EVOLVING SYSTEMS INC
Form 10-Q
August 08, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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: 001-34261

EVOLVING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1010843**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
9777 Pyramid Court, Suite 100 Englewood, Colorado	**80112**
(Address of principal executive offices)	(Zip Code)

(303) 802-1000

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting companyx
Emerging growth companyo	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act o

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

As of August 2, 2017 there were 12,523,574 shares outstanding of Registrant s Common Stock (par value $0.001 per share).

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EVOLVING SYSTEMS, INC.

Quarterly Report on Form 10-Q

June 30, 2017

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,514	$ 7,614
Short-term restricted cash	1,557	
Contract receivables, net of allowance for doubtful accounts of $224 at June 30, 2017 and $221 at December 31, 2016	7,592	5,867
Unbilled work-in-progress	5,047	3,376
Prepaid and other current assets	2,165	1,553
Total current assets	21,875	18,410
Property and equipment, net	248	546
Amortizable intangible assets, net	3,809	4,200
Goodwill	21,284	20,599
Long-term deferred income taxes	170	
Total assets	$ 47,386	$ 43,755
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Term loan - current	$ 1,988	$ 1,997
Accounts payable and accrued liabilities	4,880	4,275
Income taxes payable	784	617
Unearned revenue	3,869	3,532
Total current liabilities	11,521	10,421
Long-term liabilities:		
Term loan, net of current portion	3,000	4,000
Total liabilities	14,521	14,421
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; 2,000,000 shares authorized; no shares issued and outstanding as of June 30, 2017 and December 31, 2016		
Common stock, $0.001 par value; 40,000,000 shares authorized; 12,118,118 shares issued and 11,939,229 outstanding as of June 30, 2017 and 12,086,280 shares issued and 11,907,391 outstanding as of December 31, 2016	12	12
Additional paid-in capital	98,033	97,744

Treasury stock 178,889 shares as of June 30, 2017 and December 31, 2016, at cost		(1,253)		(1,253)
Accumulated other comprehensive loss		(8,825)		(9,992)
Accumulated deficit		(55,102)		(57,177)
Total stockholders equity		32,865		29,334
Total liabilities and stockholders equity	$	47,386	$	43,755

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
REVENUE				
License fees	$ 720	$ 629	$ 1,063	$ 1,442
Services	5,502	5,449	11,034	11,116
Total revenue	6,222	6,078	12,097	12,558
COSTS OF REVENUE AND OPERATING EXPENSES				
Costs of revenue, excluding depreciation and amortization	1,564	1,263	3,109	2,712
Sales and marketing	978	1,191	2,046	2,571
General and administrative	1,020	854	1,993	1,822
Product development	669	833	1,143	1,788
Depreciation	50	71	101	148
Amortization	196	195	392	391
Restructuring		63		1,004
Total costs of revenue and operating expenses	4,477	4,470	8,784	10,436
Income from operations	1,745	1,608	3,313	2,122
Other income (expense)				
Interest income	1	1	1	3
Interest expense	(71)	(73)	(143)	(191)
Foreign currency exchange gain (loss)	(219)	(446)	(392)	(247)
Other income (expense), net	(289)	(518)	(534)	(435)
Income from operations before income taxes	1,456	1,090	2,779	1,687
Income tax expense	354	310	704	480
Net income	$ 1,102	$ 780	$ 2,075	$ 1,207
Basic income per common share	$ 0.09	$ 0.07	$ 0.17	$ 0.10
Diluted income per common share	$ 0.09	$ 0.07	$ 0.17	$ 0.10
Cash dividend declared per common share	$	$ 0.11	$	$ 0.22
Weighted average basic shares outstanding	11,935	11,803	11,928	11,799
Weighted average diluted shares outstanding	11,972	11,964	11,958	11,961

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$ 1,102	$ 780	$ 2,075	$ 1,207
Other comprehensive gain (loss):				
Foreign currency translation gain (loss)	813	(1,435)	1,167	(2,028)
Comprehensive income (loss)	$ 1,915	$ (655)	$ 3,242	$ (821)

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(in thousands, except share data)

(unaudited)

	Common Stock		Additional Paid-in	Treasury	Accumulated Other Comprehensive	Accumulated	Total Stockholders
	Shares	Amount	Capital	Stock	Loss	Deficit	Equity
Balance at December 31, 2016	**11,907,391**	**$ 12**	**$ 97,744**	**$ (1,253)**	**$ (9,992)**	**$ (57,177)**	**$ 29,334**
Stock option exercises	31,364		24				24
Common stock issued pursuant to the Employee Stock Purchase Plan	474		1				1
Stock-based compensation expense			264				264
Net income						2,075	2,075
Foreign currency translation adjustment					1,167		1,167
Balance at June 30, 2017	**11,939,229**	**$ 12**	**$ 98,033**	**$ (1,253)**	**$ (8,825)**	**$ (55,102)**	**$ 32,865**

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Six Months Ended June 30,	
	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 2,075	$ 1,207
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	101	148
Amortization of intangible assets	392	391
Amortization of debt issuance costs	10	22
Stock based compensation	264	146
Unrealized foreign currency transaction loss, net	392	247
Provision for deferred income taxes	(170)	(73)
Change in operating assets and liabilities:		
Contract receivables	(1,797)	41
Unbilled work-in-progress	(1,471)	200
Prepaid and other assets	(549)	(346)
Accounts payable and accrued liabilities	832	(322)
Unearned revenue	162	1,376
Net cash provided by operating activities	241	3,037
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(6)	(6)
Restricted Cash - Escrow deposit for acquisition for BLS	(1,557)	
Net cash used in investing activities	(1,563)	(6)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Capital lease payments	(1)	(3)
Payments of the revolving line of credit		(10,000)
Proceeds from the term loan		6,000
Principal payments on the term loan	(1,000)	
Payments for debt issuance costs	(19)	(18)
Common stock cash dividends		(1,298)
Proceeds from the issuance of stock	25	53
Net cash used in financing activities	(995)	(5,266)
Effect of exchange rate changes on cash	217	(253)
Net decrease in cash and cash equivalents	(2,100)	(2,488)
Cash and cash equivalents at beginning of period	7,614	8,400
Cash and cash equivalents at end of period	$ 5,514	$ 5,912
Supplemental disclosure of cash and non-cash transactions:		
Income taxes paid	$ 977	$ 619
Common stock dividend declared, not yet paid		1,299

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

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EVOLVING SYSTEMS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

Organization We are a provider of software solutions and services to the wireless, wireline and cable markets. We maintain long-standing relationships with many of the largest wireless, wireline and cable companies worldwide. Our customers rely on us to develop, deploy, enhance and maintain software solutions that provide a variety of service activation and provisioning functions. In 2016, we began a shift from selling technology to offering business solutions. The value proposition has moved from cost savings to revenue increases for the carrier and our business model has moved from classic capex license and services to opex models based on recurring managed services with performance fees. Our software solution platform, *Real-time Lifecycle Marketing* (RLM), enables carriers marketing departments to innovate, execute and manage highly-personalized and contextually-relevant, interactive campaigns that engage consumers in real time. Our service activation solution, *Tertio*® (TSA) is used to activate bundles of voice, video and data services for wireless, wireline and cable network operators; our SIM card activation solution, *Dynamic SIM Allocation TM* (DSA) is used to dynamically allocate and assign resources to Mobile Network Operators (MNOs) devices that rely on SIM cards; our *Mobile Data Enablement TM* (MDE) solution provides a data consumption and policy management solution for wireless carriers and Mobile Virtual Network Operators (MVNOs) that monitor the usage and consumption of data services; our *Total Number Management* (TNM) product is a scalable and fully automated database solution that enables operators to reliably and efficiently manage their telephone numbers as well as other communication identifiers (i.e. SIMs, MSISDNs, IMSIs, ICCIDs, IPs). Our solutions can be deployed on premise or as a Software-as-a-Service (SaaS).

Interim Consolidated Financial Statements The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in conformity with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X and the related rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures included in these consolidated financial statements are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements included in this document have been prepared on the same basis as the annual consolidated financial statements, and in our opinion reflect all adjustments, which include normal recurring adjustments necessary for a fair presentation in accordance with GAAP and SEC regulations for interim financial statements. The results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that we will have for any subsequent period. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the year ended December 31, 2016 included in our Annual Report on Form 10-K.

Reclassifications - Certain reclassifications have been made to the 2016 financial statements to conform to the consolidated 2017 financial statement presentation. These reclassifications had no effect on net earnings or cash flows as previously reported.

Use of Estimates The preparation of consolidated financial statements in conformity with GAAP requires us 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 consolidated financial statements, as well as the reported amounts of revenue and expenses during the reporting period. We made estimates with respect to revenue recognition for estimated hours to complete projects accounted for using the percentage-of-completion method, allowance for doubtful accounts, income tax valuation allowance, fair values of long-lived assets, valuation of intangible assets and goodwill, useful lives for property, equipment and intangible assets, business combinations, capitalization of internal software development costs and fair value of stock-based compensation amounts. Actual results could differ from these estimates.

Foreign Currency Our functional currency is the U.S. dollar. The functional currency of our foreign operations is the respective local currency for each foreign subsidiary. Assets and liabilities of foreign operations denominated in local currencies are translated at the spot rate in effect at the applicable reporting date. Our consolidated statements of income are translated at the weighted average rate of exchange during the applicable period. The resulting unrealized cumulative translation adjustment is recorded as a component of accumulated other comprehensive loss in stockholders equity. Realized and unrealized transaction gains and losses generated by transactions denominated in a currency different from the functional currency of the applicable entity are recorded in other income (expense) in the consolidated statements of operations in the period in which they occur.

