An increase in the percentage of total revenue represented by services revenue would adversely affect our overall gross margins.

Certain of our services are contracted under fixed fee arrangements, which we base on estimates. If our estimated fees are less than our actual costs, our operating results would be adversely affected.

Services revenue as a percentage of total revenue has varied significantly from quarter to quarter due to fluctuations in licensing revenue, economic changes, changes in the average selling prices for our products and services, our customers acceptance of our products and our sales force execution. In addition, the volume and profitability of services can depend in large part upon:

competitive pricing pressure on the rates that we can charge for our services;

the complexity of the customers information technology environment and the existence of multiple non-integrated legacy databases;

the resources directed by customers to their implementation projects; and

the extent to which outside consulting organizations provide services directly to customers.

Any erosion of our margins for our services revenue or any adverse changes in the mix of our license versus service revenue would adversely affect our operating results.

> ***Our quarterly financial results fluctuate and might be difficult to forecast and, if our future results are below either any guidance we might issue or the expectations of public market analysts and investors, the price of our common stock might decline.***

Our quarterly revenue and results of operations are difficult to forecast. We have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. As a result, we believe that quarter-to-quarter comparisons of our revenue and operating results are not necessarily meaningful and that such comparisons might not be accurate indicators of future performance. The reasons for these fluctuations include but are not limited to:

the size and timing of sales of our software, including the relatively long sales cycles associated with many of our large software sales;

budget and spending decisions by our customers;

market acceptance of new products we release, such as The Patron Edge and NetCommunity;

the amount and timing of operating costs related