Principles of Consolidation The unaudited condensed consolidated financial statements include the accounts of Evolving Systems, Inc. and subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated in consolidation.

Goodwill Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but tested for impairment annually or whenever indicators of impairment exist. These indicators

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may include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to the reporting unit, and determination of the fair value of the reporting unit.

Intangible Assets Amortizable intangible assets consist primarily of purchased software and licenses, customer contracts and relationships, trademarks and tradenames, non-competition and business partnerships acquired in conjunction with our purchase of Telespree Communications (Evolving Systems Labs, Inc.) and RateIntegration, Inc. d/b/a Sixth Sense Media (Evolving Systems NC, Inc.). These assets are amortized using the straight-line method over their estimated lives.

We assess the impairment of identifiable intangibles if events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. If we determine that the carrying value of intangibles and/or long-lived assets may not be recoverable, we compare the estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition to the asset s carrying amount. If an amortizable intangible or long-lived asset is not deemed to be recoverable, we recognize an impairment loss representing the excess of the asset s carrying value over its estimated fair value.

Fair Value Measurements Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Inputs that are generally unobservable and typically reflect management s estimate of assumptions that market participants would use in pricing the asset or liability.

Cash and Cash Equivalents All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents.

Revenue Recognition We recognize revenue when an agreement is signed, the fee is fixed or determinable and collectability is reasonably assured. We recognize revenue from two primary sources: license fees and services. The majority of our license fees and services revenue is generated from fixed-price contracts, which provide for licenses to our software products and services to customize such software to meet our customers use. When the customization services are determined to be essential to the functionality of the delivered software, we recognize revenue using the percentage-of-completion method of accounting. In these types of arrangements, we do not typically have vendor specific objective evidence (VSOE) of fair value on the license fee/services portion (services are related to customizing the software) of the arrangement due to the large amount of customization required by our customers; however, we do have VSOE for the warranty/maintenance services based on the renewal rate of the first year of maintenance in the arrangement. The license/services portion is recognized using the percentage-of-completion method of accounting and the warranty/maintenance services are separated based on the renewal rate in the contract and recognized ratably over the warranty or maintenance period. We estimate the percentage-of-completion for each contract based on the ratio of direct labor hours incurred to total estimated direct labor hours and recognize revenue based on the percent complete multiplied by the contract amount allocated to the license fee/services. Since estimated direct labor hours, and changes thereto, can have a significant impact on revenue recognition, these estimates are critical and we review them regularly. If the arrangement includes a customer acceptance provision, the hours to complete the acceptance testing are included in the total estimated direct labor hours; therefore, the related revenue is recognized as the acceptance testing is performed. Revenue is not recognized in full until the customer has provided proof of acceptance on the arrangement. Generally, our contracts are accounted for individually. However, when certain criteria are met, it may be necessary to account for two or more contracts as one to reflect the substance of the group of contracts. We record amounts billed in advance of services being performed as unearned revenue. Unbilled work-in-progress represents revenue earned but not yet billable under the terms of the fixed-price contracts. All such amounts are expected to be billed and collected within 12 months.

We may encounter budget and schedule overruns on fixed-price contracts caused by increased labor or overhead costs. We make adjustments to cost estimates in the period in which the facts requiring such revisions become known. We record estimated losses, if any, in the period in which current estimates of total contract revenue and contract costs indicate a loss. If revisions to cost estimates are obtained after the balance sheet date but before the issuance of the interim or annual financial statements, we make adjustments to the interim or annual financial statements accordingly.

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In arrangements where the services are not essential to the functionality of the delivered software, we recognize license revenue when a license agreement has been signed, delivery and acceptance have occurred, the fee is fixed or determinable and collectability is reasonably assured. Where applicable, we unbundle and record as revenue fees from multiple element arrangements as the elements are delivered to the extent that VSOE of fair value of the undelivered elements exist. If VSOE for the undelivered elements does not exist, we defer fees from such arrangements until the earlier of the date that VSOE does exist on the undelivered elements or all of the elements have been delivered.

We recognize revenue from fixed-price service contracts using the proportional performance method of accounting, which is similar to the percentage-of-completion method described above. We recognize revenue from professional services provided pursuant to time-and-materials based contracts and training services as the services are performed, as that is when our obligation to our customers under such arrangements is fulfilled.

We recognize revenue from our managed services contracts primarily ratably over the service contract period. On occasion, our managed services contracts will contain a specified number of hours to work over the term of the contract. Revenue for this type of managed service contract is recognized using the proportional performance method of accounting.

We recognize revenue from our MDE contracts based on the number of transactions per month multiplied by a factor based on a unique table for transaction volumes relating to each account.

We recognize customer support, including maintenance revenue, ratably over the service contract period. When maintenance is bundled with the original license fee arrangement, its fair value, based upon VSOE, is deferred and recognized during the periods when services are provided.

We review and update our contract-related estimates regularly. The impact of an adjustment in estimate is recognized prospectively over the remaining contract term. No adjustment on any one contract was material to our unaudited Consolidated Financial Statements in the three and six months ended June 30, 2017 and 2016.

Stock-based Compensation We account for stock-based compensation by applying a fair-value-based measurement method to account for share-based payment transactions with employees and directors. We record compensation costs associated with the vesting of unvested options on a straight-line basis over the vesting period. Stock-based compensation is a non-cash expense because we settle these obligations by issuing shares of our common stock instead of settling such obligations with cash payments. We use the Black-Scholes model to estimate the fair value of each option grant on the date of grant. This model requires the use of estimates for expected term of the options and expected volatility of the price of our common stock.

The fair market value of restricted shares for share-based compensation expensing is equal to the closing price of our common stock on the date of grant. Of the restrictions on the stock awards granted during the three and six months ended June 30, 2017, 20% will be released in January 2018, and 10% annually beginning on the one year anniversary of their offering thereafter for four years. The remaining 40% will be released evenly over four years beginning in 2018 contingent upon the attainment of annual performance goals established by our Board of Directors.

Comprehensive Income (Loss) Comprehensive income (loss) consists of two components, net income and other comprehensive income (loss). Other comprehensive income (loss) refers to revenue, expenses, gains, and losses that under GAAP are recorded as an element of shareholders equity but are excluded from net income. Other comprehensive income (loss) consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency.

Restricted Cash As of June 30, 2017 we had $1. 6 million of restricted cash related to the pending asset purchase of Business Logic Systems Limited. The restricted cash became unrestricted as of July 3, 2017, once the purchase was consummated, and was applied to the purchase.

Income Taxes We record deferred tax assets and liabilities for the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in the accompanying condensed consolidated balance sheets, as well as operating losses and tax credit carry-forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. We reduce deferred tax assets by a valuation allowance if, based on available evidence, it is more likely than not that these benefits will not be realized.

We use a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities.

Segment Information We define operating segments as components of our enterprise for which separate financial information is reviewed regularly by the chief operating decision-makers to evaluate performance and to make operating decisions.

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We have identified our Chief Executive Officer and Senior Vice President of Finance as our chief operating decision-makers (CODM). These chief operating decision makers review revenues by segment and review overall results of operations.

We currently operate our business as one operating segment which includes two revenue types: license fees revenue and services revenue (as shown on the condensed consolidated statements of income). License fees revenue represents the fees received from the license of software products. Services revenue includes services directly related to the delivery of the licensed products, such as fees for custom development, integration services, SaaS service, managed services, annual support fees, recurring maintenance fees, fees for maintenance upgrades and warranty services. Warranty services that are similar to software maintenance services are typically bundled with a license sale. Total assets by segment have not been disclosed as the information is not available to the chief operating decision-makers.

Recent Accounting Pronouncements In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, Topic 606. This Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. The guidance in this Update supersedes the revenue recognition requirements in Topic 605, Revenue Recognition and most industry-specific guidance. The core principle of the guidance is that an entity should recognize revenue to illustrate the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance also includes a cohesive set of disclosure requirements that will provide users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a reporting organization s contracts with customers.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers, Topic 606: Identifying Performance Obligations and Licensing . This Update clarifies guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. The Update includes targeted improvements based on input the Board received from the Transition Resource Group for Revenue Recognition and other stakeholders. The update seeks to proactively address areas in which diversity in practice potentially could arise, as well as to reduce the cost and complexity of applying certain aspects of the guidance both at implementation and on an ongoing basis.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers, Topic 606: Narrow-Scope Improvements and Practical Expedients . The amendments in this Update address narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. Additionally, the amendments in this Update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. This ASU is the final version of Proposed Accounting Standards Update 2015-320, Revenue from Contracts with Customers, (Topic 606): Narrow-Scope Improvements and Practical Expedients, which has been deleted.

In December 2016, the FASB issued ASU No. 2016-20, Revenue from Contracts with Customers, Topic 606: Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers . The amendments in this Update address narrow-scope improvements to the guidance on loan guarantee fees, contract cost-impairment testing, contract costs-interaction of impairment testing with guidance in other topics, provision for losses on construction-type and production-type contracts, scope of topic 606 to exclude all contracts that are within the scope of Topic 944, disclosure of remaining performance obligations, disclosure of prior-period performance obligations, contract modifications, contract asset versus receivable, refund liability, advertising costs, fixed-odds wagering contracts in the casino industry and cost capitalization

for advisors to private funds and public funds. The Board decided to issue a separate Update for technical corrections and improvements to Topic 606 and other Topics amended by Update 2014-09 to increase stakeholders awareness of the proposals and to expedite improvements to Update 2014-09. This ASU is effective for fiscal years, and interim periods within those years beginning after December 15, 2017 for public companies and 2018 for non-public entities. We do not expect the adoption of this standard to have a significant impact on our financial position and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to put most leases on their balance sheets by recognizing a lessee s rights and obligations, while expenses will continue to be recognized in a similar manner to today s legacy lease accounting guidance. This ASU could also significantly affect the financial ratios used for external reporting and other purposes, such as debt covenant compliance. This ASU will be effective for us on January 1, 2019, with early adoption permitted. We are currently in the process of assessing the impact of this ASU on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350), which includes provisions intended to simplify the test for goodwill impairment. The standard is effective for annual periods beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We do not expect the adoption of this standard to have a significant impact on our financial position and results of operations.

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Recently Adopted Accounting Pronouncements In March 2016, the FASB issued ASU No. 2016-09, Stock Compensation (Topic 718), which includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. The standard is effective for annual periods beginning after December 15, 2016. We adopted this ASU during the first quarter 2017. The key effects of the adoption on our financial statements include that the Company will now recognize windfall tax benefits as deferred tax assets instead of tracking the windfall pool and recording such benefits in equity. Additionally, we have elected to recognize forfeitures as they occur rather than estimating them at the time of grant

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted cash, which requires the statement of cash flows explain the change during the period in the combined total of restricted and unrestricted balances in the statement of cash flows. Therefore, amounts described as restricted cash and restricted cash equivalents should be combined with the unrestricted cash and cash equivalents when reconciling the beginning and end of period balances on the statement of cash flow. The standard is effective for annual periods beginning after December 15, 2017, and interim periods within the fiscal years. We adopted this ASU during the second quarter 2017. The key effects of the adoption on our financial statements include that the statement of cash flows now presents a transfer of restricted cash from a cash balance as a cash transaction. As such, a restricted cash cash flow is now classified as operating, investing, or financing, as appropriate.

NOTE 2 GOODWILL AND INTANGIBLE ASSETS

Changes in the carrying amount of goodwill by reporting unit were as follows (in thousands):

		Total Goodwill
Balance at December 31, 2016	$	20,599
Effects of changes in foreign currency exchange rates (1)		685
Balance at June 30, 2017	$	21,284

(1) Represents the impact of foreign currency translation for instances when goodwill is recorded in foreign entities whose functional currency is also their local currency. Goodwill balances are translated into U.S. dollars using exchange rates in effect at period end. Adjustments related to foreign currency translation are included in other comprehensive income.

We performed our annual goodwill impairment test as of July 31, 2016, at which time we had $21.5 million of goodwill included in the following - U.S. of $7.8 million, U.K. of $13.5 million, and India of $0.2 million. The fair value of each reporting unit was estimated using both market and income based approaches. Specifically, we incorporated observed market multiple data from selected guideline public companies and values arrived at through the application of discounted cash flow analyses, which in turn were based upon our financial projections as of the valuation date. We believe that a market participant would weigh both possibilities without a bias to one or the other. Consequently, we gave equal consideration to both. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit. If the carrying value of a reporting unit were to exceed its fair value, we would then

compare the fair value of the reporting unit s goodwill to its carrying amount, and any excess of the carrying amount over the fair value would be charged to operations as an impairment loss. If the projected future performance of our segment as estimated in the income valuation approach is adjusted downward or is lower than expected in the future, we could be required to record a goodwill impairment charge. As a result of the first step of the 2016 goodwill impairment analysis, the fair value of each reporting unit exceeded its carrying value. Therefore the second step was not necessary. Due to our transition of packaging our products and services into a managed service offering, we have determined we have one reporting unit. We do not believe the aggregation of our reporting units impacts the value of our goodwill nor are there any events through the date this Form 10-Q was filed which impacts our assumptions on the determination of the fair value of our goodwill.

We amortized identifiable intangible assets for Evolving Systems Labs, Inc. and Evolving Systems NC, Inc. on a straight-line basis over their estimated lives ranging from one to eight years. As of June 30, 2017 and December 31, 2016, identifiable intangibles were as follows (in thousands):

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	June 30, 2017			December 31, 2016			
	Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Amortization Period
Purchased software	$ 2,118	$ 568	$ 1,550	$ 2,118	$ 436	$ 1,682	7.3 yrs
Trademarks and tradenames	185	153	32	185	116	69	2.6 yrs
Non-competition	33	29	4	33	21	12	2.0 yrs
Customer relationships	3,024	801	2,223	3,024	587	2,437	6.8 yrs
	$ 5,360	$ 1,551	$ 3,809	$ 5,360	$ 1,160	$ 4,200	6.8 yrs

Amortization expense of identifiable intangible assets was $0.2 million for the three months and $0.4 million for the six months ended June 30, 2017 and 2016, respectively. Expected future amortization expense related to identifiable intangibles based on our carrying amount as of June 30, 2017 was as follows (in thousands):

Twelve months ending June 30,	
2018	$ 724
2019	697
2020	693
2021	693
2022	638
Thereafter	364
	$ 3,809

NOTE 3 EARNINGS PER COMMON SHARE

We compute basic earnings per share (EPS) by dividing net income or loss available to common stockholders by the weighted average number of shares outstanding during the period, including common stock issuable under participating securities. We compute diluted EPS using the weighted average number of shares outstanding, including participating securities, plus all potentially dilutive common stock equivalents. Common stock equivalents consist of stock options and restricted stock.

Our policy is to treat unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, as participating securities, included in the computation of both basic and diluted earnings per share. We exclude unvested restricted stock from our basic earnings per share. Our restricted stock, which vests based on the passage of time are included in dilutive earnings per share. Our restricted stock which vests contingent upon the attainment of annual performance goals are included in dilutive earnings per share as the performance goals are achieved. The following is the reconciliation of the denominator of the basic and diluted EPS computations (in thousands, except per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Basic income per share:				
Net income available to common stockholders	$ 1,102	$ 780	$ 2,075	$ 1,207
Basic weighted average shares outstanding	11,935	11,803	11,928	11,799
Basic income per share:	$ 0.09	$ 0.07	$ 0.17	$ 0.10

Diluted income per share:				
Net income available to common stockholders	$ 1,102	$ 780	$ 2,075	$ 1,207
Weighted average shares outstanding	11,935	11,803	11,928	11,799
Effect of dilutive securities - options and restricted stock	37	161	30	162
Diluted weighted average shares outstanding	11,972	11,964	11,958	11,961
Diluted income per share:	$ 0.09	$ 0.07	$ 0.17	$ 0.10

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For the three months ended June 30, 2017 and 2016, 0.4 million and 0.5 million shares, respectively, of common stock were excluded from the dilutive stock calculation because their exercise prices were greater than the average fair value of our common stock for the period.

For the six months ended June 30, 2017 and 2016, 0.4 million and 0.5 million shares, respectively, of common stock were excluded from the dilutive stock calculation because their exercise prices were greater than the average fair value of our common stock for the period.

For the three and six months ended June 30, 2017, 0.6 million shares of unvested restricted stock were excluded from basic earnings per share and dilutive earnings per share. No shares of restricted stock were excluded from basic or dilutive earnings per share for the three and six months ended June 30, 2016.

NOTE 4 SHARE-BASED COMPENSATION

We account for stock-based compensation by applying a fair-value-based measurement method to account for share-based payment transactions with employees and directors, and record compensation cost for all stock awards granted after January 1, 2006 and awards modified, repurchased, or cancelled after that date, using the modified prospective method. We record compensation costs associated with the vesting of unvested options on a straight-line basis over the vesting period. We recognized $0.2 million and $0.1 million of compensation expense in the consolidated statements of operations, with respect to our stock-based compensation plans for the three months ended June 30, 2017 and 2016 and $0.3 million and $0.1 million for the six months ended June 30, 2017 and 2016 respectively

The following table summarizes stock-based compensation expenses recorded in the consolidated statement of operations (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Cost of revenue, excluding depreciation and amortization	$ 4	$ 11	$ 11	$ 23
Sales and marketing	(4)	6	4	14
General and administrative	164	35	215	70
Product development	19	18	34	39
Total share based compensation	$ 183	$ 70	$ 264	$ 146

Stock Incentive Plans

In June 2007, our stockholders approved the 2007 Stock Incentive Plan (the 2007 Stock Plan) with a maximum of 1,000,000 shares reserved for issuance. In June 2010, our stockholders approved an amendment to the 2007 Stock Plan which increased the maximum shares that may be awarded under the plan to 1,250,000. In June 2013, our stockholders approved an amendment to the 2007 Stock Plan which increased the maximum shares that may be awarded under the plan to 1,502,209. In June 2015, our stockholders approved an amendment to the 2007 Stock Plan which increased the maximum shares that may be awarded under the plan to 2,002,209. Awards permitted under the 2007 Stock Plan include: Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Awards and Other Stock-Based

Awards. Awards issued under the 2007 Stock Plan are at the discretion of the Board of Directors. As applicable, awards are granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years for employees and three years for an initial grant and one year for subsequent grants for directors and expire no more than ten years from the date of grant. At June 30, 2017, no shares were available for grant under the 2007 Stock Plan, as amended. At June 30, 2017 and December 31, 2016, 0.8 million and 0.7 million were issued and outstanding under the 2007 Stock Plan as amended, respectively.

In June 2016, our stockholders approved the 2016 Stock Incentive Plan (the 2016 Stock Plan) with a maximum of 250,000 shares reserved for issuance. In June 2017, our stockholders approved an amendment to the 2016 Stock Plan which increased the maximum shares that may be awarded under the plan to 650,000. Awards permitted under the 2016 Stock Plan include: Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Awards and Other Stock-Based Awards. Awards issued under the 2016 Stock Plan are at the discretion of the Board of Directors. As applicable, awards are granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years for employees and three years for an initial grant and one year for subsequent grants for directors and expire no more than ten years from the date of

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grant. At June 30, 2017 and December 31, 2016, 0.4 million and 0.3 million shares were available for grant under the 2016 Stock Plan, respectively.

During the three months ended June 30, 2017 65,000 shares of restricted stock were granted to members of our board and senior management. During the six months ending June 30, 2017 0.6 million shares of restricted stock were granted to members of our Board of Directors and senior management. During the three and six months ended June 30, 2016 no shares of restricted stock were granted to members of our Board of Directors or senior management. During the three months ended June 30, 2017 1,250 shares of restricted stock vested. During the six months ending June 30, 2017 2,500 shares of restricted stock vested. During the three and six months ended June 30, 2016 no shares of restricted stock vested. During the three and six months ended June 30, 2017 23,000 of restricted stock were forfeited. No shares of restricted stock were forfeited during the three and six months ended June 30, 2016. The fair market value of restricted shares for share-based compensation expensing is equal to the closing price of our common stock on the date of grant. Stock-based compensation expense includes $0.2 million and $8,000 for the three months ended June 30, 2017 and 2016, respectively, and $0.2 million and $15,000 for the six month ended June 30, 2017 and 2016, respectively, of expense related to restricted stock grants. Of the restrictions on the stock awards granted during the three and six months ended June 30, 2017, 20% will be released in January 2018, and 10% annually beginning on the one year anniversary of their offering thereafter for four years. The remaining 40%, will be released evenly over four years beginning in 2018 contingent upon the attainment of annual performance goals established by our Board of Directors.

The following is a summary of restricted stock option activity under the plans for the three and six months ended June 30, 2017:

	Restricted Stock Number of Shares (in thousands)
Shares unvested at December 31, 2016	15
Shares granted	607
Less shares forfeited	(23)
Less shares vested	(2)
Shares unvested at June 30, 2017	597

The fair value of each option grant is estimated on the date of grant using the Black-Scholes model. The Black-Scholes model uses four assumptions to calculate the fair value of each option grant. The expected term of share options granted is derived using the simplified method, which we adopted in January 2008. The risk-free interest rate is based upon the rate currently available on zero-coupon U.S. Treasury instruments with a remaining term equal to the expected term of the stock options. The expected volatility is based upon historical volatility of our common stock over a period equal to the expected term of the stock options. The expected dividend yield is based upon anticipated payment of dividends. The weighted-average assumptions used in the fair value calculations are as follows:

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2017	**2016**	**2017**	**2016**
Expected term (years)	*	*	*	6.1
Risk-free interest rate	*	*	*	1.39%
Expected volatility	*	*	*	36.90%
Expected dividend yield	*	*	*	8.24%

* None granted

The following is a summary of stock option activity under the plans for the six months ended June 30, 2017:

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	Number of Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2016	684	$ 6.17	7.30	$ 139
Less options forfeited/cancelled	(109)	6.22		
Less options exercised	(107)	3.30		
Options outstanding at June 30, 2017	468	$ 6.82	7.42	$ 86
Options exercisable at June 30, 2017	300	$ 7.09	6.98	$ 86

No stock options were granted during the three and six months ended June 30, 2017. No stock options were granted during the three months ended June 30, 2016. There were 118,000 stock options granted during the six months ended June 30, 2016. The weighted-average grant-date fair value of stock options granted were $0.74 during the three months ended March 31, 2016. As of June 30, 2017, there were approximately $2.7 million of total unrecognized compensation costs related to unvested stock options and restricted stock. These costs are expected to be recognized over a weighted average period of 3.57 years. The total fair value of stock options vested during the three & six months ended June 30, 2017 and 2016 was approximately $0.1 million.

The deferred income tax benefits from stock option expense related to Evolving Systems U.K. totaled approximately $3,000 for the three months ended June 30, 2017 and 2016, respectively. The deferred income tax benefits from stock option expense related to Evolving Systems U.K totaled approximately $5,000 and $7,000 for the six months ended June 30, 2017 and 2016, respectively,

Cash received from stock option exercises for the three months ended June 30, 2017 and 2016 was $17,000 and $26,000, respectively. Cash received from employee stock plan purchases for the six months ended June 30, 2017 and 2016 was $31,000 and $40,000 respectively.

During the three and six months ended June 30, 2017, we had net settlement exercises of stock options, whereby the optionee did not pay cash for the options but instead received the number of shares equal to the difference between the exercise price and the market price on the date of exercise. Net settlement exercises during the three months ended June 30, 2017, resulted in 5,839 shares issued and 4,975 options cancelled in settlement of shares issued. Net settlement exercises during the six months ended June 30, 2017 resulted in 18,951 shares issued and 75,327 options cancelled in settlement of shares issued. There were no net settlement exercises during the three and six months ended June 30, 2016.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan (ESPP), we are authorized to issue up to 550,000 shares. Employees may elect to have up to 15% of their gross compensation withheld through payroll deductions to purchase our common stock, capped at $25,000 annually and no more than 10,000 shares per offering period. The purchase price of the stock is 85% of the lower of the market price at the beginning or end of each three-month participation period. As of June 30, 2017, there were approximately 51,000 shares available for purchase. For the three months ended June 30, 2017 and 2016, we recorded compensation expense of $400 and $450, respectively, and $550 and $1,000, for the six months ended June 30, 2017 and 2016, respectively, associated with grants under the ESPP which includes the fair value of the look-back feature of each grant as well as the 15% discount on the purchase price.

This expense fluctuates each period primarily based on the level of employee participation.

The fair value of each purchase made under our ESPP is estimated on the date of purchase using the Black-Scholes model. The Black-Scholes model uses four assumptions to calculate the fair value of each purchase. The expected term of each purchase is based upon the three-month participation period of each offering. The risk-free interest rate is based upon the rate currently available on zero-coupon U.S. Treasury instruments with a remaining term equal to the expected term of each offering. The expected volatility is based upon historical volatility of our common stock. The expected dividend yield is based upon historical and anticipated payment of dividends. The weighted average assumptions used in the fair value calculations are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Expected term (years)	0.25	0.25	0.25	0.25
Risk-free interest rate	1.03%	0.26%	0.95%	0.22%
Expected volatility	42.49%	45.59%	42.48%	41.74%
Expected dividend yield	0.00%	8.51%	0.00%	7.95%

Cash received from employee stock plan purchases for the three months ended June 30, 2017 and 2016 was $1,400 and $2,000, respectively. Cash received from employee stock plan purchases for the six months ended June 30, 2017 and 2016, was $2,000 and $6,000, respectively.

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We issued shares related to the ESPP of approximately 350 and 400 for the three months ended June 30, 2017 and 2016, respectively. We issued shares related to the ESPP of approximately 500 and 1,000 for the six months ended June 30 2017 and 2016, respectively.

NOTE 5 CONCENTRATION OF CREDIT RISK

For the three months ended June 30, 2017, one significant customer (defined as contributing at least 10%) accounted for 15% of revenue from operations. The significant customer for the three months ended June 30, 2017 is a large telecommunications operator in Europe. For the six months ended June 30, 2017 one significant customer accounted for 13% of revenue from operations. This customer is a large telecommunications operator in Europe. For the three and six months ended June 30, 2016, no significant customers accounted for 10% of revenue from operations.

As of June 30, 2017, one significant customer accounted for approximately 10% of contract receivables and unbilled work-in-progress. This customer is a large telecommunication operator in Europe. As of December 31, 2016 no customers accounted for 10% of contract receivables and unbilled work-in-progress.

NOTE 6 LONG-TERM DEBT

On February 29, 2016, we entered into the Fifth Amendment to the Loan and Security Agreement with East West Bank which provides for a Term Loan (the Term Loan) for $6.0 million. The $6.0 million loan bears interest at a floating rate equal to the U.S.A. Prime Rate plus 1.0%. As of June 30, 2017, the U.S.A. Prime Rate was 4.25%. The Term Loan is secured by substantially all of the assets of Evolving Systems, Inc., including a pledge, subject to certain limitations with respect to stock of foreign subsidiaries, of the stock of the existing and future direct subsidiaries of Evolving Systems, Inc. Interest shall accrue from the date the Term Loan is made at the aforementioned rate and shall be payable monthly. The Term Loan shall be repaid in 36 equal monthly installments of principal, plus accrued but unpaid interest, commencing on January 1, 2017 and continuing on the first day of each month thereafter through and including January 1, 2020. On the Term Loan maturity date, the outstanding principal amount of the Term Loan and all accrued and unpaid interest thereon shall be immediately due and payable. The Term Loan, once repaid, may not be reborrowed. We must maintain a minimum current ratio, a specified ratio of Total Liabilities to EBITDA and a minimum fixed charge coverage ratio which are as defined in the Term Loan. The Term Loan requires us to pay two annual credit facility fees of $18,750 and legal fee equal to $1,000. The Term Loan agreement required us to use the term loan s proceeds and $4.0 million from our cash balances to pay off and terminate the Revolving Facilities totaling $10.0 million. The Term Loan matures on January 1, 2020.

The Term Loan includes negative covenants that place restrictions on the Company s ability to, among other things: incur additional indebtedness; create liens or other encumbrances on assets; make loans, enter into letters of credit, guarantees, investments and acquisitions; sell or otherwise dispose of assets; cause or permit a change of control; merge or consolidate with another entity; make negative pledges; enter into affiliate transactions; limits the amount of cash distributions to our shareholders; and change the nature of our business materially. Outstanding amounts under the Term Loan may be accelerated by East West Bank upon the occurrence and continuance of certain events of default, including without limitation: payment defaults, breach of covenants beyond applicable grace periods, breach of representations and warranties, bankruptcy and insolvency defaults, and the occurrence of a material adverse effect (as defined). Acceleration is automatic upon the occurrence of certain bankruptcy and insolvency defaults.

As of June 30, 2017, we are in compliance with the covenants and have a $5.0 million balance under the Term Loan net of approximately $12,500 of debt issuance costs.

NOTE 7 INCOME TAXES

We recorded net income tax expense of $0.4 million and $0.3 million for the three months ended June 30, 2017 and 2016, respectively. The net expense during the three months ended June 30, 2017 consisted of current income tax expense of $0.5 million and a deferred tax benefit of ($0.1) million. The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was related primarily to the increase of certain net deferred tax assets and amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc. in September 2015. The net expense during the three months ended June 30, 2016 consisted of current income tax expense of $0.4 million and a deferred tax benefit of ($0.1 million). The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was primarily related to the amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc.

We recorded net income tax expense of $0.7 million and $0.5 million for the six months ended June 30, 2017 and 2016, respectively. The net expense during the six months ended June 30, 2017 consisted of current income tax expense of $0.9 million and a deferred tax benefit of ($0.2) million. The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was primarily related to the increase of certain net deferred tax assets and amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc.

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Our effective tax rate was 24% and 28% for the three months ended June 30, 2017 and 2016, respectively. The decrease in our effective tax rate relates to a higher proportion of our income being generated in the U.K., for which the statutory corporate tax rate is lower and the utilization of Foreign Tax Credits (FTC).

Our effective tax rate was 25% and 28% for the six months ended June 30, 2017 and 2016 respectively. The decrease in our effective tax rates relates to a higher proportion of our income being generates in the U.K., for which the statutory corporate tax rate is lower and the utilization of FTC.

As of June 30, 2017 and December 31, 2016 we continued to maintain a valuation allowance on portions of our domestic net deferred tax asset. Such assets primarily consist of FTC, state Net Operating Loss (NOL) carryforwards, research and development tax credits and Alternative Minimum Tax (AMT) credits. Our deferred tax assets and liabilities as of June 30, 2017 and December 31, 2016, were comprised of the following (in thousands):

	June 30, 2017	December 31, 2016
Deferred tax assets		
Foreign tax credits carryforwards	$ 4,694	$ 4,360
Net operating loss carryforwards	907	544
Research & development credits	303	303
AMT credits	770	770
Stock compensation	635	561
Depreciable assets	87	71
Accrued liabilities and reserves	97	124
Total deferred tax assets	7,493	6,733
Deferred tax liabilities		
Deferred revenue		
Undistributed foreign earnings	$ (676)	$ (662)
Intangibles	(1,219)	(1,339)
Total deferred tax liability	(1,895)	(2,001)
Net deferred tax assets, before valuation allowance	$ 5,598	$ 4,732
Valuation allowance	(5,428)	(4,732)
Net deferred tax asset	$ 170	$

In our U.S. Federal income tax returns we historically deducted income taxes paid to various countries. In our 2014 U.S. Federal income tax return we had $2.3 million of NOL carryforwards. Our income tax calculations have historically been under the regular and AMT regulations found in U.S. tax laws. The U.S. tax system contains rules to alleviate the burden of double taxation on income generated in foreign countries and subject to tax in such countries. The U.S. allows for either a deduction or credit of such foreign taxes against U.S. taxable income. An election to either claim a deduction or credit on such foreign income taxes can be made each tax year, independent from elections made in other years. A credit reduces a company s actual U.S. income tax on a dollar-for-dollar basis, while a deduction reduces only the company s income subject to tax. We made a comparison of our foreign dividends paid by our foreign subsidiary for which we deducted foreign taxes claimed versus claiming a Foreign Tax Credit (FTC) on the dividend paid by the foreign subsidiary. The dividends received were grossed-up with its corresponding foreign taxes. The U.S. law requires the offset of taxable income with NOL prior to applying the FTC rules. We determined it was beneficial for the company to gross-up the foreign dividends paid by the foreign subsidiary for the years 2012 through 2014 and make the election to claim a FTC. By doing so we fully utilized our December 31, 2014, $2.3 million balance of the federal NOL. As the election to claim the foreign tax credit or deduction is made on an annual basis, we intend to compare benefits to either claim a deduction or foreign tax credit on an annual basis. The company has approximately $4.7 million of FTC s to carryforward through 2017 and subsequent years as a deferred tax asset.

Two Indian subsidiaries of SSM were acquired pursuant to the terms of the Agreement and Plan of Merger dated September 30, 2015. We have reason to believe there is uncertainty related to the lack of historical US International reporting for these two foreign subsidiaries, and are in the process of determining whether either or both of these subsidiaries are controlled foreign corporations (CFCs) within the meaning of the Internal Revenue Code and related Regulations, or if a check-the-box election has taken place to effectively treat one or both of these subsidiaries as disregarded entities for US federal tax reporting purposes. The

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Company is in the process of obtaining pertinent information to assess the degree of uncertainty and to quantify related costs or liabilities.

As of June 30, 2017 and December 31, 2016 we had no liability for unrecognized tax benefits.

We conduct business globally and, as a result, Evolving Systems, Inc. or one or more of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. Throughout the world, in the normal course of business, we are subject to examination by taxing authorities up until, two years in the U.K. and four years in India, following the end of the accounting period. As of the date of this report, none of our income tax returns are under examination.

NOTE 8 STOCKHOLDERS EQUITY

Certain Anti-Takeover Provisions/Agreements with Stockholders

Our restated certificate of incorporation allows the board of directors to issue up to 2,000,000 shares of preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by our stockholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. Issuance of preferred stock, while providing desired flexibility in connection with possible acquisitions and other corporate purposes, could make it more difficult for a third party to acquire a majority of our outstanding voting stock. As of June 30, 2017 and December 31, 2016, no shares of preferred stock were outstanding.

In addition, we are subject to the anti-takeover provisions of Section 203 of Delaware General Corporation Law which prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in the prescribed manner. The application of Section 203 may have the effect of delaying or preventing changes in control of our management, which could adversely affect the market price of our common stock by discouraging or preventing takeover attempts that might result in the payment of a premium price to our stockholders.

NOTE 9 GEOGRAPHICAL INFORMATION

We are headquartered in Englewood, a suburb of Denver, Colorado. We use customer locations as the basis for attributing revenues to individual countries. We provide products and services on a global basis through our headquarters, our London-based Evolving Systems U.K. subsidiary and our North Carolina based Evolving Systems NC, Inc. subsidiary. Additionally, personnel in Bangalore and Kolkata, India provide software development and support services to our global operations. Financial information relating to operations by geographic region is as follows (in thousands):

	For the Three Months Ended June 30, 2017		
	License	Services	Total
Revenue			
United Kingdom	$	$ 1,448	$ 1,448
Philippines	253	455	708
Other	467	3,599	4,066
Total revenues	$ 720	$ 5,502	$ 6,222

	For the Three Months Ended June 30, 2016		
	License	Services	Total
Revenue			
United Kingdom	$	$ 928	$ 928
Switzerland		701	701
Other	629	3,820	4,449
Total revenues	$ 629	$ 5,449	$ 6,078

	For the Six Months Ended June 30, 2017		
	License	Services	Total
Revenue			
United Kingdom	$	$ 2,477	$ 2,477
Other	1,063	8,557	9,620
Total revenues	$ 1,063	$ 11,034	$ 12,097

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	For the Six Months Ended June 30, 2016		
	License	Services	Total
Revenue			
United Kingdom	$	$ 1,901	$ 1,901
Switzerland		1,422	1,422
Other	1,442	7,793	9,235
Total revenues	$ 1,442	$ 11,116	$ 12,558

	June 30, 2017	December 31, 2016
Long-lived assets, net		
United States	$ 11,696	$ 12,347
United Kingdom	13,337	12,680
Other	308	318
	$ 25,341	$ 25,345

NOTE 10 COMMITMENTS AND CONTINGENCIES

(a) Other Commitments

As permitted under Delaware law, we have agreements with officers and directors under which we agree to indemnify them for certain events or occurrences while the officer or director is, or was, serving at our request in this capacity. The term of the indemnification period is indefinite. There is no limit on the amount of future payments we could be required to make under these indemnification agreements; however, we maintain Director and Officer insurance policies, as well as an Employment Practices Liability Insurance Policy, that may enable us to recover a portion of any amounts paid. As a result of our insurance policy coverage, we believe the estimated fair value of these indemnification agreements is minimal. Accordingly, there were no liabilities recorded for these agreements as of June 30, 2017 or December 31, 2016.

We enter into standard indemnification terms with customers and suppliers, in the ordinary course of business, for third party claims arising under our contracts. In addition, as we may subcontract the development of deliverables under customer contracts, we could be required to indemnify customers for work performed by subcontractors. Depending upon the nature of the indemnification, the potential amount of future payments we could be required to make under these indemnification agreements may be unlimited. We may be able to recover damages from a subcontractor or other supplier if the indemnification results from the subcontractor s or supplier s failure to perform. To the extent we are unable to recover damages from a subcontractor or other supplier, we could be required to reimburse the indemnified party for the full amount. We have never incurred costs to defend lawsuits or settle claims relating to an indemnification. As a result, we believe the estimated fair value of these agreements is minimal. Accordingly, there were no liabilities recorded for these agreements as of June 30, 2017 or December 31, 2016.

Our standard license agreements contain product warranties that the software will be free of material defects and will operate in accordance with the stated requirements for a limited period of time. The product warranty provisions require us to cure any defects through any reasonable means. We believe the estimated fair value of the product warranty provisions in the license agreements in place with our customers is minimal. Accordingly, there were no liabilities recorded for these product warranty provisions as of June 30, 2017 or December 31, 2016.

Our software arrangements generally include a product indemnification provision whereby we will indemnify and defend a customer in actions brought against the customer for claims that our products infringe upon a copyright, trade secret, or valid patent of a third party. We have not historically incurred any significant costs related to product indemnification claims. Accordingly, there were no liabilities recorded for these indemnification provisions as of June 30, 2017 or December 31, 2016.

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In connection with our acquisition of Telespree on October 24, 2013, we agreed to make a cash payment of $0.5 million on the one year anniversary of the closing. This payment was subject to reduction for certain claims and has not been paid to date. We have made claims against this payment which are currently under dispute. Once settled the final payment will be released.

In connection with our acquisition of SSM on September 30, 2015, we agreed to make a cash payment of $0.3 million on the one year anniversary of the closing. This payment is subject to reduction for certain claims and has not been paid to date. Once settled the final payment will be released.

(b) Litigation

From time to time, we are involved in various legal matters arising in the normal course of business. We do not expect the outcome of such proceedings, either individually or in the aggregate, to have a material effect on our financial position, cash flows or results of operations.

NOTE 11 RESTRUCTURING

During the second quarter of 2016, we undertook a reduction in workforce involving the termination of employees resulting in an expense of $0.1 Million primarily related to severance for the affected employees. The reduction in workforce was related to the consolidations of duplicative functions and alignment of staff with ongoing business activity as a result of the acquisition of Evolving Systems NC, Inc. in the third quarter of 2015. There was no restructuring expense for the six months ended June 30, 2017.

During the first quarter of 2016, we undertook a reduction in workforce involving the termination of employees resulting in an expense of $0.9 million primarily related to severance for the affected employees. The reduction in workforce was related to the consolidations of duplicative functions and alignment of staff with ongoing business activity as a result of the acquisition of Evolving Systems NC, Inc. in the third quarter of 2015. There was no restructuring expense for the three months ended June 30, 2017.

There was no restructuring liability as of June 30, 2017 and December 31, 2016.

NOTE 12 SUBSEQUENT EVENT

On July 3, 2017, we completed an Asset Purchase Agreement (the Purchase Agreement) by BLS Limited (EVOL BLS), a wholly owned subsidiary of the Company, and Business Logic Systems Limited (Seller). EVOL BLS and Seller are both companies incorporated under the laws of England and Wales. Under the terms of the Purchase Agreement, the Seller will sell substantially all of its assets and transfer certain liabilities relating to Seller s business of providing

customer value management solutions and data driven marketing solutions for $1.6M in cash, plus (a) an additional sum of $130K, reduced by the sums paid by EVOL BLS for certain employee severance obligations paid by EVOL BLS (collectively, the Cash Payments); (b) a percentage of collections on certain receivables over a 24-month period; and (c) an amount equal to 50% of BLS-based revenue over defined threshold levels for a period of 3 years after the closing date. The Company agreed to guarantee EVOL BLS obligations under the Purchase Agreement.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, and projections about Evolving Systems industry, management s beliefs, and certain assumptions made by management. Forward-looking statements include our expectations regarding product, services, and maintenance revenue, annual savings associated with the organizational changes effected in prior years, and short- and long-term cash needs. In some cases, words such as anticipates, expects, intends, plans, believes, estimates, variations of these words, and similar expressions are intended to identify forward-looking statements. The statements are not guarantees of future performance and are subject to certain risks, uncertainties, and assumptions that are difficult to predict; therefore, actual results may differ materially from those expressed or forecasted in any forward-looking statements. Risks and uncertainties of our business include those set forth in our Annual Report on Form 10-K for the year ended December 31, 2016 under Item 1A. Risk Factors as well as additional risks described in this Form 10-Q. Unless

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required by law, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise. However, readers should carefully review the risk factors set forth in other reports or documents we file from time to time with the Securities and Exchange Commission, particularly the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

OVERVIEW

We are a provider of software solutions and services to the wireless, wireline and cable markets. We maintain long-standing relationships with many of the largest wireless, wireline and cable companies worldwide. Our customers rely on us to develop, deploy, enhance and maintain software solutions including managed services that provide a variety of service activation and provisioning functions. RLM enables carrier marketing departments to innovate, execute and manage highly-personalized and contextually-relevant, interactive campaigns that engage consumers in real time; our service activation solution, TSA is used to activate bundles of voice, video and data services for wireless, wireline and cable network operators; our SIM card activation solution, DSA is used to dynamically allocate and assign resources to MNOs devices that rely on SIM cards; our MDE solution provides a data consumption and policy management solution for wireless carriers and MVNOs that monitor the usage and consumption of data services; our TNM product is a scalable and fully automated database solution that enables operators to reliably and efficiently manage their telephone numbers as well as other communication identifiers (i.e. SIMs, MSISDNs, IMSIs, ICCIDs, IPs). Our solutions can be deployed on premise or offered via a SaaS model.

We recognize revenue in accordance with the prescribed accounting standards for software revenue recognition under generally accepted accounting principles. Our license fees and services revenues fluctuate from period to period as a result of the timing of revenue recognition on existing projects.

RECENT DEVELOPMENTS

Consolidated revenue was $6.2 million and $6.1 million for the three months ended June 30, 2017 and 2016, respectively, and $12.1 million and $12.6 million for the six months ended June 30, 2017 and 2016, respectively. The increase in revenue for the three months ended is due primarily to growth from prepaid license fees for First User Activations (FUAs) in the current period offset by a decline of license fees from new product sales due to the migration to a managed services business model. The decrease in revenue for the six months ended is due to lower FUAs and license fees from product sales booked in Q1 2017 to Q1 2016. Services revenue slightly decreased during the period primarily due to a decline in customer support offset by an increase in managed services.

We have operations in foreign countries where the local currency is used to prepare the financial statements which are translated into our reporting currency, U.S. Dollars. Changes in the exchange rates between these currencies and our reporting currency are partially responsible for some of the changes from period to period in our financial statement amounts. The chart below summarizes how our revenue and expenses would change had they been reported on a constant currency basis. The constant currency basis assumes that the exchange rate was constant for the periods presented (in thousands).

	For the Three Months Ended June 30, 2017 vs. 2016	For the Six Months Ended June 30, 2017 vs. 2016
Revenue	$ (199)	$ (427)
Costs of revenue and operating expenses	(156)	(397)
Operating loss	$ (43)	$ (30)

RESULTS OF OPERATIONS

The following table presents the unaudited consolidated statements of operations reflected as a percentage of total revenue.

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	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
REVENUE				
License fees	12%	10%	9%	11%
Services	88%	90%	91%	89%
Total revenue	100%	100%	100%	100%
COSTS OF REVENUE AND OPERATING EXPENSES				
Costs of revenue, excluding depreciation and amortization	25%	21%	26%	22%
Sales and marketing	16%	20%	17%	20%
General and administrative	16%	14%	16%	15%
Product development	11%	14%	9%	14%
Depreciation	1%	1%	1%	1%
Amortization	3%	3%	3%	3%
Restructuring		1%		8%
Total costs of revenue and operating expenses	72%	74%	72%	83%
Income from operations	28%	26%	28%	17%
Other income (expense)				
Interest income	0%	0%	0%	0%
Interest expense	(1)%	(2)%	(1)%	(1)%
Foreign currency exchange gain (loss)	(4)%	(7)%	(3)%	(2)%
Other income (expense), net	(5)%	(9)%	(4)%	(3)%
Income from operations before income taxes	23%	17%	23%	14%
Income tax expense	5%	4%	6%	4%
Net income	18%	13%	17%	10%

Revenue

Revenue is comprised of license fees and services. License fees represent the fees we receive from the licensing of our software products. Services revenue are directly related to the delivery of the licensed product as well as integration services, managed services, SaaS services, time and materials work and customer support services. Customer support services includes annual support fees, recurring maintenance fees, minor product upgrades and warranty fees. Warranty fees are typically bundled with a license sale and the related revenue, based on Vendor Specific Objective Evidence (VSOE), is deferred and recognized ratably over the warranty period.

Revenue for the three months ended June 30, 2017 and 2016 was $6.2 million and $6.1 million respectively. The license fees revenue increased for the three months is primarily due to license fees for FUAs offset by a decline of license fees from new product sales due to the migration to a managed services business model. Services revenue slightly increased for the three months due to an increase in managed services offset by a decline of customer support. Revenue for the six months ended June 30, 2017 and 2016 was $12.1 million and $12.6 million, respectively. License fee revenue decreased primarily due to lower FUAs fees in the current period. Services revenue slightly decreased during the period primarily due to a decline is customer support offset by an increase in managed services.

License Fees

License fees revenue increased $0.1 million, or 15%, to $0.7 million for the three months ended June 30, 2017 from $0.6 million for the three months ended June 30, 2016. The increase is due to license fees from FUAs.

License fees revenue decreased $0.3 million, or 26%, to $1.1 million for the six months ended June 30, 2017 from $1.4 million for the six months ended June 30, 2016. The decrease in revenue is due to primarily from prepaid lower license fee revenue from FUAs during the first quarter in 2017 and the migration of business to a managed services model

Services

Services revenue increased $0.1 million, or 1%, to $5.5 million for the three months ended June 30, 2017 from $5.4 million for the three months ended June 30, 2016. The increase is due to higher managed services revenue offset by a decline in customer support revenue.

Services revenue decreased $0.1 million, or 1%, to $11.0 million for the six months ended June 30, 2017 from $11.1 million for the six months ended June 30, 2016. The decrease in revenue is due to lower customer support revenue in the first quarter 2017 offset by increased revenue from managed services.

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Costs of Revenue, Excluding Depreciation and Amortization

Costs of revenue, excluding depreciation and amortization, consist primarily of personnel costs and other direct costs associated with these personnel, facilities costs, costs of third-party software and partner commissions. Costs of revenue includes Product Development expenses related to software features requested in advance of their scheduled availability which are funded by customers as part of a managed service offering. Costs of revenue, excluding depreciation and amortization increased $0.3 million, or 24%, to $1.6 million for the three months ended June 30, 2017 from $1.3 million for the three months ended June 30, 2016. The increase in costs of revenue is primarily attributable to higher service project hours. The increase in project hours is primarily a result of the shift in managed services revenue model. As a percentage of revenue, costs of revenue, excluding depreciation and amortization, increased to 25% for the three months ended June 30, 2017 from 21% for the three months ended June 30, 2016. The increase as a percentage of revenue is primarily due to the aforementioned higher costs.

Costs of revenue, excluding depreciation and amortization, increased $0.4 million, or 15%, to $3.1 million for the six months ended June 30, 2017 from $2.7 million for the six months ended June 30, 2016. The increase in costs is primarily attributable to the increase of embedded software, higher service project hours and travel costs, offset by lower salary expense related to the restructuring in 2016. As a percentage of license fees and services revenue, costs of license fees and services, excluding depreciation and amortization, increased to 26% for the six months ended June 30, 2017 from 22% for the six months ended June 30, 2016. The increase in costs as a percentage of revenue is primarily due to the aforementioned higher costs during the period.

Sales and Marketing

Sales and marketing expenses primarily consist of compensation costs, including incentive compensation and commissions, travel expenses, advertising, marketing and facilities expenses. Sales and marketing expenses decreased $0.2 million, or 18%, to $1.0 million for the three months ended June 30, 2017 from $1.2 million for the three months ended June 30, 2016. The decrease in expenses is attributable to salary expense due to the restructuring in 2016 and travel expenses. As a percentage of total revenue, sales and marketing expenses decreased to 16% for the three months ended June 30, 2017 from 20% for the three months ended June 30, 2016. The decrease in sales and marketing expenses as a percentage of revenue is primarily due to aforementioned reduction of sales and marketing costs.

Sales and marketing expenses decreased $0.5 million, or 21%, to $2.0 million for the six months ended June 30, 2017 from $2.5 million for the six months ended June 30, 2016. The decrease in costs is primarily attributable to salary expense due to the restructuring, lower incentive compensation and travel expense. As a percentage of total revenue, sales and marketing expenses decreased to 17% for the six months ended June 30, 2017 from 20% for the six months ended June 30, 2016. The decrease in sales and marketing expenses as a percentage of revenue is primarily due to the aforementioned decrease in expenses during the period.

General and Administrative

General and administrative expenses consist principally of employee related costs and professional fees for the following departments: facilities, finance, legal, human resources, and certain executive management. General and administrative expenses increased $0.2 million, or 19%, to $1.0 million for the three months ended June 30, 2017 from $0.8 million for the three months ended June 30, 2016. The increase in costs is primarily attributable to professional fees related asset acquisition of BLS and higher stock incentive compensation expense due to restricted

stock grants. As a percentage of revenue, general and administrative expenses increased to 16% for the three months ended June 30, 2017 from 14% for the three months ended June 30, 2016. The increase in general and administrative expenses as a percentage of revenue is primarily due to the aforementioned increase in expenses.

General and administrative expenses increased $0.2 million, or 9%, to $2.0 million from $1.8 million for the six months ended June 30, 2017 and 2016, respectively. The increase in costs is primarily related to higher professional fees related to the asset acquisition of BLS. As a percentage of total revenue, general and administrative expenses increased to 16% for the six months ended June 30, 2017 from 15% for the six months ended June 30, 2016. The increase in general and administrative expenses as a percentage of revenue is primarily due to the aforementioned increase in expenses.

Product Development

Product development expenses consist primarily of employee related costs and subcontractor expenses. Product development expenses decreased $0.1 million, or 20%, to $0.7 million for the three months ended June 30, 2017 from $0.8 million for the three months ended June 30, 2016. The decrease in product development expenses was due to a lower salary expense related to the restructuring in 2016. As a percentage of revenue, product development expenses decreased to 11% for the three months ended June 30, 2017 from 14% for the three months ended and 2016.

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Product development expenses decreased $0.7 million, or 36%, to $1.1 million for the six months ended June 30, 2017 from $1.8 million for the six months ended June 30, 2016. The decrease in product development expenses is primarily attributable to lower salary expense due to the restructuring and hours worked on projects related to managed services. As a percentage of revenue, product development expenses for the six months ended June 30, 2017 decreased to 9% from 14% for the six months ended June 30, 2016. The decrease as a percentage of revenue is primarily due to the aforementioned decrease of expenses during the period.

Depreciation

Depreciation expense consists of depreciation of long-lived property and equipment. Depreciation expense was $0.1 million for the three months ended June 30, 2017 and 2016. As a percentage of total revenue, depreciation expense for the three months ended June 30, 2017 and 2016 remained at 1%.

Depreciation expense was $0.1 million for the six months ended June 30, 2017 and 2016. As a percentage of total revenue, depreciation expense for the six months ended June 30, 2017 and 2016 remained at 1%.

Amortization

Amortization expense consists of amortization of identifiable intangible assets acquired through our acquisition of Evolving Systems Labs, Inc. and Evolving Systems NC, Inc. Amortization expense was $0.2 million for the three months ended June 30, 2017 and 2016. As a percentage of total revenue, amortization expense remained at 3% for the three months ended June 30, 2017 and 2016.

Amortization expense was $0.4 million for the six months ended June 30, 2017 and 2016. As a percentage of total revenue, amortization expense remained at 3% for the six months ended June 30, 2017 and 2016.

Restructuring

Restructuring expense includes the costs associated with a reduction in workforce due to the consolidation of duplicative functions and alignment of staff with ongoing business activity as a result of the acquisition of Evolving Systems NC, Inc. in the third quarter of 2015. There was no restructuring expense for the three months ended June 30, 2017 and $0.1 million for the three months ended June 30, 2016. As a percentage of revenue, restructuring expense was 1% for the three months ended June 30, 2017 and 2016.

Restructuring was $1.0 million for the six months ended June 30, 2016. There were no restructuring expenses for the six months ended June 30, 2017. As a percentage of revenue, restructuring expense was 8% for the six months ended June 30, 2016.

Interest Income

Interest income includes interest income earned on cash and cash equivalents. Interest income was $1,000 for the three months ended June 30, 2017 and 2016, respectively.

Interest income was $1,000 and $3,000 for the six months ended June 30, 2017 and 2016, respectively.

Interest Expense

Interest expense includes the amortization of debt issuance costs from our debt facility, interest expense from our term loan and interest expense from our capital lease obligations. Interest expense was $0.1 million for the three months ended June 30, 2017 and 2016. As a percent of revenue, interest expense was 1% for the three months ended June 30, 2017 and 2016.

Interest expense was $0.1 million and $0.2 million for the six months ended June 30, 2017 and 2016, respectively. The decrease of $0.1 million is primarily due to the Fifth Amendment to the loan and security agreement with East West Bank which provided for a Term Loan of $6.0 million. The agreement required us to use the term loan s proceeds and $4.0 million from our cash balances to pay off and terminate the Revolving Facilities totaling $10.0 million. As a percent of revenue, interest expense was 1% and 2% for the six months ended June 30, 2017 and 2016, respectively.

Foreign Currency Exchange Loss

Foreign currency transaction losses resulted from transactions denominated in a currency other than the functional currency of the respective subsidiary and was $0.2 million and $0.4 million for the three months ended June 30, 2017 and 2016, respectively, and $0.4 million and $0.2 million for the six months ended June 30, 2017 and 2016, respectively. The losses were generated primarily through the re-measurement of certain non-functional currency denominated financial assets and liabilities of our Evolving Systems U.K. and India subsidiaries.

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Other Comprehensive Gain (Loss)

Other comprehensive loss refers to revenue, expenses, gains, and losses that under GAAP are recorded as an element of shareholders equity but are excluded from net income. Other comprehensive loss consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency. Other comprehensive gain was $0.8 million during the three months ended June 30, 2017 compared to ($1.4) million during the three months ended June 30, 2016. The current period gain is related to a strengthening British Pound Sterling and the related translation of our U.K. subsidiary s assets and liabilities to the United States Dollar for consolidation purposes.

For the six months ended June 30, 2017 other comprehensive gain was $1.2 million compared to ($2.0) million for the six months ended June 30, 2016. The gain for the for the six months ended June 30, 2017 was due to British Pound Sterling strengthening during the period and the related translation of our U.K. subsidiary s assets and liabilities to the United States Dollar for consolidation purposes. The loss generated during the six month ended June 30, 2016 was due to a weaker British Pound Sterling and the related translation of our U.K. subsidiary s assets and liabilities to the United States Dollar for consolidation purposes.

Income Taxes

We recorded net income tax expense of $0.4 million and $0.3 million for the three months ended June 30, 2017 and 2016, respectively. The net expense during the three months ended June 30, 2017 consisted of current income tax expense of $0.5 million and a deferred tax benefit of ($0.1) million. The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was related primarily to the increase of certain net deferred tax assets and amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc. in September 2015. The net expense during the three months ended June 30, 2016 consisted of current income tax expense of $0.4 million and a deferred tax benefit of ($0.1million). The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was primarily related to the amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc.

We recorded net income tax expense of $0.7 million and $0.5 million for the six months ended June 30, 2017 and 2016, respectively. The net expense during the six months ended June 30, 2017 consisted of current income tax expense of $0.9 million and a deferred tax benefit of ($0.2) million. The current tax expense consists of income tax from our U.S., U.K. and India based operations. The deferred tax benefit was primarily related to the increase of certain net deferred tax assets and amortization of intangible assets related to the acquisition of Evolving Systems NC, Inc.

Our effective tax rate was 24% and 28% for the three months ended June 30, 2017 and 2016, respectively. The decrease in our effective tax rate relates to a higher proportion of our income being generated in the U.K., for which the statutory corporate tax rate is lower and the utilization of Foreign Tax Credits (FTC).

Our effective tax rate was 25% and 28% for the six months ended June 30, 2017 and 2016 respectively. The decrease in our effective tax rates relates to a higher proportion of our income being generates in the U.K., for which the statutory corporate tax rate is lower and the utilization of FTC.

As of June 30, 2017 and December 31, 2016 we continued to maintain a valuation allowance on portions of our domestic net deferred tax asset. Such assets primarily consist of FTC, state Net Operating Loss (NOL) carryforwards, research and development tax credits and Alternative Minimum Tax (AMT) credits. See Note 7 to the financial statements for a summary of our deferred tax assets and liabilities.

FINANCIAL CONDITION

Our working capital position increased $2.4 million, or 30%, to $10.4 million as of June 30, 2017 from $8.0 million as of December 31, 2016. The increase in working capital is related increases in contract receivables, unbilled work-in-progress and prepaid and other current assets.

CONTRACTUAL OBLIGATIONS

There have been no material changes to the contractual obligations as disclosed in our 2016 Annual Report on Form 10-K.

LIQUIDITY AND CAPITAL RESOURCES

We have historically financed operations through cash flows from operations and equity transactions. At June 30, 2017, our principal source of liquidity was $5.5 million in cash and cash equivalents, $1.6 million in restricted cash related to the asset purchase of BLS and $7.6 million in contract receivables, net of allowances. Our anticipated uses of cash in the future will be to fund the expansion of our business through both organic growth as well as possible acquisition activities, the expansion of our customer base

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internationally and debt service payments on the Term Loan. Other uses of cash may include quarterly dividends, capital expenditures and technology expansion.

Net cash provided by operating activities for the six months ended June 30, 2017 and 2016 was $0.2 million and $3.0 million, respectively. Cash provided by operating activities for the six months ended June 30, 2017 was primarily due to net income coupled with increases in contract receivables, unbilled work-in-progress, prepaid and other assets, accounts payable and accrued liabilities and unearned revenue.

Net cash used in investing activities during the six months ended June 30, 2017 was $1.5 million due to a deposit paid to an escrow account for the acquisition of BLS which completed in July 2017. Cash used in investing activities for the six months ended June 30, 2016 was $6,000 for the purchase of property and equipment.

Net cash used in financing activities for the six months ended June 30, 2017 and 2016 was $1.0 million and $5.3 million, respectively. The cash used in financing activities for the six months ended June 30, 2017 was primarily related to principal payment on our term loan and the payment for second year debt issuance costs. The cash used in financing activities for the six months ended June 30, 2016 was primarily due to converting our debt by retiring our $10.0 million revolving line of credit with a $6.0 million term loan and a $4.0 million principal payment and a $1.3 million dividend payment.

We believe that our current cash and cash equivalents, together with anticipated cash flow from operations will be sufficient to meet our working capital, capital expenditure and financing requirements for at least the next twelve months. In making this assessment we considered the following:

- Our cash and cash equivalents balance at June 30, 2017 of $5.5 million;
- Our working capital balance of $10.4 million;
- Our demonstrated ability to generate positive cash flows from operations;
- Our planned capital expenditures of less than $0.5 million during 2017; and
- The repayment of our long term debt facility of which the first principal payment began in January 2017.

We are exposed to foreign currency rate risks which impact the carrying amount of our foreign subsidiaries and our consolidated equity, as well as our consolidated cash position due to translation adjustments. For the six months ended June 30, 2017 and 2016, the effect of exchange rate changes resulted in a $0.2 million increase and $0.3 million decrease to consolidated cash, respectively. We do not currently hedge our foreign currency exposure, but we monitor rate changes and may hedge our exposures if we see significant negative trends in exchange rates.

OFF-BALANCE SHEET ARRANGEMENTS

We have no off-balance sheet arrangements that have a material current effect or that are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

ITEM 3. QUANTITATIVE AND QUALITATIVE MARKET RISK DISCLOSURES

In the ordinary course of business, we are exposed to certain market risks, including changes in interest rates and foreign currency exchange rates. Uncertainties that are either non-financial or non-quantifiable such as political, economic, tax, other regulatory, or credit risks are not included in the following assessment of market risks.

Interest Rate Risks

Our cash balances are subject to interest rate fluctuations and as a result, interest income amounts may fluctuate from current levels.

Foreign Currency Risk

We are exposed to favorable and unfavorable fluctuations of the U.S. dollar (our functional currency) against the currencies of our operating subsidiaries. Any increase (decrease) in the value of the U.S. dollar against any foreign currency that is the functional currency of one of our operating subsidiaries will cause the parent company to experience unrealized foreign currency translation losses (gains) with respect to amounts already invested in such foreign currencies. In addition, we and our operating subsidiaries are

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exposed to foreign currency risk to the extent that we enter into transactions denominated in currencies other than our respective functional currencies, such as accounts receivable (including intercompany amounts) that are denominated in a currency other than their own functional currency. Changes in exchange rates with respect to these items will result in unrealized (based upon period-end exchange rates) or realized foreign currency transaction gains and losses upon settlement of the transactions. In addition, we are exposed to foreign exchange rate fluctuations related to our operating subsidiaries monetary assets and liabilities and the financial results of foreign subsidiaries and affiliates when their respective financial statements are translated into U.S. dollars for inclusion in our consolidated financial statements. Cumulative translation adjustments are recorded in accumulated other comprehensive income (loss) as a separate component of equity. As a result of foreign currency risk, we may experience economic loss and a negative impact on earnings and equity with respect to our holdings solely as a result of foreign currency exchange rate fluctuations.

The relationship between the British pound sterling, Indian rupee and the U.S. dollar, which is our functional currency, is shown below, per one U.S. dollar:

Spot rates:	June 30, 2017	December 31, 2016
British pound sterling	0.76974	0.81103
Indian rupee	64.66550	67.95500

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
Average rates:	2017	2016	2017	2016
British pound sterling	0.78228	0.69728	0.79516	0.69780
Indian rupee	64.46821	66.89923	65.74311	67.19192

At the present time, we do not hedge our foreign currency exposure or use derivative financial instruments that are designed to reduce our long-term exposure to foreign currency exchange risk. To the extent that translation and transaction gain and losses become significant, we will consider various options to reduce this risk.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Senior Vice President of Finance, as appropriate, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Senior Vice President of Finance, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Senior Vice President of Finance have concluded that our disclosure controls and procedures were effective as of the end of such period.

In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

During the three months ended June 30, 2017, there were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal matters arising in the normal course of business. Losses, including estimated costs to defend, are recorded for these matters to the extent they were probable of loss and the amount of loss could be reasonably estimated.

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on March 28, 2017.

This Quarterly Report on Form 10-Q should be read in conjunction with the risk factors defined in our Annual Report on Form 10-K for the year ended December 31, 2016 under Item 1A. Risk Factors.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101 - The following financial information from the quarterly report on Form 10-Q of Evolving Systems, Inc. for the quarter ended June 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Income, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss), (iv) Condensed Consolidated Statement of Changes in Stockholders Equity, (v) Condensed Consolidated Statements of Cash Flows, and (vi) Notes to the Condensed Consolidated Financial Statements.

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SIGNATURE

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

Date: August 8, 2017

/s/ RICHARD A. DINKEL
Richard A. Dinkel
Senior Vice President of Finance
Treasurer and Secretary
(Principal Financial and Accounting Officer)